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CHAPTER 1 – ELIGIBILITY REQUIREMENTS

INTRODUCTION

The Credit Policy Manual was developed to provide associates with a clear understanding of the elements involved in evaluating the credit worthiness and financial capacity of an applicant, and the adequacy of the proposed collateral.

Agency guidelines have been summarized and incorporated into the Credit Policy Manual by topic.

The Credit Policy Manual makes reference to “The Lender”. The Lender shall at all times refer to the institution or business which is to ultimately fund or purchase the mortgage loan. Any outside business or entity involved, at any time, in the process of the originating, processing, underwriting, or closing of the mortgage must comply with The Lender's credit policy as set forth in this manual.

UNDERWRITING PHILOSOPHY

The Lender is engaged in the origination of investment quality loans. The Credit Policy Manual is to provide direction and consistency in determining the credit decision. The Lender’s intent is to describe the general underwriting philosophy of the company on mortgage loans, however is not all inclusive of all situations that may arise from loan to loan. In discussing this general approach we have presented the minimum guidelines considered necessary for prudent mortgage compliance underwriting, the essential requirement being that the terms of the loan be related to the probability of the borrower’s repayment and to the value and marketability of the mortgaged property.

The Lender believes that there is no singular characteristic within a loan file that indicates the quality of a loan. This concept is incorporated throughout these guidelines. While The Lender will not compromise quality, we are not simply a ratio or matrix driven company. We will underwrite the entire package, analyzing and weighing all aspects (i.e. loan to value ratio, collateral value, credit history, assets and in certain instances qualifying ratios). The Lender’s underwriters approve loans of investment quality risk. All loans will be reviewed with a common sense approach. Each loan is individually underwritten with emphasis placed on the overall quality of the loan. Although multiple risk factors are assessed, the underwriter will attempt to balance the evaluation between the borrower and the property.

As an innovative leader in the mortgage industry, The Lender expects to purchase loans that represent a marketable risk. The Lender will analyze the performance of a loan based on the collateral, credit characteristics and overall market conditions. Occasionally, The Lender may apply underwriting criteria, which is either more stringent or more flexible, depending on the economic conditions of the particular market. The borrower’s loan package must contain sufficient information to enable the underwriter to reach an informed and knowledgeable decision.

IMPLEMENTING CREDIT POLICY

It is the responsibility of all associates to become familiar with:

- Fair lending regulations; and
- The Lender’s stated credit policy;
- Laws and regulations that affect mortgage banking.

To assure all applicants of fair and equitable treatment, the underwriters are expected to exhaust all possibilities before denying a loan. All reasonable alternatives must be considered and presented to the applicant, as a counter offer, if it appears the loan may be approved under different terms than as submitted.

These efforts must be documented in the system notes or written documentation must be placed in the loan file. The consideration is to be applied consistently to all loan applications.
REGULATORY ISSUES

All associates who are involved in the mortgage origination process are expected to comply with all laws and regulations, which apply to our industry. Each associate is responsible for becoming familiar with, and practicing, the fair lending regulations set forth by the federal and state government.

Underwriters are especially cautioned to be conscious of the provisions for the Equal Credit Opportunity Act when evaluating an applicant’s loan request. ECOA ensures that all persons have the same opportunity to obtain credit. A creditor cannot discriminate against an applicant on the basis of:

- Race;
- Color;
- Religion;
- National Origin;
- Sex;
- Marital Status;
- Family Status;
- Age;
- Receipt of income from a public assistance program; or
- The fact that the applicant has exercised any right under the Consumer Credit Protection Act.

GUIDELINE CHANGES

We strive to ensure the Credit Policy manual is current on all issues; however in the event that Credit Policy differs from specific investor and agency guideline changes, the most current release of the investor or agency guidelines will apply.

PRODUCT AVAILABILITY

Many of The Lender’s available products are taken from negotiated commitments with investors. As a result of these commitments, The Lender’s Product Summaries will define loan parameters and special underwriting considerations when necessary. When information is specified in the Product Summary which conflicts with existing Credit Policy, the Product Summary takes precedence over the Credit Policy Manual. It is essential that everyone become familiar with the Product Summaries and be cognizant of variances in:

- Documentation requirements;
- Eligible Property types;
- LTV and CLTV limits;
- Mortgage Insurance requirements;
- Occupancy limitations;
- Qualifying rates on ARM products;
- Qualifying ratios; and
- Subordinate financing restrictions.

SECTION 100.00 – GENERAL ELIGIBILITY ISSUES

100.01 – Applicant’s Age

There is no maximum age limit for an applicant. The minimum age is the age that the mortgage note can be legally enforced in the state or other jurisdiction where the property is located.
100.02 – Co-Borrower/Co-Signer

The definition of co-borrower & co-signer is here for explanation purposes only. The Lender has made the decision that co-signed loans will not be accepted as we do require all borrowers be on title.

Co-borrowers take title to the property and obligate themselves on the mortgage and note. A co-signer has no ownership interest in the property (does not take title) but must execute the loan application and sign the mortgage note and will be liable for the repayment of the loan. The co-borrower or co-signer's income, assets, liabilities, and credit history are included in the determination of creditworthiness. The co-signer must have a principal residence in the United States and cannot be a party to the transaction such as seller, builder, real estate agent, etc.

FHA will permit co-borrowers, who take title to the property and obligate themselves on the mortgage note. FHA will also permit a co-signer with no ownership interest in the property to execute the loan application and mortgage note and, thus become liable for repayment of the obligation. The co-signer's income, assets, liabilities, and credit history are included in the determination of creditworthiness.

- Neither a co-borrower nor a co-signer may be a party that has an interest in the transaction, such as the seller, builder, real estate agent, etc.;
  
  Note: Exceptions may be granted if the seller and the co-borrower/co-signer is a family member of the occupant owner.

- An individual signing the loan application must not be otherwise ineligible for participation in the FHA loan program;

- Unless otherwise exempted, any non-occupying co-borrower or co-signer must have a principle residence in the United States;

- Except for any distinction listed here, all references to co-borrowers, including loan-to-value limitations, will apply equally to co-signers.

100.03 – Foreign Documentation

Documents received from foreign sources that are not in English must be translated into English by a University Foreign Language Department, Embassy Official, a recognized authority in translation, or an employee who is not involved in the loan transaction. A translation to English must be attached to each individual document. The name, address and telephone number of the translator must be indicated on the translation.

Funds received from a foreign source must be supported by evidence the funds were the applicant’s prior to the transfer. Evidence of the current currency exchange rate must be provided as support for the amount converted to US dollars.

100.04 – Residency Status

The Lender will purchase or securitize mortgages made to aliens who are lawful permanent or nonpermanent residents of the United States. We do not specify the precise documentation that a lender must obtain to verify that a permanent or nonpermanent resident alien borrower is a legal resident of the United States, rather, a lender should make a determination of the alien’s residency status based on the circumstances of the individual case, using whatever documentation it deems appropriate. Some products may limit LTV and occupancy based on residency.

100.05 – Trust Eligibility Criteria

Subject to the following criteria, an Inter Vivos Revocable Trust (“Trust”) is acceptable as a “borrower and property owner”. The Trust must be established by a natural person. It may be established solely by one individual or jointy by more than one individual. Each individual establishing a Trust is a Trustor/Grantor/Settler/Donor (the Settler); the terminology used will depend upon the applicable state. At least one of the individuals/SETTLER must be Primary Beneficiary and an occupying borrower whose income or assets were used to qualify for the loan. In addition, if no institutional trustee was appointed, this same individual/Settler must be a Trustee.
In order to consider the Trust as an eligible applicant, the following eligibility requirements must be met:

- The Trust must be established by a written document during the lifetime of the individual/Settler establishing the Trust, to be effective during his or her lifetime.
- The Trust must be one in which the individual/Settler establishing the trust has reserved to himself or herself the right to revoke the Trust during his or her lifetime.
- The individual/Settler establishing the Trust must be the primary beneficiary. If there is more than one individual/Settler, there may be more than one primary beneficiary. The income and/or assets of at least one of the individuals/Settlers establishing the Trust must be used to qualify for the mortgage and that same individual/Settler must occupy the subject property and sign the mortgage instruments.
- The Trust document must name one or more Trustees to hold legal title to, and manage, the property that has been placed in the Trust. The Trustees must include either:
  - at least one of the individuals/Settler establishing the trust, OR
  - An institutional Trustee that customarily performs trust functions in the relevant state and is authorized to act as Trustee under the law of such state.
- The Trustee must have the power to mortgage the subject property for the purpose of securing a loan to the party or parties who are the “borrower(s)” under the mortgage Note.
- Full title to the subject property (security) must be vested in the Trust(s); there may be no other owners.
- A copy of the Trust documents must be provided to the Underwriter when submitting the loan file. Underwriters are required to review the documents. Using the Trust documents, the Underwriter will complete the Underwriter's Checklist for Inter Vivos Revocable Trusts to ensure the Trust conforms to investor and agency guidelines. The completed Underwriter's Checklist for Inter Vivos Revocable Trusts must be a permanent part of the loan file.
- Settlement Agents must be instructed that the Mortgage Policy of Title Insurance must state that 1.) Title to the security property is vested in the Trust(s) of the Trust and 2.) Take no exception with respect to the Trustee(s) holding title to the property or to the Trust.
- Copies of any Trust documents that the title insurance company required to make its determination regarding insurance coverage must be included in the loan file submitted to the Underwriting Department.
- The title insurance policy must assure full title to the subject property is vested in the Trustee(s) of the Trust. The title policy must not take any exceptions with respect to the Trustee(s) holding the title to the subject property or to the Trust.
- IRS Form W-9 must be completed in the name of the Trust/Trustee(s) and must include either a Tax ID Number designated for the Trust or the Trustee’s Social Security Number.

Checklist for Inter Vivos Revocable Trusts

| Borrowers: __________________________________________________________ | Loan Number: ____________ |

Note: An Inter Vivos Revocable Trust must be established, in writing, by a natural person(s) and may be established either solely or jointly (more than one Trustor and Primary Beneficiary.) The Trust MUST RUN to at least one of the Borrowers who also is named as a Trustor, Primary Beneficiary, and Trustee (unless an Institutional Trustee is appointed.)

1. Names of Inter Vivos Revocable Trust ("Trust"): ____________________________________________________ dated______________
2. The Trust is created under the laws of the State of ________________________________________________.
3. The subject property is located in the State of ___________________________________________________.
   (If the Trust state and the property state ARE NOT the same, STOP HERE: the Trust is not eligible.)
4. Trustor(s) / Grantor(s) / Settlor(s) / Donor(s): ____________________________________________________
   Primary Beneficiary(ies):
   (If at least one of the Borrowers IS NOT named as both a Primary Beneficiary and a Trustor, STOP HERE: the Trust is not eligible.)
5. Trustee(s): ________________________________________________________________________________
   (If at least one of the Borrowers IS NOT named as a Trustee and a Trustor and a Primary Beneficiary, STOP HERE: the Trust is not eligible UNLESS an Institutional Trustee has been appointed.)
6. At least one of the Borrowers who also is a Trustor and a Primary Beneficiary has reserved the right to REVOKE, alter or amend the Trust during his/her lifetime.

   ____ Yes     ____ No (If NO, STOP HERE: the Trust is not eligible.)

7. The income and/or assets of at least one of the Borrowers who is both a Trustor and a Primary Beneficiary were used to qualify for the mortgage.

   ____ Yes     ____ No (If NO, STOP HERE: the Trust is not eligible.)

8. At least one of the Borrowers who is both a Trustor and a Primary Beneficiary will occupy the property.

   ____ Yes     ____ No (If NO, STOP HERE: the Trust is not eligible.)

9. Property is:   ____ Primary Residence     ____ Second Home       (Investment Property is not eligible)

   If Trust is acceptable, Loan Approval must request for a Title Policy with NO exception(s) with respect to the Inter Vivos Revocable Trust.

   Comments:

   Completed By:               Date:

SECTION 101.00 – OCCUPANCY

101.01 – Owner Occupied Principle Residence

A principal residence is a 1-4 unit dwelling that will be the applicant’s primary residence. At least one of the applicants must occupy the dwelling as a principal residence within 60 days of closing. The following criteria define residency:

• Borrower occupies property as primary residence
• Property is occupied by the borrower for a major part of the year
• Property is convenient to the borrowers place of employment
• Property address on record for Federal income tax reporting and driver’s license
• Property possesses physical characteristics to accommodate borrowers immediate family
The Federal Housing Administration (FHA) administers the single-family housing finance program for the Department of Housing and Urban Development (HUD). FHA loans are insured by the Federal Government, which is responsible for developing guidelines and applicant eligibility requirements.

Lenders have been given the ability and responsibility for reviewing and approving mortgages which meet HUD’s established guidelines. The designated lenders representative responsible for issuing approvals is the Direct Endorsements (DE) Underwriter.

A number of HUD programs exist which are designed to provide financing in markets where conventional financing is not readily available. At this time, The Lender offers financing on 1-4 unit dwellings and condominiums. Fixed rate and one year ARM products are available; please refer to the Product Summaries for details. The eligible programs are as follows:

Approval must be received from Credit Policy Department to originate loan under HUD programs other than those listed above. The approval must be received prior to accepting an application for a HUD program not listed above.

### SECTION 201.00 – BASIC ELIGIBILITY GUIDELINES

HUD imposes restrictions, which affect the applicants’ eligibility for FHA mortgages in addition to restrictions placed on eligible purchases transactions. The intended use or occupancy status of the property and the state of construction determine its eligibility for FHA mortgage insurance, as well as the percentage of financing available. Unless otherwise stated, FHA’s single-family programs are limited to owner-occupied principal residences only.

#### 201.01 – Case Number Assignment

The Lender approved correspondent is responsible for obtaining and submitting to Underwriting, the Case Number Assignment form complete with accurate information.

#### 201.02 – Credit Alert Interactive Voice Response System (CAIVRS)

All Applicants for an FHA loan (except streamline refinances) must be screened using the Credit Alert Interactive Voice Response System (CAIVRS). The information provided by CAIVRS will be entered onto the Mortgage Credit Analysis Worksheet (MCAW). If CAIVRS indicated the applicant is presently delinquent or has had a claim paid within the previous three years, the applicant is not eligible for a new loan. Exceptions to this may be granted under the following situations:

**Assumptions:** If the applicant sold the property, with or without a release of liability, to an individual who then defaulted and it can be established that the loan was not in default at the time of the assumption; the applicant is eligible for an FHA loan.
**FHA Credit Policy Manual**

**Divorce:** An applicant may be eligible if the divorce decree or legal separation agreement awarded the property and responsibility for payment to the former spouse. However, if a claim was paid on a mortgage, which was in default at the time of the divorce, the applicant is not eligible for an FHA loan.

**Bankruptcy:** When the property was included in a bankruptcy that was caused by circumstances beyond the applicant's control (such as the death of the principal wage earner; loss of employment due to factory closings, reduction-in-force, etc., or serious long-term uninsured illness), the applicant may be eligible for an FHA loan.

If it is believed the CAIVRS message is erroneous or if the lender must establish the date of claim payment, the local HUD Field Office must be contacted for instructions or documentation to support the applicant's eligibility. The local HUD offices can provide information regarding when the three-year waiting period has passed or that the social security number on CAIVRS is an error.

HUD cannot alter or delete CAIVRS information reported from other Federal agencies such as the Department of Education, Veterans Affair, etc. The applicant must contact those agencies to correct or remove incorrect or outdated information.

HUD does not require a clear CAIVRS access number but the file must clearly document the justification of an approval based on one of the three exceptions previously mentioned and the underwriter must note the reason for the decision Mortgage Credit Analysis Worksheet (MCAW). An exception for an unclear CAIVR number requires a counter signature from the Regional Underwriting Manager.

201.03 – LDP and Federal Procurement / Non-Procurement

All participants in an FHA loan transaction including sellers, purchasers, real estate agents and builder will be screened using the HUD published "Limited Denial of Participation" list (LDP) and the General Service Administration (GSA) "List of Parties Excluded from Federal Procurement or Non-Procurement Programs". The lists must be reviewed early in the loan process to avoid customer service issues with applicants or other parties to the transaction who may be ineligible for an FHA loan.

Dates checked are confirming the information was checked and must be recorded on the MCAW. If the name of any of the parties to the transaction appears on either list, the application is not eligible for processing and must be denied for a HUD loan. An exception is made when a seller appears on the LDP list and the property being sold is the seller's primary residence. (The file must contain evidence of primary residency to support this exception).

All information can be found at "www.hud.gov.com" under the lender section.

201.04 – Citizenship and Residency Status

Citizenship of the United States is not required for eligibility. When a mortgage loan applicant indicates on the loan application that he or she holds something other than U.S. citizenship, the lender must determine residency status from the documentation provided by the borrower.

**Lawful Permanent Resident Aliens:** For those borrowers with lawful permanent resident alien status, FHA will insure the mortgage under the same terms and conditions as U.S. citizens. The lender must document the mortgage file with evidence of permanent residency and indicate on the URLA that the borrower is a lawful permanent resident alien. Evidence of lawful permanent residency is issued by the Bureau of Citizenship and Immigration Services (BCIS), formerly INS, within the Department of Homeland Security

**Non-Permanent Resident Aliens:** FHA will also insure a mortgage made to a non-permanent resident alien provided that the property will be the borrower's principle residence, the borrower has a valid SSN, and the borrower is eligible to work in the U.S. as evidenced by an Employment Authorization Document (EAD) issued by BCIS. If the authorization for temporary residency status will expire within one year and a prior history of residency status renewals exists, the lender may assume continuation will be granted. If there are no prior renewals, the lender must determine the likelihood of renewal, based on information from the BCIS.
Although social Security Cards may indicate work status, such as “not valid for work purposes,” an individual’s work status may change without the change being reflected on the actual Social Security Card. Therefore the Social Security Card is not to be used as evidence of work status for non-permanent resident aliens; the BCIS employment authorization document is to be used instead.

Non-U.S. Citizens with no lawful residency in the U.S. are not eligible for FHA-insured mortgages.

SECTION 202.00 – MAXIMUM LOAN LIMITS

The National Housing Act specifies the maximum or statutory loan limit. These statutory loan limits vary by location, program and the number of family units within a dwelling. The limits apply to both purchase and refinance transactions. Maximum loan amounts will also be limited based on applicable loan-to-value calculations.

Under most single-family mortgage programs, the FHA maximum insurance mortgage will be lesser of the statutory loan limit for the area or of the applicable loan-to-value limit. The maximum loan amount applies to the base loan amount (without MIP).

The mortgage amount, including any financed Upfront Mortgage Insurance Premium, will be rounded down to the nearest dollar. Loans without UFMIP will be rounded down to the nearest dollar. If financed into the mortgage, the UFMIP is not subject to the statutory loan amount limit or to the loan-to-value limits.

202.01 – Statutory Loan Limits

Statutory loan limits vary by FHA program and the number of units within the dwelling. Statutory loan limits apply to both purchase transactions and refinances. The National Housing Act specifies the maximum amount for each program.

Maximum mortgage limits for all areas are available through the HUD’s website https://entp.hud.gov/idapp/html/hicostlook.cfm

The standard area limits for FHA section 203b are:

(Temporary Loan Limit Increase with Credit Approval on or before December 31, 2008)

<table>
<thead>
<tr>
<th>Max Limits</th>
<th>1 Unit</th>
<th>2 Units</th>
<th>3 Units</th>
<th>4 Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low Cost Area</td>
<td>$271,050</td>
<td>$347,000</td>
<td>$419,400</td>
<td>$521,250</td>
</tr>
<tr>
<td>High Cost Area</td>
<td>$729,750</td>
<td>$934,200</td>
<td>$1,129,250</td>
<td>$1,403,400</td>
</tr>
<tr>
<td>Alaska, Guam, Hawaii and the Virgin Islands</td>
<td>$1,094,625</td>
<td>$1,401,300</td>
<td>$1,693,875</td>
<td>$2,105,100</td>
</tr>
</tbody>
</table>

(In high cost areas, the maximum FHA Section 203b loan amount may be increased by the local FHA office to 95% of the median one-family house price in an area or 75% of the FHLMC limit, whichever is lesser. Above are the maximum mortgage limits for low cost and high cost areas at the time of publication of this credit policy manual)

The local FHA office publishes the limits for each county or city within its jurisdiction. Underwriters must be aware of the loan limits and loans must not exceed the maximum statutory or loan-to-value limits as set by FHA.

Credit Policy monitors the published maximum mortgage limits and will provide changes to this information, on a regular basis, to AE’s, branches, and underwriting. This information is updated in the Credit Policy Manual on the underwriting website.

202.02 – Loan-to-Value Limitations

Loan-to-value limits require that the amount of any FHA insured loan not exceed 97.75% of the appraised value of the property or the sales prices (whichever is less) or 98.75% if the value is $50,000.00 of less. This limitation will apply to all FHA loans currently offered by The Lender. Any part of the loan exceeding 97% must be closing costs financed into the loan.
In addition to the 97.75% or 98.75% limits, the loan-to-value is also limited by both occupancy and property status. The loan-to-value limit is applied to the lesser of either 1.) sales price; or 2.) appraised value.

SECTION 203.00 – MAXIMUM MORTGAGE / CASH INVESTMENT REQUIREMENTS

The property’s sales prices, subject to certain required adjustments as described below, or the appraised value, if less, is multiplied by a loan-to-value ratio. The resulting amount is the maximum mortgage that FHA will insure. The borrower must make a cash investment at least equal to the difference between the sales price and the resulting maximum mortgage amount.

Except for certain property and transaction types as described in this section, the lower of the adjusted sales price or the appraised value is multiplied by the factor shown in the chart below. The resulting amount is the maximum loan that FHA will insure provided that the mortgagor has made a cash investment of at least three percent of the contract sales price.

Borrower-paid closing costs may be used to meet the three percent minimum cash investment. If the borrower pays no closing costs at settlement, the loan amount must be reduced sufficiently so that the minimum cash investment is met.

The maximum LTV limits shown below are determined using the lesser of the property’s appraised value or adjusted sales price (whichever is less) and the State in which the property is located. The maximum LTV’s for most purchase transactions are as follows:

<table>
<thead>
<tr>
<th>Maximum Loan-to-Value Percentages (purchase transactions only on proposed and existing construction)</th>
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</thead>
<tbody>
<tr>
<td>States with Average Closing Costs AT OR BELOW 2.1 percent of Sales Price</td>
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<tr>
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</tr>
<tr>
<td>States with Average Closing costs ABOVE 2.1 percent of Sales Price</td>
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</table>

Our definition of closing costs does not include discount points or prepaid items and, thus, these fees and expenses cannot be used in meeting the borrower’s minimum cash investment of 3%. The borrower may pay for the appraisal and credit report with a credit card. However, when fees are paid for in this manner, they may not be counted in meeting the minimum investment requirement.

Closing costs paid by the seller or lender may not be used to meet the minimum investment requirement. Subject to the limits described below, we are not concerned with the dollar amount of any particular fee charged to the seller.

SECTION 204.00 – TRANSACTIONS AFFECTING MORTGAGE CALCULATIONS

Certain types of loan transactions affect the amount of financing available and the calculation of the maximum mortgage. The following sections will address these loan transactions.

204.01 – Identity of Interest Transactions/Non-Arms Length

Identity-of-interest transactions on principal residences are restricted to a maximum LTV ratio of 85 percent. Identity-of-interest is defined as a sales transaction between parties with family relationships or business relationships. However, maximum financing above 85 percent LTV is permissible under certain circumstances:
1. A family member purchases another family member's home as a principal residence. If a property is sold from one family member to another and is not the seller's primary residence, the maximum mortgage is the lesser of either:
   a. 85 percent of the appraised value, or
   b. The appropriate LTV ratio percentage applied to the sales price, plus or minus required adjustments.
   c. The 85 percent limit may be waived if the family member has been a tenant in the property for at least six months immediately predating the sales contract. A lease or other written evidence must be submitted to verify occupancy.

2. An employee of a builder purchases one of the builder's new homes or models as a principal residence.

3. A current tenant purchases the property that he or she has rented for at least six months immediately predating the sales contract. (A lease or other written evidence must be submitted to verify occupancy.)

4. A corporation transfers an employee to another location, purchases that employee's home, and then sells the home to another employee.

For more information on transactions that affect the mortgage amount calculation, see paragraph 1-8 in HUD Handbook 4155.1 REV-5.

204.02 – Non-Occupying Borrowers

Non-Occupying Borrowers. When there are two or more borrowers, but one or more will not occupy the property as a principal residence, the maximum mortgage is limited to **75 percent** LTV. However, maximum financing, as described in paragraph 1-7, is available for borrowers related by blood, marriage or law (spouses, parent-child, siblings, stepchildren, aunts-uncles/nieces-nephews, etc.), or for unrelated individuals that can document evidence of a family-type, longstanding, and substantial relationship **not arising out of the loan transaction**.

All borrowers, regardless of occupancy status, must sign the security instrument and mortgage note. If a parent is selling to a child, the parent **cannot** be the co-borrower with the child on the new mortgage unless the loan-to-value is 75 percent or less.

To reduce risk exposure, mortgages with non-occupying co-borrowers are limited to **one-unit** properties if the LTV will exceed 75 percent.

While we do not object to legitimate transactions in which non-occupant borrowers assist in the financing of the property—such as when parents help their children buy a first home—this arrangement may not be used by non-occupant borrowers to develop a portfolio of rental properties. The degree of financial contribution by the non-occupant borrower, and the number of properties similarly owned may indicate that an investor loan has become the practical reality and that, in effect, family members are acting as "strawbuyers."

FHA does not impose additional underwriting criteria on such transactions, **unless** the occupant borrower has no credit references or has only Group II references. If the occupant borrower falls under these guidelines, they must meet the additional requirements detailed in the referenced section.

204.03 – Three and Four Unit Properties

The maximum mortgage, for three and four unit properties, is limited so that the ratio of the monthly mortgage payment divided by the monthly net rental income does not exceed 100 percent, regardless of occupancy. The projected rents from all units must be equal to or greater than the monthly mortgage payment. The mortgage calculations described below are in addition to previous calculation requirements:

- The monthly payment is defined as principal, interest, taxes, and insurance including mortgage insurance, (PITI), as well as any homeowner's association dues, computed at the note rate;
- No consideration for buy downs will be given;
- Net rental income is the appraiser's estimate of fair market rent from all units (including the unit chosen by the applicant for occupancy) less a 25% allowance for vacancies and maintenance;
- The above calculations will be used to determine the maximum loan amount;
The projected rent may be considered as gross income for qualifying purposes, but may not be used to offset the monthly mortgage payment. The applicant must qualify for the mortgage based on income, credit and assets;
On purchases transaction, the applicant must have 3 months PITI in reserves.

204.04 – Building on Own Land

If the applicant is acting as a general contractor or is having a house built on land already owned or being acquired separately, maximum financing is available if the applicant receives no cash from the settlement.

This type of loan must be underwritten as a Purchase Transaction and must be run through LP or DU as a Purchase Transaction.

The appropriate loan-to-value limits are applied to the lesser of: 1) The appraised value, or 2) The documented acquisition cost of the property, which includes:

- The builder’s price, or the sum of all subcontractors; bids, materials, etc.
- Cost of the land. (If the land has been owned more than six (6) months, or was received as an acceptable gift, the value of the land may be used instead of its cost);
- Interest and other costs associated with any construction loan obtained by the applicant to fund construction of the property;
- Closing costs and reasonable discount points to be paid by the borrower.
- The cost to payoff any existing liens on property other than the subject cannot be included in the acquisition costs.

If the applicant receives cash at closing (exceeding $250), the loan is limited to 85% of the sum of the appraised value and allowable percentage of closing costs. (Replenishment of the applicants own cash expended during construction is not considered as “cash back” provided the applicant can substantiate with canceled checks and paid receipts all out-of-pocket funds used for construction).

Equity in the land (value or cost, as appropriate, minus the amount owned) may be used for the applicant’s entire cash investment. However, the applicant may not receive any funds at closing in Texas.

The Underwriter must condition the approval to assure cash is not received at closing, where applicable.

**Documentation**

- **Acquisition of land**
  - Purchased:
    - Sales contract
    - HUD-1 or other settlement statement, if previously purchased
    - Payoff statement, if purchased with a loan
  - Owned free and clear:
    - Warranty Deed
    - Evidence of no liens against the land (i.e., title policy, etc.)
  - Acceptable gift:
    - Gift letter, fully executed and that includes all information (relationship, that land is being gifted, the identity of the land, etc.)
    - Warranty Deed showing the donor owned the land
    - Evidence of no liens against the land (i.e., title policy, etc.)
    - Evidence the land was transferred to the borrower (Warranty Deed)

- **Agreement to Construct or Sales Contract for manufactured unit**
  - Valid (legally enforceable) contract for construction is required for “stick-built” homes. It usually includes the required improvements as part of the contract and costs, but that is not a requirement.
  - Valid dealer contract for manufactured unit. It usually includes the required improvements as part of the contract and cost, but is not a requirement.
    - The manufactured unit contract cannot include the cost of land unless the dealer/seller already owns the land.
The borrower should not quit claim, or sell, the land to the dealer/builder
• Required improvements to the land (utilities, etc.), and the cost. This is usually included in
the construction or manufactured unit contract.

Paying Off Land Contracts

If the borrower will use the loan to complete payment on a land contract, contract for deed or other similar type
financing arrangement in which the borrower does not have title to the property, the new mortgage may be
processed as either a purchase or a refinance transaction with maximum FHA-insured financing if the borrower receives no cash at closing. If all loan proceeds are used to pay the outstanding balance on the land contract and eligible repairs, renovations, etc., the appropriate LTV ratio is applied to the lesser of:
• The appraised value; or
• The total cost to acquire the property (the original purchase price, plus any documented costs the purchaser incurs for rehabilitation, repairs, renovation, or weatherization), plus allowable closing costs and, if treated as
a refinance, reasonable discount points.

Equity in the property (original sales price minus the amount owed) may be used for the borrower’s entire cash in investment. However, if the borrower receives more than $250 cash at closing, the loan is limited to 85% of the sum of the appraised value and allowable closing costs. Replenishment of the borrower’s own cash expended for repairs, improvements, renovation, etc., is not considered as “cash back,” provided the borrower can substantiate with cancelled checks and paid receipts all out-of-pocket funds spent for those purposes.

Properties Under Construction or Existing Construction Less than One Year Old

Properties not meeting the criteria shown below are considered as under construction or existing construction less than one year old and are limited to 90% financing. For a property to be eligible for greater than 90% financing, whether or not it has been previously occupied, it must meet one of the criteria described below. Otherwise, the property is classified as “under construction” or “less than one year old” and is limited to 90% financing.
• Construction was completed more than one year preceding the borrower’s signature on the Addendum to Uniform Residential Loan Application; or
• The dwelling’s site plan and materials were approved by the Department of VA, an eligible DE underwriter, or a builder under FHA’s builder certification procedures before construction began; or
• The local jurisdiction has issued both a building permit (prior to construction) and a Certificate of Occupancy or equivalent (does not apply to condominiums or manufactured housing because of the special circumstances regarding their approval); or
• The dwelling is covered by a builder’s ten-year insured warranty plan that is acceptable to HUD; or
• The dwelling will be moved to a new location and the property is eligible for an insured mortgage at the new location and was approved by the Department of VA, an eligible DE underwriter, or a builder under FHA’s builder certification procedures before construction began

204.05 – Military Impact Areas

Section 238c is a rarely used FHA loan program. Under the requirements of Section 238c, an FHA mortgage executed in connection with the construction, repair or purchase of property located near any installation of the Armed Force of the United States in federally impacted areas will be eligible for insurance. Such mortgages are insured under the Special Risk Insurance Fund.
• Monthly MIP only, no Upfront MIP;
• ADP code for Direct Endorsement Lending is 774.

In the Georgia counties of Bryan, Liberty and Camden, use of the Military Impact Loan 238c was authorized in 1986. There are no other known Military Impact Areas at this time.

SECTION 205.00 – HUD OWNED PROPERTIES (PROPERTY DISPOSITION SALES)

205.01 – HUD REO Statement of Insurability
The following definitions shall apply to the insurability of a REO property:

**Insurable:** Properties marketed as "insurable" are those that meet FHA's Minimum Property Requirements (MPR) for existing housing and Minimum Property Standards (MPS) for new construction at the time of the appraisal in their as-is condition without repairs being necessary.

**Insurable With Repair Escrow:** A property that requires no more than $5,000 for repairs to meet FHA's MPR or MPS as estimated by the PCR and as reviewed and determined to be reasonable by the appraiser, is eligible to be marketed for sale in its as-is condition with FHA with mortgage insurance available, provided the purchaser(s) establishes a cash escrow to ensure the completion of the required repairs. Purchaser(s) are permitted to include in the mortgage an amount equal to 110% of the estimated cost of the repairs.

**Uninsurable:** Properties offered for sale "Uninsured" do not meet, in their as-is condition, FHA's MPR or MPS and the cost of repairs identified by the appraiser, to meet MPR or MPS, are estimated to exceed $5,000. Uninsurable properties can qualify for FHA's Section 203(k) rehabilitation program and, depending upon the scope and extent of repairs needed, the Streamlined (k) Limited Repair Program. The Lender will accept uninsurable properties under the Streamlined (k) program – however, we do not participate in FHA's Section 203(k) rehabilitation program. The contract will state if the property qualifies for the Streamlined (k) program - the underwriter is to discuss any issues with their manager.

A Statement of Insurability, in bold font, must be included in the Comment section of the appraisal report. This Statement of Insurability shall indicate if the property can be sold with FHA mortgage insurance (meets MPR if existing construction or meets MPS if new construction) either (1) in its “as-is” state without repairs or (2) in its “as-is” state with repairs costing $5,000 or less with repair escrow or (3) uninsurable. In appraising REO properties, as with the performance of any FHA appraisal, a FHA Roster appraiser must denote any deficiency to the supporting site or improvements in the appraisal report. The appraiser is to note those repairs necessary, together with a cost to cure, to bring the property into compliance with either MPR or MPS.

**205.02 – Sales Contract Requirements**

Mortgage lenders may only accept a fully executed copy of form HUD-9548, Sales Contract from purchaser(s) applying for FHA-insured financing to purchase a HUD REO property. The sales contract will specify the sales price, the financing terms, the amount of closing costs HUD will pay at settlement, the real estate commission HUD will pay, the closing date, and any discount on the sales price that will be provided at settlement. All borrowers must occupy the property.

If the contract is not complete, if there are questions about the terms or conditions, or if the contract must be amended as a condition of loan approval, mortgagees should contact the M&M contractor. Mortgagees should also be aware of the following:

- The sales contract must be signed by the M&M contractor. If the sales contract has not been signed by the M&M contractor, mortgage lenders should not process a mortgage application.
- In order to qualify for FHA-insured financing, the first block on Line 4 of the sales contract, as well as the applicable block for FHA program 203(b), or 203(b) repair escrow must be checked. REO properties that are condominiums which are offered for sale with FHA mortgage insurance should be processed under Section 234, even though Section 203(b) is specified on the sales contract.
- In the event the home inspection or the systems check reveals that repairs are needed which no longer makes the property eligible for and FHA-insured 203(b) mortgage, the mortgage lender should contact the M&M contractor to discuss alternatives to allow the sale to continue. The M&M contractor may allow the modification of the sales contract, as needed, to reflect an Insured with Repair Escrow sale in those instances where the mortgage lender provides them with sufficient documentation to support the change in financing. The sales contract must be revised to include this revision and initiated by both the purchaser and the M&M contractor.
- A specific down payment and mortgage amount is no longer required to be established on Line 4 of the form HUD-9548 Sales contract. The purchaser(s) must, however, continue to indicate the type of financing being sought.
The amount on Line 5 of the Sales Contract represents actual borrower financing and closing costs to be paid on their behalf by HUD (the Seller) out of the sales proceeds. It does not represent an amount which the borrower may finance in the mortgage.

Only the actual amount of closing and financing costs will be paid by HUD at settlement. The borrower will not be credited at settlement for any unused portion. Pre-paid items may not be paid out of the amount on Line 5.

Specified on Line 8 of the Sales Contract will be the percentage discount, if any, that will be applied to the sales price at settlement. Where the price will be discounted, the mortgage amount will be based on that discounted sales price, not the contract sales price.

Specified on Line 9 of the sales contract will be the number of days, normally 45 or 60, in which the sale must be closed.

205.03 – Case Number Processing

Concerning case numbers, please note the following:

- Mortgagees must obtain a new FHA case number for applications for FHA-insured financing involving REO properties. When entering the case information in FHA Connection, mortgagees should select “Real Estate Owned” for processing type.
- During the case number processing procedure, CHUMS will require a response to the following question, “Was this case previously sold as a Property Disposition?” Mortgage lenders should always check YES when processing an application for FHA-insured financing on an REO property. The mortgage should complete the “Previous Case Number” field.
- Do not order an appraisal on REO transactions and leave the appraiser fields blank.
- If the REO property is a condominium, FHA connection will require the entry of the Condo ID. If FHA financing was approved on the sales contract, but the condominium development is not approved and the condominium project is in compliance with the Spot Loan procedure, mortgages should enter “Yes” in the Spot Lot field. The DE underwriter will review for a Spot Condo approval and determine if the project is in compliance with FHA guidelines on condominiums.

205.04 – Properties With Escrow Repairs

In order to calculate the maximum mortgage amount and underwrite the loan, mortgage lenders must obtain from the M&M contractor a complete copy of the as-is appraisal and a copy of the Property Condition Report.

Mortgage lenders are responsible for reviewing the property description, comparable and adjustments specified on the appraisal, and for otherwise ensuring that the stated value is accurate. Mortgage lenders should also ensure, to the best of their ability, that properties financed with FHA-insured mortgages meet the Department’s MPR on the appraisal, the mortgage lender’s underwriter notes that the appraiser called for repairs which relate to MPR. If the borrower has a home inspection performed, that inspection may also identify a need for repairs which were not identified on the appraisal. In such cases, it is important that the underwriter address such issues. Section 203(b) financing should not be automatically approved simply based on the terms of the sales contract. Mortgage lenders should discuss any discrepancies with the M&M contractor for resolution.

The reverse situation is possible as well. It is not HUD’s intention to have purchaser(s) obtain financing for repairs that are not needed.

As a rule, the M&M contractor will not make repairs to HUD REO properties which are necessary to bring them up to FHA’s MPR. Where repairs are determined to be necessary, they will generally have to accommodate through Section 203(b) Repair Escrow.

Where a repair escrow is required, the escrow account should be established and administered in accordance with the procedures outlined in HUD Handbook 4145.1. A complete form HUD-92300, Mortgagee’s Assurance of Completion, should be included in the case binder submitted for insurance endorsement. A completed form HUD-92051, compliance Inspection Report, must be submitted after the completion of repairs.

Appraiser Requirements
Requirements for appraisers who perform REO appraisals are the same as for appraisers of any other property type. An appraiser of REO property must be state licensed or certified in the state in which the property is located and listed on the FHA Appraiser Roster. Appraisals for HUD REO properties may be performed only by an appraiser listed on the FHA Appraiser roster.

Appraisal Forms

Per Mortgagee Letter 2005-34 and Revised Appendix D to Handbook 4150.2, the appraiser must report the appraisal on the applicable property specific revised Fannie Mae appraisal reporting form. The appraisal report shall consist of the applicable property specific appraisal reporting forms, all required exhibits and a copy of the Property Condition Report (PCR).

The PCR contains information specific to the condition and functionality of the property. Prior to performing a site visit of a REO property, the appraiser must be provided a copy of the PCR by the M&M contractor.

Appraisal Requirements

Upon conveyance of properties to HUD’s REO inventory, HUD’s M&M contractor shall obtain an “As-is” appraisal (not as-repaired) for each HUD REO property to determine the listing price. The appraisal must fully conform to HUD’s current requirements and processing procedures. The appraisal report shall consist of the applicable property specific appraisal reporting forms, all required exhibits and a copy of the Property Condition Report (PCR).

The guidance provided in Appendix D, Appraisal Protocol, to Handbook 4150.2, applies equally to REO properties, unless otherwise indicated in the guidance presented in this appendix.

The PCR contains information specific to the condition and functionality of the property. Prior to performing a site visit of a REO property, the appraiser must be provided a copy of the PCR by the M&M contractor. REO properties are to be appraised "as-is".

Upon conveyance of properties to HUD’s REO inventory, HUD’s M&M contractor shall obtain an “As-is” appraisal (not as-repaired) for each HUD REO property to determine the listing price. Under “Assignment Type” in the Subject Section of the applicable property specific appraisal reporting form, the appraiser is to mark the box labeled “other” and indicate that the property being appraised is a HUD Real Estate Owned (REO) property.

Utility Issues

Generally, a REO property is secured with the utilities de-activated. The appraiser should request that the M&M contractor make sure the utilities, including the mechanical systems, are activated at the time the appraiser makes the property inspection. If an appraisal is completed without the utilities turned on and/or the mechanical systems functioning, the appraiser must note this in the appraisal report and must rely upon the information provided by the M&M contractor in its Property Condition Report (PCR); reference the PCR in the applicable sections of the appraisal report (condition of property or physical deficiencies) as well as append a copy of the PCR to the appraisal report.

HUD’s M&M contractor shall permit entry to the purchaser(s) during the contract period to activate the utilities for the purposes of conducting a home inspection. If the HUD REO appraisal was completed without the utilities being activated, the mortgage lender or purchaser(s) must complete the systems check while the utilities are activated.

Release of the Appraisal to Lender/Purchaser

HUD’s REO appraisal is made available to the mortgage lender or purchaser(s) at no charge when a current appraisal is available. This is done to reduce out of pocket expenses by the purchaser(s). The mortgage lender should contact the M&M contractor to obtain a copy of the current appraisal.
Ordering Updated Appraisals

Mortgage lenders may not order an updated appraisal from a roster appraiser because the sales price exceeds the as-is value specified on the M&M contractor’s appraisal. Mortgage lenders may order and the borrower may be charged for an updated appraisal only under the following circumstances:

Appraisals over six months old

Appraisals have a life of six months for existing construction. The original appraisal obtained by the M&M contractor must be used, provided the mortgage lender has approved the purchase(s) or a valid HUD sales contract was executed prior to the expiration date of the appraisal.

In those instances where the M&M contractor’s appraisal is more than six months old and a valid HUD sales contract was not executed prior to the expiration date of the appraisal, the mortgage lender must order, and the purchaser(s) may be charged for, an updated appraisal. Mortgage lenders should instruct appraisers to perform an as-is appraisal, not an as-repaired appraisal, in accordance with the procedures outlined in Appendix A-1 of HUD Handbook 4150.2. If mortgage lenders request a copy of the M&M contractor’s appraisal and such copy is not available, mortgage lenders should order a new appraisal.

If the updated appraisal results in a lower as-is value of the property, the purchaser(s) will be given the opportunity to proceed with the transaction with no adjustment made to the sales price, requiring an additional cash investment by the purchaser(s) or the purchaser(s) may withdraw their offer to purchase the property and receive a full refund of the earnest money deposit.

Should the updated appraisal result in a higher as-is value, the sales price will not be adjusted. In these situations, the mortgage amount will be based upon the value established by the updated appraisal. The mortgage amount, however, cannot exceed the sales price indicated on the sales contract.

Note: If an updated appraisal is ordered, the updated appraisal must be used when processing the application. Mortgage lenders do not have the option of ordering an updated appraisal and then deciding whether to use that appraisal or the M&M contractor’s appraisal.

205.05 – Maximum Mortgage Amount and Minimum Cash Investment

The Lender does not participate in any $100 down program available to borrowers for REO properties; but does participate in the 50% sales price reduction offered for properties under the Good Neighbor Next Door program.

HUD may authorize the M&M contractor to offer sales incentives. Where such incentives have been made available, they shall be specified in writing by the M&M contractor on either the sales contract itself or on an accompanying letter.

Absent such written authorization, maximum mortgage and minimum cash investments shall be calculated using form HUD-92900-PUR, Mortgage Credit Analysis Worksheet, and Purchase Money Mortgage. Specific instructions on processing applications for these properties are provided below.

This does represent a change from the way financing for HUD REO properties have traditionally been processed. Mortgagors should note that:

- One Section 203(b) applications, the mortgage amount must be based on the lesser of the as-is value of the sales price.
- Where a discount on the sales price is being provided, the mortgage amount shall be based on the lesser of the as-is value or the discounted sales price, not the contract sales price. Specific instructions on calculating the discounted sales price are provided below.
- Closing costs and pre-paids may not be included in the mortgage.
Acquisition is defined as the sum of the sales price for the property plus or minus the required adjustments. The following sections provide information on required adjustments. In terms of new construction, acquisition is defined as the documented cost to build.

206.01 – Closing Cost Adjustments to Loan to Value

Closing costs that may be added to the loan-to-value or refinance amount are those costs to be paid by the borrower that are common and customary in the area. Not to exceed 75% of the sales price or appraised value. Each local HUD office provides a list of maximum allowable closing costs to be used in computing acquisition costs.

Closing costs do not include discount points.

Only those costs to be paid by the borrower are included in adjusting LTV. All items being paid by a third party (seller, lender, builder, real estate agent, etc.) must be indicated as third party paid and will not be added to the LTV.

Appraisal report costs and credit report costs paid by the applicant with a credit card will not be added to the LTV.

The Lender requires the estimate of closing costs used to calculate the amount during application, processing and underwriting to be an accurate reflection of actual closing costs at the time of settlement.

206.02 – Closing Costs Guidelines

Mortgagees may charge and collect from mortgagors those customary and reasonable costs necessary to close the mortgage. Except for discount points, these fees may also be used to meet the homebuyer’s minimum investment requirement. Due to existing requirements, mortgagors may not pay a tax service fee, and may not be charged an origination fee greater than one percent. Mortgagors are also reminded that aggregate charges may not violate FHA’s tiered pricing rules.

FHA will not allow “mark-ups,” i.e., charging a fee to the mortgagor for an amount greater than that charged the mortgagee by the service provider; only the actual cost for the service may be charged the mortgagor.

206.03 – Seller Contributions

Sellers or other interested third parties such as real estate agents, builders, developers or a combination of parties may contribute up to 6 percent of the property’s sales price toward the buyer’s actual closing costs, prepaid expenses, discount points and other financing concessions. Closing costs normally paid by the borrower are considered contributions if paid by the seller. Included in the 6% limitation are:

- Permanent interest rate buy down;
- Temporary interest rate buy down, except on ARMS;
- Loan payment protection insurance;
- Payments of Upfront Mortgage Insurance Premium;
- Prepaid;
- Buyer Closing Cost;
- Discount points;
- HOA dues that comes due during the first year of the mortgage;
- Real estate taxes that come due in the first year of the mortgage.

Items typically paid by the seller, based on local law or custom or state law, are not considered contributions. Attachment “A” of the Mortgage Credit Analysis Worksheet (MCAW) HUD 92900-WS will be used to indicate the seller contributions. Any dollar amount which exceeds the allowable 6% Seller Contribution must be subtracted from the sales price of the property before calculating the base loan amount.
Sales concessions are defined as certain contributions or expenses paid on behalf of the borrower as an inducement to purchase real property. A dollar for dollar reduction in the sales price will be made before calculating the base loan amount. These inducements include, but are not limited to the following:

- Seller paid contributions that exceed the 6% limitation;
- Decorating allowances;
- Repair allowances;
- Moving costs;
- Excess rent credit;
- Gift Funds not meeting FHA gift requirements;
- Seller payment of buyer’s sales commission on a present residence;
- Seller payment of buyer’s real estate buyer agent fees above the normal and customary seller paid realty fees;
- Personal Property Items*.

*Personal property items such as cars, boats, riding lawn mowers, furniture, televisions or other gifts given to consummate the sale result in a reduction to both the sales price and the appraised value prior to the calculation of the base loan amount.

Certain items may be part of the real estate transaction without a reduction in value or sales price. These items may include ranges, refrigerators, dishwashers, washers, dryers, etc. The FHA local office will determine if these items affect value and are customary for the area. The FHA appraiser and DE Underwriter will be responsible for determining if sales price or value is to be reduced.

Replacement of existing items (such as carpet, air conditioner or other equipment) completed by the seller, prior to closing, will not require an adjustment to sales price or value, provided no cash allowance or credit or given to the buyer.

In addition, if the seller or builder of the property agrees to pay any portion of the borrower’s sales commission on the sale of the borrower’s present residence, the amount paid by the seller or builder is an inducement to purchase and must be subtracted dollar for dollar from the sales price before the LTV ratio is applied. Similarly, a borrower not paying real estate commission on the sale of a present home constitutes a sales concession, if the real estate broker or agent is involved in both transactions and the seller of the property purchased by the borrower pays a real estate commission exceeding that typical for the area. In these situations, the amount paid by the seller above the normal real estate commission is considered an inducement to purchase and must be subtracted from the sales price of the property being purchased before applying the LTV ratio.

Additions to the Mortgage Amount

In some cases, the maximum mortgage amount may be increased. Except for solar energy systems discussed below, an increase generally is permitted only when the appraised value exceeds the sales price. Only the amount by which the value exceeds the sales price may be added; any remaining costs become part of the borrower’s settlement requirements. The following may result in an increase to the mortgage amount:

1. **Repairs and Improvements** – Repairs and improvements required by the appraiser as essential for property eligibility and to be paid by the borrower may be added to the sales price before calculating the mortgage amount. (The appraised value will reflect these requirements) For the cost of repairs and improvements to be eligible for inclusion in the mortgage amount, the sales contract or addendum must identify the borrowers as responsible for paying for or otherwise completing the repairs or improvements. The amount that may be added to the sales price before calculating the maximum mortgage amount is the lowest of:
   a. The amount the value of the property exceeds the sales price; or
   b. The appraiser’s estimate of repairs and improvements; or
   c. The amount of the contractor’s bid, if available
Only repairs and improvements required by the appraiser may be included. Any repairs completed by the borrower on the property before the appraisal is made are not eligible for inclusion in calculating the maximum mortgage. The amount that cannot be financed into the mortgage will become part of the borrower’s required cash investment.

If repairs cannot be completed before loan closing due to weather-related delays, the lender must establish an escrow account to ensure eventual completion of all required repairs.

2. **Energy-Related Weatherization Items** – If weatherization items are to be added to the property and paid for by the borrower, the mortgage amount may be increased by the cost of those items as described below. Weatherization items include thermostats, insulation, storm windows and doors, weather stripping and caulking, etc. These items may be added to both the sales price and the appraised value before determining the maximum mortgage amount. (A contractor’s statement of cost of work completed or a buyer’s estimate of the cost of materials must be submitted. See HUD Handbook 4150.1 REV-1 for details) If the weatherization items cannot be completed before loan closing due to weather-related delays, the lender must establish an escrow account to ensure eventual completion of all items. The amount that may be added in calculating the maximum mortgage is:
   a. $2000 without a separate value determination; or
   b. Up to $3500 if supported by a value determination by an approved FHA appraiser or DE underwriter; or
   c. More than $3500 subject to a value determination by an approved FHA appraiser or DE underwriter and a separate on-site inspection made by a FHA-approved fee inspector.

3. **Solar Energy Systems** – the cost of solar energy systems may be added directly to the mortgage amount (before adding the UFMIP) after applying the LTV ratio limits. The statutory mortgage limit for the area may be exceeded by 20 percent to accommodate the cost of the system. The amount that may be added to the mortgage is limited to the lesser of the solar energy system’s replacement costs or its effect on the property’s market value. Both active and passive solar systems are acceptable, as are wind-driven systems. See HUD Handbooks 4150.1 REV-1 and 4930.2 for details.

**SECTION 207.00 – PURCHASE TRANSACTIONS**

FHA mortgages were developed to provide low down payment mortgages to homebuyers, which would be insured by the government. The intended use or occupancy status of the property and the stage of construction determine its eligibility for FHA financing as well as the loan-to-value.

207.01 – Owner Occupied Principal Residence

The primary applicant or the applicant’s family for the majority of the calendar must occupy the property. At least one borrower must occupy the property and sign the security instrument and mortgage note for the property to be considered owner occupied. Current security instruments require a borrower to establish bona fide occupancy in the home as the borrower’s principal residence within 60 days of signing the security instrument with continued occupancy for one year.

**Note:** Requirements for one-year occupancy may be waived for case of undue hardship or extenuating circumstances beyond the borrower’s control.

An applicant can have only one principal residence at any time whether rented or owned and regardless of the type of financing. An applicant, who owns and intends to keep a principal residence with a HUD-insured mortgage, may not purchase another principal residence with HUD mortgage insurance unless one of the following circumstances applies:

1. The applicant is relocating (and re-establishing residency) to another area not within reasonable commuting distance of the current principal residence. The principal balances on the existing FHA will not need to be reduced.
2. The applicant’s number of dependents has increased to the point where the present house no longer meets the family’s needs. In such cases, the following conditions apply:
a. The applicant must provide satisfactory evidence of the increase in dependents and how the property no longer meets the family’s need. (Keep in mind; the applicants must be able to prove the house can no longer physically accommodate the family. Each child wanting their own bedroom, or simply wanting a house with a family room does not prove “need”); AND  
b. The applicant must also pay down the outstanding mortgage balance on the present property to a 75% LTV or less (excluding and financed MIP). A current residential appraisal must be used to determine loan-to-value. Tax assessments, market analyses by real estate broker, etc. will not be acceptable

3. The applicant is vacating a residence that will remain occupied by a co-mortgagor, the individual vacating the property is permitted to obtain another FHA-insured mortgage. This does not permit two married individuals to own two primary residences but may be used in such circumstances as those following a divorce where the vacating ex-spouse will be purchasing a new home or where one of the co-mortgagors will vacate the existing property and is getting married

4. An applicant that will be a non-occupying co-borrower on property being purchased with a FHA-insured loan as a principal residence by other family members may have a joint interest in that property as will as his or her own principal residence that is covered by a FHA-insured mortgage.

In all other cases, the purchasing applicant must either pay off the HUD-insured mortgage on the previous residence or terminate ownership of the property.

207.02 – Conversion of Primary Residence

Conversion of Primary Residence Policy

Effective with case number assignments on or after September 19, 2008, when qualifying borrowers who are purchasing a new Primary Residence and retaining their existing primary residence:

Pending Sale

If the current principal residence is a pending sale, but the transaction will not be closed (with title transfer to a new owner) prior to the new transaction:  
• Both the current and proposed mortgage payments must be used to qualify the borrower

Conversion to Second Home

If the current principal residence is being retained as a Second Home:  
• Must meet qualifications as a Second Home as defined in the Credit Policy Manual  
• Both the current and the proposed mortgage payments must be used to qualify the borrower for the new transaction

Conversion to Investment Property

If the current principal residence is being retained as an Investment property  
• Both the current and the proposed mortgage payments must be used to qualify the borrower for the new transaction  
• Rental income on the property being vacated, reduced by the appropriate vacancy factor as determined by the jurisdictional FHA Homeownership Center (see http://www.hud.gov/offices/hsg/sfh/ref/sfh2-21u.cfm) may be considered in the underwriting analysis under either of the following circumstances:  
  o Relocations: When the homebuyer is relocating with a new employer, or being transferred by the current employer to an area not within reasonable and locally recognized commuting distance. Required documentation:  
    ▪ A lease, executed by all parties, of at least one year's duration after the loan has closed; AND  
    ▪ Evidence of the security deposit or first month's rent was paid to borrower  
  o Sufficient Equity in Vacated Property: The homebuyer has a loan-to-value ratio of 75 percent or less, as determined by either:  
    ▪ A current (no more than six months old) residential appraisal (The appraisal, in addition to using forms Fannie Mae1004/Freddie Mac 70, may be an exterior-only appraisal using form Fannie
Mae/Freddie Mac 2055, and for condominium units, form Fannie Mae1075/Freddie Mac 466); OR
  - Calculating the LTV by taking the current unpaid principal balance of the existing lien to the
    original sales price of the property. A copy of the purchase HUD-1 is required.

207.03 – Second Home/Secondary Residences

FHA defines a secondary residence, as a property the applicant will occupy in addition to his or her principal
residence. Secondary residences are permitted when the local FHA office agrees that an “undue hardship”
exists; meaning that affordable rental housing that meets the needs of the family is not available for lease in the
area or within reasonable commuting distance to work.

A person may have only one secondary residence at any time.

Direct Endorsement lenders are not authorized to grant hardship exceptions. Any request for a hardship
exception must be submitted to the local FHA office in writing.

Before submitting a request to the local FHA office, the correspondent must be aware that all of the following FHA
conditions apply:

- The secondary residence must not be a vacation home or otherwise used primarily for recreational purposes; and
- The applicant must obtain the secondary residence because of seasonal employment, or employment
  relocation, or other circumstances not related to recreational use; and
- There must be a demonstration lack of rental housing meeting the needs of the applicant’s employment.
  Documentation to support this must include: a) a satisfactory explanation from the applicant of his or her need
  and that rental housing meeting these needs is not available; and b) written evidence from local real estate
  professionals showing a lack of rental housing.

207.04 – Non-Owner Occupied/Investment Properties

The Lender will not lend on HUD secured investment property with no appraisal (i.e. borrower must pay closing
costs), with the exception of streamline of existing FHA loans.

207.05 – FHA Refinance Transactions

A refinance transaction involves repaying an existing real estate debt from the proceeds of a new mortgage that
has the same borrower(s) and the same property. As long as the borrower has legal title (even though not
originally on the loan), the borrower is eligible to refinance the loan. FHA offers three types of refinances; No-
Cash Out (full credit qualifying), Cash Out (full credit qualifying) and Streamline Refinancing – with or without
appraisals.

The following must be considered when processing a refinance transaction:

- **Maximum Percentage of Financing:** The maximum percentage of financing is governed by the occupancy
  status of the property, the use of the loan proceeds, and how and when the property was purchased. FHA
  will insure several different types of refinance transactions including streamline refinances of existing FHA-
  insured mortgages made with and without appraisals, “no cash-out” refinances of FHA insured mortgages
  where all proceeds are used to pay existing liens and costs associated with the transaction, and “cash-out”
  refinances.
- **Maximum Term:** The maximum term of any refinance with an appraisal is 30 years. A streamline refinance
  without an appraisal is limited to the remaining term of the existing mortgage plus 12 years (not to exceed 30
  years).
- **Re-Using an Appraisal:** FHA appraisals on existing properties remain valid for six months. However, they
  cannot be re-used during this period once the mortgage, for which the appraisal was ordered, has closed. An
  appraisal, used for the purchase of a property cannot be used again for a subsequent refinance, even if six
  months have not passed. A new appraisal is required for each refinance transaction requiring an appraisal.
• **Refinance Authorization:** A lender must obtain a Refinance Authorization Number from the FHA Connection.

- The case binder must include the payoff statements from all mortgages to be paid and also the loan amount calculations used on the Mortgage Credit Analysis Worksheet (Form HUD 92900-WS).

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### 207.06 – Property Flipping

On June 7, 2006, HUD published a final rule in the Federal Register amending regulations regarding the prohibition of property flipping in HUD’s single-family mortgage insurance programs by providing additional exceptions to the time restrictions on sales. The rule and this mortgagee letter become effective for mortgages endorsed for insurance on or after July 7, 2006. This Mortgagee Letter also rescinds, in their entirety, Mortgagee Letters 2003-07 and 2005-05.

Below are additional categories of properties exempted from the time restrictions and they include sales of properties by:

- State and Federally chartered financial Institutions and government-sponsored enterprises (GSEs) (e.g., Fannie Mae and Freddie Mac)
- Local and State government agencies
- Nonprofits approved to purchase HUD REO properties at a discount http://www.hud.gov/offices/hsg/sfh/np/np_hoc.cfm
- Sales of properties within Presidentially-Declared Disaster Areas (upon FHA’s announcement of eligibility in a mortgagee letter specific to said disaster)

**Prohibition on Property Flipping Described**

Property flipping is a practice whereby a property is resold a short period of time after it is purchased by the seller for a considerable profit with an artificially inflated value, often abetted by a lender’s collusion with the appraiser. FHA’s policy prohibiting property flipping eliminates the most egregious examples of predatory flips of properties within the FHA mortgage insurance programs.

**Overview of FHA’s Property Flipping Policy**

FHA requires that:
- a) only owners of record may sell properties that will be financed using FHA-insured mortgages; b) any resale of a property may not occur 90 or fewer days from the last sale to be eligible for FHA financing; and c) that for resales that occur between 91 and 180 days where the new sales price exceeds the previous sales price by 100 percent or more, FHA will require additional documentation validating the property’s value. FHA also has the flexibility to examine and require additional evidence of appraised value when properties are re-sold within 12 months.

**Sale by Owner of Record**

To be eligible for a mortgage insured by FHA, the property must be purchased from the owner of record and the transaction may not involve any sale or assignment of the sales contract. This requirement applies to all FHA purchase money mortgages regardless of the time between resales.

The mortgage lender must obtain documentation verifying that the seller is the owner of record and submit this to HUD as part of the insurance endorsement binder; it is to be placed behind the appraisal on the left side of the case binder. This documentation may include, but is not limited to, a property sales history report, a copy of the recorded deed from the seller, or other documentation such as a copy of a property tax bill, title commitment or binder, demonstrating the seller’s ownership of the property and the date it was acquired. Mortgagees participating in the Lender Insurance programs (see ML 2005-36) are to retain this documentation and provide it to FHA upon request.

**Resales Occurring 90 Days or Less Following Acquisition**
If the owner sells a property within 90 days after the date of acquisition, that property is not eligible security for a mortgage insured by FHA unless it falls within one of the exceptions to the time restrictions on resales as noted in this section. FHA defines the seller’s date of acquisition as the date of settlement on the seller’s purchase of that property. The resale date is the date of execution of the sales contract by the buyer that will result in a mortgage to be insured by FHA.

As an example, a property acquired by the seller is not eligible for a mortgage to be insured for the buyer unless the seller has owned that property for at least 90 days. The seller must also be the owner of record.

If a purchase contract was executed within this 90 day period, the current contract need not be canceled and/or a new contract is not required. The current contract is acceptable with the following conditions:
1) Loan does not close until the 90 day period has elapsed, AND
2) The underwriter to condition for the current sales contract to be re-executed (re-signed and re-dated) by all parties prior to closing.

By re-executing (re-dating and re-signing) the sales contract after the 90 day period has elapsed, the contract will then meet the minimum 90 day property flipping requirement.

**Resales Occurring Between 91 and 180 Days Following Acquisition**

If the resale date is between 91 and 180 days following acquisition by the seller, the lender is required to obtain a second appraisal made by another appraiser if the resale price is 100 percent or more over the price paid by the seller when the property was acquired.

As an example, if a property is resold for $80,000 within six months of the seller’s acquisition of that property for $40,000, the mortgage lender must obtain a second independent appraisal supporting the $80,000 sales price. The mortgage lender may also provide documentation showing the costs and extent of rehabilitation that went into the property resulting in the increased value but must still obtain the second appraisal. The cost of the second appraisal may not be charged to the homebuyer.

FHA also reserves the right to revise the resale percentage level at which this second appraisal is required by publishing a notice in the Federal Register.

If the resale date is more than 90 days after the date of acquisition by the seller but before the end of the twelfth month following the date of acquisition, FHA reserves the right to require additional documentation from the lender to support the resale value if the resale price is 5 percent or greater than the lowest sales price of the property during the preceding 12 months. At FHA’s discretion, such documentation may include, but is not limited to, an appraisal from another appraiser.

FHA will announce its determination to require the additional appraisal and other value documentation, such as an automated valuation method (AVM), through a Federal Register issuance. This requirement may be established either nationwide or on a regional basis, at FHA’s discretion.

**Exceptions to 90-day Restriction**

The following sales are exempt from the time restrictions
- Sales by HUD of its Real Estate Owned
- Sales by other United States Government agencies of single family properties pursuant to programs operated by these agencies.
- Sales of properties by nonprofits approved to purchase HUD-owned single-family properties at a discount with resale restrictions.
- Sales of properties that are acquired by the sellers by inheritance.
- Sales of properties purchased by employers or relocation agencies in connection with relocations of employees.
- Sales of properties by state and federally charted financial institutions (subsidiaries of State and Federally charted financial institutions are NOT eligible for this exemption) and Government Sponsored Enterprises.
• Sales of properties by local and state government agencies.

• Upon FHA’s announcement of eligibility in a notice (i.e., ML), sales of properties located in areas designated by the President as federal disaster areas, will be exempt from the restrictions of the property-flipping rule. The notice will specify how long the exception will be in effect and the specific disaster area affected.

**Date of Property Acquisition Determined by the Appraiser**

Mortgage lenders may rely on information provided by the appraiser in compliance with the updated Standard Rule 1-5 of the Uniform Standards of Professional Appraisal Practice (USPAP). This rule requires appraisers to analyze any prior sales of the subject property that occurred within specific time periods, now set for the previous three years for one-to-four family residential properties.

As a result, the information contained on the Uniform Residential Appraisal Report or other applicable appraisal report form describing the Date, Price and Data for prior Sales is to include all transactions for the subject property within three years of the date of the appraisal and the comparable sales within 12 months of the date of the comparable sale. Appraisers are responsible for considering and analyzing any prior sales of the property being appraised within three years of the date of the appraisal and the comparables that are utilized within 12 months of the date of the comparable sale.

Therefore, provided that the URAR completed by the appraiser shows the most recent sale of the property to have occurred at least one year previously, no additional documentation is required from the mortgage lender. The mortgage lender remains accountable for verifying that the seller is the owner of record and may rely on information developed by the appraiser for this purpose if provided. However, if the lender obtains conflicting information before loan settlement, it must resolve the discrepancy and document the file accordingly.

**New Construction**

These restrictions are not applicable to a builder selling a newly built home or building a home for a homebuyer wishing to use FHA-insured financing.

**207.07 – Recently Listed Properties**

• Owner Occupied properties must have been off the market for 1 month

**207.08 – Good Neighbor Next Door**

Under the Good Neighbor Next Door (GNND) programs a buyer purchasing the property with an FHA mortgage can finance into the mortgage all his reasonable and customary closing costs, including any prepaid items and real estate broker’s commission. HUD will not pay any closing costs or real estate broker commissions for the buyer under the GNND programs.

Under the Good Neighbor Next Door (GNND) program, HUD offers for sale at 50% discount from the listing prices certain properties in HUD designated revitalization areas to **teachers**. The teacher must be employed full-time by a public school, private school, or federal, state, county, or municipal educational agency as a state-certified classroom teacher or administrator in grades pre-Kindergarten through 12. The public or private school where the teacher is employed must in the normal course of business serve the students from the area where the home is located. A teacher doesn’t have to be a first-time homebuyer to participate. However, neither the teacher nor her/his spouse may have owned any residential real property during the year prior to the date of submitting a bid on a home. In addition, the teacher and her/his spouse must not have purchased another home under the GNND program or under the predecessor Officer Next Door or Teacher Next Door programs. Finally, the teacher must agree to own and live in the home as her/his sole residence for three years after moving into it.

A **police officer** can buy a HUD home at a 50% discount from the listing price under HUD’s Good Neighbor Next Door (GNND) program. These homes are located in HUD designated revitalization areas. Police officers that meet the eligibility requirements for the program may submit offers to purchase a home during the bidding period and the successful bidder is selected by an electronic lottery. Bids must be submitted through real estate brokers.
A **firefighter or EMT** can buy a HUD home at a 50% discount from the listing price under HUD's Good Neighbor Next Door (GNND) program. These homes are located in HUD designated revitalization areas. The home to be purchased must be located in an area served by the firefighter/EMT's employer. Firefighters/EMTs that meet the eligibility requirements for the program may submit offers to purchase a home during the bidding period and the successful bidder is selected by an electronic lottery. Bids must be submitted through real estate brokers.

Can time served on active military duty count toward occupancy for the Good Neighbor Next Door (GNND) programs?

GNND participants who are called to active military duty at posts outside the commuting area of the home purchased under the GNND Program may be unable to satisfy the three year occupancy requirement. For these individuals, HUD will credit all time served on active military duty against the three-year occupancy requirement.

Properties sold under the GNND Program are located in revitalization areas of metropolitan cities. To lessen the impact of vacant properties on these neighborhoods, HUD will allow GNND participants called to active military duty to rent their homes during their absence. The term of the rental should not exceed the estimated period of active duty. GNND Program participants will be expected to resume residence in the property once they are released from a remote duty assignment.

GNND participants requesting this special accommodation must provide an approved request from HUD/C&L Service Corp/Morris-Griffin Corp, along with a copy of: (1) Active Duty Orders, (2) Power of Attorney, and (3) Rental Agreement (if applicable).

### SECTION 208.00 – NO CASH OUT REFINANCES

The lender must provide a payoff statement in the case binder. For all refinance loan transactions, the borrower will not be required to make or bring the current months payment due to closing, nor will the principal balance of the existing loan be reduced by the amount of that unpaid principal.

As long as the borrower has legal title (even though not originally on the loan), the borrower is eligible to refinance the loan. However, a 12 month mortgage payment history is required and any derogatory must be considered as part of the borrower's credit history. Verification of the principal balance (i.e., payoff stmt) of all current mortgages secured by the property must be in the file.

The maximum mortgage is based on the lesser of the two calculations below:

- “Maximum loan-to-value percentages” multiplied by the appraised value, exclusive of closing costs. (Please refer to HUD Handbook: 4155.1 Paragraph 1-11A chart); OR
- Sum of existing first lien, any purchase money second mortgage and/or any junior liens over twelve (12) months old, closing costs, prepaid expenses, accrued late charges, escrow shortages, borrower paid repairs required by the appraisal, discount points, and other fees as determined by the appropriate HUD Homeownership Center (HOC), subtract any refund of up-front MIP. The prepaid expenses may include per diem interest to the end of the month on the new loan, hazard/flood insurance premiums, mortgage insurance premiums and property tax deposits needed to establish the escrow account. The existing first lien may include the interest charged by the servicing lender, when the payoff is not received by the first of the month, but may not include any delinquent interest.

Subordinate liens, including credit lines, regardless of when taken, may remain outstanding, provided the FHA-insured mortgage meets our eligibility criteria for mortgages with secondary financing as described in Section 5 of this chapter.

If the purpose of the new loan is to refinance an existing mortgage to buy out an ex-spouse’s or other co-borrower's equity, the specified equity to be paid is considered property-related indebtedness and is eligible for inclusion in calculating the new mortgage. The divorce decree, settlement agreement, or other bona fide equity agreement must be provided to document the equity awarded to the ex-spouse or co-borrower.
If the property was acquired less than one year before the loan application and is not already FHA-insured, in addition to the calculations described above, the original sales price of the property also must be considered in determining the maximum mortgage. With conclusive documentation, expenditures for repairs and rehabilitation incurred after the purchase of the property may be added to the original sales price in calculating the mortgage amount.

**Conventional to FHA Refinances and FHA Secure Refinances**

Unlimited CLTV for new subordinate financing, and unlimited CLTV for re-subordination or modification of existing subordinate financing.

**FHA to FHA Refinances**

Standard FHA CLTV ratios apply on new subordinate financing as per Section 5 of HUD-4155.1 REV-5 (CLTV cannot not exceed the applicable FHA LTV and maximum mortgage limit for the area). **Unlimited CLTV for re-subordination or modification of existing subordinate financing.**

### 208.01 – Purchasing Ex-Spouse’s/Co-Borrower Equity

If the new loan is to refinance an existing mortgage to buy out an ex-spouse’s or other co-borrower’s equity, the specified equity to be paid is considered property-related indebtedness and is eligible for inclusion in calculating the new mortgage. The divorce decree or settlement agreement of other bona fide equity agreement must be provided to document the equity awarded to the ex-spouse or co-borrower.

The HUD-1 must show the funds were paid directly to the other party. The applicant must receive no cash from the transaction.

**SECTION 209.00 – CASH OUT REGULAR REFINANCE**

The lender must provide a payoff statement in the case binder. For all refinance loan transactions, the borrower will not be required to make or bring the current months payment due to closing, nor will the principal balance of the existing loan be reduced by the amount of that unpaid principal.

As long as the borrower has legal title (even though not originally on the loan), the borrower is eligible to refinance the loan. However, a 12 month mortgage payment history is required and any derogatories must be considered as part of the borrower’s credit history. Verification of the principal balance (i.e., payoff stmt) of all current mortgages secured by the property must be in the file.

**FHA Cash-Out Refinances**

Unlimited CLTV for re-subordination and/or modification of existing subordinate financing. Applicable for FHA 85% and 95% LTV first mortgages.

Effective for mortgages endorsed on or after October 31, 2005, FHA offers a two-tier cash-out refinance program and in computing maximum allowable mortgage amounts the following must be applied:

**Loan-To-Value = 85.01% to 95%:**

- The loan is limited to 95% of the appraised value.
- The property that is security for the refinanced mortgage must be a 1- or 2-unit dwelling.
- The borrower as his or her principal residence must have owned the subject property for at least 12 months preceding the date of the loan application.
- If the property is encumbered by a mortgage, the borrower must have made all of his/her mortgage payments within the month due for the previous 12 months, i.e., no payment may have been more than 30 days late and is current for the month due.
- Properties that are owned free and clear may be refinanced as cash-out transactions (per HUD phone call reference number 08312006-91).
- Subordinate financing may remain in place, but subordinate to the FHA insured first mortgage, regardless of the total indebtedness or combined loan-to-value ratio, provided the homeowner qualifies for making scheduled payments on all liens.
• Any co-borrower or co-signer being added to the note must be an occupant of the property.
• If the loan is scored through FHA TOTAL Scorecard and received an “Accept/Approve” recommendation, but there are one or more 30-day late payments on the first mortgage in the past 12 months, then the loan is not eligible for 95% LTV cash out.
• 95% LTV for cash-out refinances does not apply to building on own land, identity of interest and paying off land contract transactions. The changes announced in Mortgagee Letter 05-43 which provide for insured mortgages up to 95% LTV only apply to cash-out refinances meeting the criteria specified in the referenced Mortgagee Letter.
• Borrowers in Chapter 13 bankruptcies may be considered for cash out refinances above 85% if all of the following are satisfactory:
  o No delinquent mortgage payments included in the bankruptcy, and
  o There are no late payments within the last 12 months as verified by direct VOM, and
  o All other 95% cash out requirements stated in this section are met, as well as,

Loan-To-Value = Up to 85.00%

• The loan is limited to a combined LTV (FHA insured first mortgage and any subordinated lien) of 85% of the appraised value provided the borrower has owned the property for at least one year.
• The property that is security for the refinanced mortgage may be a 1-4 unit property.
• Property must be owner-occupied.
  o If the property was purchased less than one year preceding the final application, the mortgage amount must be calculated using the lesser of the appraised value or the original sales price of the property multiplied by 85%.
• Properties acquired by inheritances within the past 12 months are eligible for a cash-out refinance transaction limited to 85% of the appraised value. The lender must document the acquisition by the borrowers via inheritance.

SECTION 210.00 – STREAMLINE REFINANCES

The lender must provide a payoff statement in the case binder. For all refinance loan transactions, the borrower will not be required to make or bring the current months payment due to closing, nor will the principal balance of the existing loan be reduced by the amount of that unpaid principal.

Streamline refinances are designed to lower the monthly principle and interest payments on a current FHA-insured mortgage and must involve no cash back to the borrower, except for minor adjustments at closing not to exceed $500. Streamline refinances can be made with or without an appraisal. FHA does not require repairs to be completed (except for lead-based paint repairs) on streamline refinances with appraisals.

HUD’s Credit Alert Interactive Voice Response System (CAIVRS) need not be checked, but HUD’s Limited Denial of Participation (LDP) and General Services Administration (GSA) exclusion lists are still required to be checked for all borrowers. FHA does not require a full credit report, only the most recent 12 month payment history on all mortgages on subject property (except for the credit-qualifying streamline refinances) or a termite inspection on this type of loan. For all non-credit qualifying streamline refinances the lender requires that the application is to show borrower(s) employment information unless the borrowers are of normal retirement age. Income does not need to be disclosed.

Loan must be current at the time of closing/funding.

A refinance transaction involves repaying an existing real estate debt from the proceeds of a new mortgage that has the same borrower(s) and the same property. As long as the borrower has legal title (even though not originally on the loan), the borrower is eligible to refinance the loan. Verification of the principal balance (i.e., payoff stmt) of all current mortgages secured by the property must be in the file.

A mortgage on a principal residence may be refinanced to a shorter-term mortgage, provided the monthly principal and interest increases no more than 20 percent.

Unlimited CLTV for re-subordination or modification of existing subordinate financing.
210.01 – Streamline Refinances Without Appraisals

Streamline transactions involve the refinance of the FHA insured first mortgage only. This type of loan is designed to lower the monthly principal and interest payments on the current FHA insured mortgage and involves no cash back to the borrower, except for minor adjustments at closing not to exceed $500.

The Limited Denial of Participation (LDP) and General Services Administration Debarment (GSA) lists are required to be checked; however there is no need to check the Credit Alert Interactive Voice Response System (CAIVRS).

FHA does not require repairs to be completed (except for lead-based paint) on streamline refinance transactions, however the lender may require the repairs to be completed; if so, they must be an out of pocket expense to the borrower.

The maximum insurable mortgage is the lower of the two calculations below:

- Original Loan Amount: The original principal balance of the existing FHA insured mortgage, including any upfront MIP, plus the new UFMIP being charged on the refinance; OR
- Existing Debt: The sum of the existing FHA insured first lien, closing costs, accrued late charges, escrow shortages, reasonable discount points and the prepaid expenses necessary to establish the escrow account minus any refund of UFMIP plus the new up-front MIP. The existing first lien may include the interest charged by the servicing lender when the payoff is not received by the first of the month but may not include delinquent interest.

The above mortgage calculation applies only to owner-occupied properties. Investment properties, even if originally acquired as principal residence by the current borrowers, may only be streamline refinanced (FHA to FHA) without an appraisal for the outstanding principal balance. The term of the mortgage is the lesser of 30 years or the remaining term of the mortgage plus 12 years.

210.02 – Streamline Refinances With Appraisals (No Credit Qualifying)

Streamline transactions involve the refinance of the FHA insured first mortgage only. This type of loan is designed to lower the monthly principal and interest payments on the current FHA insured mortgage and involves no cash back to the borrower, except for minor adjustments at closing not to exceed $500.

The Limited Denial of Participation (LDP) and General Services Administration Debarment (GSA) lists are required to be checked, however there is no need to check the Credit Alert Interactive Voice Response System (CAIVRS).

FHA does not require repairs to be completed (except for lead-based paint) on streamline refinance transactions, however the lender may require the repairs to be completed; if so, they must be an out of pocket expense to the borrower.

The maximum insurable mortgage is the lower of the two calculations below:

- “Maximum loan-to-value percentages” multiplied by the appraised value, exclusive of closing costs; OR
- Sum of the existing FHA insured first lien, closing costs, accrued late charges, escrow shortages, reasonable discount points and the pre-paid expenses necessary to establish the escrow account minus any refund of up-front MIP. The existing first lien may include the interest charged by the servicing lender, when the payoff is not received by the first of the month, but may not include any delinquent interest.

210.03 – Credit Qualifying Streamline Refinances

Certain circumstances may require evidence that the remaining borrowers on a mortgage loan have an acceptable credit history and the ability to make the mortgage payments. In these cases, the calculation of the
mortgage amount is the same as other streamline refinance. However credit underwriting will be required and the file must at minimum provide:

- Normal disclosures are required;
- A fully completed loan application and all addenda are required;
- A Residential Mortgage Credit Report or a Three Merge Report; and
- Verification of Income using standard or alternative documentation; and
- Verification of assets, if funds are needed for closing, using standard or alternative documentation;
- Applicant must meet acceptable mortgage payment and obligation to income ratios.

Do not run through an AUS system

The Credit qualified streamline refinance will be used:

- When a change in the mortgage term on a fixed rate loan will result in an increase in the mortgage payment. Permitted on owner-occupied loans and on investment properties purchased by governmental agencies and eligible non-profits;
- When deletion of a borrower will trigger due-on-sale clause;
- Following an assumption of a mortgage where the transferability restriction (due on sale clause) was not triggered, such as when a property is transferred by a court order contained in a divorce decree or through an inheritance by will of court order and the assumption occurred less than six months previously.

210.04 – MIP Refund for FHA-to-FHA Refinances

When an applicant refinances an FHA loan in which the Upfront MIP (or previous One-Time MIP) was financed, the unearned premium must be subtracted from the outstanding principal balance.

The refund credit may not exceed the amount of the new MIP due to HUD. No more than the amount of the new premium is to be shown as a credit towards the new MIP. Any excess amount will be refunded direct to the applicant by HUD and is not to be reflected on the HUD-I Settlement Statement.

An MIP netting authorization is required to confirm the correct amount of the MIP refund to be credited to the applicant. This is found on the case number of the assignment and must be recorded on the MCAW.

210.05 – Subordinate Financing for Streamline Refinances

Subordinate financing may remain in place without regard to the total indebtedness against the property only on streamline refinances, with or without appraisals. The applicant is not required to satisfy any outstanding subordinate liens as long as they will clearly be subordinate to the new HUD-insured refinance mortgage.

210.06 – Adding or Deleting Individuals to Title on Streamline Refinance

New individuals may be added to title on a streamline refinance without a credit worthiness review.

Deleting individuals from title on a streamline refinance is restricted to the following:

Credit qualifying streamline refinance. When an assumption of a mortgage not containing a due on sale clause occurred more than six months previously and the assumption can document that he or she has made the mortgage payments during this interim.

Following an assumption of a mortgage where the transferability restriction (due on sale clause) was not triggered, such as in a divorce where a property transfer results from the divorce decree or by will or by court order and the assumption or quit-claim of interest occurred more than six months previously and the remaining owner-occupant can demonstrate that he or she has made the mortgage payments during this time.

Any other situation where an applicant desires to be deleted from title may be processed under the credit qualifying streamline refinance guidelines.
210.07 – Streamline Refinance ARM-to-ARM Rate

On owner occupied principal residences only, an adjustable rate mortgage (ARM) may be refinanced to another
ARM, with or without an appraisal, provided that an immediate payment reduction occurs and that the maximum
interest rate of the new mortgage does not exceed the maximum interest rate of the old mortgage being
refinanced.

210.08 – Streamline Refinance ARM-to-Fixed Rate

An FHA One Year ARM may be refinanced to a fixed-rate mortgage provided the interest on the new fixed-rate
mortgage will be no greater than two percent above the current rate of the ARM. In addition, all mortgage
payments must have been made been within the month due for the past twelve months or total number of months
the loans has been in force, if less than 12 months.

210.09 – Streamline Refinance FHA Hybrid ARM-to-Fixed Rate

A Hybrid ARM, (3-, 5, 7-, or 10-year mortgage) may be streamline refinanced to a fixed rate mortgage, with or
without an appraisal, provided that the payment will not increase by more than 20 percent and all mortgage
payments must have been made within the month due for the past 12 months or the period the mortgage has
been in force, if shorter.

210.10 – Streamline Refinance Fixed Rate-to-ARM Rate

Fixed – Rate mortgages, on owner-occupied principal residences only, may be refinanced to a one-year ARM,
with or without an appraisal, provided the interest rate of the new mortgage is at least two percent below the
interest rate of the mortgage being refinanced. A fixed rate to hybrid ARM need only result in an immediate
payment reduction to the borrower to be eligible for a streamline refinance.

210.11 – Appraisals for Streamline Refinance

If the appraisal value comes in low, and the applicant could refinance a larger amount by refinancing without an
appraisal, the appraisal may be voided and the underwriter should note on the MCAW the loan is proceeding
without the appraisal (owner-occupied only).

When an appraisal is provided, the appraiser should indicate the required repairs. The underwriter will note on
the Conditional Commitment (92800.5B) the appraisal is valid for a streamline refinance only.

- Minor repairs can be deleted. The Lender will require repairs that affect the structural integrity of the dwelling
  and will require lead paint abatement;
- Health and safety issues must be addressed by the appraiser and the underwriter. Repairs will be required,
  when applicable;
- Lead base paint abatement cannot be waived;
- The cost of repairs cannot be financed. (The applicant could, however, convert to a credit qualifying
  refinance);
- Flood insurance cannot be waived.

SECTION 211.00 – NEW CONSTRUCTION

211.01 – Construction Definitions

Pre-approval on New Construction Properties – For a high ratio loan, HUD requires the property to be pre-
approved prior to start of construction. If the property is not pre-approved, a final inspection and a 10-year
warranty are required for a high ratio loan.
Regardless of the process used, the lender must certify, by using form HUD 92900-A, that the property (both on and off site improvements) is 100% complete and the property meets HUD’s minimum property standards.

HUD defines pre-approval as follows:

- **Appraised:** The property is appraised and the DE lender issues form HUD-92800.5b, Conditional Commitment of Appraised Value, prior to the start of construction; OR
- **Building Permit and Certificate of Occupancy:** In those jurisdictions that issue BOTH a building permit prior to the start of construction (or it’s equivalent) and a Certificate of Occupancy (or it’s equivalent), HUD will accept these as evidence of pre_approval. For those jurisdictions that do not issue a Certificate of Occupancy, HUD will accept as its equivalent, a copy of the building permit and the inspection card reflecting all inspections with a certificate from the DE underwriter indicating the final inspection on the inspection card is the equivalent of the Certificate of occupancy. Additionally, the DE must certify the property is 100% complete (both on site and off site improvements) and the property meets HUD’s minimum property standards by properly completing page 3 of the HUD-92900-A.
  - Note: This definition does not apply to condominium properties or manufactured housing due to special requirements applicable to those housing types. A copy of both the permit and the Certificate of Occupancy must be included in the case binder; OR
- **Early Start Letter:** Use of the Early Start procedure allows relief when a backlog occurs during high volume situations when an appraiser cannot be obtained to perform the appraisal in a timely manner. The procedure allows builders to start construction to completing the appraisal.

**Proposed Construction** – A property prior approved for mortgage insurance prior to the beginning of construction, first placement of concrete or other permanent construction materials. The appraisal’s site photos should reflect a vacant lot, or site may be trenched and formed prior to placing of the concrete or other permanent construction materials.

- Inspections – HUD requires three inspections; Initial, Framing, and Final, to be completed by an FHA Compliance Panel Inspector, or by the local building authority. HUD will also accept a final inspection with a 10 year warranty in lieu of the 1st and 2nd inspections.

**Under Construction** – A property that is not complete at the time of the appraisal. Under Construction status is in effect with the first placement of concrete (permanent construction materials) through the point of being 99% complete. The appraisal site photos in the appraisal should reflect this status.

- Inspections – Final inspection by FHA compliance Panel Inspector, or local building authority.
- Ten Year Warranty – Required for a high ratio loan if the property was not pre-approved. All three local authority or FHA Compliance Inspections will not waive the 10 year warranty requirement if the property was not pre-approved prior to the start of construction.

**Existing construction** – A property that is 100% complete at the time the appraisal is performed. “Complete” means installation of all buyer preferences such as flooring and appliances, with utilities on and fully functioning, and all site improvements completed at the time appraisal performed.

- Existing Less than 1 Year vs. Existing – Less than 1 year the age of the property begins with the earliest:
  - Date of the Certificate of Occupancy; OR
  - Date of final approval reflected on the building inspection card; OR
  - Date of a letter from the local or state authority showing the completion of construction.
- Existing – the term existing typically refers to homes that have been 100% complete for more than 1 year
- Inspections – Appraisal may serve as final inspection if the property is 100% complete at the time of appraisal with no conditions. The appraiser is to provide photos of each diagonally opposite front and rear corner of the house reflecting adequate grading and drainage and provide a specific statement that the grading and drainage are acceptable. Appraiser is to verify general conformance with plans and specs.
- Ten Year Warranty – Required for a high ratio loan. All three local of FHA Compliance inspections will not waive the 10 year warranty requirement when the loan was not Pre-approved.

211.02 – Requirements for New Properties
For high ratio, HUD requires a minimum of three inspections; Initial, Framing, and Final, or a Final only inspection with a HUD approved 10 year warranty.

Inspections

HUD will accept the following:

- All three inspections by an approved FHA Compliance Inspector; OR
- A Certificate of Occupancy from a local jurisdiction provided they issue BOTH a building permit (or its equivalent, and Certificate of Occupancy or its equivalent. The building permit must be issued prior to the start of construction; OR
- Appraisal may serve as the final inspection, if the home is 100% complete at time of the appraisal:
  - The appraiser is to provide photos of each diagonally opposite front and rear corner of the house reflecting adequate grading and drainage.
  - Appraiser is to verify general conformance with Plans and specs for required statement
  - If the appraisal serves as the final, Form HUD-92051 is not required.
  - Should the appraiser find that the property is under construction and not 100% complete; the appraiser will perform the appraisal and call for a final inspection. Appraiser cannot perform this final. The appraiser will make the following statement on the appraisal report; “Property under construction; complete according to submitted construction exhibits”; and check the box on page 2 of the URAR “subject to completion per plans and specifications.”

Inspection documents

- Local Inspections – When using local authority inspections, a copy of both the building permit and certificate of occupancy, or their equivalents, must be included in the case binder as evidence of the required inspections.
- FHA Compliance Inspections – When using inspection(s) from FHA Compliance inspectors, the lender must include the completed Compliance Inspection Report(s) form HUD 92051 in the case binder. The final inspection will include photographs of each diagonally opposite front and rear corner of the house to record adequate grading and drainage of the site, a specific statement on the acceptance of grading and drainage and a statement on the HUD 92051 similar to “This is a newly completed dwelling and appears to be in conformance with submitted construction exhibits.” The DE must complete, sign and date section IV of the HUD 92051.
- Appraisal – If the home is 100% complete at the time of the appraisal, the appraisal may serve as the final inspection if requirements of HUD Handbook are followed.

10 Year Warranty

A 10 year warranty is required for all high ratio loans on properties that are not pre-approved prior to the start of construction. Therefore, all properties appraised as under construction or existing less than 1 year old will require a 10 year warranty for a high ratio loan, unless they were pre-approved per HUD guidelines. Evidence of all 3 local building department inspections or FHA Compliance inspections will not waive the 10 year warranty requirement if the loan was not pre-approved prior to construction.

211.03 – Checklist for New Properties – Stick Built

**Proposed** – Approved prior to the beginning of construction by either a Conditional Commitment or Early Start Letter.

**Low Ratio Loan (90% or less):**

- Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite State)
- Builder’s Certification (HUD-92541), not for endorsement binder
- Final inspection by fee inspector (HUD-92051), or C.O., (C.O. is not acceptable on condominium or manufactured home)
- Health Authority Approval on well and septic if needed.
- Flood Insurance, if needed.
High Ratio Loan (90.01% or higher)
- Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite State)
- Builder’s Certification (HUD-92541), not on condominiums
- 1 year warranty (HUD-92544)
- 10 year warranty and final inspection by fee inspector (HUD-92051); OR Conditional Commitment and 3 inspections by fee inspector (HUD-92051); OR Early Start Letter and 3 inspections by fee inspector (HUD-92051); OR Building Permit (or equivalent) and C.O. (or equivalent), (C.O. is not acceptable on condominium or manufactured home)
- Health Authority Approval, if needed
- Flood Insurance, if needed

Under Construction

Low Ratio Loan (90% or less)
- Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite States)
- Builder’s Certification (HUD-92541), not for endorsement binder
- Final inspection by fee inspector (HUD-92051), or C.O., (C.O. is not acceptable on condominium or manufactured home)
- Health Authority Approval on well and septic if needed.
- Flood Insurance, if needed.

High Ratio Loan (90.01% or higher)
- Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite State)
- Builder’s Certification (HUD-92541), not on condominiums
- 1 year warranty (HUD-92544)
- 10 year warranty and final inspection by fee inspector (HUD-92051); OR Conditional Commitment and 3 inspections by fee inspector (HUD-92051); OR Building Permit (or equivalent) and C.O. (or equivalent), (C.O. is not acceptable on condominium or manufactured home)
- Health Authority Approval, if needed
- Flood Insurance, if needed

Existing (New) – Less than 1 year

Low Ratio Loan (90% or less)
- Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite States)
- Builder’s Certification (HUD-92541)
- Health Authority Approval on well and septic if needed.
- Flood Insurance, if needed.

High Ratio Loan (90.01% or higher)
- Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite State)
- Builder’s Certification (HUD-92541), not on condominiums
- 1 year warranty (HUD-92544)
- 10 year warranty; OR Building Permit (or equivalent) and C.O. (or equivalent), (C.O. is not acceptable on condominium or manufactured home)
- Health Authority Approval, if needed
- Flood Insurance, if needed

211.04 – Checklist for Manufactured Housing

Proposed – Approved prior to the beginning of construction by either a Conditional Commitment or Early Start Letter for High Ratio loans.

Low Ratio Loan (90% or less):
- Engineer’s Certification
• Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite State)
• Builder’s Certification (HUD-92541), not for endorsement binder
• Final inspection by fee inspector (HUD-92051)
• Health Authority Approval on well and septic if needed.
• Flood Insurance, if needed.

High Ratio Loan (90.01% or higher)
• Engineer’s Certification
• Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite State)
• Builder’s Certification (HUD-92541)
• 1 year warranty (HUD-92544)
• 1st and Final inspection by fee inspector (Engineer may complete 1st inspection, there is no intermediate inspection); OR 10 year warranty and final inspection by fee inspector (HUD-92051); OR Early Start Letter and 1st and Final inspections by fee inspector (HUD-92051)
• Health Authority Approval, if needed
• Flood Insurance, if needed

NOTE: Engineer’s and inspections from local jurisdiction would be acceptable in areas where fee inspectors are not available. The lender must document their efforts to obtain a HUD fee inspector in the HUD endorsement file.

Under Construction

Low Ratio Loan (90% or less):
• Engineer’s Certification
• Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite State)
• Builder’s Certification (HUD-92541), not for endorsement binder
• Final inspection by fee inspector (HUD-92051)
• Health Authority Approval on well and septic if needed.
• Flood Insurance, if needed.

High Ratio Loan (90.01% or higher)
• Engineer’s Certification
• Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite State)
• Builder’s Certification (HUD-92541)
• 10 year warranty
• Final inspection by fee inspector (HUD-92051)
• Health Authority Approval, if needed
• Flood Insurance, if needed

NOTE: Engineer’s and inspections from local jurisdiction would be acceptable in areas where fee inspectors are not available. The lender must document their efforts to obtain a HUD fee inspector in the HUD endorsement file.

Existing (New) less than 1 year

Low Ratio Loan (90% or less):
• Engineer’s Certification
• Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite State)
• Builder’s Certification (HUD-92541), not for endorsement binder
• Health Authority Approval on well and septic if needed.
• Flood Insurance, if needed.

High Ratio Loan (90.01% or higher)
• Engineer’s Certification
• Subterranean Termite Treatment Report – NPCA-99A and 99B (Termite State)
• Builder’s Certification (HUD-92541)
• 1 year warranty (HUD-92544)
• 10 year warranty
• Health Authority Approval, if needed
• Flood Insurance, if needed

NOTE: Engineer’s and inspections from local jurisdiction would be acceptable in areas where fee inspectors are not available. The lender must document their efforts to obtain a HUD fee inspector in the HUD endorsement file.

Existing over 1 year

• Engineer’s Certification (except on FHA Refinance)
• Comply with all conditions on 92800.5B

211.05 – Second / Subsequent Purchases of FHA Properties Less Than One Year Old

FHA will treat a re-sale to a second or subsequent purchaser of a new less than one year old property that is 100% complete (including all on and offsite improvements) as an existing property and the new construction exhibits normally submitted will not be required, provided that:
1. The re-sale is an arms length transaction.
2. The lender clearly identifies the transaction as a resale to a second or subsequent purchaser in the case binder (to avoid an NOR being issued by the Homeownership Center for missing new construction exhibits).
3. If the property is a manufactured home, the engineer preparing the foundation certification makes a site inspection and the property is 100% complete at the time of the inspection. (Foundation certifications based on proposed construction will not be acceptable.)

With respect to property the flipping rule, lenders are reminded that while a builder selling a newly built home is not subject to the property flipping rule, a subsequent seller would be.

SECTION 212.00 – SUBORDINATE FINANCING

Secondary Financing is permitted in some instances, but not the same type of parameters customarily used for conventional mortgages.

The first mortgage and the second mortgage must conform to FHA criteria. The Subordinate lien cannot impose conditions on The Lender or on the first lien held by The Lender.

212.01 – Secondary Financing from Federal, State and Local Government Agencies

The Lender will accept second liens on HUD/FHA loans from Federal, State and local government Agencies for the applicant’s entire cash investment requirement. The following conditions will apply to such loans:

The FHA insured first lien when combined with the second mortgage, as well as any other mortgages, grants, etc., may not result in cash back to the applicant.

The sum of all financing may not exceed 100% of the cost to acquire the property including down payment, closing costs and any normal prepaid expenses.

The required monthly payment under both the insured mortgage and the second mortgage or lien, plus other housing expenses and all recurring charges, cannot exceed the applicant’s reasonable ability to pay. The source, amount, and repayment terms must be disclosed in the mortgage application and the applicant must acknowledge understanding of and agreement to the terms.

212.02 – Secondary Financing from Non-Profit Agencies Considered Instrumentality’s
The Lender will originate FHA first mortgages which have acceptable secondary financing provided by non-profit agencies that have been approved by the appropriate HOC for that area.

In addition the non-profit must meet the following requirements:

- The non-profit agency is of the type described in FHA Section 501(c)(3) as exempt from taxation under FHA Section 501a of the Internal Revenue Code of 1986; AND
- The non-profit provides evidence of having two years experience as a provider of housing for low and moderate income persons; AND
- The non-profit agency has a voluntary board with no part of the net earnings of the organization benefiting any member, founder, contributor, or individual; AND
- Has been approved as an instrumentality of the government by the appropriate HOC. If the non-profit has not bee approved as an instrumentality of government by the HOC but meets the above requirements, they may also provide secondary financing if:
  - The borrower makes a cash investment of at least 3% of acquisition cost; AND
  - The combined amounts of the 1st and 2nd mortgages do not exceed the statutory loan limit for the area.

### 212.03 – Secondary Financing from Other Organizations and Private Individuals

Other organizations and private individuals may provide secondary financing under the following conditions:

- The combined amount of the 1st and 2nd mortgages do not exceed the applicable LTV Ratio and the maximum mortgage limit for the area.

The repayable terms of the second mortgage must:

- Not provide for a balloon payment before ten years (or not such time acceptable to HUD), unless the property is sold or refinanced; and
- Must permit prepayment by the applicant, without penalty, after giving lender 30 days advance notice;
- The required monthly payment under both the insured mortgage and the second mortgage or lien, plus other housing expenses and all recurring charges, cannot exceed the borrower’s reasonable ability to pay (normal underwriting ratios/criteria apply);
- Any periodic payments due on the second mortgage are due monthly and are substantially the same in amount;
- The source, amount, and repayment terms must be disclosed in the mortgage application and the applicant must acknowledge that he or she understands and agrees to those terms;
- The Lender providing the 1st mortgage cannot be the same as the one providing the 2nd mortgage.

### 212.04 – Grants

Down payment assistance or closing assistance “grants” must be a grant or gift, free and clear of other requirements. The source of funds for a gift to the applicant must be totally unrelated to the loan transaction.

When a lien is filed against the property for recapture upon sale, the lien (so called “Soft Second”) is underwritten using secondary financing criteria.

DE Underwriting are responsible for careful review of these loans to determine that all HUD/FHA financing criteria have been met. In addition, the DE Underwriter will be responsible for determining that the property is free of legal restrictions on conveyance, which do not meet HUD/FHA regulations.

All assistance programs, as well as second mortgage programs, should provide evidence of HUD/FHA approval. If the homebuyer may only use the builder, developer, real estate firm, etc., which contributed funds, the program will in all likelihood be unacceptable for FHA mortgage insurance.

The Lender requires all assistance or grant program to be approved by the Senior Credit Officer or Credit Policy Department, prior to any application utilizing the program. The current approved list may be found on the underwriting website.
SECTION 213.00 – TEMPORARY INTEREST RATE BUY DOWN

Interest rate buydowns, although a small percentage of FHA's insured mortgage portfolio, have not performed as well as those mortgages made without buydowns. Consequently, effective August 1, 2004, FHA will no longer permit underwriting at the buydown rate on fixed rate mortgages. Builders and sellers may still offer buydowns but the borrower must qualify at the note rate.

Since the borrower must qualify at the rate exclusive of the payment reduction provided by the buydown account, the underwriting requirements described in the HUD-4155.1 REV-5, paragraph 2-14B2(a) through (d) no longer apply. All other programmatic instructions for temporary buydowns, including the buydown agreement requirements, remain in effect.

SECTION 214.00 – 203(H) DISASTER RELIEF

214.01 – Mortgage Insurance for Disaster Victims

FHA provides mortgage insurance to assist victims of Presidentially-declared disasters. Under this program, individuals or families whose residences were destroyed or damaged to such an extent that reconstruction or repair is necessary are eligible for 100% financing for the purchase of a home. The Federal Emergency Management Agency (FEMA) provides listings of the specific affected counties and cities and corresponding declaration dates. This information can be found on the internet at http://www.fema.gov/disasters.

The procedures described are in effect whenever a disaster is declared by the President and remain in effect for one year from the date of the President's declaration.

214.02 – Program and Underwriting Requirements

The borrower’s previous residence must have been in the disaster area and must have been destroyed or damaged to such an extent that reconstruction or replacement is necessary. The borrower must provide conclusive evidence of this fact. Documentation showing a permanent residence in the affected area before the disaster includes a valid driver’s license, a voter registration card, utility bills, etc. Documentation regarding destruction of the residence includes an insurance report, an inspection report by an independent fee inspector or government agency, or conclusive photographic evidence showing the destruction or damage. The borrower may have been the owner of the property or a renter of the property affected.

The borrower is eligible for 100% financing of the sales price and no down payment is required. However, closing costs and prepaid expenses not paid by the seller must be paid by the borrower in cash or paid through premium pricing.

Maximum mortgage amounts are the same as for Section 203(b)/203(h). A list can be accessed from the lender web page on HUD’s website at www.hud.gov or on FHA Connection at https://entp.hud.gov/clas/.

The program is limited to one-unit detached homes or units in an approved condominium project. “Spot units” in condominiums are eligible also. Two-, three-, and four-unit properties may not be purchased under the Section 203(h) program.

The borrower’s mortgage loan application must be submitted to the lender within one year of the President’s declaration of the disaster.

ARM’s may be used with the Section 203(h) program.

214.03 – Underwriting Guidance
Since many borrowers affected by a disaster will experience difficulty in providing traditional documentation regarding employment and funds for closing due to the disaster, the underwriter should be as flexible as prudent decision making permits when applying FHA’s underwriting criteria and documentation requirement. To the extent possible, underwriters should be accommodating towards borrowers eligible for Section 203(h) regarding gaps in employment, documentation for employment and funds available, qualifying ratios. In addition, lenders should also be accommodating towards these borrowers when evaluating recent derogatory credit, bankruptcy, foreclosure, deed-in-lieu of foreclosure and delinquent federal obligations, as reported into HUD’s Credit Alert Interactive Voice Response System (CAIVRS) that were the direct result of a disaster. The examples contained below are meant to be general guidance only and are not the only circumstances in which alternative documentation or other proof can be used when traditional documentation is not available. Each case is different and will ultimately need to be evaluated on its own merits. The guiding principle should be to provide FHA financing to disaster victims who can make mortgage payments but may not have all the traditional documentation as proof of their ability to do so.

214.04 – Borrower Eligibility

In determining eligibility for Section 203(h), the borrower must have been an owner, renter or otherwise have occupied the unit that was destroyed or damaged to such an extent that reconstruction or replacement is necessary.

214.05 – Credit

The underwriter should be able to review credit reports and determine if derogatory credit occurred subsequently to a disaster. If the credit report indicates satisfactory credit prior to a disaster, and any derogatory credit subsequently to that date can be related to the effects of the disaster, FHA will consider, for its underwriting standards, that the borrower is a satisfactory credit risk.

FHA is adding situations involving Presidentially-declared disasters to the list of exceptions on CAIVRS. If the borrower is reported in CAIVRS but the credit report indicates the loan was current prior to the disaster, and any delinquency or claim paid can be related to the effects of the disaster, the borrower may be considered eligible.

214.06 – Income

Borrowers affected by a disaster may not be able to document past or present employment. If prior employment cannot be verified (business records destroyed, etc.), but the borrower has a current position in the same or similar field, it still may be possible to consider the income. W2’s and tax returns may be obtained from the IRS to confirm employment and income. If that cannot be done on a timely basis, it is possible the credit report will indicate the borrower’s prior employment. Short-term employment will be considered in light of the circumstances. Although it is anticipated that the Lender will make every effort to obtain documentation on prior employment, FHA will be flexible on documentation requirements. In all cases where traditional documentation cannot be obtained, lenders should document their efforts.

214.07 – Qualifying Ratios

When a borrower is purchasing a new home, yet still has an outstanding mortgage on a property located in a FEMA disaster area, the lender may exclude the mortgage payment on the previous residence from the qualifying ratio calculation provided the borrower provides the lender with information indicating they are working with the service lender to appropriately address the mortgage obligation and that any property insurance proceeds will be applied to the mortgage on the damaged home.

214.08 – Assets

Because “hard copy” bank statements may be unavailable, lenders should encourage borrowers to access their financial institution’s websites to try to download statements confirming assets needed to close the loan. As above, lenders should document their efforts to verify assets and make every effort to ensure that the borrower will have funds to complete the transaction.
214.09 – Liabilities

With regard to the continued mortgage obligations on a prior loan securing a property that has been destroyed or damaged, FHA understands that the record may show late payments as a result of a disaster. Lenders should not consider the outstanding mortgage obligation on destroyed or seriously damaged properties when determining a borrower’s ability to make payments on a new loan provided the requirements under Qualifying Ratios have been met. FHA has taken the position that insurance settlements are likely to pay off remaining obligations. If the borrower was three or more months delinquent on the loan prior to the disaster and the property has been destroyed, it would not be prudent for a lender to make a new loan unless they can show and document extenuating circumstances.

SECTION 215.00 – MORTGAGE INSURANCE PREMIUMS (MIP)

All FHA loans have two different MIP (Mortgage Insurance Premium): Monthly Mortgage Insurance (MMI) those loans which have a monthly premium, and those which have both an Upfront Mortgage Insurance Premium (UFMIP) and a monthly insurance premium. The UFMIP will be paid at closing by either the applicant, in cash, by seller contribution or it may be financed by adding the amount to the base loan amount.

Note: The upfront mortgage insurance premium must be 100% financed or paid 100% in cash. The upfront MIP may not be partially financed. If the seller pays all or part of the upfront MIP (subject to the 6% contribution limitation) or if all or any portion of the upfront MIP is paid by premium pricing, then the entire upfront MIP must be paid in cash.

Note: The financed UFMIP is not included in the statutory loan limit.

The monthly MIP is calculated on the base loan amount (without financed MIP). Principal and interest payments are calculated on the loan amount with financed MIP.

215.01 – Risk-Based Premiums for FHA Mortgage Insurance

Effective with new FHA case number assignments on or after July 14, 2008, FHA will implement risk-based premiums on one- to four-unit single family mortgages. The premium matrix is shown below, replacing the premium matrix in Mortgagee Letter 00-38, which identifies the current mortgage insurance premiums for FHA’s single family programs.

<table>
<thead>
<tr>
<th>Decision Credit Score (FICO)</th>
<th>Non-Traditional</th>
</tr>
</thead>
<tbody>
<tr>
<td>850-680</td>
<td>125/50</td>
</tr>
<tr>
<td>679-640</td>
<td>125/50</td>
</tr>
<tr>
<td>639-600</td>
<td>125/50</td>
</tr>
<tr>
<td>599-560</td>
<td>150/50</td>
</tr>
<tr>
<td>559-500</td>
<td>175/50</td>
</tr>
<tr>
<td>499-300</td>
<td>175/50</td>
</tr>
</tbody>
</table>

A first-time homebuyer, with HUD-approved counseling, will pay only 200 basis points for the upfront mortgage insurance premiums.

The premium grid is based solely on the prospective borrower’s credit bureau score and the loan-to-value ratio; both are defined below.
Future Changes to the Risk-based Premium Schedule

It is FHA’s intent to make any subsequent changes to the risk-based premium schedule only on an annual basis and make them effective at the beginning of the fiscal year. FHA’s fiscal year begins October 1 and ends September 30.

Highlights Regarding FHA’s Risk-Based Premiums

- UFMIP will range from 1.25 percent of the loan amount for lower-risk borrowers to 2.25 percent for riskier borrowers.
- No borrower who qualifies for a FHA-insured mortgage will pay more than 2.25 percent on the upfront mortgage insurance premium (UFMIP) and 55 basis points for the annual premium.
- Borrowers with credit bureau scores must be risk-classified by FHA’s TOTAL Mortgage Scorecard.
- Those in risk categories without a premium shown are not eligible for FHA-insured mortgage financing.
- Borrowers without credit bureau scores will need to be manually underwritten and deemed as eligible based on criteria described in Mortgagee Letter 2008-11; the mortgage insurance premium will be determined by the loan-to-value ratio for the non-traditional column in the premium schedule.

Loan-to-Value

For risk-based premium purposes, the loan-to-value ratio, computed to two decimals (e.g., 95.65), is calculated by dividing the mortgage amount prior to adding on any upfront mortgage insurance premium by the sales price or appraised value, whichever is less. Please note that for purchase transactions, the loan-to-value will be the percentage of the sales price (or appraised value) that is borrowed, e.g., 97.75 percent, as prescribed by law. While borrowers must have at least a three percent cash investment into the property, a portion of their closing costs may be used to meet that amount.

For refinance transactions, which often include closing costs in the loan amount, the LTV is determined by dividing the loan amount prior to adding on any upfront mortgage insurance premium by the appraiser’s estimate of value.

“Decision Credit Score” Defined

If a credit score is available, it must be used to determine the decision credit score for the application and the premium to be charged. A “decision credit score” is determined for each applicant according to the following rule: when three scores are available (one from each repository), the median (middle) value is used; when only two are available, the lesser of the two is chosen; when only one is available that score is used.

Multiple Borrowers. If more than one individual is applying for the same mortgage, the lender must determine the decision credit score for each individual borrower and then select the lower (or lowest if more than two borrowers). That "decision" credit score is then used to determine the appropriate insurance premium in conjunction with the LTV ratio.

Multiple Borrowers/One Without Credit Score(s). The borrower representing the greatest risk to the Department will determine the premium charged. For example, if the decision credit score for one borrower is between 559-500 and the other borrower is in the non-traditional credit category, the decision credit score between 559-500 is used to determine the premium. However, if the decision credit score for one borrower is between 639-600, and the other borrower is in the non-traditional credit category, the non-traditional credit category is used to determine the premium.

Multiple Borrowers/Ineligible Score. Borrowers who fall into a cell with no premium price shown are not eligible for FHA-insured financing. Lenders may consider reducing the loan-to-value ratio to 90 percent or removing the borrower from the loan to proceed with the application.

Borrower Disputes Credit Score. If the mortgage applicant(s) disputes the accuracy of the credit report and, thus, the credit scores:
• The borrower may delay the transaction and work to repair his/her credit, or
• The borrower may pay the mortgage insurance premium based on the credit score generated (and LTV)

Non-Traditional Credit

For premium purposes, the borrower representing the greatest risk to the Department will determine the premium to be charged (see Multiple Borrowers/One Without Credit Score(s)). For underwriting purposes, borrowers with non-traditional credit (or insufficient credit) must qualify based on the underwriting guidance described in Mortgagee Letter 2008-11.

To clarify the guidance in Mortgagee Letter 2008-11 regarding ‘thin-file’ credit reports, the intention was to give lenders the option to also use non-traditional credit sources should they have a minimum trade line requirement to use a credit bureau score. While the premium charged is based on the borrower representing the greatest risk to the Department, for underwriting purposes lenders may use non-traditional credit methodology to make their determination on the borrower’s willingness to repay the new FHA-insured mortgage.

Refinancing Delinquent Loans into FHASecure

For borrowers refinancing delinquent non-FHA ARMs the Upfront mortgage insurance premiums (UFMIP) is set at 2.25 percent of the base loan amount (loan amount excluding UFMIP) regardless of the loan-to-value (LTV) ratio.

Automated underwriting systems will provide lenders with a feedback message that will inform them of the premium to be charged without recognizing that the loan being refinanced is delinquent. Therefore, the feedback message providing the premium message will caution lenders that if the loan being refinanced is delinquent, then the premium is 2.25 percent for the UFMIP and .55 percent for annual premium when LTV ratio greater than 95 percent; if the LTV ratio is equal to or less than 95 percent, the annual premium is .50 percent.

Borrowers who refinance their delinquent non-FHA ARM loan into FHASecure and subsequently wish to refinance to another FHA-insured mortgage must use a refinance product that requires full qualifying, e.g., a rate and term refinance. Once the FHA-to-FHA full qualifying refinance is insured, these borrowers will be able to take advantage of FHA’s Streamline Refinance program.

Underwriting Rules When Using FHA’s TOTAL Mortgage Scorecard

If TOTAL renders a refer risk classification or triggers a review rule, the mortgagee’s Direct Endorsement underwriter must determine whether the borrower qualifies for the mortgage using the basic underwriting and eligibility requirements outlined in Mortgagee Letter 2004-47 (TOTAL Mortgage Scorecard User Guide) and handbook HUD-4155.1 REV-5. However, once determined as eligible for a FHA-insured mortgage, the insurance premium charged is as shown in the matrix above.

Review Rules for FHA’s TOTAL Mortgage Scorecard include excessive payment-to-income ratios and debt-to-income ratios; and from the credit files, a previous mortgage foreclosure within 3 years, a bankruptcy discharged within 2 years and late mortgage payments. TOTAL will refer the application for underwriting analysis if any mortgage trade line, including mortgage line-of-credit payments, during the most recent 12 months shows:

• 3 or more late payments of greater than 30 days; or
• 1 or more late payments of 60 days plus one or more 30-day late payments; or
• 1 payment greater than 90 days late

Although FHA will be charging a slightly higher mortgage insurance premium for certain categories of riskier transactions (e.g., borrowers with low credit bureau scores and high LTVs), those transactions referred by TOTAL are to be fully and properly underwritten. The increased premiums compensate FHA somewhat for the risk represented by the combination of LTV and credit bureau score, but are not themselves grounds for underwriter approval of a mortgage. The Refer decision from TOTAL suggests that, absent additional factors that can be documented by the underwriter, the credit risk of the loan may be too great FHA to insure. Such mortgages, which may exhibit other risk-layering characteristics beyond credit bureau score and LTV, are to be approved solely on
the underwriter’s judgment of the likelihood of successful and sustained homeownership, not on the insurance premium collected.

If the underwriter approves a loan for which non-credit review rules are triggered, i.e., excessive payment-to-income ratios and debt-to-income ratios, the borrower will pay the mortgage insurance premium based on the decision credit score and LTV ratio.

First-Time Homebuyer with HUD-Approved Pre-Purchase Counseling

First-time homebuyers (as defined below) who will be obtaining a mortgage with an LTV greater than 95 percent and whose decision credit score is in the 559-500 range are entitled to a reduction of their upfront mortgage insurance premium from 2.25 percent to 2.00 percent provided the homebuyer completes HUD-approved pre-purchase counseling.

A first-time homebuyer is an individual who has had no ownership in a principal residence during the 3-year period ending on the date of purchase (closing date) of the property. A first-time homebuyer includes any individual that has only owned with a former spouse while married and also includes an individual who has only owned a principal residence not permanently affixed to a permanent foundation, or a property that was not in compliance with State, local, or model building codes and cannot be brought into compliance for less than the cost of constructing a permanent structure. If any of the occupant-owners on the mortgage meet this definition, then the mortgage is considered as having been made to a first-time homebuyer.

Pre-purchase counseling must be obtained from a HUD-approved housing counseling agency, a participating agency of a HUD-approved housing counseling intermediary or a state Housing Finance Agency receiving HUD housing counseling grant funds, and the counseling must occur prior to execution of the sales agreement. With this requirement, it is FHA’s intent to encourage borrowers to participate in meaningful counseling prior to the decision to purchase a home, not to create an incentive or burden for lenders to have borrowers re-execute the sales contract in order to receive a reduced premium.

The counseling may be completed up to one year before the homebuyer signs a purchase agreement (executes a sales contract) for the subject property. It must be one-on-one, face-to-face counseling unless a hardship can be demonstrated, and then the counseling may be conducted one-on-one over the telephone. The counseling must consist of, but is not limited to:

- Budgeting and credit, including an analysis of the household’s unique financial/credit situation;
- Assessing homeownership readiness, including an evaluation of home and monthly payment affordability;
- Development of a written action plan outlining the steps the household and the counselor will take to help the household meet their goals;
- Financing a home, including a discussion of alternative types of mortgage loans/features and special financing products, common lending documents, and steps in the loan application, approval, and closing processes;
- Shopping for a home, including understanding the professionals involved in the process; and
- Maintaining a home, including preventive maintenance, taxes, and insurance;

Even if group sessions or homebuyer education classes cover the topics above, they do not meet the level of one-on-one counseling needed to receive the reduced mortgage insurance premium. To find a list of housing counseling agencies, please visit the Department’s website at http://www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm.

Programs Covered by Risk-Based Premiums

Risk-based premiums and the requirements described in this mortgagee letter apply to those forward mortgages insured under FHA’s Mutual Mortgage Insurance (MMI) fund, the Section 203(k) rehabilitation mortgage insurance program, and individual condominium units insured under Section 234(c). Risk-based premiums do not apply to mortgages insured under Title I of the National Housing Act, nor to reverse mortgages under FHA’s Home Equity Conversion Mortgage (HECM). Risk-based premiums also do not apply to Section 223(e)(declining
Refinance Transactions

The mortgage insurance premium for refinance transactions will depend on several variables. These include whether the refinance is of a FHA-insured mortgage to another FHA-insured mortgage, as under FHA’s streamlined refinance options, is a rate-and-term refinance or is a refinance under the FHASecure initiative. Except for streamlined refinances and mortgage refinancing under the FHASecure initiative, the new LTV and new decision credit score determine the mortgage insurance premiums. Additional information is provided below:

Full Qualifying Refinances (e.g., rate-and-term; FHASecure refinance of a conventional mortgage not presently delinquent; cash-out refinances; any that require complete underwriting). These refinances are subject to the mortgage insurance premiums based on the LTV and decision credit score for the refinance application.

Streamline Refinances. The mortgage insurance premiums charged are subject to whether the existing FHA-insured loan being streamline refinanced was charged premiums based on A) the pre-July 14, 2008 premium structure of 150/50 basis points or B) the post July 14, 2008 LTV/decision credit score premium schedule. The following examples illustrate the appropriate premiums that will be charged for streamline refinances.

A. FHA-insured loans pre-July 14, 2008/Borrower paid 150/50 basis points

- Borrowers with an existing FHA-insured loan where the case number for the streamline refinance transaction was assigned before July 14, 2008, will be charged 150 basis points upfront and 50 basis points annually. On subsequent streamline refinances where the case number is assigned on or after July 14, 2008 borrowers will be charged 100 basis points upfront and 50 basis points annually.

- Borrowers with an existing FHA-insured mortgage where the case number for the streamline refinance transaction was assigned on or after July 14, 2008, will be charged 100 basis points upfront and 50 basis points annually. On subsequent streamline refinances borrowers will be charged 100 basis points upfront and 50 basis points annually.

B. FHA-insured loans On or After July 14, 2008/Borrower paid Risk-based Premium

- Borrowers with an existing FHA-insured mortgage (purchase or full qualifying refinance transaction) where the case number for that existing mortgage was assigned on or after July 14, 2008, will be charged premiums on the subsequent streamline refinance transaction using the decision credit score and LTV for the existing mortgage being refinanced.

- If the streamline refinance transaction is “credit qualifying” (with or without an appraisal) premiums are based on the new decision credit score and the LTV from the existing mortgage being refinanced.

Borrowers who refinanced their delinquent non-FHA ARM into an FHASecure mortgage are not eligible to streamline refinance their FHASecure mortgage. The refinance transaction subsequent to the FHASecure mortgage must be a full qualifying refinance.

Previous Case Number. To determine the case number of the loan being refinanced, lenders may use the Case Query screen in FHA Connection using the borrower’s name, address and/or social security number.

Premium Feedback. The Case Number Assignment screen in FHA Connection will provide a feedback message with the appropriate premium to be charged for refinance transactions.

Refund of Upfront Premiums. Refunds of upfront premiums are available to borrowers refinancing to another FHA-insured mortgage within a three-year time period, as shown below.

<table>
<thead>
<tr>
<th>Month of Year</th>
<th>Upfront Mortgage Insurance Premium Refund Percentages</th>
</tr>
</thead>
</table>

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On any refinance where the MIP refund exceeds the Upfront MIP required on the new loan, the overage will be refunded directly to the borrower from HUD. The lesser of the MIP refund or the new upfront MIP should be subtracted from the unpaid principal balance before calculating the new mortgage amount.

<table>
<thead>
<tr>
<th>Type of Refinance</th>
<th>Risk-Based Premium Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash-Out Refinances</td>
<td>Premiums based on new LTV and credit bureau score/see premium matrix</td>
</tr>
<tr>
<td>Rate-and-Term Refinance (no cash out)</td>
<td>Premiums based on new LTV and credit bureau score/see premium matrix</td>
</tr>
<tr>
<td>FHA Secure/Not Delinquent</td>
<td>Premiums based on new LTV and credit bureau score/see premium matrix</td>
</tr>
<tr>
<td>FHA Secure/Delinquent</td>
<td>Premium is 2.25% upfront. Annual premium is 55 basis points if LTV &gt; 95%; otherwise, 50 basis points</td>
</tr>
<tr>
<td>Streamlined Refinance of RBP Loan</td>
<td>Premiums based on previous LTV and previous credit bureau score/FHA will provide feedback with initial values/Any refund to be applied to new upfront premium</td>
</tr>
<tr>
<td>“Credit qualifying” Streamlined Refinance</td>
<td>Premiums based on new credit bureau score and previous LTV/FHA will provide feedback with initial values/ Any refund to be applied to new upfront premium</td>
</tr>
<tr>
<td>Streamline Refinance with new case number assigned prior to July 14, 2008</td>
<td>Premium is 1.50 percent upfront and .50 percent annually/ Any refund to be applied to new upfront premium</td>
</tr>
<tr>
<td>Streamline Refinance with new case number assigned on or after July 14, 2008</td>
<td>Premium is 1.00 percent upfront and .50 percent annually/ Any refund to be applied to new upfront premium</td>
</tr>
</tbody>
</table>

15 Year and Shorter-Term Mortgages

Mortgages with terms of 15 years or fewer have a slightly different upfront and annual premium structure due to the risk shorter-term mortgages represent. The mortgage insurance premium matrix is shown below:

<table>
<thead>
<tr>
<th>FHA Single Family Mortgage Insurance</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Upfront Mortgage and Annual Mortgage Insurance Premiums</td>
<td></td>
</tr>
<tr>
<td>Loan Terms of 15 Years or Fewer</td>
<td></td>
</tr>
<tr>
<td>Effective as of July 14, 2008</td>
<td></td>
</tr>
<tr>
<td>All premiums are specified in basis points (0.01%)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Decision Credit Score (FICO)</th>
<th>LTV</th>
<th>850-680</th>
<th>679-640</th>
<th>639-600</th>
<th>599-560</th>
<th>559-500</th>
<th>499-300</th>
<th>499-300</th>
<th>NON-TRADITIONAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>≤ 90.00</td>
<td>100/0</td>
<td>100/0</td>
<td>125/0</td>
<td>150/0</td>
<td>175/0</td>
<td>175/0</td>
<td>150/0</td>
<td>150/0</td>
<td></td>
</tr>
<tr>
<td>90.01-95.00</td>
<td>100/25</td>
<td>125/25</td>
<td>150/25</td>
<td>175/25</td>
<td>200/25</td>
<td>n/a</td>
<td>175/25</td>
<td>175/25</td>
<td></td>
</tr>
</tbody>
</table>

Systems

Lenders are reminded of the importance of data integrity to ensure that the appropriate premium is charged and that the data submitted to TOTAL and FHA Connection is accurate. Also, system edits will prevent lenders from Streamline Refinancing FHA Secure loans that were previously delinquent non-FHA ARM loans.

Additional Information about FHA’s Risk-Based Premiums
• Except for streamline refinances, premiums are the same for purchase and refinance transactions, i.e., based solely on the decision credit bureau score and the loan-to-value ratio
• There are no “add-ons” to the premiums or other adjustments to the mortgage insurance premiums for property type, e.g., multiple unit properties and mortgages on manufactured housing
• The source of the downpayment is not a factor in determining the mortgage insurance premium

215.02 – Moratorium on Risk-Based Premiums for FHA Mortgage Insurance

The following section is for case #’s issued on or after 10-1-08

The Housing and Economic Recovery Act of 2008 provides for a one-year moratorium on the implementation of FHA’s risk-based premiums beginning October 1, 2008. Consequently, effective with new FHA case number assignments on or after that date, FHA will no longer base its mortgage insurance premiums on a combination of credit bureau score and loan-to-value ratio. The new premiums (upfront and annual) to be implemented for all loans for which a case number is assigned on or after October 1, 2008, are described below. Mortgagee Letter 2008-16 is rescinded in its entirety. Please note that certain parts of that mortgagee letter are retained and reiterated in the guidance that follows.

Upfront Premiums: FHA will charge an upfront premium in an amount equal to the following percentages of the mortgage:

- Purchase Money Mortgages and Full-Credit Qualifying Refinances = 1.75 Percent
- Streamline Refinances (all types) = 1.50 Percent
- FHASecure (Delinquent Mortgagors) = 3.00 Percent.

Annual Premiums: An annual premium, shown in basis points below, to be remitted on a monthly basis, will also be charged based on the initial loan-to-value ratio and length of the mortgage (except for FHASecure delinquent mortgages) according to the following schedule:

- Purchase Money Mortgages, Full-Qualifying Refinances, and Streamline Refinances:

<table>
<thead>
<tr>
<th>LTV (initial loan term)</th>
<th>Annual for Loans &gt;15 Years</th>
<th>LTV (initial loan term)</th>
<th>Annual for Loans ≤15 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 95</td>
<td>50</td>
<td>&lt; 90</td>
<td>-None-</td>
</tr>
<tr>
<td>&gt; 95</td>
<td>55</td>
<td>&gt; 90</td>
<td>25</td>
</tr>
</tbody>
</table>

- FHASecure (delinquent mortgagors):

<table>
<thead>
<tr>
<th>LTV (all loan terms)</th>
<th>Annual (all loan terms)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 95</td>
<td>50</td>
</tr>
<tr>
<td>&gt; 95</td>
<td>55</td>
</tr>
</tbody>
</table>

Highlights Regarding FHA’s Mortgage Insurance Premiums

- All loans to borrowers with a credit score must be risk-classified by FHA’s TOTAL Mortgage Scorecard.
- Borrowers with decision credit scores below 500 and with loan-to-value ratios at or above 90 percent are not eligible for FHA-insured mortgage financing.
- Borrowers without credit bureau scores will need to be manually underwritten and deemed as eligible based on criteria described in Mortgagee Letter 2008-11.
- Eligibility for delinquent mortgagors under the FHASecure initiative is described in full in ML 2008-13.
For insurance premium purposes and eligibility for FHA mortgage insurance, the loan-to-value ratio, computed to two decimals (e.g., 95.65), is calculated by dividing the mortgage amount prior to adding on any upfront mortgage insurance premium by the sales price or appraised value, whichever is less.

For refinance transactions, which often include closing costs in the loan amount, the LTV is determined by dividing the loan amount prior to adding on any upfront mortgage insurance premium by the appraiser’s estimate of value.

**“Decision Credit Score” Defined**

If a credit score is available, it must be used to determine the decision credit score for the application and for eligibility for FHA-insured mortgage financing. A “decision credit score” is determined for each applicant according to the following rule: when three scores are available (one from each repository), the median (middle) value is used; when only two are available, the lesser of the two is chosen; when only one is available that score is used.

**Multiple Borrowers.** If more than one individual is applying for the mortgage, the lender must determine the decision credit score for each individual borrower and then select the lower (or lowest if more than two borrowers). That “decision” credit score is then used to determine whether the loan is eligible for FHA mortgage insurance. Applications where the decision credit score is below 500 are not eligible for FHA-insured financing unless the loan-to-value ratio is less than 90 percent. A transaction where one borrower had only “nontraditional credit” and the other had a decision credit bureau score under 500 would not be eligible for FHA mortgage insurance unless they had equity of 10 percent or more.

**Non-Traditional Credit.** For underwriting purposes, borrowers with non-traditional credit (or insufficient credit) must qualify based on the underwriting guidance described in Mortgagee Letter 2008-11. Please note that if TOTAL renders an “accept/approve” risk-classification, it can be relied on (subject to correct data) except in those situations where none of the owner-occupants of the property have credit bureau scores and the borrower(s) must be underwritten using the insufficient credit instructions in that mortgagee letter.

The guidance in Mortgagee Letter 2008-11 regarding ‘thin-file’ credit reports was intended to give lenders the option to also use non-traditional credit sources should they have a minimum trade line requirement to use a credit bureau score.

**Refinancing Delinquent Loans into FHASecure**

For borrowers refinancing delinquent non-FHA ARMs the upfront mortgage insurance premium (UFMIP) is set at 3.00 percent of the base loan amount (loan amount excluding UFMIP) regardless of the loan-to-value (LTV) ratio. The loan-to-value will determine the annual premium.

Automated underwriting systems will provide lenders with a feedback message that will inform them of the premium to be charged without recognizing that the loan being refinanced is delinquent. Therefore, the feedback message providing the premium message will caution lenders that if the loan being refinanced is delinquent, then the premium is 3.00 percent for the UFMIP and .55 percent for annual premium when LTV ratio greater than 95 percent; if the LTV ratio is equal to or less than 95 percent, the annual premium is 0.50 percent.

Borrowers who refinance their delinquent non-FHA ARM loan into FHASecure and subsequently wish to refinance to another FHA-insured mortgage must use a refinance product that requires full qualifying, e.g., a rate and term refinance. Once the FHA-to-FHA full qualifying refinance is insured, these borrowers will be able to take advantage of FHA’s Streamline Refinance program.

**Underwriting Rules When Using FHA’s TOTAL Mortgage Scorecard**

If TOTAL renders a refer risk classification or triggers a review rule, the mortgagee’s Direct Endorsement underwriter must determine whether the borrower qualifies for the mortgage using the basic underwriting and eligibility requirements outlined in Mortgagee Letter 2004-47 (TOTAL Mortgage Scorecard User Guide) and handbook HUD-4155.1 REV-5.
Review Rules for FHA’s TOTAL Mortgage Scorecard include excessive payment-to-income ratios and debt-to-income ratios; and from the credit files, a previous mortgage foreclosure within 3 years, a bankruptcy discharged within 2 years and late mortgage payments. TOTAL will refer the application for underwriting analysis if any mortgage trade line, including mortgage line-of-credit payments, during the most recent 12 months shows:

- 3 or more late payments of greater than 30 days; or
- 1 or more late payments of 60 days plus one or more 30-day late payments; or
- 1 payment greater than 90 days late

The Refer decision from TOTAL suggests that, absent additional factors that can be documented by the underwriter, the credit risk of the loan may be too great for FHA to insure. Such mortgages, which may exhibit other risk-layering characteristics beyond credit bureau score and LTV, are to be approved solely on the underwriter’s judgment of the likelihood of successful and sustained homeownership.

If the underwriter approves a loan for which non-credit review rules are triggered, i.e., excessive payment-to-income ratios and debt-to-income ratios, the borrower will pay the mortgage insurance premium based on the LTV ratio and term of mortgage in years.

First-Time Homebuyer with HUD-Approved Pre-Purchase Counseling

The Housing and Economic Recovery Act also provides for a reduction of the upfront premium from 3.00 to 2.75 percent for first-time homebuyers (as defined below) who complete HUD-approved pre-purchase counseling. However, since no premium for purchase money mortgages will exceed 1.75 percent through September 30, 2009, there will be no reduction in the upfront premium for counseled first-time homebuyers. Nevertheless, we are repeating the instructions of what constitutes acceptable pre-purchase counseling below.

A first-time homebuyer is an individual who has had no ownership in a principal residence during the 3-year period ending on the date of purchase (closing date) of the property. A first-time homebuyer includes any individual that has only owned with a former spouse while married and also includes an individual who has only owned a principal residence not permanently affixed to a permanent foundation, or a property that was not in compliance with State, local, or model building codes and cannot be brought into compliance for less than the cost of constructing a permanent structure. If any of the occupant-owners on the mortgage meet this definition, then the mortgage is considered as having been made to a first-time homebuyer.

Pre-purchase counseling must be obtained from a HUD-approved housing counseling agency, a participating agency of a HUD-approved housing counseling intermediary or a state Housing Finance Agency receiving HUD housing counseling grant funds, and the counseling must occur prior to execution of the sales agreement. With this requirement, it is FHA’s intent to encourage borrowers to participate in meaningful counseling prior to the decision to purchase a home, not to create an incentive or burden for lenders to have borrowers re-execute the sales contract in order to receive a reduced premium.

The counseling may be completed up to one year before the homebuyer signs a purchase agreement (executes a sales contract) for the subject property. It must be one-on-one, face-to-face counseling unless a hardship can be demonstrated, and then the counseling may be conducted one-on-one over the telephone. The counseling must consist of, but is not limited to:

- Budgeting and credit, including an analysis of the household’s unique financial/credit situation;
- Assessing homeownership readiness, including an evaluation of home and monthly payment affordability;
- Development of a written action plan outlining the steps the household and the counselor will take to help the household meet their goals;
- Financing a home, including a discussion of alternative types of mortgage loans/features and special financing products, common lending documents, and steps in the loan application, approval, and closing processes;
- Shopping for a home, including understanding the professionals involved in the process; and
- Maintaining a home, including preventive maintenance, taxes, and insurance;
Even if group sessions or homebuyer education classes cover the topics above, they do not meet the level of one-on-one counseling needed to receive the reduced mortgage insurance premium. To find a list of housing counseling agencies, please visit the Department's website at http://www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm.

Programs Covered by Insurance Premiums Shown Above

The upfront and annual premiums and the requirements described in this mortgagee letter apply to those forward mortgages insured under FHA’s Mutual Mortgage Insurance (MMI) fund; the Section 203(k) rehabilitation mortgage insurance program; and individual condominium units insured under Section 234(c). These premiums do not apply to mortgages insured under Title I of the National Housing Act, nor to reverse mortgages under FHA’s Home Equity Conversion Mortgage (HECM). These premiums also do not apply to Section 223(e)(declining neighborhoods), Section 238(c)(Military Impact areas in Georgia and New York), Section 247 (Hawaiian Homelands), and Section 248 (Indian Reservations).

Refinance Transactions

The mortgage insurance premium for refinance transactions will depend on the type of refinance (e.g., rate-and-term; streamlined FHA-to-FHA refinance; or FHA Secure delinquent), the loan-to-value ratio, and the term of the mortgage.

Full Qualifying Refinances (e.g., rate-and-term; FHA Secure refinance of a conventional mortgage not presently delinquent; cash-out refinances; any that require complete underwriting except delinquent loans being refinanced under FHA Secure). These refinances are subject to the same mortgage insurance premiums as purchase money mortgages shown above.

Streamline Refinances. The mortgage insurance premiums charged are based on the loan-to-value ratio (either the calculated LTV based on the existing mortgage, or a new LTV based on a new FHA-appraisal) and the term of the mortgage.

Borrowers who refinanced their delinquent non-FHA ARM into an FHA Secure mortgage are not eligible to streamline refinance their FHA Secure mortgage. The refinance transaction subsequent to the FHA Secure mortgage must be a full qualifying refinance.

Previous Case Number. To determine the case number of the loan being refinanced, lenders may use the Case Query screen in FHA Connection using the borrower’s name, address and/or social security number.

Future Changes to the Risk-based Premium Schedule

It is FHA’s intent to make any subsequent changes to the premium schedule only on an annual basis and make them effective at the beginning of the fiscal year. FHA’s fiscal year begins October 1 and ends September 30.

Systems

Lenders are reminded of the importance of data integrity to ensure that the appropriate premium is charged and that the data submitted to TOTAL and FHA Connection is accurate. Also, system edits will prevent lenders from streamline refinancing FHA Secure loans that were previously delinquent non-FHA ARM loans.

215.03 – Cancellation of Annual MIP

For loans closed on or after January 1, 2001, FHA’s annual MIP will be automatically terminated under the following conditions:
1. For mortgages with terms more than 15 years, the MIP will be terminated when the LTV reaches 78%, provided the borrower has paid the MIP for at least 5 years. If the LTV reaches 78% and the borrower has not paid the MIP for at least 5 years then the borrower must continue to pay MIP until the 5 year requirement is met.
2. For mortgages with terms 15 years and less and with LTV ratios of 90% and greater the MIP will be terminated when the LTV reaches 78%, irrespective of the length of time the borrower has paid the MIP.

3. Mortgages with terms 15 years and less and with LTV ratios of 89.99% and less will not be charged MIP.

Note: The MIP cancellation provision excludes those loans not insured by the Mutual Mortgage Insurance fund. The MMI does not cover mortgage on condominiums or Section 203(k) Rehabilitation loans.

Although the MIP will be terminated as described, the FHA insurance will remain in force for the loan’s full term. This MIP termination provision only applies to loans where the borrower also paid an UFMIP at closing.

FHA will determine when a borrower has reached the 78% LTV ratio based on the lesser of the sales price or appraised value at loan origination. FHA regulations do not permit the borrower to submit a new appraisal to reach the threshold for termination of MIP. Termination of MIP will normally be based on the scheduled amortization of the loan. However, borrowers may reach the 78% threshold in advance of the scheduled amortization because of prepayments of loan principal. A borrower whose loan reaches the 78% LTV threshold sooner than projected because of prepayment may have the MIP terminated (but not sooner than 5 years from loan closing for loans with terms greater than 15 years) if the borrower has not been more than 30 days delinquent in paying the mortgage payments during the previous 12 months. The borrower must submit a termination request to the lender and the lender must provide the borrower’s request and supporting documentation with respect to the mortgage payments during the last 12 months to FHA for such termination.

SECTION 216.00 – UNDERWRITING DOCUMENTATION

216.01 – Face to Face Interview

Face to Face Interviews are no longer required as long as the two forms of identification are present in the loan file satisfying the Patriot's Act Disclosure requirement.

216.02 – Home Inspection/Lead Paint Hazard Notice

On purchases of residential property built prior to 1978, the seller is required to provide purchaser with information concerning the existence of lead-based paint and to offer the homebuyer the opportunity to have the property inspected.

FHA has developed a disclosure for all existing properties that will involve an FHA loan. Called “Importance of Home Inspections”, the disclosure is to be signed and dated by the applicant(s) on or before the date that the sales contract is executed or re-executed if necessary. New construction and refinances are exempt from this requirement.

The Lender will require a copy of the executed disclosure to be in the loan file at time of underwriting. The executed disclosure must conform to FHA’s requirements.

216.03 – Social Security Number Validation

The applicants must provide evidence of their Social Security Number on all transactions. The actual Social Security Card is not required as the number can be obtained from pay stubs, driver’s license, W-2’s, etc.

216.04 – Pay stubs/Verification of Employment

The applicant(s) must provide the most recent pay stub for each current employer to support the Verification of Employment. The pay stub must be the most recent the applicant has available, but the document itself must not be more than 120 days old when the loan closes (180 days on new construction). If used in lieu of a VOE, must contain borrowers name, social security number and year-to-date earnings.

216.05 – Current Bank Statement/Verification of Deposit
VOD and most current bank statements or 2 most recent bank statements are required.

Automated findings may reduce the required 2 months bank statements; however, if a VOD is used a bank statement must always be obtained as supporting documentation.

216.06 – Real Estate Certification

All applicants, sellers, builders, and real estate agents are required to sign a certification which indicates the sales contract contains all terms and agreements among the parties. A separate Real Estate Certification (part of the HUD addendum to sales contract) is to be utilized only when the executed sales contract does not contain the necessary language.

216.07 – Notice to Homebuyer

Form HUD-92900-B (12/2004) must be read and signed at the time of application. The intent of the form is to inform the homebuyer of their rights to:

- Condition of Property
- Loan Fraud
- Discrimination
- Prepayment
- FHA Mortgage Insurance

216.08 – Amendatory Clause

The amendatory clause is required when an applicant for an FHA loan has not been informed of the property appraised value at the time the contract is signed. It is a required addendum to (or a preprinted section of) the Sales Contract.

The executed sales contract and all addenda, including the amendatory clause, must be in the file when loan is underwritten. The amendatory clause, as a separate addendum or as part of the sales contract, must be signed and dated by both the purchaser(s) and the seller(s).

216.09 – FHA Sales Contract/Purchase Agreement

The file must contain an original or certified true copy of the sales contract (purchase agreement) and all addenda that has been signed and dated by all parties.

Neither FHA nor The Lender are a party to the sales contract. The contract does not have to specify FHA financing, but must clearly indicate the terms of the purchase, including the agreed upon date of closing. If the agreed upon date of closing is extended, a copy of the modification or extension will be required.

When a sales contract contains conditions that, if performed, would violate FHA requirements, such as excess seller contributions, a modification or addendum to the sales contract must be obtained. In all cases, the loan must close in accordance with FHA requirements.

216.10 – Hotel and Transient Use Certification

A Hotel and Transient Use certification (form HUD-92561), signed by the applicant must be obtained for every application on a two, three, or four-family dwellings, or if the property is a single-family dwelling which is one of a group of five or more dwellings held by the same applicant. This is FHA’s assurance the property will not be used for hotel or transient purposes, or otherwise rented for periods less than 30 days.

216.11 – Mortgage Credit Analysis Worksheet (MCAW)
The MCAW is a synopsis of the information verified about the applicant: income, assets and liabilities. It is the review form where the underwriter evaluates the applicant’s adequacy of credit, funds to close, job stability and income, and then renders a credit decision. A completed MCAW is required on all FHA loans regardless of status as approved, pended, or denied. The MCAW on approved or denied files must be signed and dated by the DE underwriter. There are two types of MCAW – one for purchase and one for refinance.

When a loan is approved with qualifying ratios in excess if FHA guidelines or other guidelines have been exceeded, the DE Underwriter must justify the loan approval. The underwriter must disclose on the MCAW, the compensation factors or other risk analysis used to determine that the loan should be approved.

216.12 – Changes to Approved FHA Loans

Only the Direct Endorsement Underwriter has authority to approve or deny an FHA loan. Underwriters must re-underwrite an FHA loan when certain changes are made after the approval was issued. Loan files are to be re-worked (new URLA, 92900A and MCAW) by the DE Underwriter:

- The loan is renegotiated to a higher interest rate which exceeds the interest rate at which the loan was approved;
- The mortgage amount is increased;
- The mortgage term is decreased;
- The discount points increase above the points shown on the loan approval;
- The applicant’s cost to close exceeds the amount approved by Underwriting.

**Tolerance Levels:**
FHA is now providing a degree of tolerance before triggering the requirement that a mortgage be rescored. Often, there are minor differences between what the borrower reports for income or assets on the loan application and what the documentation verifies. In these cases, rarely would the difference between data entered into TOTAL and verified by the lender result in a change in risk classification. Therefore, the following tolerances are now available to FHA-approved mortgage lenders scoring loans through TOTAL.

- **Cash Reserves:** There is no need to resubmit the mortgage to TOTAL for rescoring provided the cash reserves verified are not more than 10% less than that reported by the borrowers on the loan application.
- **Income:** There is no need to resubmit to TOTAL provided the verified income is not more than 5% less than that reported by the borrowers on the loan application.
- **Tax & Insurance Escrows:** There is no need to resubmit to TOTAL when tax and insurance escrow estimates used at scoring and later verified at or near loan settlement do not result in more than a two-percentage point increase in the payment-to-income and debt-to-income ratios.

Please note that these tolerance thresholds are provided for those situations where loan application data differ from what the mortgage lender entered into TOTAL early in the loan processing phase and then documents later on. They are not to result in willfully manipulating these application variables into the TOTAL mortgage scorecard to obtain an accept/approve risk classification.

216.13 – Use of More Than One DE Underwriter

It is not necessary for the same DE to underwrite both the property and the applicant’s credit/income and assets. The DE underwriter who underwrites the property and issues the 92800.5b DE Statement of Appraised Value must indicate on the “5b” their name and CHUMS number.

The DE underwriter who underwrites the applicant’s credit, income and assets must indicate their name and CHUMS number on the MCAW. The underwriter identified on the MCAW will be recorded in CHUMS as the underwriter of record.

216.14 – Adjustable Rate Mortgages
Applicants for the One Year Adjustable Rate Mortgage (ARM) must qualify using the mortgage payments based on the contract or initial interest rate plus one (1%) percent; i.e., the anticipated second year rate when the loan-to-value is 95.00% or greater.

If the ratios exceed guidelines at the qualifying interest rate, then the underwriter's justification for the excess ratio and the compensating factors used, must be indicated in the loan file, on the MCAW unless the loan has an automated approval through the Total Scorecard System.

Temporary buy downs will not be allowed on Adjustable Rate Mortgage (ARM).

Exceeding ratios is permitted upon Automated Underwriting approval. However, all documentation and ratios must be run qualifying 1% above start rate.

SECTION 217.00 – ASSUMABILITY OF FHA LOANS

All FHA insured loans are assumable; however FHA has placed certain restrictions on the assumability of FHA-insured mortgages originated since 1986. Depending on the date of loan origination, a creditworthiness review of the assumptor by The Lender may be required. Mortgages originated before December 1, 1986 generally contain no restrictions on assumability. To determine what restrictions to assumability have been placed on the mortgage, The Lender must review the legal documents of the mortgage. Additional details regarding assumability are contained in the HUD handbook 4330.1 REV-5, “Administration of Insured Home Mortgages”. Some mortgages executed in years 1986 through 1989 contain language that is not enforced due to later Congressional action. Mortgages from that period are now freely assumable, despite any restrictions stated in the mortgage.

Streamline Refinances for FHA

**Holding Period before Eligibility.** A borrower who assumed or took title subject to an FHA-insured mortgage, without being credit qualified and with the previous mortgagees receiving a release of liability, must have owned the property for at least six months before being eligible for the streamline refinance program without credit qualifying. This rule applies to mortgages that do not contain restrictions limiting the assumption only to creditworthy assumptors. Typically those mortgages were made prior to December 1989.
CHAPTER 3 – CREDIT

SECTION 300.00 – DOCUMENTING CREDIT

Documentation in the file must clearly support an applicant’s ability to meet financial obligations in a timely, responsible manner. Although more weight is given to the applicant’s payment experience within the past two years, the underwriter must always consider the applicant’s entire credit history.

A Residential Mortgage Credit Report or a Merged Report must be obtained for all applicants where credit qualification is required. The original credit report, as well as all updates, corrections, and supplements must be included in the applicant’s submission package. When the credit report fails to verify the applicant’s payment history for mortgage, rental, or other significant debts, separate evidence of a satisfactory payment history must be developed.

The applicant’s credit history may contain traditional trade lines. A trade line is defined as the type of credit obligation generally reported by a credit report indicating such information as date opened, high loan or credit amount, the current credit balance and the periodic payment history. The credit history may also contain non-credit or non-traditional references. These non-credit references are defined as continuing obligations, such as rent, utilities and insurance, which require a periodic payment at least quarterly. Non-credit payment references may appear on a credit report or may be verified by written verification.

Note: To be used to establish a minimum payment history, a non-credit payment reference must have existed for at least 12 months.

A lack of credit history alone is not reason for denial of an FHA mortgage. Every effort must be made to develop a history (minimum two (2) years) of the applicant, including residence, credit, income and assets. The credit history may be developed by using non-credit payment references and/or non-traditional forms of credit.

SECTION 301.00 – CREDIT HISTORY

The applicant must have a credit history which indicates a reasonable ability and willingness to meet obligations as they become due.

Any or all of the following are indicators of an unacceptable credit history unless the cause of the problem was beyond the applicant's control:

- Incidents of more than one debt payments being more than 30 days late if the incidents have occurred within the last 12 months. This includes more than one late payment on a single account.
- Loss of security due to a foreclosure if the foreclosure has occurred within the last 36 months.
- Outstanding tax liens or delinquent Government debts with no satisfactory arrangements for payments, no matter what their age as long as they are currently delinquent and/or due and payable.
- A court-created or affirmed obligation (judgment) caused by nonpayment that is currently outstanding or has been outstanding within the last 12 months.
- Two or more rent payments paid 30 days or more past due within the last 3 years.
- Accounts which have been converted to collections within the last 12 months (utility bills, hospital bills, etc.).
- Collection accounts outstanding, with no satisfactory arrangements for payments, no matter what their age as long as they are currently delinquent and/or due and payable.
- Any debts written off within the last 36 months.

The following will not indicate an unacceptable credit history:

- "No history" of credit transactions by the applicant.
- A bankruptcy in which applicant was discharged more than 36 months before application.
- A satisfied judgment or foreclosure with no loss of security which was completed more than 12 months before the date of application.
Mitigating circumstances to establish the borrower's intent for good credit when the applicant provides documentation that may be considered if:

- The circumstances were of a temporary nature, were beyond the applicant's control, and have been removed (e.g., loss of job; delay or reduction in government benefits or other loss of income; increased expenses due to illness, death, etc.); or
- The adverse action or delinquency was the result of a refusal to make full payment because of defective goods or services or as a result of some other justifiable dispute relating to the goods or services purchased or contracted for.

SECTION 302.00 – OTHER FEDERAL DEBTS

Check HUD's Credit Alert Interactive Voice Response System (CAIVRS) to determine if the applicant is delinquent on a Federal debt. The Lender will clearly document both its CAIVRS identifying number and the borrower and co-borrower's CAIVRS access code near the signature line on the mortgage application form. No decision to deny credit can be based solely on the results of the CAIVRS inquiry. If CAIVRS identifies a delinquent Federal debt, the Lender will immediately suspend processing of the application.

The applicant will be notified that processing has been suspended and will be asked to contact the appropriate Federal agency, at the telephone number provided by CAIVRS, to resolve the delinquency. When the applicant provides the Lender with official documentation that the delinquency has been paid in full or otherwise resolved, processing of the application will be continued. An outstanding judgment obtained by the United States in a Federal Court (other than the United States Tax Court), which has been recorded, shall cause the applicant to be ineligible to receive a loan guarantee until the judgment is paid in full or otherwise satisfied. RHCDS loan guarantee funds may not be used to satisfy the judgment. If the judgment remains unsatisfied or if the applicant is delinquent on a Federal debt and is unable to resolve the delinquency, the Lender will reject the applicant.

SECTION 303.00 – RESIDENTIAL MORTGAGE CREDIT REPORT

303.01 – Three Repository Merged Credit Report

May utilize a three repository merged credit report in lieu of the Residential Mortgage Credit Report (RMCR). The credit report must contain all credit that is available in the repositories, be accurate and complete and provide an account of the credit, residence history and public record information of each applicant. The merged report must meet all of the requirements of a RMCR, with the exception of the applicant interview and confirmation of employment.

- The report must provide a bureau score, accompanied by reason codes, for each applicant.
- The report must include all of the information verified by the three repositories.
- Any social security number discrepancy must be disclosed by the repositories.
- Each individual trade line must identify the primary repository which provided the account information.
- The applicant is unable to provide documentation to support payment of collections, judgments or liens which reflect open balances on the merged report;
- The applicant indicates the accounts have different balances than what is shown on the report, but is unable to provided updated account statements; or
- The underwriter determines a RMCR is required to properly underwrite the mortgage.
- The faxed alternative documentation process was used.

Business Credit Report

A Business Credit Report is required for self-employment applicants on Corporations and S Corporations.

303.02 – Unacceptable Credit Reporting Practices

It is not acceptable for the credit reporting agency to change information collected from the repositories. It is acceptable to delete duplications, to translate codes into plain language, and make appropriate adjustments to resolve conflicting information. The credit reporting agency may not:
303.03 – Credit Reports on Non-Borrowing Spouses

FHA requires a credit report (RMCR) on the applicant’s spouse in community property states where the spouse will not be an applicant. The community property states where this will be required are:

Arizona, Louisiana, Texas, California, Nevada, Washington, Idaho, New Mexico, Wisconsin

Although the credit history of the spouse will not be considered as a basis for loan approval, the borrowing spouse must qualify with all obligations, personal, joint and those of the non-borrowing spouse.

303.04 – Separate Verifications of Credit

When the credit report does not contain a reference covering the most recent 12 months for the applicant’s mortgage or rent payments, a direct verification will be required providing the mortgage payment history and/or rental payment history for the 12 months preceding the loan application, as required.

303.05 – Document Expiration Dates

Document expiration dates vary based upon whether the property is existing or under construction. The oldest document being considered determines the expiration date. Documents considered are the credit report, the most recent of a group of canceled checks provided to verify payment history, or individual written verifications of mortgage, rental or other debts, bank statements or investment account statements. That will include all documents provided for alternate documentation including pay stubs and bank account statements.

All asset verifications must be based upon current documentation; this includes the verification of assets for reserves. Expired documents must be fully updated and all information re-verified.

Existing construction: not older than 120 days from the date of the note.

- All pre-existing homes; or
- FHA properties where construction began prior to the date of the appraisal.

Proposed or under construction: not older than 180 days from the date of the note.

- FHA properties where construction had not been started at time of the appraisal.

303.06 – Credit Explanation Letters

Credit reporting agencies are required to report credit history for the past 7 years (bankruptcy and foreclosures may be 10 years); the credit report may contain derogatory history for the same period of time (past seven to ten years).

Outside of automated approvals, underwriters must provide justification for the underwriting decision. The underwriter always has the right to ask for additional documentation and/or an explanation for any issue which remains unclear or that may have an impact on the underwriting decision. The underwriter may require the applicant’s explanation for derogatory credit that has occurred more than 24 months prior to application. Any letter of explanation must be provided directly from the applicant. Applicants must provide a written explanation of the circumstances surrounding the derogatory credit and must sign and date the letter.

Credit explanations must make sense and cannot conflict with other verified information or documentation in the file. When an applicant indicates unusual circumstances have contributed to serious delinquencies or derogatory
credit, documentation to support those circumstances should be obtained if necessary to justify a decision to approve a loan with recent credit problems.

SECTION 304.00 – REVIEWING CREDIT HISTORY / ANALYSIS OF RISK

304.01 – Non-Traditional Credit Verification and Evaluation

FHA has long permitted mortgage lenders to establish a borrower’s credit history through nontraditional means, including the compilation of performance on rental payments; utility bills; telephone and cellular phone services; cable television service; payments to local stores, etc. This is further described in handbook HUD-4155.1 REV-5, paragraphs 2-3 and 2-4B.

This practice is appropriate when the borrower has insufficient trade lines with Equifax, Experian, or TransUnion and a credit bureau score cannot be derived. Lenders also may use nontraditional credit verification to augment “thin-file” credit reports where a credit score was generated but based on only a few trade lines. However, nontraditional credit reports may not be used to enhance any poor credit history on a traditional credit report.

**Nontraditional Credit—Basic Guidance**

The following provides guidance in establishing that a borrower has sufficient credit references for evaluating bill paying habits, which include: three (3) credit references, including at least one from Group I, covering the most recent 12 months activity from date of application. Group I references should be exhausted prior to considering Group II for eligibility purposes, as Group I is considered more indicative of a borrower’s future housing payment performance. Borrowers with no Group I trade references will be underwritten using the criteria set forth under “insufficient credit” below.

**Group I** – rental housing payments (subject to independent verification if the borrower is a renter), utility company reference (if not included in the rental housing payment), including gas, electricity, water, land-line home telephone service, cable TV. If the borrower is renting from a family member, request independent documents to prove regularity of payments, such as cancelled checks.

**Group II** – insurance coverage, i.e., medical, auto, life, renter’s insurance (not payroll deducted); payment to child care providers – made to a business providing such services; school tuition; retail stores – department, furniture, appliance stores, specialty stores; rent to own – i.e., furniture, appliances; payment of that part of medical bills not covered by insurance; Internet/cell phone services; a documented 12 month history of saving by regular deposits (at least quarterly/non-payroll deducted/no NSF checks reflected), resulting in an increasing balance to the account; automobile leases, or a personal loan from an individual with repayment terms in writing and supported by cancelled checks to document the payments.

**Verifying Nontraditional Credit**

We require that all non-traditional credit references be independently verified by a credit bureau agency and this must be stated on the report and reported back to the lender as a nontraditional mortgage credit report (NTMCR) in the same manner as traditional credit references. A NTMCR is designed to assess the credit history of the borrower without the benefit of institutional trade references and should format as traditional references – including creditor’s name, date of opening, high credit, current status of the account, required payment, unpaid balance, and a payment history in the delinquency categories of 0x30, 0x60 etc. It should not include subjective statements such as “satisfactory, acceptable, etc.”

Only if a NTMCR is impractical or such a service is unavailable may a lender choose to obtain independent verification of trade references. Documents confirming the existence for a nontraditional credit provider may include a public record from the state, county, or city records, or other means providing a similar level of objective confirmation. To verify the credit information, lenders must use a published address or telephone number for that creditor and not rely solely on information provided by the applicant. Rental references from management companies with payment history for the most recent 12 months may be used in lieu of 12 months cancelled checks. Credit references may also be developed via independent verification directly to the creditor.
a method is used to verify credit information or rental references other than NTMCR, all references obtained from individuals must be backed up with the most recent 12 months cancelled checks.

**Evaluating Nontraditional Credit**
The following guidelines apply when evaluating borrowers with nontraditional credit histories. A satisfactory credit history, at least 12 months in duration, must include:

- No history of delinquency on rental housing payments
- No more than one 30-day delinquency on payments due to other creditors
- No collection accounts/court records reporting (other than medical) filed within the past 12 months

**Insufficient Credit**
The following guidelines apply when evaluating borrowers with no credit references, or otherwise having only Group II references. A satisfactory credit history, at least 12 months in duration, must include:

- No more than one 30-day delinquency on payments due to any Group II reference
- No collection accounts/court records reporting (other than medical) filed within the past 12 months

In addition, for such borrowers, to enhance the likelihood of homeownership sustainability, the following underwriting guidance is being provided:

- Qualifying ratios are to be computed only on those occupying the property and obligated on the loan, and may not exceed 31 percent for the payment-to-income ratio and 43 percent for the total debt-to-income ratio. Compensating factors are not applicable for borrowers with insufficient credit references.
- Borrowers must have two months of cash reserves following mortgage loan settlement from their own funds (no cash gifts from any source should be counted in the cash reserves for borrowers in this category).
- If the occupying borrower has only Group II credit references but the non-occupying co-borrower has sufficient credit to render a Scorecard Accept; the loan must be downgraded to a Refer. In this instance, the occupying borrower must individually qualify with ratios that do not exceed 31/43. They also must have 2 months cash reserves of their own funds; gift funds cannot be included. Compensating factors are not applicable.

**304.02 – Applicant’s Willingness to Repay Debt/Manual Underwriting**
When evaluating an applicant’s credit history, primary emphasis will be placed upon the manner in which the monthly housing expenses have been paid. Consideration will next be given to the timeliness with which installment loans, revolving accounts and other obligations have also been met.

The credit report must show the applicant has a history of paying obligations in a timely, responsible manner, and if, for some reason, payment was delayed, every effort was made to rectify the situation as soon as financially possible. This scenario represents a willingness to repay obligations.

Greater emphasis is to be placed upon the applicant’s overall history of repayment, than upon isolated incidents of late payments which are not the result of an applicants disregard for obligations. The underwriter must take into consideration that even the most creditworthy applicant occasionally may experience a problem, such as slow or lost mail, or a disputed bill.

Credit history is considered for the past 7 years. Barring serious derogatory credit such as judgments, bankruptcies and foreclosures, the past twenty four (24) months of an applicant’s credit is of primary concern. Recently opened accounts do not establish credit history as they are not an indicator of an individual’s ability to repay debt since only a limited number of payments have been made on the account.

Delinquencies of 60 days or more are considered serious and indicative of an applicant’s inability to manage finances or a possible disregard for obligations. When the applicant's credit history reflects a pattern of late payments which involve several accounts and a significant amount of debt, the underwriter must determine
whether the delinquencies were an isolated incident due to unforeseen circumstances beyond the applicant's control, or whether the problems were due to the applicant’s financial mismanagement or disregard for obligations. A 12 month period of clean credit is not sufficient for an applicant who has had a prior history of serious, chronic delinquencies.

The minimum time period established following a bankruptcy or foreclosure indicates the earliest time an individual may be eligible for consideration for a mortgage. This does not mean the individual’s request for a loan will be approved because the minimum time period has passed. The same may be true of other derogatory credit. Having recently paid the debt does not automatically make the applicant eligible for loan approval. Consideration must be given to the applicant’s efforts to repay those debts.

The underwriter must review all documents in the file to determine that the applicant had a willingness to repay the debts involved but was unable to do so due to extenuating circumstances.

If it is determined that the applicant had the means to repay the debt but elected not to use available assets for that purpose, the applicant will not be eligible for a mortgage even when a minimum time period has passed. Examples of the situations which would be unacceptable are:

- An individual who let a rental property be foreclosed upon because it had a negative cash flow;
- A property which was foreclosed upon due to the applicant’s inability to sell it for the outstanding loan amount, when the applicant had substantial assets or the ability to obtain funds sufficient to cover any short fall at closing;
- A bankruptcy which was filed due to an applicant becoming overextended for credit and the applicant currently has numerous accounts with outstanding balances; or
- An individual who filed bankruptcy for what does not appear to be insurmountable debt, especially when the individual had a home with substantial equity exempt from the bankruptcy.

If there is a question about an applicant’s willingness to repay obligations, the underwriter should request and review documents from that time period. The underwriter can utilize the applicant’s financial and income data to determine whether sufficient assets were available to avoid the serious credit deficiencies. An applicant’s unwillingness to use available assets to satisfy debt obligations indicates a high credit risk and unacceptable credit behavior.

### 304.03 – Paying Down Debt to Qualify

It is not acceptable for an applicant to “pay down” the balance on an installment or revolving debt to fewer than ten months remaining so that the debt will not count in the overall debt ratio.

On installment loans where the debt will not exceed ten months at closing, underwriting will not include the debt in ratio unless the payment is substantial and the applicant has limited cash reserves. The underwriter should state on the 1008, the Mortgage Credit Analysis Worksheet or the Loan Analysis why the debt was included, or excluded, from the qualifying ratios.

### SECTION 305.00 – CREDIT AND LIABILITY DOCUMENTATION

#### 305.01 – Alimony/Separate Maintenance

Alimony and separate maintenance are considered to be long term obligations. The applicant must provide proof of obligation arising from a divorce or legal separation.

Because of the tax consequences of alimony payments, the lender may choose to treat the monthly alimony obligation as a reduction from the borrower’s gross income in calculating qualifying ratios, rather than as a monthly obligation.

#### 305.02 – Automobile Leases
Automobile lease payments must be treated as an ongoing long term obligation, regardless of the remaining term on the lease. The current lease payment must be included in the applicant’s long term obligations unless the applicant can provide conclusive evidence that:

- Another method of transportation has been secured (any new debt must be included in ratios); or
- An agreement, signed prior to mortgage loan closing, will renew the lease or purchase the vehicle (any new debt must be included in ratios).
- If the debt is fully paid, no payment will be counted.

305.03 – Bankruptcy

When reviewing documents pertaining to an applicant’s bankruptcy, the type of bankruptcy must be determined. In a Chapter 13 Bankruptcy, debts are frozen and no additional interest is charged on the debt. A schedule of repayment is established and the debtor obligates themselves to repay the outstanding debt. In the Chapter 7 Bankruptcy, the debts are discharged (wiped out) and no repayment is made to the creditor. Care should be taken to determine that the applicant did not change from a Chapter 13 to a Chapter 7 or vice versa. Guidelines for these bankruptcies may differ.

The schedule of debts must support the applicant’s explanation for the bankruptcy. For example, if a bankruptcy was the result of excessive medical bills, numerous doctor and hospital bills should appear on the schedule of debts contained in the bankruptcy petition. Review the debts to determine whether a foreclosure was included in the bankruptcy, and if it was, then foreclosure guidelines will apply. If the bankruptcy was recent, any debts which the applicant reaffirmed (continued to pay) should be verified and must reflect a satisfactory payment history whether current or paid in full.

Each applicant, who has filed bankruptcy, must be evaluated on a case-by-case basis to determine eligibility for financing. Generally, bankruptcy must be a result of extenuating circumstances over which the applicant had no control. The underwriter must investigate the circumstances which caused the bankruptcy to be reasonably certain the events which caused the bankruptcy are not likely to recur. In all cases, the applicant must have re-established good credit and demonstrated an ability to successfully manage personal finances. Re-established credit is not accomplished through payroll deduction loans. The applicant must clearly take responsibility for actively managing personal finances. The file must contain:

- Copies of the bankruptcy petition, schedule of debts and the discharge papers indicating which debts were discharged;
- Evidence that all debts not satisfied by the bankruptcy have been paid or are being paid in a satisfactory manner (only those payments or delinquencies which occurred during the bankruptcy are to be omitted from credit reporting - those payments since discharge on reaffirmed debts must be verified and paid on time);
- A written statement from the applicant satisfactorily explaining the causes of the bankruptcy, and
- Any other evidence necessary to support the fact that factors outside the applicant’s control caused the bankruptcy and the applicant has re-established and maintained an acceptable credit reputation.

A self employed applicant with a prior bankruptcy which was the result of a business failure is not a candidate for financing unless three (3) years have passed since the bankruptcy and the file contains evidence the new business is financially sound.

When an applicant has had a foreclosure on a mortgaged property included in a bankruptcy, a 3 year time period will be used for determining eligibility for a mortgage.

A Chapter 7 bankruptcy (liquidation) does not disqualify a borrower from obtaining an FHA-insured mortgage if at least two years have elapsed since the date of the discharge of the bankruptcy. Additionally, the borrower(s) must have re-established good credit or chosen not to incur new credit obligations. The borrower(s) also must have demonstrated a documented ability to responsibly manage their financial affairs. An elapsed period of less than two years, but not less than 12 months, may be acceptable if the borrower can show that the bankruptcy was caused by extenuating circumstances beyond his or her control and has since exhibited a documented ability to manage his or her financial affairs in a responsible manner. Additionally, the lender must document that the borrower's current situation indicates that the events that led to the bankruptcy are not likely to recur.
A Chapter 13 bankruptcy does not disqualify a borrower from obtaining an FHA-insured mortgage provided the lender documents that one year of the payout period under the bankruptcy has elapsed and the borrower’s payment performance has been satisfactory (i.e., all required payments made on time). In addition, the borrower must receive permission from the court to enter into the mortgage transaction.

### 305.04 – Business Debts (Self-employed Applicant) Corporations

An applicant may be personally responsible for debts incurred for business related expenditures that appear on the applicant’s credit report. The business debt will not be included in the applicant’s obligations if the applicant can provide 12 months canceled checks showing the business makes all the payments.

### 305.05 – Child Care

Child care is not considered when qualifying an applicant.

### 305.06 – Child Support

Court ordered child support is considered to be a long term obligation. The payment from the 1003, pay stub or other documentation in the file must be included in the debt to income ratio. In order to negate the payment the borrower must provide documentation that there are less than 10 payments remaining.

Voluntary child support is also considered a long term debt when disclosed by the applicant or when disclosed by documentation in the loan file.

Child support that is in arrears must be brought current. If a payment schedule has been established with the Court for the past due amount and a history of satisfactory payments is provided, the applicant will not be required to pay the past due amount in full. Both the payment for the past due child support and the regular court ordered support payment will be included in the applicant’s income to total debt ratio.

Voluntary child support is considered to be a liability on FHA financing if disclosed by the applicant. The applicant should provide documentation, such as a voluntary child support agreement or other documents, to support the amount and duration of the child support to be paid.

### 305.07 – Collection Accounts

FHA does not require that collection accounts be paid off as a condition of mortgage approval. Collections indicate a borrower’s regard for credit obligations and must be considered in the analysis of creditworthiness with the DE Underwriter documenting their reasons for approving a mortgage where the borrower has collection accounts on a manually underwritten loan. Also the borrower must explain in writing the circumstances surrounding the collections. If loan is approved through the Total Scorecard AUS System (LP or DU), no further explanation is required.

### 305.08 – Consumer Credit Counseling Services (CCCS)

Participation in a consumer credit counseling payment program does not disqualify a borrower from obtaining an FHA-insured mortgage provided The Lender documents that one year of the pay-out period has elapsed under the plan and the borrower’s payment performance has been satisfactory (i.e., all required payments made on time). In addition, the borrower must receive written permission from the counseling agency to enter into the mortgage transaction.

Applicants who have fully completed CCCS or similar credit counseling are subject to normal, standard credit criteria, including payment history and letter of credit explanation.

### 305.09 – Contingent Liability/Co-Signed-Debts
When the applicant has a contingent liability resulting from having co-signed for another party to obtain credit, the debt must be included in the applicant’s total debts unless:

- The applicant can provide evidence that the primary obligor has been making the payments on a regular basis; and
- There have been no delinquent payments in the previous 12 month period; and
- The due date and amount of loan payment must be provided.
- Cash as a source of payment is not acceptable. The applicant must be able to furnish canceled checks, copies of consecutive money orders, etc. for a 12 month period when payment history is not shown on the credit report.

If the co-signed account has had any late payments in the last 12 months, the payment will be included in the applicant’s income for total debt ratio. A letter of explanation for the late payments must be provided by the applicant — OR — If the co-signed account, has had late payments in the last 12 months and the applicant can provide a court order, final decree of divorce, or legal separation indicating debt is the responsibility of the other party, the debt will not be included in qualifying.

The underwriter must clearly document and justify any exception to this guideline.

When a mortgage applicant remains obligated on an outstanding FHA insured mortgage secured by a property that has been sold or traded within the last twelve months without a release of liability, or is to be sold on assumption without a release of liability being obtained, the contingent liability must be considered unless:

- The originating lender of the mortgage being underwritten obtains from the servicer of the loan assumed, a payment history showing that mortgage has been current during the previous 12 months: or
- An appraisal or dosing statement from the sale of the property supports a value that results in a 76% loan-to-value ratio, i.e., the outstanding balance on the mortgage loan minus any UFMIP, if applicable cannot exceed 75% of the appraised value or sales price.

- Co-signed Obligations – if the individual applying for an FHA-insured mortgage is a co-signer or is otherwise co-obligated on a car loan, student loan, mortgage, or any other obligation, contingent liability applies unless the lender obtains documented proof that the primary obligor has been making payments during the previous 12 months on a regular basis and does not have a history of delinquent payments on the loan.

305.10 – Deed in Lieu of Foreclosure

A conveyance of a deed-in-lieu of foreclosure disclosed on a credit report or by the applicant is considered significant derogatory information and must be attributable to documented extenuating circumstances.

This derogatory information will be handled in the same manner as a foreclosure.

305.11 – Delinquent Housing (Mortgage or Rental)

An applicant’s ability to successfully pay his or her monthly housing expense is traditionally the most critical piece of credit. All housing payments that are reported as over 30 days late are considered delinquent when evaluating an applicant’s credit. In particular, payments for rent or mortgage that were paid over 30 days late, in the last 24 months, are considered a serious credit deficiency. An applicant with such late housing payments may be considered if the credit deficiency is mitigated by a usable bureau score of 720 or greater.

An applicant with an isolated housing payment delinquency (such as one 30 day late) may be considered for loan approval provided:

- The applicant provides a written explanation for the late payments that must indicate cause of the delinquency was beyond the applicant’s control.
- If available, documentation to support the cause of the delinquency must be provided.
- The applicant must have demonstrated a prior satisfactory credit history over the last 24 months.
305.12 – Delinquencies – Installment

All installment accounts must be current. Installment debts are very similar to considering the individual’s ability to repay these regularly scheduled, fixed payment an applicants housing expense when a debt.

One minor or isolated instance of an installment payment received no more than thirty days after the due date in the past 24 months should not prevent an applicant from being approved. The applicant however, must provide a satisfactory, written explanation for the late payment.

Multiple installment payments more than 30 days late or payments received 60 or more days after the due date are considered a serious credit deficiency. In order for the applicant to be considered for loan approval, the applicant must be able to show the delinquency occurred more than 24 months ago and was caused by extenuating circumstances beyond the applicant’s control, circumstances that are not likely to reoccur.

Multiple installment payments paid more than 30 days after the due date, in the last 24 months, is considered unacceptable credit and will be considered a reason to deny the loan request.

Satisfactory credit is considered to be re-established after the borrower, or borrower and spouse, have made satisfactory payments for twelve (12) months after the date of the last derogatory credit item.

305.13 – Delinquencies - Revolving

All revolving loan accounts must be current. A minor or isolated 30 day late payment on a revolving account in the past 24 months will not prevent loan approval. The applicant must provide a satisfactory, written explanation for the late payment.

Repeated late payments to a substantial number of the applicant’s accounts or any payments received 60 or more days past the due date, in the last 24 months, will be considered a reason to deny the loan request.

Late payments, 30 days or more, on revolving debt that occurred less than 24 months prior to loan application must have a written explanation from the applicant.

Satisfactory credit is considered to be re-established after the borrower, or borrower and spouse, have made satisfactory payments for twelve (12) months after the date of the last derogatory credit item.

305.14 – Delinquent Federal Debt-FHA

If the applicant is presently delinquent on to:

- VA guaranteed mortgage
- HUD Section 312 Rehabilitation Loan
- Federal student loan;
- Federal Taxes; or
- Small Business Administration loan.
- Any Federal debt including, but not limited or Title I loan;

The applicant is not eligible unless the delinquent account is brought current, or

- The account is paid in full, or
- A satisfactory repayment plan has been made between the applicant and the Federal agency owed and an acceptable twelve (12) month payment history is provided.

As in the case of other delinquent obligations, a written explanation from the applicant regarding the delinquent debt will be required.

The overall analysis of the applicant’s credit worthiness must consider the applicant’s previous failure to make payments to the Federal agency in the agreed to manner.
305.15 – Defaulted Student Loans

If on a defaulted student loan, the applicant and the agency or financial institution have re-negotiated a repayment plan of the defaulted loan, copies of the last 12 months payments and Repayment Agreement will be acceptable. If a repayment plan has not been re-established, the defaulted loan must be paid in full prior to loan closing.

305.16 – Deferred Loans

When an applicant has projected liabilities where payments are to begin at a future date, such as a student loan, the first payment due date must be verified. When payments are scheduled to begin within 12 months of the date of closing on the subject mortgage, the payment must be included in total liabilities unless the applicant can provide written confirmation the debt has been deferred outside this time period.

Special deferments upon graduation are available for several years to doctors, teachers and other “in demand” professions. These situations require evidence of the applicant’s ability to renew the deferment 12 months past closing.

305.17 – Employee Savings Plan Loans (401K, etc.)

Retirement contributions such as a 401k, including the repayment of debt secured by these funds, will not be considered as an obligation in determining the income to total debt ratio.

305.18 – Foreclosure/Primary Residence

When the property was financed on an FHA mortgage, the applicant is not eligible for a new FHA mortgage for 3 years from the date the claim was filed to the previous lender.

When a foreclosure was included in a bankruptcy, the three year waiting period takes precedence over the two year period required for bankruptcies. When an ex-spouse was awarded both the property and the debt, it will not be considered against the applicant if evidence is provided showing the mortgage was not in default at time of divorce.

Exceptions to the three year requirement may be considered if the foreclosure, of the borrower’s principal residence, was the result of extenuating circumstances and file can document the circumstances. The applicant must complete a recovery period of not less than 12 months with no new delinquencies during that time. Extenuating circumstances will not be given consideration if the foreclosure resulted in the payment of a claim on an FHA or VA mortgage. The applicant must have a clear CAIVRS number.

305.19 – Foreclosures on Second Homes or Investment Property

Consideration will not be given to waiving the three year waiting period, even with extenuating circumstances, when the applicant has had a foreclosure on an investment property or a second home. Applicants must wait the full three years and must have re-established a satisfactory credit history. This restriction applies to all types of mortgage loan requests.

305.20 – Garnishment

A garnishment is an order to attach property or income to satisfy a creditor. Generally, a garnishment of wages will be indicated on an applicant’s pay stub or verification of employment. It may also appear on the credit report.

Documentation to indicate the type of obligation, the amount of debt, the length of time required to repay the debt in full and the applicant’s explanation for the garnishment will be required. The garnishment must be treated as a debt and included in debt-to-income ratios unless the underwriter determines, that due to the underlying reason for the garnishment (such as a tax lien), the debt must be paid in full.
305.21 – Judgments

Court ordered judgments must be paid off before the mortgage loan is eligible for FHA insurance endorsement. An exception may be made if documentation is provided there is a written repayment plan with the creditor, all payments have been made in accordance with the agreement, and a six month payment history is obtained. The monthly debt will be included in qualifying ratios.

If a Judgment was included in a Chapter 7 Bankruptcy and it is reflected in the bankruptcy discharge papers this is all the documentation that is required as the court will not allow collection of the debt to proceed any further.

305.22 – Lawsuits

When an applicant discloses involvement in a lawsuit, or a pending law suit appears on the credit report, it is essential to determine the extent of the applicant’s exposure. Details of the lawsuit must be obtained from the applicant’s attorney that outlines:

- Whether the applicant is the plaintiff or defendant,
- The amount of the lawsuit and potential damages which may be awarded;
- The extent to which the applicant is covered by insurance against damages; and
- The amount of the applicant’s potential out of pocket expenses.

When the applicant is the defendant, the applicant must have adequate insurance coverage and/or assets to cover the amount of potential liability in the event the lawsuit is lost. If the applicant does not have adequate resources, the loan may not be considered for approval until the lawsuit has been settled.

305.23 – Military Allotments

When reviewing the Leave and Earnings Statement (LES) for an active duty applicant, it is necessary to determine the purpose of any allotments to determine if the allotments reveal additional undisclosed debt or are merely reflecting payroll reductions for automatic payments. Only those allotments that meet the test for long term obligations must be included in qualifying ratio. Allotments for insurance, etc. are not considered long term debt.

305.24 – Military Advance Pay

When reviewing the Leave and Earnings Statement (LES) for an active duty application, it is necessary to determine any deductions for advance pay. Any repayments of advance pay which meet the test for long term obligations must be included in the qualifying ratio.

305.25 – Mortgage History

With the exception of automated approved loans, at minimum, a 12 month history of the applicant’s mortgage history must be provided. FHA will accept the standard written verification of mortgage or rent. An original verification form must be sent directly from The Lender’s correspondent to the applicant’s lender or landlord, and upon completion, be returned directly by the lender or landlord to correspondent.

If verified on the RMCR or the tri-merged report, a separate verification is not required. If a mortgage payment history is provided it must meet the following criteria:

- Be computer generated or typed, not handwritten,
- Identify the issuing lender or servicing agent,
- Clearly identify the Borrower and the mortgage,
- Show the total mortgage payment due,
- Show the due date of each payment,
- Show a 12 month history of the dates when payments were applied, and show the current outstanding principal balance.
Twelve (12) months of canceled checks must be obtained to support a satisfactory payment history, when the applicant is renting from a family member, the seller, real estate agent, or other interested parties to the transaction, or in transactions where there is an “identity of interest”.

Canceled checks must:

- Be legible
- Show the bank endorsement for deposit
- Show the date of bank endorsement
- Identify the servicer as payee
- Be copied, front and back

305.26 – Non-Purchasing Spouse

If required by state law in order to perfect a valid and enforceable first lien, the non-purchasing spouse may be required to sign either the security instrument or documentation evidencing that he or she is relinquishing all rights to the property. If the non-purchasing spouse executes the security instrument for such reasons, he or she is not considered a borrower for our purposes and need not sign the loan application. In all other cases, the non-purchasing spouse is not to appear on the security instrument or otherwise take title to the property at loan settlement.

Where there are non-purchasing spouses who sign security instruments relinquishing their rights to the property pursuant to applicable state laws, these non-purchasing spouses do not have to sign the mortgage note. Signing the security instrument for such purposes does not make the non-purchasing spouse a co-borrower.

Except for the obligations specifically excluded by state law, the debts of the non-purchasing spouse must be included in the borrower’s qualifying ratios if the borrower resides in a community property state or the property to be insured is located in a community property state. Although the non-purchasing spouse's credit history is not to be considered a reason for credit denial, a credit report must be obtained for the non-purchasing spouse in order to determine the debt-to-income ratio. However, a judgment in the name of a non-purchasing spouse does need to be paid off for the purchasing spouse to be eligible for an FHA mortgage. Court-ordered judgments must be paid off before the mortgage loan is eligible for FHA insurance endorsement. An exception may be made if the borrower has agreed with the creditor to make regular and timely payments on the judgment and documentation is provided that the payments have been made in accordance with the agreement.

Debts and Judgments

Except for the obligations specifically excluded by State law, the debts of the non-purchasing spouse must be included in the borrower's qualifying ratios if the borrower resides in a community property state or the property to be insured is located in a community property state. Therefore, a judgment in the name of a non-purchasing spouse does need to be paid off for the purchasing spouse to be eligible for an FHA mortgage. Court-ordered judgments must be paid off before the mortgage loan is eligible for FHA insurance endorsement. An exception may be made if the borrower has agreed with the creditor to make regular and timely payments on the judgment and documentation is provided that the payments have been made in accordance with the agreement.

Security Instruments

If required by state law in order to perfect a valid and enforceable first lien, the non-purchasing spouse may be required to sign either the security instrument or documentation evidencing that he or she is relinquishing all rights to the property. If the non-purchasing spouse executes the security instrument for such reasons, he or she is not considered a borrower for our purposes and need not sign the loan application. In all other cases, the non-purchasing spouse is not to appear on the security instrument or otherwise take title to the property at loan settlement.

Where there are non-purchasing spouses who sign security instruments relinquishing their rights to the property pursuant to applicable state laws, these non-purchasing spouses do not have to sign the mortgage note. Signing the security instrument for such purposes does not make the non-purchasing spouse a co-borrower.
305.27 - Projected Liabilities

When an applicant has projected liabilities where payments are to begin at a future date, such as a balloon note, or a ninety day note, the first payment due date must be verified. When payments are scheduled to begin within 12 months of the date of closing on the subject mortgage, the payment must be included in total liabilities unless the applicant can provide written confirmation the debt has been deferred outside this time period.

305.28 - Real Estate Expense

When an applicant owns property free and clear, expenses related to the property must be included in the applicant’s long term debt before calculating ratios. Monthly property related expenses include: taxes, insurance, maintenance, homeowners association dues, assessments and ground rents (leasehold payments). If these expenses are already included in calculations used to determine net rental income or losses, they do not need to be shown as a separate obligation. These expenses must be specifically included in obligations when the property is not rented.

305.29 - Rental Loss

If net rental income is a loss, the amount of the loss must be included in the applicant’s total obligations.

305.30 - Revolving Accounts

Revolving accounts are credit cards or lines of credit (such as overdraft protection on a checking account) where the balance fluctuates and the payment amount is based upon a percentage of the outstanding balance. In the absence of a verified or stated payment amount according to the credit report, a payment will be calculated at 5% of the outstanding balance, but not less than $10.

305.31 - Installment Accounts

All installment accounts with ten payments or more remaining will be included in long term obligations for qualifying purposes. Payments less than 10 months remaining that are of such size as to impact applicant’s ability to make the mortgage payments will be counted in the qualifying ratios.

Deduct significant debts and obligations from total effective income when determining ability to meet the mortgage payments. Significant debts and obligations include:

- Debt and obligations with a remaining term of 10 months or more, that is, long-term obligations, and
- Accounts with a term less than 10 months that require payments so large as to cause a severe impact on the family’s resources for any period of time.

Example: Monthly payments of $300 on an auto loan with a remaining balance of $1500, even though it should be paid out in 5 months, would be considered significant.

Debts assigned to an ex-spouse by a divorce decree will not generally be charged against the borrower. This includes debts that are now delinquent.

305.32 - Tax Liens

Tax liens are of a great concern to The Lender, as the potential for additional liens against the subject property would increase our risk as a lender. The applicant must explain the reasons for the tax lien (Federal, state, or local).

Since the IRS or Department of Defense routinely take a second lien position on purchase money mortgages without the necessity of independent documentation, eligibility for FHA mortgage insurance will not be jeopardized by outstanding tax liens remaining on the property if a repayment plan has been made between the borrower and the agency owed and is verified in writing with a 12 month satisfactory payment history.
Tax liens that are subordinated by the lien holder need not be paid in full providing all of the following criteria have been met:

- Taxing authority must provide copy of repayment agreement or terms of any repayment agreement. Monthly debts will be included in ratios.
- Taxing authority must provide an acceptable subordination agreement for review by underwriting prior to loan approval.
- A title insurance binder must be provided indicating no exception to subordinated tax lien prior to underwriting.

305.33 – Term Notes

When an applicant has a term note with interest only payments, the interest must be included in total obligations. Additionally, if the applicant will not have sufficient liquid assets remaining after closing to repay the obligation, a monthly principal reduction must be calculated and added to the applicant’s monthly obligations. If the note becomes due and payable within 12 months of closing, the applicant must be able to either:

- Pay the note in full or support sufficient payments to retire the debt; or
- Provide the terms under which the note can be renewed and be able to qualify under those terms.

Computing the monthly principal reduction will be based upon the remaining term of the note.

305.34 – Debts Owed to Relatives

When an applicant has been renting from a relative, or has debts, including any mortgage, which are owed to a relative, canceled checks must be obtained to support a satisfactory repayment history and to establish the amount of the monthly payment. Since an applicant’s ability to repay debt is demonstrated by the manner in which current debts are paid, confirmation that the applicant has been able to successfully meet a sizable obligation is essential to evaluating the applicant’s ability to manage the proposed monthly housing expense.

305.35 – Margin Loans/Stock Accounts

Loans secured by stock are acceptable as assets to close and reserves. A margin loan from a stock broker is also an acceptable source of funds for down payment and reserves. This allows the applicant to withdraw funds from the brokerage account without having to sell the stock. Typically, no debt service is calculated on the margin loan since the underlying value of the stock is at least twice the amount of the margin loan. The stock could be sold at any time if needed to pay off the loan. If payments are required on the loan, they are to be included in the total obligations ratio.

305.36 – Repossessions

Repossessions are considered to be major derogatory credit. A minimum period of two years must have elapsed between the date of the repossession and the date of the application and a 24 month satisfactory, re-established credit history must be documented.

When the repossession was a result of documented extenuating circumstances, a minimum period of 12 months re-establishing credit and finances must have elapsed.

A repossession is considered derogatory credit. When a repossession is an isolated incident and applicant has no other derogatory credit, extenuating circumstances may be considered without seasoning or time period.

305.37 – Employment/Job Related Expense

Employment related expenses must be documented. Such costs may include but are not limited to dependent care, significant (or unusual) commuting costs, tools or job specific costs, etc.

Employment related expenses must be included in total debts when qualifying the applicant(s).

305.38 – Short Pays at Loan Payoff
A “short pay” is defined as the proceeds a bank, mortgage lender, or private mortgage insurer accepts as payoff that is less than the total principal and interest due on the loan. A short pay may occur when a property is sold as a “pre-foreclosure” sale or at a sale that, due to lower property values, does not net sufficient proceeds to cover the payoff of the mortgage loan. There may be other reasons why a borrower negotiates a short pay with a lender.

If the short pay is not the result of derogatory or delinquent credit, it will not be considered an adverse factor.

**305.39 – Rent Payments**

With the exception of automated approvals, at a minimum, 12 months of rental history must be verified. If the credit report does not contain a reference covering the most recent 12 months of the applicant’s rent, then a direct verification must be sent to the landlord.

Canceled checks to cover the most recent 12 month period application will be acceptable. The canceled checks must:

- Be legible.
- Show the bank endorsement for deposit.
- Show the date of bank endorsement
- Identify the landlord as payee
- Be copied, front and back

**305.40 – NSF / Non-Sufficient Funds**

Underwriters may require explanations for any NSFs found on an applicant's bank statements, but generally will not require an explanation for an isolated incident.

An isolated incident may be that loan file where there is no evidence of problems with cash flow (such as late payments on credit accounts) and there is one or more NSF shown on the applicant’s bank statements in the past 60 days.

When review of the loan documents indicates cash flow difficulties and there are 2 or more NSFs in the last 60 days, the applicant’s written explanation will be required.

**SECTION 306.00 – EXTENUATING CIRCUMSTANCES**

When considering extenuating circumstances which apply to a bankruptcy, foreclosure, or deed-in-lieu of foreclosure, a different level of scrutiny is applied than when reviewing delinquencies.

What is considered to be a reasonable excuse for a period of bad credit, such as a short term layoff, illness, or similar incident, is not considered to be the caliber of financial hardship which should result in a bankruptcy, foreclosure, or deed-in-lieu of foreclosure. The criteria which is applied to extenuating circumstances requires the occurrence of a catastrophic event which resulted in extreme financial hardship from which the applicant(s) could not recover considering the income and debt load at that time. Specifically, events must have caused either a long term loss of income which was not preventable or massive debt which the applicant was not able to pay. Applicants must provide evidence of the events as well as an explanation.

An applicant who experienced financial difficulties due to extenuating circumstances in the past may present less risk than that indicated by his or her credit score or other loan file documentation.

If there is a question about an applicant's specific circumstances which is not addressed below, please contact our Regional Underwriting Center.

**306.01 – Examples of Extenuating Circumstances**
Examples of situations which are considered to be extenuating circumstances and qualify for special consideration when evaluating a bankruptcy, foreclosure, or deed-in-lieu of foreclosure are:

- The death of a primary wage earner.
- Loss of employment due to business closings and reductions-in-force which resulted in substantial unemployment in the area, document with a copy of the Warren Act notice.
- A primary wage earner suffered a serious long term illness or injury which resulted in a loss of income.
- The uninsured extended illness or injury of an immediate family member which resulted in massive medical bills.

### 306.02 – Situations That Do Not Qualify as Extenuating Circumstances

An applicant may be faced with a temporary financial hardship or an unrecoverable financial hardship that does not fit the description of extenuating circumstances (that warrant special consideration when evaluating a past bankruptcy, foreclosure, or deed-In-lieu of foreclosure). Examples of situations that do not qualify as extenuating circumstances are:

- A failed self-employed business venture;
- The loss of a job in an area which is not experiencing high levels of unemployment or plant closures;
- An applicant’s divorce;
- The applicant was taken advantage of by a friend, relative, or spouse;
- The applicant was out of town or out of the country and relied upon someone else to pay their bills; or
- An individual moved or relocated (for whatever reason) and was unable to sell their home or other property.

### SECTION 307.00 – RE-ESTABLISHING CREDIT

An important aspect of lending to an individual whose has experienced a period of flawed credit is the re-establishment of an excellent credit history. A minimum period of twelve (12) months is necessary to determine whether the individual has successfully recovered from their financial difficulties.

Recently opened credit accounts do not support a re-establishment of credit, as the payment history is too new to evaluate.

Re-establishment of credit is considered for applicants who have a proven track record, i.e., applicants who had a prior history of 24 to 36 months of excellent credit and experienced a period of difficulty but who have regained their prior status.

Re-establishing credit must require a conscious effort on behalf of the individual to make timely payments. Payroll deduction loans do not prove the applicant has the ability to actively manage monthly payments. Alternative forms of credit or nontraditional credit documentation may not be used to re-establish credit that was traditional and unsatisfactory. At a minimum, the applicant must be able to demonstrate an ability to manage monthly housing expenses and payment of housing related utilities.

The period of flawed credit must be fully explained and the circumstances must be isolated and not likely to occur. This section does not address chronic flawed credit. An applicant who has had prior credit problems for extended periods of time cannot use the 12 months of recent credit to compensate for chronic flawed credit.

### SECTION 308.00 – REVIEWING QUALIFYING

An applicant’s past performance for meeting obligations and accumulating savings will be given primary consideration when determining whether the applicant is an acceptable risk. The underwriter must consider:

- Will the applicant’s monthly housing expense and other long term obligations represent an affordable portion of the individual’s income?
- How will an increase in monthly housing expense affect the applicant’s ability to pay the mortgage?
• Are there recent changes in the applicant’s financial situation (a raise, new car payment, etc.) which will affect the ability to repay the mortgage?

308.01 – Applicant’s Qualifying Ratios

It is essential that the applicant’s monthly housing expense and other long term obligations represent an affordable percentage of the applicant’s stable monthly income. When qualifying ratios are exceeded, the loan must contain sufficient compensating factors to offset the higher ratios.

308.02 – An Increase in Obligations

The underwriter must evaluate the applicant’s ability to successfully manage an increase in monthly housing expense. The manner in which the applicant uses personal funds, which includes savings as well as spending, is a good indicator of the individual’s ability to manage this increase. A history of regular savings of an amount similar to the proposed increase in monthly housing expense or a substantial accumulation of savings would indicate the applicant has the ability to manage the personal finances.

On the other hand, an applicant with limited or no savings, who will be increasing monthly housing expense, and who has not shown an ability to manage a similar level of expenses may represent a greater credit risk.

SECTION 309.00 – QUALIFYING THE APPLICANT

For purposes of qualifying an applicant for a mortgage, ratios are calculated to determine what percentage of the applicant’s income will be spent on the proposed monthly housing expense and total of all obligations.

309.01 – Monthly Housing Expense

The applicant’s monthly housing expense consists of:

• Principal and interest payment.
• Monthly escrow for real estate taxes, hazard insurance, and flood insurance.
• Monthly payment of mortgage insurance premiums.
• Homeowners Association dues.
• Ground rents (leasehold payments).
• Special assessments.
• Payments on subordinate financing.

The applicant is responsible for Payment of all of these items, whether placed in escrow with The Lender or paid by the applicant. Even when the applicant will not escrow for taxes and insurance, those figures must still be included with the principal and interest (PITI) in the calculations for the Purpose of qualifying the applicant.

309.02 – Total Monthly Obligations

An applicant’s total monthly obligations are the total of the applicant’s monthly housing expense (PITI) and long term liabilities. The applicant’s long term liabilities include all installment loans, revolving accounts (including charge accounts, overdraft protection, and lines of credit), real estate loans (including real estate taxes, hazard insurance and Homeowners Association Dues on other real estate) stock pledges, alimony, child support, and all other debts of a continuing nature.

309.03 – Long Term Obligations

Long term obligations are those fixed term obligations that extend beyond a specified number of months and include continuing obligations, such as automobile leases and negative rental income. Long term obligation must be included in the applicant’s total debt for the purpose of calculating qualifying ratios.
Qualifying ratios were developed by the agencies and investors as a framework for evaluating an applicant’s ability to repay their obligations.

**Ratio Guidelines**

Ratio guidelines have been established and may be exceeded with automated underwriting approval. On a manual underwrite, the underwrite is strongly encouraged to follow the manual underwriting ratios shown below.

<table>
<thead>
<tr>
<th>Qualifying Ratios</th>
<th>Housing</th>
<th>Total Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>FHA Standard</td>
<td>31%</td>
<td>43%</td>
</tr>
<tr>
<td>Energy Efficient Home</td>
<td>33%</td>
<td>45%</td>
</tr>
</tbody>
</table>
CHAPTER 4 – INCOME

SECTION 400.00 – INTRODUCTION

This section discusses our requirements for assessing income stability, determining the adequacy and continuance of income, and deciding which sources of income are acceptable for a salaried or commissioned borrower. These guidelines also apply to borrowers who rely on income received from trusts, capital gains, royalties, real estate or other miscellaneous earnings that are not the result of the borrower’s employment (including those borrowers who have less than 25% ownership in a business).

400.01 – Income History

A borrower must have a history of receiving stable income from employment or other sources and a reasonable expectation that the income will continue to be received in the foreseeable future (usually for the next 3 years). Typically, when a borrower has been generating income for two or more years from full-time work with an employer(s), the lender does not need to look further into the income history of the borrower.

400.02 – Stable Earnings

Income from employment should be from related fields if the applicant has held several jobs. Not all types of employment offer year round employment with one employer, such as the building trades or farm workers. The evaluation of stable earnings must be based upon whether the applicant is able to consistently generate a similar amount of income. If the income is stable, the next step is to develop an income figure from the verified information which represents dependable earnings as a basis for repayment of the loan.

Special attention must be given to additional compensation in the form of overtime, bonus, commission, or from secondary sources so that the income used to qualify is truly representative of what the applicant will continue to earn. Variances in earnings from these sources must be carefully evaluated to determine if income is stable.

Employment should be stable in most cases with at least a two-year history in the same job or in the same line of work. Self-employed borrowers must have been in business for at least two years.

Frequent job changes without advancement or in a different line of work must ensure consistent or increasing income levels and likelihood of continued stable employment.

The applicant must explain in writing any employment gaps that exceed one (1) month (unless relieved by automated underwriting findings).

For a borrower employed by a relative or closely held family business, the supporting documents must be adequate to support the loan decision. Documentation required would be similar to that required of a self-employed borrower. A VOE signed by a family member is not acceptable.

400.03 – Continuance of Income

The applicant’s income should continue for a sufficient period of time to be a reliable source for repayment of the mortgage. Evaluation of the applicant’s history of employment, ability to generate similar income consistently, number of years in the same field of employment, specific educational background, and sources of any additional compensation must indicate the income can be expected to continue.

The applicant may be required to provide evidence at loan closing that there have been no changes or decreases in the income used to qualify.

SECTION 401.00 – DOCUMENTING INCOME
The documentation requirements stated in this chapter are not necessarily the minimum requirements for establishing income. **Automated approvals may give documentation relief and the underwriter must follow the feedback certificate and document according to that, first.** The underwriter has the responsibility to obtain any additional information required to establish the applicant’s income.

All loan types require that a full two year history of employment be documented on the application.

### 401.01 – Alternative Documentation

As an alternative to obtaining a VOE, or if the AUS findings state alternative documentation is acceptable, the lender may obtain the borrower’s original pay stub(s) covering the most recent 30-day period, along with original IRS W-2 Forms from the previous two years. At a minimum, the pay stub(s) must show the borrower’s name, social security number, and year-to-date earnings. The lender also must verify by telephone all current employers. The loan file must include a certification from the lender that original documents were examined and the name, title, and telephone number of the person with whom employment was verified.

If the employer will not give telephone confirmation of employment or if the W-2 indicates inconsistencies (e.g., FICA payments not reflecting earnings), standard employment documentation must be used.

### 401.02 – Written Verification of Employment

FHA will all accept the standard written verification of employment (VOE) to document the two year history. An original VOE form must be sent directly from The Lender’s correspondent to the applicant’s employer, to the attention of personnel or payroll. Upon completion, the VOE must be returned directly from the employer to The Lender’s correspondent. A written verification of employment is required in any of the following circumstances:

- The applicant is paid hourly (full or part-time) and the employer must provide the number of hours worked, if not provided on pay stub(s);
- The employer must comment on the likelihood of continuance of overtime or bonus.

A current YTD pay stub is required for all forms of employment, in addition to the written verification of employment. When the applicant does not receive a pay stub, or the paystub is handwritten; a payroll ledger must be obtained which has been signed and dated by the employer.

### 401.03 – Income Tax Returns

Income tax returns may be necessary to document income. The applicant's complete individual federal income tax return for the most recent two years must be provided with all schedules and attachments. The applicant should sign the signature page of all tax returns to indicate the forms provided are a true and correct copy of those documents filed with the IRS.

It is not acceptable for the applicants to provide only a portion of their tax returns.

The applicants will be required to sign an IRS Form 4506T which enables The Lender to obtain information on tax returns directly from the IRS. The Lender may, in its sole discretion, request IRS verification on all files requiring tax returns. The following is a list of some of the types of income and expenses where tax returns will be needed (The list may not include all instances when tax returns are required):

- Auto Allowance (if needed to qualify);
- Commissioned earnings;
- Contract employee;
- Dividend income;
- Employed by a family owned business;
- Employee business expenses (not reimbursed);
- Interest income;
- Minister (if needed, case by case basis);
- Partnership income;
• Rental income;
• Royalties;
• Seasonal employee;
• Truck Driver (over the road/long haul);
• Self-employed applicant;
• Union employee.

401.04 – Reviewing Employment Documentation

The income documentation must be reviewed to confirm that the information is consistent throughout the file and supportive of the income necessary to qualify. The pay stub should clearly identify the applicant, and should show no sign of any alterations.

Inconsistencies and discrepancies that cannot be supported with further documentation must be reviewed with Underwriting Managers, or Credit Policy. When misrepresentation is suspected the file must be moved to Underwriting Manager for review.

When an applicant is a salaried employee, the pay stubs should indicate withholding for federal income tax, state income tax (where applicable), social security and Medicare. If there is no withholding, the applicant may be paid as a contractor and must be treated as self-employed. If an applicant is paid a salary, the pay checks should be for the same amount each time. If the gross wages are not consistent and the variance is not clearly identified on the pay stub, an explanation must be obtained. The pay stub should be reviewed to determine any payroll deduction for debts, such as 401(k), ESOP, or credit union loans, salary advances, garnishments or child support.

W-2s must have all appropriate sections completed, including the employer ID number. The name and address of the employer and the employee should correspond to the pay stubs, 1003, VOE or other file documentation. Variances may be as simple as a change of ownership of the employer, but any variances must be clarified in the loan file. Incomplete W-2s must be reviewed thoroughly and the missing information must be confirmed and documented in the file. The earnings shown should be consistent with other verified information.

Written VOEs should not contain any alterations or evidence of alterations. Any corrections must be initialed by the individual completing the VOE.

Note: If documentation contained in the file clearly supports the corrections, such as a correction in year to date earnings supported with a W-2 for that year, it is not necessary to return the VOE for initials on the correction.

When reviewing the information on the VOE, earnings must be supported by other documents in the file.

SECTION 402.00 – CALCULATING INCOME

An applicant’s income base income can be calculated in a variety of ways. For qualifying purposes, the income must be converted to a monthly rate of pay. When performing income calculations, it is essential to review the applicant’s pay stub, W-2 and the rate of pay indicated on any VOE to confirm that current earnings support the income used to qualify.

402.01 – Calculating Variable Forms of Income

Qualifying income of a fluctuating nature, such as bonus, overtime, commission earnings, seasonal employment, foster care pay, or rental income is obtained by averaging the applicant’s income, typically over the last 24 months (unless given documentation waiver by automated approval. The monthly income figure, obtained by averaging, must then be compared to the applicant’s current year to date earnings. Any decline in income must then be investigated.

There may be situations where normal calculations will not apply to the income the applicant receives. Some employment fields, such as health care professionals, do not work a forty-hour work week, but continue to pay
overtime or other fluctuating income. Calculating the income for such employment may require a VOE, in addition to a pay stub and W2s, to provide an explanation of earnings pattern.

Credit should not be given for both a 40 hour work week and overtime, in such cases. It may be that an average of the applicant's total income would give a more accurate picture of the applicant's earnings. The overall strength of the applicant, the stability of income and the likelihood of the continuance of the income must be considered when using variable forms of income.

When averaging income using an applicant’s W2, credit should be given for income which has been deferred into a 401(k), 403 (b), or 501(c)(18) savings plan. These types of voluntary income deferrals are found on the W2 or the pay stub. This income would be available to the applicant to meet obligations, if the applicant desired, and should be included in qualifying income. These voluntary deductions may help to clarify situations when the wages on the VOE do not match the figure on the W2 for gross wages.

**402.02 – Source of Income**

Income may derive from a variety of sources such as salary, bonus, commissions, self-employment and/or other sources.

All income sources will be reviewed with regard to the borrower’s ability to service the total debt obligation.

Income from such sources as seasonal type work of less than 12 months duration, commissions, overtime, bonuses, and unemployment compensation must be computed as the estimated annual amount of such income for the upcoming 12 months. Consideration should be given to whether the income is dependable based on verification by the employer and the applicant's history of such income over the previous 24 months.

**402.03 – Non-Taxable Income**

In considering income that is not subject to Federal income tax, the amount of tax savings attributable to the nontaxable income may be added for use with the repayment ratios. Adjustments for other than the applicable tax rate are not authorized. The Lender must verify that the income is not subject to Federal income tax and that the income (and its non-tax status) is likely to continue for the next 3 years. The Lender must fully document and support any adjustment made.

An applicant who receives non taxable income has a greater spending power than someone who is paying taxes on their earnings. A person receiving $1,000 a month in non taxable income has $1,000 to spend. On the other hand, an individual who is employed receiving gross wages of $1,000 would see his/her take home pay reduced by payroll taxes. To equalize this tax difference, for qualifying purposes, the non taxable income must be “grossed up”.

All tax exempt income will be grossed up, except where bond programs, investor or agency criteria have specifically disallowed grossed up income. The grossed up income must be identified on the loan application, transmittal summary, or MCAW, or loan analysis.

The payer of the income must provide documentation indicating the amount of benefit the applicant is currently receiving, define the benefit and, where possible, indicate the income is likely to continue.

The following is a list of sources of non taxable income, but may not contain all such sources:

- Accident and health insurance proceeds;
- Child support payments;
- Clergy housing allowance;
- Damages awarded for physical injury or sickness;
- Federal Employee’s Compensation Act payments;
- Food Stamps;
- Foster care payments;
- Government cost of living allowances;
FHA has determined that a 25% gross up is appropriate for FHA loans.

The calculation is: Income times 1.25 equals qualifying income. It must be established that the non taxable income is likely to continue for the three years following the loan closing.

In addition, if a particular source of regular income is not subject to federal taxes, the amount of continuing tax savings attributable to the non-taxable income source may be added to the borrower's gross income. The percentage of income that may be added may not exceed the appropriate tax rate for that income amount, and no additional allowances for dependents are acceptable. The lender must document and support the adjustments (the amount the income is "grossed up") made for any non-taxable income source. The lender should use the tax rate used to calculate last year's income tax for the borrower. If the borrower is not required to file a federal income tax return, the tax rate to use is 25 percent.

SECTION 403.00 – TYPES OF INCOME

403.01 – Alimony / Separate Maintenance

Income in this category may be considered as effective if such payments are likely to be consistently received for the first three years of the mortgage. The borrower must provide a copy of the final divorce decree, legal separation agreement, or voluntary payment agreement, as well as evidence that payments have been received during the last twelve months. Acceptable evidence of payment regularity includes cancelled checks, deposit slips, tax returns, and court records. Periods less than twelve months may be acceptable, provided the payer's ability and willingness to make timely payments is adequately documented by the lender. Automated underwriting approval findings may also indicate less than 12 months also acceptable.

403.02 – Auto Allowance

Only the amount by which the borrower's automobile allowance or expense account payments exceed actual expenditures may be considered income. The borrower must provide IRS Form 2106, Employee Business Expenses, for the previous two years to establish the amount of income that may be added to gross income. The borrower also must provide verification from the employer that these payments will continue. (If these calculations show a loss, that amount must be treated as a recurring debt. If the borrower uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income.) Additionally, the borrower's monthly car payment must be treated as a recurring debt; it may not be offset by the car allowance.

403.03 – Bonus

For bonus income to be considered as stable income, the written Verification of Employment (VOE) must support a two year history of receipt plus reasonable prospects of its continuance, with the exception of waivers by the automated underwriting findings. The VOE must not state categorically that such income is not likely to continue.

Bonus income used to qualify will be calculated using a 24 month average.

Large variances in the amount of bonus income must be questioned, especially if there has been a decrease in the amount of bonus income. Information may be requested to clarify the bonus structure and how often the bonus is paid. A signing bonus paid to a new employee would generally not be considered continuing income for qualification purposes. In situations where the applicant is paid an annual bonus and is requesting loan approval
subject to receipt of the bonus income for funds to close, the file must indicate if the entire bonus will be used as assets to close. Bonus income used for closing will not be used as effective income to support monthly obligations.

403.04 – Capital Gains

Income received from a capital gain is generally a one-time transaction; therefore, it should not usually be considered as part of the borrower's stable monthly income. However, if the income reflected on Schedule D- Capital Gains and Losses shows that the borrower has realized capital gains for the last two years – as may be the case when the borrower’s business has a constant turnover of assets that produces regular gains and losses – the recurring gains may be considered in determining the borrower's stable monthly income – as long as the borrower provides evidence that he or she owns additional property or assets that can be sold if extra income is needed to make future mortgage payments.

403.05 – Child Support

Income in this category may be considered as effective if such payments are likely to be consistently received for the first three years of the mortgage. The borrower must provide a copy of the final divorce decree, legal separation agreement, or voluntary payment agreement, as well as evidence that payments have been received during the last twelve months. Acceptable evidence of payment regularity includes cancelled checks, deposit slips, tax returns, and court records. Periods less than twelve months may be acceptable, provided the payer's ability and willingness to make timely payments is adequately documented by the lender. Automated underwriting approval findings may also indicate less than 12 months also acceptable.

403.06 – Clergy

Ministers are individuals duly ordained, commissioned or licensed by a church or church denomination. Ministers or other members of the clergy are generally considered self-employed unless exempted by IRS from self-employment taxes. An exception from the IRS must be provided, when applicable.

The applicant may have elected to have social security and federal income taxes withheld from paychecks, but it is not mandatory.

Rental or housing allowance received may be considered income for qualifying the applicant. Written documentation, such as a VOE provided by the church, must be obtained showing receipt of this income. The applicant's pay stub should also reflect receipt of the housing allowance. If the applicant is newly employed, obtain a copy of the church budget (in lieu of a check) showing funds have been allocated for housing allowance. Housing allowance for ministers is non-taxable income and may be grossed up for qualifying.

The church may budget for educational, medical insurance, life insurance, retirement, etc. to be paid on behalf of applicant; however, these items will not be considered as qualifying income, unless exempted by the IRS. The housing allowance, although not subject to federal income taxes, is subject to self-employment taxes. Gross income on Schedule SE of the applicant's 1040 should include housing allowance paid.

403.07 – Commission

Commission income must be averaged over the previous two years. The applicant must provide the last two years personal tax returns along with a recent pay stub. Un-reimbursed business expenses must be subtracted from gross income. Individuals whose commission income shows a decrease from one year to the next require significant compensating factors to allow for loan approval.

Applicants with commission income received between one and two years may be considered favorably provided the underwriter is able to justify the acceptance and can document the likelihood of continuance or if automated findings provide a waiver for one year documentation.
Commissions earned less than one year are not considered effective income. An exception may be made in those situations where the applicant’s compensation was changed from a salary to commission within a similar position with the same employer. An applicant may also qualify when that portion of earnings not attributable to commissions would still be sufficient to qualify the applicant for the mortgage.

403.08 – Contractor/Consultant

All independent contractors will be treated as a self-employed. Two years personal tax returns and a year to date profit and loss will be required, with the exception of a waiver from the automated findings. When the applicant’s pay stubs do not show withholding for taxes, social security and Medicare, the applicant is paid 1099 income. Please refer to the self-employed chapter for additional information on review of tax returns.

403.09 – Disability

All disability benefits must be verified with a photocopy of the award letter. The letter must indicate the amount and length of time the benefits will be received. If the disability is short-term, verification of the applicant’s anticipated return to work should be obtained. Must continue for a minimum of 24 months.

To be able to use disability income for qualifying, the applicant must provide evidence the disability is constant in nature, such as a physician’s statement. (If applicant is receiving disability and permanence has already been established). Income would be taken from the benefits award letter. Disability benefits are generally non-taxable and may be grossed up.

In addition, if a particular source of regular income is not subject to federal taxes, the amount of continuing tax savings attributable to the non-taxable income source may be added to the borrower’s gross income. The percentage of income that may be added may not exceed the appropriate tax rate for that income amount, and no additional allowances for dependents are acceptable. The lender must document and support the adjustments (the amount the income is "grossed up") made for any non-taxable income source. The lender should use the tax rate used to calculate last year’s income tax for the borrower. If the borrower is not required to file a federal income tax return, the tax rate to use is 25 percent.

403.10 – Dividends and Interest

Interest and dividend income may be used, provided that documentation (Schedule B tax returns or account statements) supports a two-year history of receipt and is expected to continue to be received for the next three years. This income must be averaged over the last two years. The lender must verify the borrower’s ownership of the assets on which the interest and/or dividend income was earned. If the borrower is using liquid assets to close, only the interest generated by the funds remaining will be given consideration as qualifying income.

Example: Applicant has $100,000 in CD’s; $40,000 will be used for closing, leaving $60,000. $60,000 earning 5% interest is $3,000 per year. The past 2 years tax returns show earnings of $5,163 and $4,796 which supports roughly 5% earnings on $100,000 each year. You would use the $3,000 or 60% of the average income for the last 2 years (2987) ± 12 for a monthly figure. If tax returns show interest from notes receivable, exclude this income from interest calculations and follow guidelines for “Note Receivable”.

403.11 – Family Owned Business

Borrowers employed at businesses owned by their family member(s) are required to provide additional income documentation. These borrowers must provide the normal verification of employment, pay stubs, and evidence that they are not an owner of the business. This evidence may include copies of the borrower’s signed personal tax returns or a signed copy of the corporate tax return showing ownership percentages.

403.12 – Foster Care Income/Court Ordered Custody

Foster care income may be considered if it is recurring and likely to continue for the next 3 years. A two (2) year history of past receipts is required. The income must be averaged over a two (2) year period.
Foster care income may be considered as qualifying income if underwriting is able to document a two year history of providing foster care services under a state or county sponsored program. Income received for a minimum two year period will be considered likely to continue. Income from foster care should be averaged over two years. Document earnings through a letter from the administering agency. Foster care earnings are non-taxable and may be grossed up.

There are circumstances outside of a divorce involving parental custody where the court has ordered custody of a child (not foster care) and a child custody payment is made (such as from social services); such income may be considered stable if it has been received a minimum of 12 months. The age of the child in custody will be considered in determining the reasonable continuation of the income.

In addition, if a particular source of regular income is not subject to federal taxes, the amount of continuing tax savings attributable to the non-taxable income source may be added to the borrower's gross income. The percentage of income that may be added may not exceed the appropriate tax rate for that income amount, and no additional allowances for dependents are acceptable. The lender must document and support the adjustments (the amount the income is "grossed up") made for any non-taxable income source. The lender should use the tax rate used to calculate last year's income tax for the borrower. If the borrower is not required to file a federal income tax return, the tax rate to use is 25 percent.

403.13 – Foreign Income

Please refer to Residency Status when considering residency and source of income. Please review the following:

When the applicant is a US citizen or Permanent Resident Alien:

Employed in the United States by a foreign corporation, the income may be used to qualify when documented by a VOE evidencing a two year earnings history. The earnings must be in US dollars (or converted to US dollars) and the employer must confirm that the income is protected from any exchange rate fluctuations.

Employed abroad by a US company or a foreign company, the personal tax statement filed with the IRS will be required to indicate the income earned outside the US Tax returns indicate US Dollars and have been adjusted for any exchange rate fluctuations. The income may be used to qualify. Please refer to the specific product summary for details, but in most instances the applicant is eligible for a loan on a second home, a primary residence occupied by immediate family and investment property.

When the applicant is a Non-permanent Resident Alien:

Employed in the United States by a foreign corporation, the income may be used to qualify when employment, residence and credit have been verified for a minimum two year period. Please refer to the specific product summary for details, but the applicant should be eligible for loans on a primary residence only.

Employed abroad by a foreign company, the income is ineligible for qualifying.

403.14 – Government Assistance Programs

Income from government assistance programs is acceptable, subject to documentation from the paying agency, provided the income is expected to continue at least three (3) years. If the income is not expected to be received for at least three years, such income may be considered only as a compensating factor.

Unemployment income must be documented for two years. Reasonable assurance of its continuance is also required. This requirement may apply to individuals employed on a seasonal basis, such as farm workers, resort employees, etc.

403.15 – IRA/KEOGH Distributions
Once an individual reaches 59½ years of age, he/she may become eligible to receive distributions from his/her personal or business retirement funds, such as IRAs or KEOGHs, to which they have contributed.

If an account has been set up for regular distributions, the amount of the distribution may be acceptable qualifying income provided the payments would continue for a minimum of 3 years. Obtain a letter from the administrator of the account to verify the terms of the distribution. Document receipt of the funds and the current balance of the account.

Note: Do not use the same assets to determine interest income.

### 403.16 – Military (Active Duty)

Obtain a current Leave and Earnings Statement (LES). Income will be based on base income and any allowances as provided by the VA (which may be grossed up). The exception is situations where the veteran is being discharged within 12 months of closing.

### 403.17 – Mortgage Differential Payments

Payments received from an employer or government agency to supplement mortgage payments may be added to qualifying income; they may not be used to offset the mortgage payment. Obtain written documentation to support the amount received and the duration of the payments. If the payments are set up on a declining scale, the smallest amount received will be the amount used for qualifying purposes. The mortgage differential payments must continue for no less than three years.

### 403.18 – Notes Receivable

Income from notes receivable is evidenced by a copy of the executed note and proof the applicant has received the payments on a consistent basis for the past 12 months. This proof may be in the form of bank statements or deposit slips for the last 12 months, or the applicant may provide tax returns. When reviewing tax returns, Schedule B will show receipt of interest payments and the applicant may declare capital gains (Schedule D), if gains were realized on the sale of an asset. If the interest received supports regular receipt of payments, exclude any related interest or capital gains calculations from any self-employed income calculations and credit the applicant with the full payment as qualifying income (averaging tax returns may give credit only for interest and not principal payments received). Payments must continue for at least three years.

### 403.19 – Overtime

The use of overtime income for qualifying is acceptable when the applicant has a two year history of receipt of overtime and documents a likelihood of continuance of overtime, with the exception of documentation waivers by the automated underwriting engine. The VOE must not state categorically that such income is not likely to continue.

If the VOE or alternative documents itemizes the amount of overtime hours, an average of the hours multiplied by the current overtime hourly rate will be used. If the number of overtime hours is not available from the employer, an average of earnings will be used. A current pay stub and two years W-2’s must be reviewed to confirm actual income figures. Overtime received for periods of less than two years, but at least 18 months may be acceptable provided the underwriter adequately justifies and documents the reason for using the income for qualifying purposes. An earnings trend must also be established for overtime income.

If the overtime income shows a continual decline, the underwriter must provide a sound rationalization for including the overtime income for applicant qualifying.

Overtime earnings that are guaranteed or required by the employer as a normal work week (such as a required work week of 45 hours with 40 hours at standard pay and 5 hours at time and one-half) will be considered as effective income without any time period or seasoning when verified and documented by the employer.
Overtime earnings less than 18 months but at least 12 months may be considered on a case by case basis. File documentation and applicant’s current pay stubs must strongly support the use of such income in qualifying. The underwriter must consider all the risks inherent in the file and indicate that layering of risks has not occurred. The underwriter must provide written justification for considering overtime earnings less than 18 months on both the underwriting analysis and in Loan Commander’s note pad. This requirement is waived with automated underwriting findings requiring less documentation.

403.20 – Partnership Income

A partnership is a legal form of business, which has two or more partners. General partners have unlimited personal liability for the debts and losses while limited partners are only liable for the amount of their investment in the partnership. The partners control the partnership and the amount of control each partner has is addressed in the partnership agreement. In addition to an individual Form 1040, the partnership will file a Schedule K-1 with Form 1065.

When an applicant is a limited partner with less than 25% interest, as in a law or accounting firm, and partnership income is needed to qualify in addition to wages received, the applicant must provide 2 years personal tax returns with the Schedule K-1 for the partnership. The K-Is must be reviewed to determine whether there are capital contributions being made. If there are capital contributions, the partnership agreement must be obtained to determine the amount of further required contributions. The earnings will be decreased by the amount of capital contributions and the income averaged over two years.

When an applicant owns 25% or more of a partnership or is a general partner, partnership returns will be required and the applicant will be treated as self-employed.

403.21 – Pension/Retirement

Pension or retirement benefits may be verified through a benefits award letter or separate verification from the plan administrator. Monthly payments and the term of the payments must be verified. If the monthly benefit will continue for more than three years, the income can be used for qualifying. Receipt of the income can be verified from tax returns, W-2 forms, 1099 forms.

If the applicant is receiving military retirement and VA disability, the payments are remitted on a combined check, but the amounts are broken out on the veterans’ annual statement. The VA benefit must not be counted twice. VA disability is non-taxable and may be grossed up.

403.22 – W2 Professional Salaried Income

A Physician or Attorney who has graduated out of school within the past two years and has not been employed in their profession long enough to establish a two year history within that profession. A verbal verification must confirm along with any documentation needed to evidence history of school, such as a diploma or transcripts.

403.23 – Projected Income

Projected income is not allowed for self-employed applicants

The use of projected income is allowed when the applicant has received a non-revocable employment contract from a new employer, and work is to begin within 60 days of anticipated loan closing.

The loan file must verify that the applicant has sufficient reserves to meet obligations during the 60 day or less time period. An example of allowable projected income would be a teacher who is under contract and moving during June or July, but will not begin work until August.

403.24 – Rental Income
Rent received for properties owned by the applicant may be used for qualifying, subject to proper documentation. A separate schedule of real estate is not required provided all properties are shown on the URLA.

Rent received from the additional units in a multiple—unit property in which the applicant resides in one of the units may be used for qualifying purposes. The rent, after subtraction of the local FHA estimate for vacancies and maintenance (25% if no local estimate) may be added to the applicant’s gross income in calculating the qualifying ratios.

**Vacancy Factors Developed by HOC Jurisdiction**

- Santa Anna HOC – 10% Vacancy Rate
- Philadelphia HOC – 15% Vacancy Rate
- Atlanta HOC – 15% Vacancy Rate
- Denver HOC
  - 10% Vacancy Rate for: Colorado, Iowa, Minnesota, Montana, and Wisconsin
  - 15% Vacancy Rate for: Kansas, Louisiana, Missouri, Nebraska, New Mexico, North Dakota, South Dakota, Texas, and Wyoming
  - 20% Vacancy Rate for: Arkansas, Oklahoma, and Utah

Income from roommates, etc., in a single family property to be occupied as the applicant’s primary residence is not acceptable. Rental income from “boarders” is acceptable when provided by a relative and the rental income is shown on the applicant’s tax returns. Otherwise, the income may only be considered as a compensating factor and must be adequately documented.

In order to verify rental income, the following is required:

- Schedule E of IRS Form 1040. Depreciation may be added back to the net income or loss as shown on Schedule E. Positive rental income is considered as gross income for qualifying purposes; negative rental income must be treated as a recurring liability;
- The Underwriter must make certain the applicant still owns each property listed by comparing the Schedule E with the real estate owned section of the residential loan application;
- If six or more units are owned by the applicant in the same general area, a map disclosing the locations must be submitted evidencing compliance with FHA’s seven unit limitation;
- If a property was acquired since the last income tax filing (loan file must document acquisition and date) and is not shown on Schedule E, a current signed lease or other rental agreement must be provided. Gross rental amount will be reduced for vacancies and maintenance by 25% or percentage provided by the local FHA office, before subtracting principal, interest, taxes, insurance and any homeowner’s association dues, etc. and applying the remainder to income or, if negative figure, to recurring debts.

**FHA Owner Occupied 2-4 Unit Properties**

To consider rental income from a duplex, fair market rent (as determined by the appraiser) is multiplied by the same vacancy factor per HOC Jurisdiction above or by 75% (25% maintenance & vacancy factor if no local estimate) to arrive at net rental income. If negative, this amount should be included in monthly obligations.

Three and 4 unit properties must be self-sufficient. The net rental income from all units must be greater than the monthly PITI (including HOA dues) payment calculated at the note rate. If not, the loan amount must be decreased to a level where this is accomplished. Net rental income is the appraiser’s estimate of fair market rent for all units, (including the unit occupied by the applicant) less a 25% allowance for maintenance and vacancy. For example, gross rents of $800 x 75% = $600 net rental income. This must exceed the PITI payment on the mortgage for 3-4 unit properties. The applicant must also have 3 months PITI in cash reserves after closing. The housing ratio is always computed using the full PITI payment for the subject property.

403.25 – Reservist/National Guard

Income received as a member of the military Reserve or National Guard will be treated as qualifying income if the applicant has served for a period of time and will continue to do so for no less than three years. Income
should be averaged to obtain qualifying income as one month of the year typically includes 2 weeks active
duty/maneuvers and the other months the applicant receives pay for one weekend.

403.26 – Room and Board

Income from roommates in a single-family property to be occupied as the borrower's primary residence is not
acceptable. Rental income from boarders is acceptable if the boarders are related by blood, marriage, or law.
The rental income may only be considered effective income if shown on the borrower's tax returns Schedule E.
Otherwise, the income may only be considered as a compensating factor.

403.27 – Seasonal Employment

Income from seasonal employment may be considered if the applicant has worked the same job "in season" for
the past two years and expects to be rehired for the next season. A verification of employment (VOE) and the last
two years (2) W-2’s are required.

Income from such sources as seasonal type work of less than 12 months duration, commissions, overtime,
bonuses, and unemployment compensation must be computed as the estimated annual amount of such income
for the upcoming 12 months. Consideration should be given to whether the income is dependable based on
verification by the employer and the applicant's history of such income over the previous 24 months.

Seasonal employment is acceptable as qualifying income if the applicant has worked in the same line of work for
the past two years and the current employer confirms on the VOE that the applicant will be re-hired. If the
applicant's income is from multiple employers two years lax returns must also be obtained as support for income.
Seasonal income should be averaged over the 24 month period being reviewed.

Seasonal employees may receive unemployment compensation during the "off season".

403.28 – Second Job

Note: Second jobs may take the form of seasonal employment, such as a referee for football games or running
snow removal equipment. Such employment is considered uninterrupted and may be used in qualifying if the
applicant has worked the same type of job for the past two years and expects to be re-hired during the next
season.

To use income from a source other than the applicant’s primary employment as qualifying income, the applicant
must have worked the second job uninterrupted for the past two years and will continue to do so.

Income from a second job that has been received for less than two years but at least 18 months may be included
as effective income provided the underwriter is able to determine that the income's continuance is likely. Income
from second jobs not meeting these requirements may be considered as a compensating factor.

403.29 – Shift Differential

Shift differential is paid as an incentive to employees who work shifts, such as evenings, nights or weekends.
When considering a shift differential as stable qualifying income and the shift differential is a permanent
component of an applicant’s income, the amount may be considered without a history of receipt. If the shift
differential varies periodically, a minimum one year history is required. The employer must confirm the applicant
will continue to receive the income. Receipt of shift pay must be supported by the current pay stub as well as by
the prior year’s earnings shown on the VOE or W-2s.

403.30 – Social Security - Retirement

Retirement and Social Security Income. Retirement and social security income require verification from the
source (former employer, Social Security Administration) or federal tax returns. If any benefits expire within the
first full three years, the income source may be considered only as a compensating factor.
403.31 – Social Security -- Surviving Spouse and Child or Payments to Family Members

SSI is a form of government assistance provided to individuals who are disabled. Those cases where it is expected the applicant will medically improve are reevaluated during the first 6-8 months. SSI received longer than 18 months will be considered ongoing income and will be used to qualify. A benefits awards letter or a printout from 881 will be required. If the applicant recently became eligible for SSI, documentation of continuance will be required (letter from a doctor or similar documentation typically will satisfy this condition).

Family members may be eligible to receive social security benefits after the disability, or retirement of a primary wage. Obtain a copy of the benefits awards letter (benefits must be payable to our applicant) and evidence of the Ages of the dependents. Payments must continue for no less than three years.

403.32 – Temporary Employment

Temporary employment will be considered when the applicant works through an agency (or agencies) and has demonstrated this to be a stable form of income. The applicant's work history must be verified for two years and the applicant must have worked steadily as a temporary employee for a minimum of 18 months. Income will be averaged over the two year period, but not less than 18 months. Obtain W-2s for 2 years plus a current pay stub.

Note: No consideration will be given to the income of an individual who is not employed through a temporary agency and whose sole employer states the applicant's employment is "temporary".

403.33 – Tips

The applicant must have a two year history evidencing receipt of tip income. The applicant must provide two years of personal income tax returns, together with a current pay stub. Tip income will be averaged over a two year period. If the tip income is not reported on the pay stub or tax returns, then the income may not be used for qualifying.

403.34 – Trailing Spouse

When the subject property is being purchased as the result of relocation of the primary wage-earner and the secondary wage-earner has an established history of employment, is expected to return to work and there is a reasonable prospect for securing employment in a similar occupation in the new area, the trailing spouse income will be considered as a compensating factor. The underwriter must address the availability of such possible employment and must note on the 1008, MCAW and in Note Pad what income was considered and how the compensating factor was used.

403.35 – Truck Drivers

When an applicant is a truck driver, it is necessary to determine whether the individual is a local, short-haul driver, or an over-the-road, long-haul driver. A long-haul driver will normally have substantial non-reimbursed business expenses which must be subtracted from income, and tax returns must be obtained to verify the amount of business related expenses. Such applicants may be paid either by the hour or by the mile. Income must be averaged over a two year period, but not less than 18 months.

403.36 – Trust Income

Income from trusts may be used if guaranteed, constant payments will continue for at least the first three years of the mortgage term. Documentation is required and includes a copy of the Trust Agreement, or other trustee's statement, confirming amount, frequency of distribution, and duration of payments. Funds from the trust account also may be used for the required cash investment with adequate documentation.

403.37 – Unemployment Compensation
Usually income derived from unemployment compensation cannot be considered due to the limited duration.

Unemployment compensation will be used as qualifying income when the applicant is employed in a seasonal type of job or field where temporary periods of unemployment are typical. Develop a two year history using tax returns and average this income over 24 months. In this situation, the applicant’s regular income would also be averaged. Unemployment income can not be used for qualifying where the applicant underwent long periods of unemployment (i.e., greater than 26 weeks) due to factors other than seasonal employment.

403.38 – Union Member

If a union member such as a plumber, electrician, merchant marine, or sheet metal worker is continuously employed by one employer, normal methods of calculating hourly or salary income will be used. Standard alternative documentation or VOE’s will suffice.

Union members, who at the direction of their union local, may work for a number of employers will have the union local verify how long the applicant has been a member and their current rate of pay.

To determine income, obtain 2 years tax returns and/or W-2s from all employers and year to date income. Develop an average number of hours worked and apply the present hourly rate of pay to determine qualifying income. The tax returns and W-2’s must support the income developed. Applicants may also receive unemployment compensation which is typically shown on the tax returns and which can be included in the average of income.

403.39 – VA Benefits

VA benefits may be used as qualifying income if continuance is likely. The amount can be verified by a benefits awards letter or VA distribution form. VA benefits are non-taxable and income may be grossed up to qualify. VA educational benefits cannot be used as qualifying income.

403.40 – Workers Compensation

Workers Compensation benefits differ by state and benefits are usually reevaluated annually.

A consistent and diligent effort must be made to obtain adequate information to allow the use of the income as qualifying income. Any workers compensation used must be documented in file and should, at minimum include the physician’s statement, the awards letter, and evidence of receipt of the funds. The justification for workers compensation income used must be indicated on the FHA MCAW.

Temporary income benefits are paid for injuries which are expected to medically improve, usually for a term of two years, or such time as the employee can return to work. The workers compensation benefit will be used as qualifying income, unless the employee will be returning to work at a set time in the immediate future. If the employee will be returning to work, the employer must confirm the position and rate of pay.

A second type of workers comp is paid for permanent disability (which affects ability to perform previous job, but does not prevent the individual from working) until such time as the applicant can be trained for a new occupation. This type of benefit usually continues for 5-8 years from the date of injury as a supplement to income and can only be used as qualifying income if it will continue for three years after closing.

• Lifetime workers compensation benefits are paid for a catastrophic injury such as loss of sight, hearing, or loss of limb.
• Death benefits are also available for the surviving spouse and minor children. The duration of this income is determined by state law and may be considered as qualifying income if three years continuance is established.
• Lump Sum benefits are also paid to workers in lieu of temporary or permanent disability payments and are considered as savings.
Workers compensation is non-taxable income which may be grossed up for qualifying on FHA.

Note: Diligence on the part of Underwriting must be made to obtain the amount of income, the terms under which the money is paid and evidence the income can reasonably be expected to continue.

403.41 – Lottery Income

In order to consider income from the applicant’s winning a lottery, the file must document the following:

- Income must have been received for no less than a two year period prior to application;
- Income must be expected to continue for a period not less than three years from loan closing;
- Funds for closing and/or down payment must come from applicant’s assets currently verified; and
- The source of funds for closing and/or down payment must be verified and cannot involve any gift funds.

SECTION 404.00 – SPECIAL INCOME CRITERIA

404.01 – Maternity Leave

If an applicant, on maternity leave at the time of application for a mortgage, indicates the intent to return to work, the income can be treated as continuous and stable. Provided we have documented a two year work history, current employer states that the position will be held at the same rate of pay, when the applicant is scheduled to return to work and we have cash reserves equal to the amount of qualifying monthly income if the applicant will not return to work within 60 days of loan closing.

404.02 – Payroll/Leasing Company Employees

Businesses may utilize a payroll services company. Verification of income through the use of pay stubs and W-2s from the payroll service will be acceptable. The loan file documentation must indicate the confirmation of the employer and the specific payroll service used.

Businesses may also lease permanent position employees from an employment firm. The applicant may work for the employment firm with pay stubs and W2s indicating the employment firm, but physically the employee is leased to another company. This is an acceptable form of income. The file must document the applicant’s circumstances.

404.03 – Unacceptable Forms of Income

Certain types of income may not be given consideration for qualifying the applicant. These are:

- Educational benefits, such as VA benefits, scholarships, etc.;
- Gifts, regardless of duration or amount;
- Lump sum payments such as inheritances, or lawsuit settlements (may be verified as assets to close);
- Payments which are received for purchase or reimbursement of specified items;
- Retained earnings;
- Secondary income which will continue for less than three years;
- Taxable forms of income which the applicant does not declare on federal tax returns;
- Unverifiable income;
- Value of a company furnished automobile; and
- Value of employment benefit packages which are not received as cash wages.
- Lump sum payments of lottery earnings that are not ongoing.

SECTION 405.00 – SELF-EMPLOYED BORROWERS

A borrower with a 25 percent or greater ownership interest in a business is considered self-employed for FHA mortgage loan underwriting purposes.
The following conditions apply to underwriting self-employed borrowers:

A. **Minimum Length of Self-Employment.** Income from self-employment is considered stable and effective if the borrower has been self-employed for two or more years. The high probability of failure during the first few years of a business makes the following requirements necessary for individuals who have been self-employed less than two years:

1. **Between One and Two Years.** An individual self-employed between one and two years must have at least two years of documented previous successful employment (or a combination of one year of employment and formal education or training) in the line of work in which the borrower is self-employed or in a related occupation to be eligible.

2. **Less than One Year.** The income from a borrower self-employed less than one year may not be considered effective income.

B. **Documentation Requirements.** The following documents are required from self-employed borrowers:

1. Signed and dated individual tax returns, plus all applicable schedules, for the most recent two years.
2. Signed copies of federal business income tax returns for the last two years, with all applicable schedules, if the business is a corporation, an "S" corporation, or a partnership.

C. **Analyzing Income.** The lender must establish the borrower's earnings trend over the previous two years but may average the income over three years, if all three years' tax returns are provided. If the borrower provides quarterly tax returns, the analysis can include income through the period covered by the tax filings. If the borrower is not subject to quarterly tax filings or does not file quarterly returns (Form IRS 1040 ES), the income shown on the P&L statement may be included in the analysis, provided the income stream based on the P&L statement is consistent with the previous years' earnings. If the P&L statements submitted for the current year show an income stream considerably greater than what is supported by the previous years' tax returns, the analysis of income must be predicated solely on the income verified through the tax returns.

To determine if the business can be expected to continue to generate sufficient income for the borrower's needs, lenders must analyze carefully the business's financial strength, the source of its income, and the general economic outlook for similar businesses in the area. Annual earnings that are stable or increasing are acceptable. Conversely, a borrower whose business shows a significant decline in income over the period analyzed is not acceptable, even if current income and debt ratios meet our guidelines.

The following provides additional information on analyzing tax returns:

1. **Individual Tax Returns (IRS Form 1040).** The amount shown on the IRS Form 1040 as "adjusted gross income" either must be increased or decreased, based on the lender's analysis of the individual tax returns and any related tax schedules. Particular attention must be paid to the following:

   a. **Wages, Salaries, and Tips.** An amount shown under this heading may indicate that the individual is a salaried employee of a corporation or has other sources of income. It also may indicate that the spouse is employed, in which case the income must be subtracted from the adjusted gross income in the analysis.

   b. **Business Income or Loss (from Schedule C).** The sole proprietorship income calculated on Schedule C is business income. Depreciation or depletion may be added back to adjusted gross income.

   c. **Rents, Royalties, Partnerships, Etc. (from Schedule E).** Any income received from rental properties or royalties may be used as income after adding back any depreciation shown on Schedule E.

   d. **Capital Gain or Loss (from Schedule D).** This transaction generally occurs only one time, and it should not be considered in determining effective income. However, if the business has a constant
turnover of assets resulting in gains or losses, the capital gain or loss may be considered in
determining the income, provided the borrower has at least three years' tax returns evidencing
capital gains. An example includes an individual who purchases old houses, remolds them, and
sells them for a profit.

e. Interest and Dividend Income (from Schedule B). This income, which is taxable and tax-exempt,
may be added back to the adjusted gross income only if it has been received for the past two years
and is expected to continue. (If the interest-bearing asset will be liquidated as a source of the cash
investment, the lender must adjust accordingly.)
f. Farm Income or Loss (from Schedule F). Any depreciation shown on Schedule F may be added
back to the adjusted gross income.
g. IRA Distributions, Pensions, Annuities, and Social Security Benefits. The non-taxable portion of
these items may be added back to the adjusted gross income, if the income is expected to continue
for the first three years of the mortgage.
h. Adjustments to Income. Certain adjustments to income shown on the IRS Form 1040 may be
added back to the adjusted gross income. Among these adjustments are IRA and Keogh retirement
deductions, penalties on early withdrawal of savings, health insurance deductions, and alimony
payments.
i. Employee Business Expenses. These expenses are actual cash expenses that must be deducted
from the borrower's adjusted gross income.

2. Corporate Tax Returns (IRS Form 1120). Corporations are state-chartered businesses owned by
their stockholders. Compensation to its officers, generally in proportion to the percentage of ownership,
is shown on the corporate tax returns and will appear on individual tax returns. If the borrower's
percentage of ownership is not shown, it must be obtained separately from the corporation's
accountant, with evidence that the borrower has the right to those funds. Once the adjusted business
income is determined, it should be multiplied by the borrower's percentage of ownership in the
business.

In analyzing the corporate tax returns, lenders must adjust for the following:

a. Depreciation and Depletion. The corporation's depreciation and depletion must be added back to
after-tax income.
b. Taxable Income. Taxable income is the corporation's net income before federal taxes. It must be
reduced by the tax liability.
c. Fiscal Year vs. Calendar Year. If the corporation operates on a fiscal year that is different from the
calendar year, an adjustment must be made by the lender to relate corporate income to the
individual tax return.
d. Cash Withdrawals. The borrower's withdrawal of cash from the corporation may have a severe
negative impact on the corporation's ability to continue operating.

3. "S" Corporation Tax Returns. An "S" corporation is generally a small, start-up business, with gains
and losses passed on to stockholders in proportion to each stockholder's percentage of business
ownership. The income for the owners comes from W-2 wages and is taxed at the individual rate.

The "compensation of officers" line on the IRS Form 1120S is transferred to the borrower's IRS Form
1040. Both depreciation and depletion may be added back to income in proportion to the borrower's
share of income. However, income also must be deducted proportionately by the total obligations
payable by the corporation in less than one year. The borrower's withdrawal of cash from the
corporation may have a severe negative impact on the corporation's ability to continue operating and
must be considered in the analysis.

4. Partnership Tax Returns. A partnership is formed when two or more individuals form a business and
share in profits, losses, and responsibility for running the company. Each partner pays taxes on his or
her proportionate share of the partnership’s net income.
Both general and limited partnerships report income on the IRS Form 1065; this form must be reviewed by the lender to assess the viability of the business. The partner's share of income is carried over to Schedule E of IRS Form 1040. Both depreciation and depletion may be added back to income in proportion to the borrower's share of income. However, income also must be deducted proportionately by the total obligations payable by the partnership in less than one year. The borrower's withdrawal of cash from the partnership may have a severe negative impact on the partnership's ability to continue operating and must be considered in the analysis.
CHAPTER 5 – ASSETS

SECTION 500.00 – INTRODUCTION

The applicant must have sufficient liquid assets available to pay the down payment and the costs associated with obtaining the mortgage, meet any required investment criteria, and retain sufficient reserves following closing, as needed. An applicant’s ability to accumulate assets provides insight into the individual’s ability to successfully manage personal finances. Assets must be verified for reserve, closing costs and down payment.

500.01 – Required Funds

At the time the loan is submitted to underwriting for final approval, it must contain verification of adequate funds for closing and required reserves. If the applicant is liquidating assets for funds to close, the file should clearly indicate which assets will be liquidated. The final loan application must provide an accurate estimate of the funds required from the applicant to close the transaction. Incomplete or inaccurate figures in the details of the transaction may result in problems or delays at closing.

SECTION 501.00 – DOCUMENTING ASSETS

When documenting assets, the loan file must provide conclusive evidence the applicant has adequate funds available to close the loan and comply with any requirements for cash reserves. When the underwriter has concerns about the adequacy or source of funds which have been documented, it is both the underwriter’s right and responsibility to request additional documentation to resolve any concerns regarding available funds.

501.01 – Alternative Documentation

All loan types require conclusive documentation of sufficient funds to close the loan and meet reserve requirements (where applicable). The Lender’s policy is to utilize alternative documentation whenever possible. The borrower may receive documentation relief from automated underwriting findings. Additional documentation may be required to support the source of funds for any increases in account balances or new accounts.

Alternative Documentation of assets requires the applicant to provide all pages of account statements evidencing all transactions for the most recent 60 day period. The account statement must meet the following criteria, unless otherwise stated in automated underwriting system:

- Account statements for FHA loans may be originals, computer generated or certified photocopies.
- Computer generated statements must be signed and dated by the preparer.
- Computer generated statements must provide starting and ending balances together with all activity for the period covered.
- Computer generated statements require the name of the issuing bank and must indicate the name and title of the individual preparing the print-out.
- The entire statement must be copied.
- Identify the issuing institution (depository or broker/dealer).
- Identify the account owner(s) (applicant).
- Identify the account number (if applicable).
- If depository, show all transactions on the account (deposits and withdrawals) for a sixty day period.
- If stocks or securities, identify the stocks and/or securities and the dates acquired and/or sold.
- Account statements must show any outstanding loans, if applicable
- Show the period covered and ending balance or cash value.

501.02 – Written Verification of Deposit (VOD)

All loans may use the standard written verification of deposit (VOD) with no alterations or white out. An original VOD form must be sent directly from the correspondent to the applicant’s depository institution (or brokerage), and upon completion, be returned directly from the depository institution to correspondent.
A VOD should be obtained when the applicant’s account is a “passbook savings” account or other account that does not provide a statement or sufficient information to allow alternative documentation.

SECTION 502.00 – ACCESS TO FUNDS

File documentation must indicate the applicant has immediate access to the funds in the verified account or additional documentation must be provided to support liquidation of an asset.

- Account statements or Verification of Deposits, provided for funds needed to close or meet reserves, must indicate the applicant as the account holder.
- Applicant must indicate amount of funds to be withdrawn from a 401K, ESOP, SEP or other employee savings plan.
- Funds to be received from an employer, trust fund or other source must be documented with letter from the provider or other similar supporting document.
- Applicant must indicate what assets are to be liquidated, the amount of funds to be received and provide a supporting document indicating sufficient funds are available.

When assets are to be liquidated, the underwriter must condition the loan for proof of liquidation and evidence of the net proceeds (as required by automated approval) from the account in a dollar amount adequate to close the mortgage, or to combine with amounts verified as already in the bank equaling sufficient funds for closing.

The underwriter cannot assume assets are available unless written verification is obtained. Currently, only verified assets are printed on the final loan application in the assets column and only those assets, as verified, will be considered by Underwriting.

SECTION 503.00 – SOURCE OF FUNDS / ASSETS TO CLOSE

Funds used as down payment, closing costs, prepaid, and any required reserves, must not only be adequate to close the mortgage transaction, but must be adequately documented. The file must clearly indicate the applicant’s source of funds. Additional documentation may be required when:

- An account has been opened within the 90 days prior to application unless the balance in the account, or the account statements, clearly shows the current balance to be only the result of deposits of the applicant’s normal paychecks.
- No average balance is indicated on the VOD (account statements or a transaction history covering a 60 day period must be obtained).
- Account balances indicate an increase in the average balance that exceeds one month take home pay for the applicant.
- Deposits appearing on the applicant’s account statements exceed the applicant’s normal take home pay.
- Checking accounts have only deposit activity and no withdrawals. The applicant must explain how the normal day to day living expenses are being paid.

503.01 – 1031 Exchange

The 1031 Tax Deferred Exchange (1031 Exchange) feature provides borrowers with an additional means for obtaining down payment funds. A tax deferred exchange allows the borrower to exchange the “like kind” (residential to residential) property as long as the acquired property is of greater or equal value to the relinquished property.

Proceeds from an IRS Exchange are acceptable. An IRS 1031 Exchange allows a borrower to place proceeds from the sale of a property into an escrow account to be held and used toward the purchase of another like kind property. The following documentation must be provided in order to verify funds from the 1031 Exchange at closing:

- HUD 1 from both properties
- Statement from the Accommodator verifying available funds
- Exchange agreement
503.02 – Bank Account

In addition to the above requirements, when using computer generated printouts, a correspondent must indicate on the print-out that the forms are provided in lieu of original or certified true bank statements which the applicant could not provide. The correspondent must sign and date the statement.

503.03 – Bridge Loan

A bridge loan is an acceptable source of funds, as long as it is secured by a valid second lien against the applicant’s previous residence:

- It must have regularly scheduled payments or a payment must be estimated for amount and term of the loan;
- If the bridge loan payment is not monthly (or there is no scheduled payment) the payment must be converted to a monthly amount for qualifying purposes;
- The bridge loan may not be secured by the subject property;
- If it is a short term loan, it must be renewable; and
- The applicant must be qualified using the bridge loan payment, the previous mortgage payment, the new loan and other debts.

The underwriter will review a copy of the note or approval letter from the financial institution or other entity providing the bridge loan and issue an approval subject to receipt of executed bridge loan documents for the payment and dollar amount specified.

503.04 – Cash

“Cash” is considered to be any of the following:

- Funds on deposit in the Borrower’s checking, savings, money market or certificate of deposit account or other depository account.
- A gift that is from a Related Person of the Borrower, that does not have to be repaid and is documented.
- A gift of Equity from a Related Person is allowed provided it meets the requirements.
- A gift or grant from An Agency that does not have to be repaid, is given pursuant to an established program
- Proceeds of a loan fully secured by the Borrower are owned assets.
- Proceeds from the sale of the Borrower’s assets.
- A cash deposit toward the purchase, the source of which is verifiable.
- Funds disbursed from a trust if documented.
- Funds on deposit in an Individual Development Account (IDA) and matching funds provided by An Agency.
- Funds on deposit in a Community Savings System that are deposited by the borrower and documented.

None of the following is considered to be cash:

- Proceeds of a personal or unsecured loan.
- A gift that must be repaid in full or in part.
- A cash advance on a revolving charge account or unsecured line of credit.
- Cash for which the source cannot be verified (cash on hand).

503.05 – Cash Advance on Credit Card

Cash advances are not permitted as an acceptable source of funds for down payment, closing costs or reserves.

Please Note: Applicant(s) may charge appraisal and credit report charges to a credit card. On FHA purchase loans the appraisal and credit report, charged on a credit card, may not be included in acquisition or the calculation of the maximum mortgage loan amount. Credit report and appraisal fees are not included in the mortgage calculation on the FHA streamline refinance.
Credit card charges, cash advances or unsecured line of credit

The amount charged by a Borrower on a credit card to pay fees associated with the Mortgage application, credit report and appraisal reports, or a cash advance taken by the Borrower on a revolving credit card account or an unsecured line of credit to pay these fees may be used as Borrower Funds if the following conditions are met:

The maximum amount charged or advanced may not exceed one percent of the Mortgage amount. While charges for the credit report and appraisal are not required to be included in the one percent limitation, the total amount charged by the Borrower on a credit card or taken as a cash advance for the credit report and appraisal may not exceed $500.00.

The amount charged or advanced must be included in the Borrower's total outstanding debt and the repayment of such amount must be included when determining the Borrower's monthly debt payment-to-income ratio.

The Borrower has sufficient funds to pay these fees; however, the Borrower is not required to pay off these charges at closing.

503.06 – Cash Saved at Home

Borrowers who have saved cash at home and are able to demonstrate adequately the ability to do so are permitted to have this money included as an acceptable source of funds to close the mortgage. To include such funds in assessing the homebuyer's cash assets for closing, the money must be verified—whether deposited in a financial institution or held by the escrow/title company—and the borrower must provide satisfactory evidence of the ability to accumulate such savings.

The asset verification process requires the borrower to explain in writing how such funds were accumulated and the amount of time taken to do so. The lender must determine the reasonableness of the accumulation of the funds based on the borrower's income stream, the time period during which the funds were saved, the borrower's spending habits, documented expenses and the borrower's history of using financial institutions. (All other factors being equal, individuals with checking and/or savings accounts are less likely to save money at home than an individual with no history of such accounts.)

503.07 – Collateralized/Secured Loans

Funds can be borrowed for the required investment as long as satisfactory evidence is provided that funds are fully secured by existing marketable assets. These assets may include stocks, bonds, automobiles, real estate (other than the property being purchased), and the cash value of life insurance policies. A tax refund anticipation loan, provided by a lending firm filing automated returns, is considered to be a collateralized loan.

The borrowed funds must be provided by an independent third party. The seller, real estate agent or broker, or lender may not provide such funds.

Unacceptable borrowed funds include signature loans, cash advances on credit cards, and similar unsecured financing.

503.08 – Commission From Sale of Subject Property

When the applicant will receive commission from the sale of the property being purchased, the file must clearly document the applicant’s right to those funds and the amount the applicant will be receiving.

Technically, the commissions are unearned until the loan is closed. The applicant is entitled to the commission funds but such funds are not to be used in the subject loan transaction.

The HUD1 must indicate the applicant has paid the down payment and closing costs and prepaids, if applicable, from his or her own funds. A check must be issued by the Closing Agent for the amount of commission funds due
the applicant. The check must not be net of funds needed to close. A copy of the Closing Agent’s check will be
required as an approval condition by underwriting.

503.09 – Corporate Funds

An applicant may use corporate funds for money to close if the following conditions are met:

• The applicant owns at least 51% of the stock in the corporation.
• A current balance sheet is provided indicating sufficient cash assets.
• Funds are verified on deposit for the corporation.
• Verification of receipt of the funds by the applicant, prior to closing.
• The file contains a letter from the corporation’s CPA stating the company is capable of disbursing the funds
  without impairing the operation of the company.
• A copy of the Corporate Resolution indicating the applicant will be permitted to withdraw funds from the
  corporation.

503.10 – Currency Conversions

When an applicant’s funds are from a foreign source, the funds must be deposited in a Bank in the United States,
and verified. The verified funds will be the result of currency being converted from the foreign source to US
dollars. Evidence of the currency exchange rate is required to support the amount of funds converted to US
dollars.

503.11 – Earnest Money Deposit

Earnest money deposits must be fully documented by cancelled check, certified funds or money order. If
documents are less than 90 days old verify borrower had funds available to make the transaction. Copy of
deposit documentation from realtor or seller is not acceptable documentation. If deposit funds can not be verified
the amount of deposit must be deducted from verified assets in the loan file.

Verification of earnest money deposit is a prior to closing requirement and may never be required at closing.

Underwriter is to condition AC-Earnest money verified in the amount of $______.

503.12 – Employee Savings Plans (401K)

Many employers offer savings plans as a benefit to their employees where the employer matches a specified
percentage of the employee’s contributions. When considering these accounts to meet cash reserve
requirements, only the applicant’s vested portion, less the balance of any outstanding loans, will be considered
towards meeting reserve requirements. Examples of these accounts are 401K and ESOP savings plans.

• The value of the account must be documented by the applicant’s most recent statement.
• Funds to close may be in the form of a withdrawal or a loan against the account.
• When the applicant is withdrawing funds to close, the proceeds check must evidence sufficient net proceeds
  (after penalty for early withdrawal, and federal withholding) to close the loan and meet reserve requirements
  when the proceeds are combined with other verified liquid assets.
• When borrowing against an employee’s saving account, a copy of the loan agreement and proceeds check
  must be obtained.

401K or other IRS approved employer retirement account statements must be documented as follows:

Statement must be computer generated or typed (not handwritten).

• Must identify the employer.
• Must identify the account owner(s) (Applicant).
• Must identify the stocks, securities and/or other specific type of assets held in the account.
• Must show the vested balance or the percent of vesting and the ending balances as of the date of the
  statement.
Must show the period covered and ending balance.
Must show any outstanding loans.

The company requirements showing the conditions under which funds may be withdrawn and/or borrowed must be documented as required by automated findings when needed to cover closing costs and/or down payment.

60% of the vested amount may be used for reserves

503.13 – Gambling or Lottery Winnings

Winnings from gambling or the lottery are acceptable for funds to close and must be documented by a statement of earnings from the casino or lottery commission.

A W-2G must be issued to the recipient of lottery and gambling winnings; therefore, records can be accessed to document source of funds.

503.14 – Gifts

A gift is acceptable if the donor is:
  • A relative of the applicant; a relative can be a spouse, parent, stepparent, legal guardian, grandparent, brother, sister or child.
  • The applicant’s employer or labor union; a charitable organization;
  • A governmental agency or public entity that has a program to provide home ownership assistance to low and moderate income families or first time homebuyers;
  • A close friend with a clearly defined and documented interest in the applicant, evidenced by joint assets, joint debts, joint leases or other evidence as may be provided by the applicant,

A gift from any other source is considered an inducement to purchase and requires a dollar-for-dollar reduction to the sales price.

The gift must be documented with a gift letter that must include:
  • The relationship of the donor to the borrower.
  • The specific amount of the gift and the date the funds will be given to the borrower.
  • The donor’s name, address and telephone number.
  • The donor’s statement that no repayment is required.

In addition, the donor’s ability to give the gift and receipt of the funds by the borrower must be documented. If the funds have already been given to the borrower, the transfer transaction (the withdrawal from the donor’s account and the deposit to the borrower’s account) must be documented. Should the donor provide the gift at closing, a copy of the donor’s certified check and evidence of receipt by the settlement agent will be required.

The gift letter must contain language asserting that the funds given to the homebuyer were not made available to the donor from any person or entity with an interest in the sale of the property including the seller, real estate agent or broker, builder, loan officer, or any entity associated with them.

The loan file must document the transfer of the funds from the donor to the applicant. Acceptable procedures include:
  • If the gift funds are in the homebuyer’s account, the underwriter must document the transfer of the funds from the donor to the homebuyer by obtaining a copy of the canceled check or other withdrawal document showing the withdrawal is from the donor’s personal account, along with the homebuyer’s deposit slip or bank statement that shows the deposit; or
  • If the funds are not deposited to the applicant’s account prior to closing, obtain verification that the gift funds are received from the donor for the amount of the gift. Verification may be any of the following:
    • Cashiers check or Bank Check together with a copy of the donor’s withdrawal slip;
    • Certified check drawn on the donors account with evidence of withdrawal from donor’s account;
• Cash together with a copy of the donors withdrawal slip;
• Bank Receipts which indicate a wire of funds from the donors account to the applicant’s account or the closing agent’s account for benefit of the applicant.

Note: In all cases, the investors and the agency require evidence of the donor’s withdrawal or remittance of the gift funds.

If the donor borrowed the gift funds and, thus, cannot provide the documentation from his or her bank or other savings account, the donor must provide evidence that those funds were borrowed from an acceptable source, i.e. not from a party to the transaction including the mortgage lender. “Cash on hand” is not an acceptable source of the donor’s gift funds.

Subject to proper documentation, any gift funds that remain in the borrower’s account following loan closing, may be considered as cash reserves when scoring the mortgage application through TOTAL. However, there should not be any gift funds remaining if received from any non-profit agencies because all of these funds are to be applied to the downpayment.

If the applicants source of funds is a gift or grant from an employer, a municipality, nonprofit religious organization or nonprofit community organization, the loan file documentation must: provide a copy of the legal agreement that specifies the terms and conditions of the gift or grant. The legal agreement must:
• Establish that the funds are provided by the employer, municipality, or nonprofit;
• Establish that the organization has a formal gift program;
• Indicate that the funds are a gift or grant to the applicant that does not have to be repaid;
• Identify the donors mailing address’
• Include an indication of how the funds will be transferred.

Included in the mortgage file must be evidence of the transfer of the funds that clearly shows receipt of the specific check providing the donated funds, such evidence may be a copy of the donors canceled check or a settlement agent’s statement or HUD1. This requirement may be waived by automated approval. Refer to documentation matrix.

Examples of documentation that may be used include copies of the grant program materials, award letters, or terms and conditions provided to the applicant. The gift or grant should be shown on the closing statement.

503.15 – Gift of Equity

Only family members – defined as relatives in Section 503.14 may provide equity credit as a gift on a property being sold to other family members.

503.16 – Government Bonds

Government bonds should be valued at their purchase price unless the redemption value can be determined and verified. The actual receipt of funds must be documented.

503.17 – Grant

A grant is treated like a gift when considering it as funds to close. An acceptable donor may be a church, municipality or nonprofit (charitable) organization. An award letter on the agency’s letterhead must be provided that will:
• State the amount of the gift or grant;
• State no repayment is required;
• Establish that the organization has a formal gift (grant) program; and
• Specify how the funds will transfer.
At closing receipt of the grant must be documented by canceled check or the HUD-I clearly evidencing receipt of funds. A copy of the legal agreement specifying the terms and conditions of the grant must be obtained. Please be aware that grants which result in a lien against the property for recapture upon sale are considered “soft seconds” and are underwritten using secondary financing criteria.

An additional acceptable donor is a government agency or public entity which offers down payment assistance.

Grants or loans from state and federal agencies (e.g., Federal Emergency Management Agency (FEMA) that provide immediate housing assistance to individuals displaced due to natural disaster, may be used for the applicant's cash investment. Secured or unsecured disaster relief loans administered by the Small Business Administration (SBA) may also be used. However, if the SBA loan will be secured against the subject property, it must be clearly subordinate to the FHA insured mortgage. Any monthly payment arising from such a loan must be included in the qualifying ratios.

503.18 – Inheritance

Funds received through an inheritance may be treated as the applicant’s own funds. Receipt of funds should be evidenced by a letter from the executor of the estate or a copy of the will, plus a copy of the proceeds check.

503.19 – Lawsuit or Insurance Settlement

When an applicant anticipates receiving a lump sum settlement as the result of a lawsuit or insurance claim, the applicant must provide a copy of the settlement agreement, judgment, or letter from an attorney providing the amount of the applicant’s portion of the settlement. The receipt of funds must be documented with a copy of the settlement check and deposit slip. These funds are considered as the applicants own funds.

Funds already on deposit in the applicant's account must be supported by bank statements and evidence of settlement such as a settlement agreement, letter from the settlement attorney, claims statement, court order, etc.

503.20 – Relocation Benefits

Benefits provided by an applicant's employer to offset relocation expenses are considered acceptable funds for closing and will be treated as the applicant's own funds to meet minimum investment requirements. When an applicant will be using these funds to close, the following guidelines will apply:

- The property must be an owner occupied primary residence.
- The applicant must provide a copy of the relocation policy and evidence he or she is eligible for the stated benefits.
- The applicant must provide a copy of the request for funds anticipated for closing, and
- A copy of the check from the employer.

Relocation assistance in the form of a reimbursement from the employer, that is to be received after closing, will not be counted as available funds to close. The reimbursement funds may be given consideration when meeting reserve requirements.

503.21 – Relocation Equity Buyout

A corporation relocation buyout of an applicant's current home is acceptable when documented by sufficient evidence. Such evidence may include combinations of the following to the satisfaction of underwriting:

- Copy of executed relocation agreement;
- Fully executed offer to purchase, agreement with the applicant’s employer or a third party relocation company (TPRC);
- Evidence of an assigned sale with guaranteed purchase by the employer or TPRC should the assigned sale fail to close;
- Evidence of the equity advance received from the employer or TPRC; or
• HUD 1 or other closing statement as evidence of settlement between the applicant and the employer, TPRC or third party buyer.

503.22 – Rent Credit (Equity)

The cumulative amount of the rental payments that exceed the appraiser's estimate of fair market rent may be considered accumulation of the borrower's cash investment. The lease-with-option-to-purchase agreement along with copies of canceled checks for the past 12 months must be provided. Plus the appraiser's estimate of market rent must be included on the appraisal report. Both of these must also be included in the endorsement package.

Conversely, if the sales agreement reveals that the renter has been living in the property (or one owned by the seller) rent-free, or that an agreement was made allowing the renter to occupy at a rental amount considerably below fair market value in anticipation of eventual purchase of the property, this situation must be treated as an inducement to purchase with an appropriate reduction to the mortgage.

Exceptions may be granted in situations, such as when a builder fails to deliver a property at an agreed-to time and then permits the borrower to occupy that or another unit for less-than-market rent temporarily until construction is complete.

503.23 – Pension Plan

Typically an applicant does not have access to funds in pension plan. These accounts can be accessed only when the applicant quits or retires; therefore, pension plans are not considered as assets for closing or reserves.

503.24 – Salary Advance

A salary advance is not an acceptable source of funds.

503.25 – Sale of Assets

Documentation to support proceeds from the sale of an asset, including personal property, must be a valid Bill of Sale, receipt or settlement statement that clearly:

• Identifies the applicant as the seller of the property;
• Identifies the property which was sold;
• Show the net proceeds to the seller;
• Show the disposition of all liens against the property, if any;
• Is signed by the buyer and the seller, or their authorized agents.
• Provides the buyers name, address and telephone number

The loan file must provide written evidence to support liens paid in full or transferred to the purchaser of the asset.

Proceeds received from the sale of an applicant's assets, including personal property, will be acceptable as long as the applicant can provide:

• Evidence of ownership of the asset; i.e. copy of car title, insurance policy, appraisal, etc.
• Documentation which supports the value of the asset, such as published value or estimates or an appraisal by a qualified appraiser;
• Conclusive evidence the items have been sold and ownership transferred, such as a bill of sale or a statement from the purchaser; and
• Evidence of receipt of the purchase proceeds, such as a deposit slip or bank statement.

Only the lesser of the documented value or actual sales price may be considered as funds to dose. The item(s) in question must be sold to a party outside of the loan transaction.

Note: Evidence that the applicant owned the property being sold required. Further, the transaction must make sense, i.e., sufficient collateral sold obtain the net proceeds.
503.26 – Sale of Real Estate

Proceeds from the sale of real estate must be documented with:

- A copy of the fully executed settlement statement (HUD-1).
- The HUD-1 must be a certified copy of the final, fully executed document.
- The amount of net proceeds to the seller (who must be the same person as our applicant), must be of an adequate amount to close the loan and meet any cash reserve requirements when combined with the applicant’s verified assets.

503.27 – Sale of Real Estate – Joint Ownership

When an applicant is relying upon funds to close from the sale of jointly-owned property, and the co-owner of the property being sold is not an applicant on the loan, it is necessary to verify the applicant’s percentage of ownership and the resulting proceeds from that sale.

The proceeds from the sale of a jointly-owned property must be verified with a certified copy of the HUD-1 and a copy of the applicant’s proceeds check.

503.28 – Savings as a Source of Funds

The ability to accumulate savings reflects well upon the applicant’s ability to meet financial responsibility. An applicant with little or no savings history may have difficulty meeting future financial needs, especially where the proposed monthly housing expense will be increasing.

Funds saved for loan closing must be supported by periodic deposits as evidenced by bank statements or deposit slips. A 60 day history is required on all funds. If the applicant is taking funds from a non-depository account, account statements completing a 60 day history on those funds must be provided in addition to evidence of proceeds from that account.

Accumulated savings should be proportionate to the applicant’s stated income. Account statements should support an applicant’s assets as they relate to income.

When assets are disproportionate to the applicant’s income, the underwriter will be justified in requiring documentation and explanation of source of funds.

503.29 – Savings Bonds

Savings bonds must be valued at their purchase price unless the redemption value can be determined and verified.

When the bonds have not been redeemed at time of underwriting, the loan file must contain a list of bonds owned by the applicant, stating face value and serial number. An associate of NBMO or an official of the applicants bank must sign the list and certify they personally reviewed the bonds and the owner of the bonds is the applicant.

The actual receipt of funds from redemption of the bonds must be documented by use of the Bank issued 1099 or other official documentation.

503.30 – Stocks

The value of stocks may be verified by a current statement from the stockbroker or a photocopy of the stock certificate along with a dated newspaper stock list. The actual receipt of funds from the sale of stock must be documented.

503.31 – Sweat Equity
Sweat equity is defined as labor performed or materials furnished by the applicant before closing, on the property being purchased. This sweat equity may be considered as the equivalent of a cash investment to the extent of the estimated cost of the work or materials. Sweat equity may be gifted subject to both the gift requirements and the sweat equity requirements listed below:

- On existing construction, only the repairs or improvements listed on the appraisal or the conditional commitment are eligible for sweat equity. My work completed or materials provided before the appraisal is made are not eligible.
- On proposed construction, the sales contract must indicate the tasks to be performed by the home buyer during construction.
- The applicant’s labor may be considered as the equivalent of cash if the applicant can demonstrate his or her ability to complete the work in a satisfactory manner. The underwriter must be able to document the contributory value of the labor through either the appraiser’s estimate or through a cost estimating service.
- Delayed work (on site escrow), clean-up, debris removal, and other general maintenance cannot be included as sweat equity.
- Landscaping cannot be included as sweat equity.
- There can be no cash back to the applicant in these transactions.
- Sweat equity on a property other than the property being purchased is not acceptable. Compensation for work performed on other properties must be paid in cash, not equity and be properly documented.
- If materials are furnished by the applicant, evidence of the source of funds used to purchase and the market value of the materials must be provided.

Note: Direct Endorsement Underwriters have the authority to approve regional property differences. The underwriter must document the MCAW when sweat equity items approved for local FHA jurisdictions differ from those listed above.

503.32 – Tax Refunds

Many applicants rely heavily upon their tax refunds to have sufficient funds to close. The underwriter must determine if an applicant’s tax returns have been properly filed. If a potential tax liability is evident due to an incorrectly filed return, the tax refund will not be acceptable as a source of funds to close a loan. (An example of a filing error may be where married couples each file as “Head of Household”). To utilize tax refunds for closing, the following documentation will be required:

- Copy of the filed tax return together with any documentation reflecting an “EZ” or “Rapid” refund, signed and dated by applicant and
- A copy of the deposit slip or certified printout indicating deposit of the tax refund (source of funds documentation).

503.33 – Trade Equity

Trade Equity may be utilized when the property trade is between the borrower and a seller. The trade transaction file must contain:

- A current appraisal on the borrower’s property being traded; and
- An appraisal on the property being acquired; and
- A closing statement on the borrower’s property evidencing the net proceeds available.

The following applies to trade equity from the borrower(s) existing manufactured home.

- If owned 12 months or more, prior to the application date, 90% of the retail value based on the NADA manufactured housing appraisal guide, or
- If owned less than 12 months, prior to application date, the lesser of:
  - 90% of the retail value, or
  - The lowest price at which the manufactured home was sold during the 12 month period preceding the application date.
Note: Any costs resulting from the removal of the home or any outstanding indebtedness secured by liens on the home must be deducted from the maximum equity contribution. The trade equity must be documented by a lien search in the appropriate records to verify ownership and liens. The seller of the new manufactured home must provide proof of title transfer and satisfaction of liens on the traded home.

503.34 – Unsecured Loan

The proceeds of an unsecured loan are not an acceptable source of funds to close. Examples of unsecured loans include signature loans, lines of credit, cash advances on credit cards and overdraft protection on checking accounts. The underwriter must review the credit report for recently opened loans (within 90 days) as well as bank statements for monthly deposits which exceed take home pay as a possible indicator of cash advances against credit cards or other forms of loan proceeds.

Credit card charges, cash advances or unsecured line of credit

The amount charged by a Borrower on a credit card to pay fees associated with the Mortgage application, credit report and appraisal reports, or a cash advance taken by the Borrower on a revolving credit card account or an unsecured line of credit to pay these fees may be used as Borrower Funds if the following conditions are met:

The maximum amount charged or advanced may not exceed one percent of the Mortgage amount. While charges for the credit report and appraisal are not required to be included in the one percent limitation, the total amount charged by the Borrower on a credit card or taken as a cash advance for the credit report and appraisal may not exceed $500.00

The amount charged or advanced must be included in the Borrower's total outstanding debt and the repayment of such amount must be included when determining the Borrower's monthly debt payment-to-income ratio.

The Borrower has sufficient funds to pay these fees; however, the Borrower is not required to pay off these charges at closing

503.35 – Unverifiable Source of Funds

When the applicant is unable or unwilling to provide documentation supporting a satisfactory source of funds, the funds in question will not be acceptable for consideration when determining available funds for closing.

503.36 – Life Insurance Cash Value

Cash value on a life insurance policy may be used as the applicant’s assets for down payment and closing. The cash value life insurance verification must be provided and must meet the following:

- Must be a computer generated or typed statement from the insurance company (not handwritten).
- Must identify the life insurance company.
- Must identify the policy owner(s) (applicant).
- Must show the period covered and the ending cash value.
- Must show any outstanding loans.
CHAPTER 6 – APPRAISALS

SECTION 600.00 – PROPERTY AND APPRAISAL OVERVIEW

The Lender will extend first lien financing for the purpose of purchasing or refinancing one-to-four family residential real estate. The property must constitute an acceptable form of collateral for the requested mortgage. The security for the mortgage may be single family detached or attached, a townhouse or PUD, a condominium, or a two-to-four family dwelling.

Please refer to Product Summaries for specific product criteria. The information contained in the Product Summary will take precedence over the information found in the Credit Policy Manual.

On properties to be insured by either FHA, the FHA office with jurisdiction over the subject property may have local property criteria that differs from the information contained in this manual. The Regional Underwriting Department is responsible for being aware of these local differences and for indicating in the loan file the local policy that dictates an exception to any of the policies contained in this manual. For appraisal or property information not contained in this section, please contact your Regional Underwriting Center.

600.01 – Ineligible Properties

The following are the types of ineligible properties:

- Commercially Zoned Properties
- Condotels
- Cooperatives
- Houseboats
- Industrially Zoned Properties
- Multi-family Dwellings containing more than 4 units
- Properties rates in fair or poor condition without repairs to bring to average condition
- Properties subject to hazardous conditions
- Properties that do not have full utilities meeting all standard and local code.
- Properties utilized as a place of worship
- Tax Shelters
- Timeshares
- Unimproved Land
- Working Farms
- Properties in Lava Zones 1-3
- All properties under 600 square feet

If the appraisal indicates a “fair” or “poor” condition, the appraisal is unacceptable. The appraisal may be appraised with the condition as “average” and made subject to the repairs that will bring it to acceptable (“average” or “good”) condition. The appraiser must list necessary repairs. A final inspection will be required to be performed by the appraiser prior to funding.

600.02 – Types of Appraisals & Requirements

Building Sketch

For detached, 1 Unit properties, end Planned Unit Development (PUD) units and units in detached Condominium projects (site condominiums), the exterior sketch of the improvements must include the dimensions and calculations the appraiser used to determine the size of the subject property.

For Condominium Units and interior PUD units, an interior perimeter sketch is acceptable. Appraisers may rely on the dimensions and estimates for gross living area as shown on the plat or exhibits to the condominium or
PUD documents, or may provide legible photocopies of floor plans or individual unit plats that include the dimensions and calculations.

For 2-4 unit properties, the sketch must also include each unit’s layout and entries.

**Location Map**

The location map must locate the subject property and all comparable properties (including sale, rental, and listing comparables, as applicable). This map may be a photocopy of a printed street map showing the location of the subject property and comparable properties in the relation to major streets and influences such as parks and schools.

**Photographs of Comparable Sales**

One clear color or black and white photograph of the front of each comparable sale is required. Each photograph must be an original (produced by photography or electronic imaging) or facsimile, be appropriately identified, and be illustrative of the comparable sale. If an original photograph of a comparable sale cannot be obtained, a clear copy of the photograph of the comparable from a multiple listing service (MLS) is acceptable. The appraisal report must reasonably justify using the MLS source.

If black and white photographs of the comparables are used, the appraiser must note on the appraisal report any information that would have been evident in color photographs but is not apparent in black and white images and could adversely affect the market value or marketability of the mortgaged premises.

**600.03 – Appraisal and Inspection Report Forms**

**Form 70 – Uniform Residential Appraisal Report**

Form 70 is designed to report the results of an appraisal of a 1-unit property to include a unit in a PUD, a unit in a detached condominium project (site condominium) or a 1-unit property with an accessory unit. The form may not be used for an appraisal of a Manufactured Home or a unit in a condominium project. An interior and exterior inspection of the subject property is required.

**Form 70B – Manufactured Home Appraisal Report**

Form 70B – Manufactured Home Appraisal Report is designed to report an appraisal of a 1-unit Manufactured Home, including a Manufactured Home in a Planned Unit Development (PUD). A Manufactured Home located in a condominium project requires the appraiser to inspect the project and complete the project information section of the Form 465, Individual Condominium Unit Appraisal Report, and attach it as an addendum to form 70B. The Manufactured Home Appraisal Report is also designed to report an appraisal of a 1-unit Manufactured Home that is located in a cooperative project; however, mortgages secured by a cooperative are not eligible for sale.

**Form 72 – Small Residential Income Property Appraisal Report**

Form 72 is designed to report the appraisal results for a 2 to 4 unit property. An interior and exterior inspection of the subject property is required.

**Form 465 – Individual Condominium Unit Appraisal Report**

Form 465 is designed to report the results of an appraisal of a 1-unit property in a condominium project, excluding units in detached condominium projects (site condominiums). An interior and exterior inspection of the subject property is required.

**600.04 – HUD Form 92051 – Compliance / Repair Inspection Report**
For appraisal reports made subject to repairs, alterations, or conditions, or subject to completion in accordance with plans and specifications, the Seller must include a completion report in the mortgage file. The certificate must be dated before the delivery date of the mortgage, unless an escrow account has been established. The certification must:

- Be made after completion of the repairs, improvements, alterations, conditions or construction
- Clearly state that all conditions or requirements set forth in the original appraisal report of the mortgaged premises have been fulfilled.
- Be prepared and signed by the original appraiser, if available, or by another qualified appraiser.

600.05 – As Is Appraisals

Generally, an appraiser will issue the Uniform Residential Appraisal Report (URAR) indicating a property value that is based upon property in an “as is” condition. In most instances the “as is” appraisal will indicate no repairs; however, if the appraiser identifies items found to be in a below average condition, the underwriter must investigate the extent and/or impact of such conditions.

The underwriter must order such inspections, documentation or information as need to ascertain the full condition of the subject property. The underwriter will require appropriate action be taken to correct or repair any property conditions that pose a structural risk to the property or a health or safety hazard to the occupants.

SECTION 601.00 – UNIQUE PROPERTIES

Sometimes a unique property, such as a log home, an extra small home, lower than normal ceiling heights, etc., is submitted for FHA insuring. The eligibility of these properties depends on whether or not the property is structurally sound and readily marketable. If a property meets these criteria, the appraiser establishes market value. However, depending on the uniqueness of a property, the final determination to accept or reject the house is made by the lending institution’s underwriter.

Please refer to Handbook 4150.2, Section 4-4; or the HOC Reference Guide (1-17) for further info.

601.01 – Dome Homes

Dome homes are acceptable properties if located in an area with other similar types of construction and the property is homogenous with the neighborhood. The appraisal should indicate the property is in an area of proven marketability and the dwelling meets all standards for construction. The Appraiser must provide “like” comps.

601.02 – Earth Sheltered Homes

Earth sheltered homes are acceptable properties if located in an area with other similar types of construction and the property is homogenous with the neighborhood. The appraisal should indicate the property is in an area of proven marketability and the dwelling should be constructed to resist moisture and must meet all standards for construction. Earth sheltered homes are not acceptable in the following areas:

- Coastal areas where wind driven seas present a flood hazard;
- Any flood prone area; or
- Areas having high water tables.

601.03 – Leasehold Estates

- The term of the leasehold must extend at least ten years beyond the maturity date of the mortgage.
- Rental amounts may not increase during the first three years.
- The annual ground rent may not exceed the lesser of (1) 12% of the site value, or (2) the site value times the mortgage interest rate, less 2%.
Example: If the interest rate is 13% and the lot value is $10,000, the ground rent is limited to the lesser of:

- $10,000 XL 1% or $1,100 (mortgage interest rate less 2%)
- or $1,200 ($10,000x 12%)(standard 12%)

601.04 – Log Homes

Log homes are acceptable properties if located in an area with other similar types of construction and the property is homogenous with the neighborhood. The appraisal should indicate the property is in an area of proven marketability and the dwelling meets all standards for construction. The appraiser must provide a minimum of one log home comparable, preferably two.

601.05 – Manufactured Homes

A Manufactured Home must have the following characteristics:

- The Manufactured Home must be built on a permanent chassis in compliance with the National Manufactured Construction and Safety Standards Act by the Department of Housing and Urban Development (HUD)
- A “HUD Certification Label” must be permanently affixed to each transportable section of the Manufactured Home evidencing compliance with Federal Manufactured Home Construction and Safety Standards. If the certification label has been removed, compliance may be evidenced using the HUD data plate located near the main electrical panel or in another readily accessible and visible location. The HUD label number(s) appear on both the HUD data plate and the “certification label(s).”
- The Manufactured Home must be a 1-unit dwelling that is legally classified as real property.
- The stabilizing devices must comply with the manufacturer's design or a design by a licensed (registered) professional engineer. Stabilizing devices refer to all components of the anchoring assemblies, and any other equipment, materials, and methods of construction that support and secure the Manufactured Home to the ground.
- The Manufactured Home must be affixed to a permanent foundation for the site conditions, home design features, and the loads the home was designed to withstand in accordance with the manufacturer's instructions or a design by a licensed (registered) professional engineer. The foundation must meet all local, State or federal codes, as applicable.
- The Manufactured Home must be at least 12 feet wide and have a minimum of 600 square feet of gross living area.
- The manufactured Home must have been built on or after June 15, 1976.

A Manufactured Home must meet the following requirements:

- The Manufactured Home must be a 1-unit dwelling comprised of a multiple sections (a “multi-wide manufactured home”), “single-wide” is not allowed.
- The wheels, axels, and towing hitches must be removed from the manufactured home
- The Manufactured Home must be permanently attached to the land and the land must be owned by the borrower in fee simple, unless the Manufactured Home is located in a condominium project. A mortgage secured by a Manufactured Home located on a leasehold estate is not eligible.
- A multi-wide Manufactured Home may be located on an individual lot, in a sub-division, or PUD.
- The Manufactured Home must be permanently connected to a sewage disposal system such as a public sewer or a septic tank, and to other utilities that meet local, State and federal requirements.
- The mortgaged premises must conform to all applicable use restrictions and must be zoned for residential use, and not commercial or business uses.
- The square footage and room dimensions must be acceptable to typical purchasers in the market area.
- The Manufactured Home must be permanently attached to the site, connected to the utilities and any additional improvements, modifications or repairs that affect the habitability of the Manufactured Home must be completed.
- Any structural modifications to an existing Manufactured Home must be approved by a licensed professional engineer or the local, State or federal authority.

To be eligible for FHA financing:
• The unit must not have been installed or occupied previously at another location. Manufactured units may be moved only from the manufacturer's or dealer's lot to the site on which the unit will be insured. If a permanent foundation is to be constructed under an existing eligible unit, the unit may be jacked up in order to install a new foundation.
• The property must be classified and taxed as real estate.
• The finished grade beneath the home is at or above the 100-year flood elevation.
• A structural engineer must certify the foundation complies with the guidelines set forth in HUD Handbook, foundation system meets the soil conditions of the site; Foundations and footings are appropriate to the manufactured unit, the site and weather conditions of the area. This procedure does not apply when the current FHA borrower refinances their loan. It is applicable for all re-sales.
• If the current owner of a manufactured home has an engineer's certification that the permanent foundation meets HUD requirements, the lender may re-use the certification for a new buyer of the home, provided that there have been no alternations or additions to the home since the certification was issued by the engineer. The appraisal should note if any alterations or additions to the manufactured home have been made. FHA permits the engineer's certification to be re-used by a new buyer so that it will save the new buyer time and money in completing the transaction.
• An Engineer’s Certification on Foundation Compliance is not required on HUD/FHA Real Estate Owned (REO) Division sales where the borrower will secure FHA insured financing.

**Vinyl Skirting**

Section 3-4B5 of Handbook 4145.1 requires that a manufactured home have a properly enclosed crawl space with a continuous permanent foundation-type construction (similar to a conventionally built foundation, i.e., concrete, masonry or treated wood). The perimeter enclosure of the crawl space, if separate from supporting the foundation, must:

• Be designed to resist all forces to which it may be subject without transmitting to the building superstructure any movements or effects caused by frost heave, soil settlement (consolidation), or the shrinking or swelling of expansive soils;
• Be adequately secured to the perimeter of the unit to exclude entry of vermin and water; and
• Allow proper ventilation of the crawl space.

Non-structural vinyl skirting (the typical application in manufactured housing) does not meet the above requirements. However, a crawl space enclosure properly designed to meet the above requirements that uses vinyl siding as an exterior cover only, is acceptable.

**Other types of factory-built housing**

• Other types of factory-built housing not subject to the National Manufactured Construction and Safety Standards Act, such as modular or panelized housing are not included in the definition of Manufactured Homes. Mortgages secured by one of those types of factory-built housing are acceptable as long as property eligibility requirements are met.

A VA CRV on manufactured housing will be acceptable for FHA insuring unless the site is unacceptable to HUD or the property has been previously rejected by HUD.

Note: Confirm acceptability with local HUD office within jurisdiction.

**HUD Certification Labels/Tags and Data Plates**

All manufactured homes must have an affixed HUD certification label (tag) located on the outside of the home. If the home is a multi-wide unit, each unit must have a label. If for any reason the labels are missing, appraisers must REJECT the property and notify the lender. In some States a manufactured home may not be re-sold if missing a label.

HUD does not reissue labels for manufactured homes. However, HUD has authorized the Institute for Building Technology and Safety (IBTS) to issue letters of label verification for units for which it can locate the necessary information within its data base. Effective January 2007 a consumer may request a letter of label verification from
IBTS by visiting the IBTS website at http://www.ibts.org/label_req.htm and completing an online request form or submitting the request form via fax at: 703-437-6894.

The information needed by IBTS to issue a letter of label verification can be found on the above website and will generally appear on the data plate inside the home in one of three locations: on or near the main electrical panel, in a kitchen cabinet or in a bedroom closet. The data plate has a map of the United States to let the consumer know the Wind Zone and Snow Load for which their home was built. A manufactured home is eligible for FHA financing if the manufacturer's data plate is missing but not if the HUD Certification label is.

The processing time for IBTS is expected to be 3-5 business days and costs $50. URGENT requests are given the highest priority, and are completed within 24 -36 hours of request (1-2 business days). The cost of an URGENT request is $75. These costs are non-refundable if the home is not located in the IBTS database. You can also contact IBTS by calling 703-481-2012.

The data plate is different from the HUD Certification Label, also known as the HUD Seal or HUD Tag. The HUD Certification Label is affixed to the outside of the home near the tail light end of each transportable section of the home. To be eligible for FHA financing, each section of the home must have a HUD Certification Label.

601.06 – Mixed Use Property

The criteria for Mixed-Use Properties are as follows:

- The property must be a one-family property occupied by the applicant as a principal residence.
- The mixed use of the property must represent a legal, permissible use of property in accordance with local zoning requirements.
- The applicant must be both the owner and operator of the business.
- The property must be primarily residential in nature.
- The market value of the property must be based upon residential use and characteristics, rather than any business use or special business-use modifications that were made.
- The property must not require a significant expenditure to convert the property to use solely as a residence.

In addition to the criteria noted above, the nonresidential use must be subordinate to the property’s residential use and may not exceed 25% of the total floor area.

601.07 – Modular Homes

Modular homes are defined as factory built, off-site. Other descriptions include panelized, prefabricated or sectional housing. The factory built house is delivered to the subject property in sections. Upon delivery to the site, the sections are put together and the property takes an appearance and characteristics of a site-built residence. Modular housing must assume the characteristics of site built housing and comply with all local zoning and building codes. The appraiser should use similarly constructed properties as comparable; however, if sales are not available, the appraiser may use site built housing if an explanation is provided for why this was done, and adjustments are made to reflect any market preference for site built housing.

601.08 – Rural Property/ Excess Land

A rural area is defined as relating to the country or anything beyond suburban areas. It is not uncommon for a rural area to have residential properties with relatively large sites and one or more outbuildings. The rural area may have mixed-use properties, vacant buildings or agricultural use properties.

There is no limitation on the amount of acreage which may be financed on rural properties if similar comparable sales support the acreage as common for the area. However, excess land is unacceptable for inclusion in value. Excess land is defined as the area that exceeds the size of typical lots in the neighborhood AND is capable of a separate use. However, in small communities and outlying areas, appraisers must use different criteria because the market may accept a wide variance in lot sizes.
If the plot contains excess land, the appraiser should describe it but not value it. In this instance, the appraisal is based upon a hypothetical condition. A legal description of the portion being appraised is required. The lender will require that the excess land be excluded from the mortgage security.

For example, if the subject property has 10 acres, and the comparables have similar acreage, but are not limited to strictly residential use, then a market has not been demonstrated for residential property with the same amount of land as the subject. Refer to Handbook 4150.2 REV1, Section 4-4 and 4-5A2 if needed.

Zoning may be residential/agricultural. The residential use of the property must represent the “highest and best use” of the property.

The appraisal must indicate that the subject property maintains the characteristics of residential property, such as:

- Must be primarily residential;
- Must not be used for agricultural, farm, ranch or commercial use.
- Must be readily accessible by a roadway;
- Outbuildings are of minimal value to the overall property value;
- Must be serviced by adequate utilities.
- Must be available for year-round occupancy.

The underwriter’s knowledge of the area and comments provided by the appraiser will determine if the amount of land included in the transaction is typical for the area.

601.09 – Limited Access Properties (Flag Lots)

Unusual shaped lots, known as “Flag Lots” have limited access. Such lots usually have an easement created across other land to provide vehicular access to the property. The subject property, in a flag lot, has no portion of the property fronting onto a road.

The appraisal must address the site and view, and the impact on the property’s marketability and accessibility. The land value must be clearly justified. Unless marketability can be supported, the property will be ineligible for a mortgage.

601.10 – Manufactured Homes with Stick Built Additions

Additions or structural modifications may bring the original unit out of compliance with the HUD Manufactured Home Construction Safety Standards (MHCSS) and make the home ineligible for FHA financing. However, the lender can obtain an engineer's inspection report certifying that the structural changes or additions to the property were made in accordance with the MHCSS and the home will be eligible for FHA financing. The addition or modification shall be treated like a conventional stick-built home and should comply with the applicable building codes of the local jurisdiction and the MHCSS.

Some States require a state agency (often this is the State Administrative Agency) to approve all modifications to manufactured homes once they leave the factory. The appraiser and lender's underwriter are held responsible for knowing the local regulations on this. If the area where the manufactured home is located has such requirements, then the property must meet these requirements or it shall be deemed ineligible for FHA insurance.

601.11 – Seven Unit Limitation

Qualified investor entities are limited to a financial interest (i.e., any type of ownership, regardless of type of financing) in seven rental dwelling units, when the subject property is part of, adjacent to or contiguous to a property, subdivision or group of properties owned by the investor. Each dwelling unit in two-, three-, and four-family properties counts toward the seven-unit limitation. The rental units in an owner-occupied two-, three-, or four-unit property also count toward this limitation. The lender is responsible for assuring compliance with this regulation (see 24 CFR 203.42 for additional information). Waivers to the seven-unit limitation can only be initiated by the jurisdictional HOC for good cause.
For streamline refinances, an eligible investor that has a financial interest in more than seven rental units, as described in 24 CFR 203.42, may only refinance without appraisals.

601.12 – Shared Lots with Undivided Interests

With the exception of condominiums, properties with legal descriptions that read "an undivided 1/2 (or 1/3, or any other fraction) interest in and to Lot x or to a certain metes and bounds description" are **NOT** eligible for mortgage insurance because this indicates that the borrower shares joint ownership of the property with someone else and does not have the sole right to possess the property or mortgage it. If requested to do an appraisal on a property with this kind of legal description, the appraiser should **REJECT** the property as the lot is not considered a Fee Simple entity.

601.13 – Heavy Traffic Areas

Property location on streets having heavy or fast traffic lessens desirability because of noise and danger and often affect's the value. Sites backing to freeways or other thoroughfares which are heavily screened or where traffic is well below grade and sufficient distance from the property may not be adversely affected. If the appraiser feels that there is sufficient noise to affect the marketability of the property, it should be rejected and a clear explanation provided. Distance alone is not sufficient to reject the property.

**SECTION 602.00 – THE APPRAISER**

The Lender relies upon qualified real estate appraisers to provide an estimate of the fair market value of the subject property based upon research of current market data for use by the underwriter in making a risk decision. The Lender does not have an Approved Appraisers List, however does have a published Exclusionary List that must be checked for each file underwritten that requires an appraisal.

602.01 – FHA Appraisers

The Lender will use FHA appraisers from the HUD Lender Selection Roster who have a current license/certification and a current HUD Lender Selection Roster number and have not been placed on restricted use.

When a loan file has been transferred from another lender, the DE underwriter must underwrite the unexpired appraisal; verify that the appraiser’s license/certification and CHUMS number are current before issuing the DE Statement of Appraised Value. If the transferred appraisal includes a DE Statement of Appraised Value issued by the previous lender, the DE underwriter must still review the appraisal and concur with the value. The DE Statement of Appraised Value must be signed by the DE underwriter.

The DE Statement of Appraised Value may be signed by one DE underwriter, while the credit package may be signed by a different underwriter. FHA CHUMS will recognize the DE Underwriter signing off on the credit package as the DE Underwriter of record on the loan.

Underwriters must be aware of any unacceptable performance by appraisers and provide such information to the Regional Underwriting Manager or to Credit Policy Department.

Documentation of the specific violation of the regulations and/or policies of the FHA will be required. The Regional Underwriting Manager, Senior Credit Policy Officer, Quality Control Manager, FHLMC and FNMA will review the documentation and determine the appropriate course of action.

602.02 – Responsibilities of the Appraiser

The Lender’s approved appraisers are expected to provide complete and accurate appraisals in a prompt fashion. Appraisers of FHA properties are expected to provide complete and accurate appraisals and to prepare such appraisals in the manner dictated by the policies and regulations of the specific government agency. The
appraiser must never work in cooperation with others to arrive at a requested value. When completing an appraisal, the appraiser must:

- Prepare the appraisal using the Uniform Standards of Professional Appraisal Practice;
- Prepare an objective and unbiased appraisal report;
- Obtain and utilize complete and accurate data by thoroughly researching the market using reliable independent data sources to locate recent, similar sales which provide a true indication of the subject’s market value;
- Personally inspect the interior and exterior of the subject property as well as the exteriors of the comparable sales;
- Consider any market forces, economic trends, or environmental hazards on the subject’s site, or in the vicinity, and note these factors on the appraisal.
- Note conditions that potentially influence or affect the value or marketability of the subject property; and
- Adjust the value of the comparable sales to accurately reflect the differences in the market place for the differences between the subject and the comparable sales.

602.03 – Unacceptable Appraisal Practices

It is the responsibility of The Lender to deliver loans to our investors containing appraisals which evidence a sound investment; it is therefore, The Lender’s responsibility to monitor the quality of these appraisals to ensure the appraisers who provide appraisal services to The Lender do not engage in unacceptable appraisal practices. Unacceptable appraisal practices include:

- Failure to adhere to fair lending practices in the appraisal process;
- Failure to comment on adverse negative factors with respect to the neighborhood, subject property, or proximity of the subject property to adverse influences;
- Inclusion of inaccurate or incomplete data about the subject neighborhood, site, improvements or comparable sales;
- Use of comparable sales when the appraiser did not inspect the exterior of the property, at the very least, by completing a drive-by inspection;
- Failure to use comparable sales that are the most similar available sales compared to the subject property in terms of location, age, design, size, and amenities;
- Use of data, especially comparable sales data, that was provided by parties with a financial interest in the sale or financing of the property without confirmation by a disinterested third party;
- Failure to make adjustments when the market clearly indicates a reaction to a difference between the subject property and the comparable, or using excessive adjustments which do not reflect the market reaction to the differences;
- Reaching a value conclusion which is not supported by available market data;
- Development of a value based upon sex, color, race, religion, handicap, national origin, or familial status of either the prospective owners, occupants of the property or the present owners, or occupants of properties in the vicinity of the subject property or that is based on any other factor that local, state, or federal law designates as being discriminatory;
- Use of unsupported assumptions, personal opinions or perceptions about market forces or other factors that may or may not affect the use or value of the property;
- Failure to apply the same appraisal standards to those properties sold under an affordable housing program or located in areas undergoing rehabilitation;
- Failure to review required documentation including but not limited to sales contract, plans, specifications, or property inspection before determining appraised value;
- Failure to comply with all HUD requirements when appraising property for an FHA insured loan.

SECTION 603.00 – APPRAISAL REQUESTS AND DOCUMENTATION

The appraisal is critical to the lending process. The lender does not see the property which will serve as the collateral for the mortgage, therefore, the underwriter must rely completely upon the appraisal as a means of evaluating risk. It is essential the underwriter be able to interpret the facts and observations provided by the appraiser in order to make an informed decision on the loan.
603.01 – Converting a VA Appraisal to FHA

VA appraisals may be converted to FHA once a VA Certificate of Reasonable Value (CRV) or Master Certificate of Reasonable Value (MCRV) has been issued except when:

- The property has an outstanding FHA case number;
- The property or site are known to be unacceptable (i.e., periodic flooding, PUD or Condo not approved, etc.);
- Property or site were previously rejected by HUD;
- The VA CRV expired before execution of the FHA contract;
- The case is processed DE and the property does not qualify as proposed construction; or
- Property is a unit in a condo project which does not meet HUD criteria.

When converting a CRV or MCRV on proposed construction or an existing dwelling less than one year old, HUD’s requirements regarding new construction will apply. The builder must complete the Builders Certification of Plans, Specifications, & Site to ensure the site complies with FHA’s standards.

When converting a MCRV, the file must contain a copy of the actual appraisal report to see whether the property was proposed or existing construction at the time the appraisal was completed to determine if the property is eligible for a high ratio loan. The final inspection, if required, will be performed by the VA Compliance Inspector.

The DE underwriter is responsible for determining whether the property is eligible for FHA financing and for reviewing the appraisal and resolving any concerns about the value of the property.

In order to convert a LAPP Notice of Value to an FHA appraisal, FHA requires that the NOV must be sent to VA for review and issuance of a CRV, before requesting conversion.

Note: The local FHA office, in your area, may have other criteria. Please check with your Regional Underwriting Department.

603.02 – Appraisal Extension / Reuse

Reuse. Appraisals cannot be reused after the mortgage for which the appraisal was ordered has closed. For example, an appraisal used for the purchase of a property cannot be used again for a subsequent refinance, even if six months has not passed. A new appraisal is required for each refinance transaction requiring an appraisal.

Extensions. If a borrower signs a valid sales contract or is approved for a loan prior to the expiration date of the appraisal, the term of the appraisal may be extended, at the option of the lender, for 30 days to allow for the approval of the borrower and closing of the loan. Approval of the borrower occurs when the lender’s DE underwriter signs the Mortgage Credit Analysis Worksheet, Form HUD-92900-WS/92900-PUR.

603.03 – Appraisal Expiration Dates

Term. The appraisal has a term of six months for existing construction and 12 months for proposed construction. However, if the appropriate HOC determines that soft market conditions exist in certain areas or markets, it may shorten the term of appraisals for proposed construction and substantial rehabilitation to a period of less than 12 months upon advance notice to lenders. The term of the appraisal begins on the day the home is inspected by the FHA appraiser and this date appears on the URAR.

603.04 – Statement of Limiting Conditions

The appraiser may not make any changes, deletions, or additions to this form. An executed copy of this form must be attached to each individual appraisal. Additionally, the appraiser must check the box in the Reconciliation section on page 2 of the URAR, and indicate the date of the current 1004B which is attached.

603.05 – Required Appraisal Documents
The type of financing and the number of units dictate the appropriate appraisal forms and required supporting exhibits for completion by the appraiser.

603.06 – Owner of Record

Effective for mortgage applications taken on or after May 1, 2005, when a new appraisal is required, the Seller must verify:

For Purchase Transactions:

- The property seller listed on the sales contract is the Owner of Record of the subject property, or
- If the transaction involves the sale of land separate from the dwelling, the property seller listed on the sales contract for the land is the Owner of Record for the land.

For Refinance Transactions:

- The Borrower is an Owner of Record of the subject property

603.07 – Electronic Imaging/Appraisal Software

Appraisers are permitted to use computer software programs which are designed to reproduce the URAR, including those programs which have the capability of expanding areas of the form set aside for narrative comments. Any expansion may not result in the Sales Comparison Analysis being separated so that it appears on two pages. The sequence of information may not change from that which appears in the preprinted forms.

Electronic signatures will be acceptable. The appraiser must be responsible for the security measures taken to insure that no misuse of the electronic signature occurs. When a PDF file or email, appraisal is used in conjunction with underwriting paperless files the underwriter must upload the appraisal to attach to the Loan Queue file.

603.08 – Photographs

Photographs of the subject property and the comparable sales must provide a clear image of the completed improvements. The photos must be originals which are produced either by photography or electronic imaging.

When the appraiser is not able to provide a clear photo of a comparable sale, the appraiser should provide a copy of the photo from the multiple listing services (MLS), if available, in addition to the actual photograph to assist the underwriter in assessing the similarity of the properties. An example where this would apply is when a comp is a rural property which has considerable acreage and a wooded lot, making it impossible for the appraiser to get a better picture without trespassing. The appraiser must also provide an explanation why the picture from the multiple listing services was used.

603.09 – Inspections Required By Underwriter

Underwriters may require, as a condition of approval, a property inspection as deemed appropriate by the underwriters including but not limited to an inspection from an appraiser, pest company, engineer, or other inspector such as roofer, electrician, etc. If the requirement for an inspection or certification is the result of a recent event, such as a roof inspection required as a result of a hurricane or hail storm, the inspection or certification must occur and be dated after the event. The underwriter must be made aware of any potential need for repairs, such as property damage found as a result of any required inspection.

The underwriter required inspections must be no more than 90 days old at time of loan funding. If any inspection report is over 90 days old, the closer must confer with underwriting to resolve the situation. Closers are accountable for the review of appraisal conditions, inspections, certifications and purchase contracts for any repair items. The closer is responsible for assuring that no loan is funded until all repair conditions,
including new or additional repairs discovered as a result of underwriter conditions or/and required inspections have been completed and reviewed.

### 603.10 – Inspections for New Construction

A satisfactory final inspection is required when the appraisal is subject to repairs or completion per plans and specifications. Photographs are required when, at the time of original appraisal, the home was not substantially complete to show completed as originally appraised. The original appraiser should complete this inspection.

Any Compliance Inspection Report that is checked under Item 16. That indicates a “submit or resubmit incomplete items as noted above”, is not a clear inspection.

The loan may not close until the outstanding appraisal conditions are met. Some incomplete items may be available in the loan file that the appraiser does not see, such as a satisfactory termite/pest inspection or evidence the applicant has received the lead paint notice. If the required items are contained in the loan file, the DE underwriter must countersign and date the inspection report and the loan may close and fund. All other conditions must be met unless an escrow has been established for incomplete weather related items.

### 603.11 – Repairs

Photos are not typically required for repairs unless the physical appearance of the property is altered. The completion certificate must be dated after completion of the work and prior to loan closing unless an approved escrow has been established. It must clearly state that all repairs (conditions of the appraisal) have been satisfactorily completed, in a workmanlike manner. The repair inspection must be signed by the original appraiser.

In the performance of an FHA appraisal, the appraiser is to note those repairs necessary to make the property comply with FHA’s Minimum Property Requirements (MPR) or Minimum Property Standards (MPS) together with the estimated cost to cure. The lender will determine which repairs for existing property must be made for the property to be eligible for FHA-insured financing.

Cosmetic repairs are not required; however they are to be considered in the overall condition rating and valuation of the property. Examples of cosmetic repairs would include surface treatments, beautification or adornment not required for the preservation of the property. For example; worn floor finishes or carpeting, holes in window screens, or a small crack in a windowpane are examples of deferred maintenance that do not rise to the level of a required repair but must be reported by the appraiser.

Required repairs will be limited to necessary requirements to:

- protect the health and safety of the occupants (Safety)
- protect the security of the property (Security)
- correct physical deficiencies or conditions affecting structural integrity (Soundness)

A property with defective conditions is unacceptable until the defects or conditions have been remedied and the probability of further damage eliminated. Defective conditions include:

- defective construction
- other readily observable conditions that impair the safety, sanitation or structural soundness of the dwelling

Typical conditions that would require further inspection or testing by qualified individuals or entities include, but are not limited to:

- infestation – evidence of termites
- inoperative or inadequate plumbing, heating or electrical systems
- structural failure in framing members
- leaking or worn-out roofs
• cracked masonry or foundation damage, and
• drainage problems

SECTION 603.12 – LENDER CERTIFIED REPARIS

When The Lender is required to certify repairs (per the appraisal), an on-site inspection must be made by the Account Executive, Branch Manager or other designated employee or other responsible party. Photographs must be made of the repaired site and placed in loan file with a written, signed and dated report itemizing each repair item inspected and approved. The name and signature of the associate making the inspection must be legible.

SECTION 604.00 – APPRAISAL AND PROPERTY STANDARDS

The appraiser is responsible for determining the condition and value of the subject property. The appraiser and underwriter are responsible for the review of the property to assure The Lender that the property criteria of the investor or insuring agency are met. FHA is specific about the minimum property standards.

The underwriter must confirm the appraisal’s support of value and obtain, if necessary, additional comparables or explanations, or whatever may be necessary to establish a fair market value. Just because an appraiser has provided an explanation does not mean it automatically makes the issue acceptable. The underwriter must evaluate the appraiser’s explanation in terms of risk. Explanations must make sense and provide justification for the appraiser’s conclusions. If the loan is foreclosed upon, sale of the property is the means of recouping any loss, so the value must be supported and the property must be marketable.

The Lender requires properties to be safe, sound and sanitary. Any deficiencies noted by the appraiser which affect these basic requirements must be corrected.

For items not mentioned within this Credit Policy, refer to FHA Handbook 4150.1 or 4150.2.

For all FHA appraisals, the appraiser must clearly indicate the subject property conforms to applicable minimum FHA property standards as set forth in HUD Handbooks (existing properties) or (proposed or new construction). The appraiser is to make this certification on the back side of the URAR, in the top right hand corner, under “Comments on Cost Approach”. This statement must be Included on the appraisal before the underwriter can issue the Conditional Commitment (form HUD 92800-5b).

The minimum requirements that must be met for all dwellings:

• A continuing supply of safe, potable water.
• Sanitary facilities and a safe method of sewage disposal.
• Connection must be made to public or community water or sewage disposal system whenever feasible.
• Heating adequate for health and comfort (unless the local field office has determined the climate does not justify mechanical heating).
• Domestic hot water.
• Electricity for lighting and equipment.
• Utilities must be separate for each property. Each unit must be equipped with separate utility shut-off.
• Vehicular access to the property by means of an all weather road (public or private).
• Access to the living unit must be provided without passing through another unit plus there must be access to the rear yard.

SECTION 604.01 – APPRAISAL DESCRIPTION, ANALYSIS AND ADJUSTMENTS

The appraisal report must be completed in a manner that correctly depicts or describes the neighborhood, site and improvements. The following sections correspond to Form 70, URAR, but all of the requirements and guidelines also apply to the other appraisal report forms unless otherwise stated in this section.

Subject Section
FHA Credit Policy Manual

- This section of the report must clearly identify the subject property by providing a complete property address and legal description. If a legal description is lengthy, the appraiser may attach it as an addendum to the report.
- Identify the “property rights appraised” as either a fee simple or leasehold.
- The appraiser must complete the section, including the data sources used to verify the listing and sale price information.

Contract Section

- The sales price, contract date and loan charges paid by the property seller, or the financing and sales concessions made by the property seller, must be stated in the sales contract. The mortgage originator must provide the complete contract for sale for the subject property to the appraiser with each appraisal request. The appraiser must have the necessary and appropriate data sources for the area in which the subject property is located. If the appraiser cannot obtain the complete contract for sale for the subject property and all information needed to perform the analysis, the appraiser should decline the appraisal assignment.
- The appraiser must analyze and report his or her conclusions on any current contract for sale for the subject property, any offerings or listing for sale for the subject property as of the effective date of the appraisal, and, if such information is available in the normal course of business, the sales history of the subject property and comparable sales.

Neighborhood Section

- The neighborhood section of the report must contain an accurate description of the subject neighborhood and the factors that influence market value and marketability in the neighborhood. The information presented in the neighborhood section must be consistent with, and support, the conclusions reached by the appraiser throughout the appraisal report. For example, if the subject property is a residential mixed-use property, such as a storefront, then neighborhood analysis must demonstrate that the neighborhood is primarily residential and that storefront/mixed-use properties are acceptable residences in the neighborhood.
- Unfavorable factors revealed in the neighborhood section require the appraiser to address the impact of those factors on value and marketability. If the appraisal report demonstrates that there is a viable market for housing in the neighborhood or that the neighborhood is undergoing revitalization, the unfavorable factors do not necessarily make the mortgage ineligible for sale.
- An appraiser may use a block-by-block analysis in neighborhoods that have undergone significant deterioration or abandonment in the past, but are now undergoing an evident revitalization effort, to demonstrate that there is a viable market for housing. In this analysis, the appraiser should describe the extent of revitalization efforts under way, the demand evidenced for renovated housing and the boundaries of the revitalized area being used as the subject neighborhood. This analysis must be consistent with the data presented and support the conclusions reached by the appraiser throughout the report.
- If the appraiser has selected comparables from a competing neighborhood, the appraiser must identify the competing neighborhood in this section or an appropriate addendum and describe why it is comparable to the subject neighborhood. The appraiser should explain why the competing neighborhood is a more relevant source of comparables than the subject neighborhood, as of the effective date of the appraisal.
- The appraiser must certify that the estimate of market value in the appraisal report is not based on the race, color, sex, handicap, familiar status, religion or national origin of:
  o Prospective owners or occupants of the subject property, or
  o Present owners or occupants of the properties in the vicinity of the subject property
- In addition, the appraisal must not improperly take into consideration the:
  o Property modifications made to accommodate handicapped persons
  o Age or location of a dwelling, or
  o Age of the neighborhood or census tract where the dwelling is located
- No mortgage will be accepted that is supported by an appraisal report that makes reference to the race, color, religion or national origin of any person, or the age or racial composition of the neighborhood.

Site Section

Property characteristics – This section must accurately describe the physical characteristics of the site, site improvements and available utilities, and must fully analyze any locational factors affecting the site.
- Zoning – the appraisal report must accurately state:
o The zoning classification (if classified), and
o Whether the use of the subject property complies with the reported classification
o The use of the mortgage premises must conform to applicable zoning and use restrictions and enable the mortgage to qualify as a home mortgage. The Lender may purchase a home mortgage secured by property that does not conform to applicable zoning and use restrictions, if the property is a legal use (commonly referred to as legal nonconforming use). The appraiser must comment on any adverse effect of any nonconforming use when estimating the market value and marketability of the property.
o Zoning requirements cannot be the basis for classifying a project as a Planned Unit Development (PUD) or condominium project.

- Utilities
  o The utilities serving the subject property must meet community standards. In addition, the comparable sales should have utilities similar to the subject property. When differences in utilities exist between the subject property and the comparable sales, any adjustments or lack of adjustments made to the comparable sales for significant differences must be explained in the comments area or on an attached addendum. In addition, the appraisal report must evaluate the effect these differences have on the subject property’s value or marketability.

- Streets
  o The subject property must have legally appropriate ingress and egress. The streets serving the subject property must be maintained in a manner that generally meets community standards. In addition, the comparable sales should have street maintenance similar to the subject property. When differences exist between the ownership or maintenance of the subject property’s streets and the comparable sale’s streets, adjustments or lack of adjustments made to the comparable sales for the differences must be explained in the comments area or on an attached addendum. In addition, the appraisal report must evaluate the effect these differences have on the subject property’s value or marketability.

- Additional Parcels
  o When the subject property includes two or more adjoining parcels of real estate, the site description must accurately describe the land and any improvements included in each of the parcels. In addition, the comparable sales should have adjoining parcels similar to the subject property. When differences in sites exist between the subject property and the comparable sales, any adjustments or lack of adjustments made to the comparable sales for significant differences must be explained in the comments area or on an attached addendum. In addition, the appraisal report must explain the effect these differences have on the subject property’s value or marketability.

- Flood Hazard
  o The appraisal report must indicate whether the dwelling on the subject property lies within a “Special Flood Hazard Area” (SFHA) as identified by the Federal Emergency Management Agency (FEMA) through the National Flood Insurance Program (NFIP).
  o The flood zone, flood map number and map date must also be stated.
  o The appraiser need not complete this section if the flood zone is determined by another party, such as a non-appraiser on the staff of the Seller, a surveyor or a specialized flood zone determination company. If the flood zone determination is not made by an appraiser, the resulting flood zone documentation must contain at least the flood hazard information required in the appraisal report and must be attached to the appraisal report.
  o The seller warrants that any flood zone determination made on or after June 1, 1995, by a party other than the seller is guaranteed by the flood zone determination maker to be accurate, in accordance with federal law. The seller, however, remains responsible for the accuracy of any flood zone determination made by the seller or a party other than the seller.
  o Any flood zone determination made by any party on or after January 2, 1996, must be documented by a completed FEMA Standard Flood Hazard Determination, FEMA Form 81-93, in accordance with federal law. The SFHDF may be used in printed, computerized or electronic format. If an electronic format is used, the exact format and layout of the SFHDF are not required, but all fields and elements not identified as optional on the SFHDF are required.

Impact of Contaminated Sites, Hazardous Substances and other adverse conditions
The appraiser must consider any known Contaminated Sites or Hazardous Substances that affect the property or the neighborhood in which the property is located. The appraiser must also note the presence of contaminated Sites or Hazardous substances in the appraisal report, make appropriate adjustments to reflect any impact on market value and comment on the effect they have on the marketability of the subject property.

Examples of matters about which the appraiser must note and comment include but are not limited to:
- Any presence of asbestos, urea-formaldehyde or any similar insulation in the dwelling
- Proximity of the property and/or its neighborhood to a contaminated site
- Proximity of the property to ground water contamination, chemical or petroleum spills or other hazardous substances that are expected to impact the area for more than one year
- Proximity of the property to areas that may affect the value or marketability of the property including, but not limited to, the following:
  - Industrial sites
  - Waste or water treatment facilities
  - Commercial establishments (other than retail establishments that serve the residential neighborhood)
  - Airport approach paths
  - Floodplains
  - Landslide areas

**Improvements Section**

- The appraisal report must contain an accurate description of the improvements and any factors that may affect the market value or marketability of the subject property.
- An unusual floor plan, such as a home with tandem bedrooms or a bathroom off the kitchen, does not make a property ineligible for financing. The appraiser should address whether an unusual floor plan or similar obsolescence is also found in other properties in the neighborhood, and to the extent possible, comparables used should also have similar obsolescence in order to demonstrate marketability and support value.
- A 1-unit detached property may have an incidental accessory unit that is incidental to the overall value and appearance of the subject property. Examples of such properties include a dwelling with a unit above a detached garage, a dwelling with a guest apartment, or a detached PUD with a basement unit. The appraiser must describe the accessory unit, and analyze any effect on the value or marketability of the subject property.
- When the subject property does not conform to its neighborhood in terms of type, design, age, and the materials and techniques used in its construction, the appraiser must evaluate the effect the nonconformance has on the property’s value and marketability. The appraisal must not improperly take into consideration the age of the dwelling.
- Other requirements and conditions relating to the improvements are the following:
  - The property must be habitable as a year-round residence
  - The appraiser must note if the subject property is dissimilar to competing properties in the neighborhood and address the impact on marketability

**Sales Comparison Approach**

- The sales comparison approach is considered to be the most reliable approach to value. Therefore, a Seller must place primary emphasis on this approach when reviewing and judging the acceptability of each appraisal report.
- Each comparable sale must be analyzed for similarities and differences between it and the subject property. The appraiser must make appropriate adjustments for differences, and indicate the dollar amount of the adjustments to reflect the value of the differences to the market. Comparable sales must be adjusted to the subject property, except for sales and financing concessions that must be adjusted to the market at the time of the sale.
- The appraiser should try to select at least two comparable properties that bracket the subject property in terms of identifiable characteristics; the third comparable should be similar to that of the subject property. Through the adjustment process, the superior comparable adjusts downward to the subject property and the inferior comparable adjusts upward. The comparable property most similar (of the three comparables) to the subject property required few, if any, adjustments. In choosing comparable for bracketing purposes, the appraiser should select properties that best support the subject property as its final market value.
• The appraiser must analyze pending and recent sales of comparable properties. At least three verified, closed (settled) sales of comparable properties must be analyzed with adjustments made for significant differences between the comparable sales and the subject property.

• The three comparable sales listed in the report must be:
  o Similar to and located near the subject property
  o Properties whose closing (settlement) occurred before the effective date of the appraisal of the subject property
  o Recently sold. No sales over one year old are permitted except as “additional comparable sales” and would be identified as comparable sale(s) 4, 5 or 6. Properties under contract may be also be submitted as additional comparable sales 4, 5 or 6 to support trends or value conclusions observed.
  o Additional comparables, in the form of closed sales, sales under contract or current listings, may be used to support the appraiser’s adjustments and conclusions, address change in the market, support the use of older comparables in stable neighborhoods or support the use of distant or less similar comparables in rural areas.

• Additional comparables are not always needed, but may contribute significantly to understanding unusual situations, such as limited markets, neighborhoods with little turnover of property and areas with a variety of distinct property types. For example, if the subject property is mixed-use, such as a storefront residence, then additional comparable sales may be needed to support the appraiser’s conclusion that the property use is primarily residential, the value is based on residential use and there is a ready acceptance of such properties as residences.

• Comparables may be taken from a competing neighborhood if:
  o The appraiser has established that the neighborhoods are comparable and compete for the same buyers, and
  o Comparables taken from the competing neighborhood are better indicators of current market trends in the subject neighborhood than the existing comparables available in the subject neighborhood.

• For properties located in existing established subdivisions, PUD’s or ground lease communities and for unit in existing Condominium Projects, the appraisal report may use three comparable sales from within that subject project or subdivision. However, if the subject property is in a controlled market (such as a new subdivision or project, a newly-converted project or an area where the property seller owns a substantial number of units), at least one comparable sale must be outside the influence of the developer, builder or property seller. Resales from within the subject project or subdivision may be used to meet this requirement. When comparable sales from outside the subject project or subdivision are used, they must also be outside the influence of the subject property’s developer, builder or property seller.

Sale and Listing history

• The appraiser must research, verify, analyze and report:
  o Any current agreement for sale for the subject property
  o Any offerings for sale of the subject property in the twelve months prior to the effective date of the appraisal
  o Any prior sales or transfers of the subject property for the three years prior to the effective date of the appraisal
  o Any prior sales or transfers of each comparable sale for the year prior to the date of sale of each comparable sale

• The Seller’s review of the acceptability of each appraisal report should include an analysis of the sale and listing history. The Seller must confirm that the sale price trend in relation to the appraiser’s estimate of value is reasonable and representative of the market.

• For purchase transactions, the Seller should analyze the appraisal report and the current contract for sale for the subject property

• For both purchase and refinance transactions, the Seller’s underwriting analysis of the appraisal report should include any current listing or offering for sale for the subject property, the sales history of the subject property and comparable sales, and the current ownership of the subject property

• To reduce the Seller’s risk of liability resulting from fraudulent or inaccurate appraisal reports, the Seller should analyze the subject property and comparable sales and evaluate the time elapsed between the date(s) the property was acquired and the date(s) resold, or the date of the current resale contract, if applicable. If the sales history of the subject property or comparable sales indicates current or prior sale prices may be
excessive, and resale dates occurred shortly after the property seller’s acquisition of the property, the appraisal report should provide evidence to support a rapidly appreciating real estate market, significant improvements that resulted in a corresponding increase in the property value or a previous sale that was below market value due to a distress or tax sale.

Reconciliation
- The data and information presented in the appraisal report must support the appraiser’s estimate of market value. The appraiser must explain how the final value conclusion was determined, and the rationale must be consistent with the comments, conclusions and assumptions stated throughout the appraisal report.
- The reconciliation must contain any conditions of the appraisal on which the final estimate of value is based.

Comments section
- Any additional features; necessary repairs or modernization; or physical, functional or external inadequacies must be reported in the "comments" sections of the appraisal report or detailed in the addenda to the appraisal report.
- Repairs that affect the safety, structural integrity, mechanical systems or habitability of the improvements must be repaired. Cosmetic repairs, those that do not affect the safety, structural integrity, mechanical systems or habitability need not be repaired as long as:
  - The appraiser has made any necessary adjustments to the comparables
  - The appraisal is not made subject to repairs and
  - The appraiser has addressed whether the condition affects the value or marketability of the property
- Examples of cosmetic repairs include: worn floor coverings, minor cracks in windows, minor holes in interior walls or interior doors, etc.
- If the appraiser notes that additions or alterations were made without required permits, the appraisal report should also contain comments on the quality and appearance of the work. In addition, the appraiser should note special energy-efficient items and adverse environmental conditions.
- If the property has been modified to accommodate mixed use, the appraiser should address whether the modifications affect the property’s marketability as a residence and whether the cost to restore the property to solely residential use will affect its value.

Cost approach
- The cost approach for appraisals of Manufactured Homes is only required when the Manufactured Home is new construction. It is not required for appraisals of attached PUD or Condominium Units.
- The Seller may request the appraiser to develop and report the cost approach to value when not required for the transaction. The appraiser must develop and report the result of any approach to value that is applicable and necessary for an appraisal report, even if the Seller did not request it. The approach may be appropriate especially when appraising properties that are:
  - New or proposed construction
  - Under renovation
  - Unique because of their styles or construction methods, or
  - Have functional obsolescence not typical for the market
- When the cost approach to value is developed, the appraiser must make proper adjustments for any items detrimental to stability or marketability, such as physical, functional and external depreciation that are not typical for the market.
- Appraisal reports that rely primarily on the cost or income approaches to value in order to estimate market value are unacceptable.

Income approach
- The income approach to value is required for appraisals of 2- to 4-unit properties. The Seller may request the appraiser to develop and report the income approach to value when not required for the transaction. The appraiser must develop and report the result of any approach to value that is applicable and necessary for an appraisal report, even if the Seller did not request it.
- Appraisal reports that rely primarily on the income or cost approaches to value in order to estimate market value are unacceptable.
PUD units

- The appraisal report must describe the subject project and any common property. It must also identify and analyze any differences between the amenities and monthly unit charge of the subject property and the comparable properties, if the comparable properties are from competing projects. The appraisal report form must include the project name for the subject project.

Condominium Units

- Appraisal reports used for Condominium Units require the appraiser to analyze project information and individual unit data in estimating the Condominium Unit's marketability and market value. The appraiser must also report the project name, amenities, unit charge and the property rights for each comparable sale, and must compare them to the subject property in the market data analysis.

Manufactured Homes

Additional appraiser qualifications

In addition to the appraiser qualifications, the Seller must determine that the appraiser demonstrates the knowledge and experience to perform quality appraisals for Manufactured Homes. The appraiser must:

- Have adequate experience and must have previously completed real property appraisals of Manufactured Homes
- Have adequate education and/or training related to the appraisal of Manufactured Homes
- Understand the unique features that affect the quality of Manufactured Homes and the factory construction techniques for Manufactured Homes
- Understand the manufacturers’ and federal, State and local requirements for the installation of Manufactured Homes
- Be knowledgeable concerning the local Manufactured Home market, and
- Have access to appropriate data sources to establish an opinion of value. Traditional appraisal data sources may not provide sufficient quality Manufactured Home data for the appraiser to develop a supportable and well-documented appraisal. Although the MLS and public records information remain an important source of data, the appraiser must develop other sources such as Manufactured Home retailers and builders experienced in the installation of Manufactured Homes. The N.A.D.A. Manufactured Housing Appraisal Guide and Marshall & Swift Residential Cost Handbook may also be used to provide support for the appraiser's quality adjustments and value conclusions.

Contract for sale provided to appraiser

- If the transaction is a purchase or "no cash-out" refinance that involves the conversion of interim construction financing to permanent financing, the Seller must provide the appraiser with:
  - A complete copy of the executed contract for sale of the Manufactured Home and the land, or if the Manufactured Home and land have separate contracts, the executed contract for each is required. If the Borrower has owned the land for 12 months or more, a copy of the executed contract for the land is not required.
  - For a new Manufactured Home, the Seller must provide the appraiser with a copy of the manufacturer's invoice and the Manufactured Home Purchase Agreement. For a purchase transaction or any transaction that involves the conversion of interim construction financing to permanent financing, the appraiser must analyze the contract for sale and other documents for the transaction, including for new Manufactured Homes, the manufacturer's invoice and Manufactured Home Purchase Agreement.

Appraisal requirements

The appraiser must, at a minimum:

- Perform a complete visual inspection of the interior and exterior areas of the Manufactured Home
- Inspect the neighborhood
- Inspect each of the comparable sales from at least the street
- Research, verify, and analyze data from reliable public and/or private sources
- Develop an opinion of the market value of the Manufactured Home based on the sales comparison approach to value. Non-realty items, such as insurance, warranties or furniture must be excluded from the value conclusion.
• Develop the cost approach to value as support for the sales comparison approach
• Report his or her analysis, opinions, and conclusions on Form 70B, Manufactured Home Appraisal Report
• Match the manufacturer's serial number(s) and the HUD Certification Label number(s) on the dwelling to the number(s) on the contract for sale, manufacturer's invoice, and any other documentation provided. If the numbers do not match, the appraisal report must clearly state that the Manufactured Home is not the same dwelling referenced on the contract for sale or other applicable documentation.
• Complete the Form 70B in its entirety

Sales comparison approach
• The appraiser must state the specific number of manufactured home sales and listings as well as the respective price ranges that were used in the analysis.
• The appraisal report for the Manufactured Home must contain at least two comparable Manufactured Home sales of similar configuration (i.e., multiwide comparable sales for a multiwide subject property) and similar quality.
• The appraiser may use either site-built housing or a different type of factory built-housing as the third comparable sale if the appraiser explains the reason for selecting the comparable and makes and supports the appropriate adjustments in the appraisal report. More than three comparable sales may be used if needed to adequately support the appraiser's opinion of value.
• If the Manufactured Home is in a controlled market (such as a new subdivision or project, a newly converted project or an area where the property seller owns a substantial number of units), at least one comparable sale must be outside the influence of the developer, builder or property seller. Resales from within the subject project or subdivision may be used to meet this requirement. When comparable sales from outside the subject project or subdivision are used, they must also be outside the influence of the subject property's developer, builder or property seller.
• The appraiser must not create comparable sales by combining vacant land sales with the contract purchase price of the Manufactured Home. If the appraiser is unable to develop an appraisal based on at least two comparable sales of similar Manufactured Homes, the Mortgage is not eligible for sale.

Cost approach
• The cost approach and sales comparison approach are complementary for the valuation of manufactured housing and must support the final value conclusion.
• A detailed cost approach to value based on published sources and supported by market data is required for all Manufactured Home appraisals. It must, at a minimum, provide the information indicated on Form 70B and provide sufficient information and data to allow the Seller and other reviewers to replicate the cost figures and calculations.
• The cost figures must come directly from a published cost service without modification by the appraiser.
• The appraiser must report the source of the cost data and the effective date of cost data.
• The appraiser must provide a quality rating from the cost service used. The appraiser's quality rating must be based on objective criteria.
• The appraiser must provide his or her opinion of site value supported by a summary of comparable land sales or other methods used for estimating site value.

Income Approach
• The income approach to value is not required; however, the appraiser must consider the income approach to value and develop it if applicable and necessary to develop a credible report.

Completion certificate
• If the appraisal is performed before the Manufactured Home is delivered and installed on a permanent foundation, the Seller must obtain a completion certificate or appraisal update from the appraiser. The certificate or update must report the appraiser's analysis of previously unavailable information, and provide certification that the conditions of the appraisal have been satisfied. Form 442 or a comparable form with an interior inspection may be used.

2- to 4-unit properties
• In addition to the other requirements and guidelines set forth in this chapter, the following requirements and guidelines are applicable to completing Form 72, Small Residential Income Property Appraisal Report, for 2- to 4-unit properties.

**Comparable rent data**
• At least three rental comparables must be analyzed in the "comparable rental data" section. These rental comparables must:
  o Have current rental information
  o Be units similar to and located near the subject property
• The rental comparables are usually not the same comparable properties used in the sales comparison approach. The appraisal report should state that the units and properties selected as rental comparables are comparable to the subject property (both the units and the overall property) and should accurately represent the rental market for the subject property unless otherwise stated in the report.

**Subject's rent schedule**
• This section contains the subject property's current actual rents and the estimated market rents. The estimated market rents for the subject property must be supported in the appraisal report and be consistent with the data presented throughout the report.

**Sales comparison approach**
• In addition to the other requirements in this chapter, the appraisal must contain the unadjusted units of comparison for the comparable sales. If the appraisal is prepared in conjunction with a purchase transaction, the units of comparison must be provided for the subject property as well. These units of comparison are the sales price per square foot of gross building area (GBA), per unit and per room and the gross rent multiplier (GRM). The comment area of the sales comparison analysis must reconcile the adjusted sales prices of the comparable sales and the unadjusted units of comparison, as appropriate, according to the manner in which such properties sell in the defined market area.
• The appraiser must indicate in the comments area which factors are deemed most consistent and which factors typical investors or purchasers in that market consider when purchasing a similar property.

**Leasehold estates in ground lease communities**
For leasehold estates in ground lease communities, the appraiser must:
• Include in the neighborhood section a description of the amenities and common property
• Comment on the monthly unit charge of the subject property and the comparable properties, if the comparable properties are from competing ground lease communities, and
• Consider and analyze how the ground lease affects value and make the appropriate adjustments to the comparable sales

**Energy-efficient properties**
• An energy-efficient property uses cost-effective design, construction, materials, equipment and site orientation to conserve energy, consistent with the climate of the area in which the property is located. Items that contribute to the energy efficiency of a property include, but are not limited to, the following:
  o Insulation with adequate R-values installed in ceilings, exterior walls and roofs; around hot water heaters; under floors that cover unheated areas; and surrounding ducts and pipes that are not air-conditioned
  o Caulking and weather stripping
  o Double- or triple-paned windows
  o Window shading or landscaping for solar control
  o Storm doors and windows
  o Automatic setback thermostats
  o Heating, cooling and lighting systems and appliances designed to be energy-efficient
  o Solar systems for water heating, space heating and cooling
  o Wood-fired heating systems (using outside combustion air)
  o Building designs that minimize energy use, such as reduced window areas and earth sheltering
• The appraisal report must list the energy-efficient items in the subject property and note their contribution to the value for the Mortgage to receive the special underwriting.
604.02 – General Requirements

Origin of Request

- The appraisal or inspection report must be signed by an appraiser approved by the Seller. A Seller may not accept a mortgage if the appraisal or inspection report is made for anyone other than the Seller or mortgage originator. The appraiser must be impartial and unbiased. The appraiser may not have any present or contemplated future interest in the subject property. In addition, neither current nor future employment or compensation for performing the appraisal or inspection may be contingent on the results reported by the appraiser.

Seller Warranties

- With respect to each appraisal or inspection report, the Seller represents and warrants that:
  o All information known to the seller that may affect the estimate of value or marketability has been provided to the appraiser in conjunction with the appraisal or inspection request
  o It has reviewed the mortgage and has concluded that the mortgaged premises is adequate security for the mortgage.
  o The report complies with the applicable requirements in this chapter
  o The report is of professional quality and supports all of the appraiser’s assumptions, data, analyses, rationale and conclusions that were relied on in estimating the value and addressing the marketability of the mortgaged premises
  o The information in the report is accurate, internally consistent, written in clearly understandable language, fully supported and sufficiently documented

- Deficient appraisal or inspection reports will be considered a breach of the Seller’s warranty as to the acceptability of the mortgage. In addition to reviewing the appraisal or inspection report submitted, the Seller may make property inspections and/or other investigations to assure property eligibility and proper underwriting of the mortgage offered for sale.

Market Value Definition

- An appraisal report must be based on the following definition of market value:
  o The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus.

- Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:
  o Buyer and seller are typically motivated
  o Both parties are well informed or well advised, and each acting in what he considers his own best interest
  o A reasonable time is allowed for exposure in the open market
  o Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto, and
  o The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

- Adjustments to the comparable must be made for special or creative financing or sales concessions. No adjustments are necessary for those costs which are normally paid by sellers as a result of tradition or law in a market area; these costs are readily identifiable since the seller pays these costs in virtually all sales transactions. Special or creative financing adjustments can be made to the comparable property by comparisons to financing terms offered by a third-party institutional lender that is not already involved in the property or transaction. Any adjustments should not be calculated on a mechanical dollar-for-dollar cost of the financing or concession but the dollar amount of any adjustments should approximate the market’s reaction to the financing or concessions based on the appraiser’s judgment.

- The market value estimate of the subject property must not include value assigned to furniture or any other personal property

Detrimental Conditions
On appraisal or inspection reports, the appraiser must note the presence of detrimental conditions, such as expansive soils, underground mines or subsidence in the immediate area of the subject property. In addition, the appraiser must note any evidence of dampness, infestation or abnormal settlement observed on the subject property and call for correction of the observed condition or professional inspections to determine the seriousness of the condition. The appraiser must also consider the effect of such conditions in estimating the subject property’s market value and/or any effect on marketability.

For any appraisal report that is made subject to inspections or conditions due to detrimental conditions, the Seller must include in the mortgage file evidence of corrective action as called for by the inspector or appraiser (such as an exterminator’s certificate, engineer’s report or satisfactory completion certificate) dated before the delivery date of the related mortgage.

Maximum Financing

For any appraisal report, the Seller must consider the appraiser’s indication of the trend of property values in the area in which the subject property is located with respect to offering financing to the maximum loan-to-value (LTV) ratio.

Statement of Assumptions and Limiting Conditions, and Appraiser’s Certifications

The Statement of Assumptions and Limiting Conditions, Appraiser’s Certification and Supervisory Appraiser’s Certification are incorporated into each appraisal and inspection report form. Modifications or deletions to these are not permitted. However, additional certifications that do not constitute material alterations to the report, such as those required by law or those related to the appraiser’s continuing education or membership in an appraisal organization, are permitted.

Owner of Record

Effective for mortgage applications taken on or after May 1, 2005, when a new appraisal is required, the Seller must verify:

- For purchase transactions:
  - The property seller listed on the sales contract is the Owner of Record of the subject property or
  - If the transaction involves the sale of land separate from the dwelling, the property seller listed on the sales contract for the land is the Owner of Record for the land.
- For refinance transactions, the borrower is an Owner of Record of the subject property
- For transactions that involve the payoff of a land contract, the property seller is the vendor on the recorded land contract and the Owner of Record of the subject property; and the borrower is a vendee on the recorded land contract.

Seller must retain documentation evidencing the verification in the mortgage file. Such documentation may include, but is not limited to, the appraiser’s analysis and conclusions in the appraisal report, a property sales history report, a copy of the recorded deed, a copy of a property tax bill, or the title commitment or binder indicating the legal ownership of the property.

604.03 – Negative Time Adjustments

Negative time adjustments made in the sales comparison approach of an appraisal indicate declining values and should be commented on by the appraiser and reviewed carefully by underwriting.

The appraiser must provide written justification for time adjustments before the underwriter issues the final statement of appraised value. The underwriter must determine that the time adjustments are applicable to the local FHA jurisdiction.

604.04 – Comparables

The appraiser is to provide a 36 month history of any prior sales of the subject and comparables, including sales price and any other available data. The underwriter must question any property which resold in a short time for a much higher price. Very often, these circumstances involve substantial rehabilitation, and the appraiser should furnish details.
When reviewing comparable sales, the amenities must be similar comps should be from within the same project and one should be from a competing project, but in the same market area. Ideally, 2 of the comps.

On refinance loans, the appraiser must provide comparables that support the subject property value. The comparables should “bracket” the value of the subject property, for example if the subject is valued at $120,000, it would be inappropriate for the adjusted value of all comparables to be less than $120,000. At least one of the comparables should be of a higher value.

Properties in rural areas or with acreage must have comparables with similar locations or property size. On non-conforming loans, the maximum acreage allowed is ten (10) acres. At least two (2) comparable must be provided to support the market value.

604.05 – Property Located in Areas Affected by Natural Disasters

It is the responsibility of each associate, correspondent and Account Executives to be aware of natural disasters occurring in the areas served by the correspondent of A.E. The underwriting and closing of loans is dramatically affected by hurricanes, earthquakes, flooding, hail storms, forest fires, tornadoes, mud slides or other natural disasters.

For properties in areas that have sustained damage, the Lender’s Drive by Inspection Certification, is to be completed on all loans in the pipeline that have not closed, where appraisals have been performed prior to the date of the natural disaster.

The following additional criteria must be met:

- If the loan has not been underwritten, the underwriter will require the Lender’s Certification form as a “PTD” condition.
- Any damage noted will require an inspection by the appraiser to determine the extent of damage and affect on value.
- Approved loans on property that has incurred damage will be returned to the Regional Underwriting Department for review.
- No fee will be charged to the applicant for the Lender’s Inspection.
- Properties where the Lender Certification indicates no damage” will require an acknowledgment and Hold Harmless Letter from the applicant(s) at loan closing.

*If conditions exist that are conducive to damage, such as high water marks on the side of the building, standing water or other questionable factors, the issue should be brought to the attention of the Regional Underwriting Department. The underwriter will determine what additional inspections may be needed. If additional guidance is required, the underwriter will contact the Credit Policy Department.

As a result of a national disaster such as flooding, hurricanes, tornadoes, fires, earthquakes, etc., the federal government will designate the affected area to be a Presidential Declared Disaster Area. In such designated areas, the following is required:

- If an appraisal was completed on a property within the affected area prior to the date of the disaster, the appraiser or another designee will be required to re-inspect the property prior to closing.
- The designee must provide an addendum to the appraisal identifying property defects which could affect the health or safety of the occupants.
- The appraiser must address any effect the disaster had on the value marketability of the subject.

When the re-inspection evidences damage to the property, the loan must be resubmitted to underwriting to re-evaluate the adequacy of the collateral.

Note: Some FHA offices will require that a Compliance Fee Inspector make the necessary inspection. Inspections by an appraiser will not be accepted in those jurisdictions.

604.06 – Purchase & Refinances/Damage Sustained
On properties that have sustained damage and the applicant desires to close on the loan prior to completion of repairs, the following criteria must be met:

- The underwriter must review the estimate for repairs and any request for an escrow, prior to loan closing.
- No escrow may be released without a final inspection by an appraiser or Compliance Inspector. All escrow agents must be advised that a release of escrow must be presented in writing from either an underwriter or operations personnel. No funds are to be released without written approval.
- When approving a loan, the underwriter must condition the approval to collect all repair inspection fees at loan closing.
- The title company must provide an endorsement to insure against mechanic’s and material men’s liens. Any additional fee for the endorsement will be the responsibility of the applicant.

Other scenarios may result from loan applications on damaged properties. Please contact your Regional Underwriting Department for assistance in determining the proper course of action. In addition, The Production Support Group or the Credit Policy Department may be contacted for assistance.

604.07 – Value Conclusion and Appraiser Signatures

The market value is determined by evaluating the sales comparison approach, the cost approach and the income approach (when applicable). The value is then noted in the lower right hand corner of the appraisal above the appraiser’s signature.

The underwriter must condition for a certification of completion when the appraisal is made subject to repairs or completion. Required repairs should not include cosmetic items which do not affect the value or marketability of the property. Repairs should generally be limited to those items which affect the structural integrity of the dwelling or pose a health or safety hazard to the occupants.

The appraisal must be signed by the appraiser and dated.

The FHA appraiser assigned to the case, who physically inspects the property, must sign the appraisal.

604.08 – Appliances

The subject property is not required to have kitchen appliances installed at the time of closing, provided the appraiser has adjusted any value for comparable properties with installed appliances. However, inoperable or damaged appliances must be addressed appropriately by the appraiser.

604.09 – Burglar Bars

Bedroom windows with security bars require a quick release mechanism for emergency egress. If not so equipped or inoperable, condition the appraisal on a “required repair”.

604.10 – Common Use Agreements

A common use agreement provides for the sharing of repair and maintenance costs and ingress/egress access for completion of repairs and maintenance. Where common and customary, common use agreements will be required where common use areas exist, such as walls, driveways, etc., which are shared by adjacent properties. The rights of each owner must run with the land and pass to successors in title.

DE underwriters Automatic underwriters must be aware of the requirements of the local office with jurisdiction over the subject property. Generally, the agencies will require common use agreements.

604.11 – Earthquakes Fault Lines
The title insurance policy issued for the Lender may not take any exception to natural fault lines, including those determined by a survey.

604.12 – Encroachments

When there is a minor encroachment, a “hold harmless” letter must be executed by the borrowers at closing and title insurance coverage must be obtained for the encroachment. Examples of acceptable encroachments are:

When the improvements of the adjoining property do not exceed one foot over the lot line, provided the encroachments do not touch any buildings or interfere with the use or enjoyment of the subject’s improvements.

Hedges or removable fences belonging to the subject or adjoining property.

When the driveway encroaches on adjoining property by one foot or less, provided there is a minimum clearance of eight feet between the buildings on the subject property and the property line affected by the encroachment.

604.13 – Environmental Hazards

The presence of hazardous wastes, materials containing asbestos, urea, formaldehyde insulation, radon gas, or other toxic substances on or near the subject property, must be noted on the appraisal as a hazardous condition. The appraiser must comment on the effect the hazard may have on the property’s value and marketability. The value must be adjusted to reflect market reaction to the hazard.

Properties affected by an environmental hazard are acceptable if the appraiser can demonstrate the impact of the hazard is measurable and support value with the use of comparable sales from both the affected area and a similar competing area without the negative influence.

The appraiser should comment on any conditions which may be affected by the hazard, such as a well, septic or public water facility. When there is a concern, the underwriter must condition for appropriate tests to determine whether there is any contamination. If there is contamination, the property will not be eligible for financing.

The applicant must execute a hold harmless” letter at closing which addresses the nature of the hazard.

Note: Lead paint hazards that may exist in properties built before 1978 have come under the jurisdiction of the Environmental Protection Agency (EPA). The EPA now requires notification to all purchasers of the possible hazard of lead paint and purchasers are to be offered a period of time to allow for home inspections.

604.15 – Soil Contamination

The appraiser must check for readily observable evidence of hazardous substances in the soil. Conditions that could indicate soil contamination include pools of liquid, pits, ponds, lagoons, stressed vegetation, stained soils or pavement, drums or odors. If any of these conditions exist further analysis or testing is required. If there is any surface evidence of leakage from an underground storage tank, further analysis or testing is required.

The appraiser must also note the proximity to any dumps, landfills, industrial sites or other sites that could contain hazardous wastes. Refer to Handbook 4150.2, (Section 3-6A3); ML 05-48; ML 05-34

604.15 – Excess Property/Land or Buildings

(Excess land is addressed rural properties.)

When a property contains what appears to be excess property or buildings, such as mother-in-law suites, carriage houses, or other property, the appraiser must address the effect on value, conformity to local custom and zoning. The comparables provided by the appraiser must have similar features or line adjustments in the comparable grid on page two of the appraisal. The appraisal must support the market value as determined by the appraiser. The underwriter must confirm the appraisal’s support of value. Also see, Reconsideration or Changes in Value.

Accessory Dwelling Units (ADUs) are commonly understood to be a separate additional living unit, including separate kitchen, sleeping, and bathroom facilities, attached or detached from the primary residential unit on a
single-family lot. ADUs are usually subordinate in size, location, and appearance to the primary unit and may or may not have separate means of ingress or egress. Attached units, contained within a single-family home, known variously as “mother-in-law apartments”, are the most common type of accessory dwelling unit. An accessory apartment must be connected to the utilities (except telephone, television and cable) of the dwelling unit and may not have separate services.

604.16 – Flood Insurance

Flood insurance is required by law for all mortgage loans originated or serviced by a Federal insured institution when any portion of the improvements of the secured property lie in a Federal Emergency Management Agency (FEMA) declared Special Flood Hazard Area (SFHA). If the improved property is located in a SFHA requiring flood insurance and the flood insurance is not available for the community it does not participate in the Flood insurance program. The property is not eligible for financing with The Lender. There are no exceptions to waivers to this requirement.

The office of Federal Emergency Management Agency (FEMA) may determine a building site is no longer designated a Special Flood Hazard Area (SFHA). FEMA will issue a Letter of Map Amendment (LOMA) for an individual site or a Letter of Map Revision (LOMR) for same areas (or subdivisions) to show changes to flood plains, flood ways or flood elevations.

Stick Built

• **Proposed and New Construction:** If any portion of the property improvements (the dwelling and related structures/equipment essential to the value of the property and subject to flood damage) is located within a special flood hazard area (SFHA) designated by the Federal Emergency Management Agency (FEMA), the property is not eligible for FHA mortgage insurance unless: (1) a final Letter of Map Amendment (LOMA) or final Letter of Map Revision (LOMR) that removed the property from the SFHA location is obtained from FEMA or (2) if the property is not removed from the SFHA location by a LOMA or LOMR, the lender obtains a FEMA National Flood Insurance Program Elevation Certificate (form FEMA 81-31) (“flood elevation certificate”) documenting that the lowest floor (including the basement) of the residential building and related improvements to the property is built at or above the 100 year flood elevation in compliance with the National Flood Insurance program criteria. National flood insurance is not required if a LOMA or LOMR is obtained but is required when a flood elevation certificate documents that the property remains located within the SFHA. The LOMA, LOMR, or flood elevation certificate must be submitted with the case for endorsement.

• **Existing Construction:** Flood insurance must be obtained and maintained for an existing property with any portion of the residential buildings located in a special flood hazard area.

Manufactured Homes

• If any portion of the property improvements for both new and existing manufactured home properties are located within a SFHA, the property is not eligible for FHA mortgage insurance without:
  o a FEMA issued LOMA or LOMR, or
  o an elevation certification prepared by a licensed engineer or surveyor on the finished construction indicating the ground beneath the manufactured home is at or above the 100 year flood plain. When utilizing an elevation certification, the property is still in the SFHA and the loan will require flood insurance.

Condominiums

• The Homeowners' Association (HOA), not the individual owner, is responsible for maintaining flood insurance on condominium buildings located within a special flood hazard area. If the FHA appraiser reports that buildings in a condominium project are located within a SFHA, the lender is responsible for ensuring that the HOA obtains and maintains national flood insurance on the buildings located within the flood hazard area. The lender is not permitted to submit a LOMA, LOMR or elevation certification for any specific dwelling unit located within a newly constructed condominium project less than one year old.

604.17 – Heat and Air Conditioning

All properties must be provided with a safe, adequate active heat source. Space heaters must be inspected by a licensed heating company, who must certify the heaters are properly vented and conform to local code.
Air conditioning, if installed, must provide a safe cooling system. The Lender has no specific requirements for window air conditioners as they are considered personal property.

604.18 – High Pressure Gas and Liquid Petroleum Transmission Lines

When the residential structure is located 10 feet or more from the outer boundary of the pipeline easement, but with 220 yards on either side of the centerline of the transmission line, the following must be obtained:

A statement from an authorized official of the pipeline company certifying Compliance with:

- Federal Regulation 49 CFR, sections 192.607, 192.609, 192.611 and 192.613 for high-pressure gas pipelines; or
- Federal Regulation 49 CFR, sections 195 and all amendments for liquid petroleum pipelines.

Note: Providers of gas or electrical service are familiar with the Federal Regulations noted above. Copies of the Federal Regulations should not be needed by the Lender.

604.19 – Lot Dimension Variances

When the lot dimensions noted on the appraisal differ substantially from the survey, the appraiser must be contacted to determine whether the variance warrants a change in value. If the value has changed, the appraisal must be resubmitted to underwriting before the loan may close.

A substantial variance in lot size is considered to be a difference of more than 2% on the length of the frontage of the property or more than 6% of the length of any other dimension.

604.20 – Private Road, Alley or Common Drive

- Each property shall be provided with vehicular or pedestrian access by a public or private street.
- If the property is not provided with an all-weather surface, note the absence of such in the appraisal. FHA defines all-weather surface as a road surface over which emergency and the area’s typical passenger vehicles can pass at all times.
- Private streets and shared driveways must be protected by permanent recorded easements or be owned and maintained by a Home Owners Association (HOA).

Underwriters' Review:
The recorded easement must be reviewed and approved by the Direct Endorsement Underwriter and documented in the Lender’s file at the time the loan is submitted for mortgage insurance. Evidence of a road maintenance agreement is not required.

604.21 – Structural Damage

When the appraisal appears to indicate the property has suffered structural damage, the appraiser must either reject the property or require a satisfactory structural engineer’s report. The report must be prepared by a licensed registered professional engineer and must be dated prior to any repairs. A final inspection evidencing satisfactory completion of all recommended repairs by the original engineer will be required.

Structural damage is not limited to the foundation alone and may involve the root load bearing walls, etc. It is ultimately the underwriter’s responsibility to accept the property with repairs, or to reject the property. The Regional Underwriting Manager must review the appraisal and sign the loan approval or denial.

The borrower is to be provided with a copy of the initial engineer’s report, any interim and final inspection reports and a copy of the warranty. The borrower must sign a statement acknowledging receipt of these items. The
borrower must sign a Hold Harmless letter acknowledging that neither FHA nor The Lender warrants the property or the repair.

In addition to the previously stated requirements, FHA requires the engineer to inspect foundation work in progress when support members are in place and issue an interim inspection report. All work must be performed by a licensed, bonded foundation repair company who must provide the borrower with a one year unconditional warranty.

Note: In some HUD jurisdictions, if the property has had foundation work done in the past 12 months and did not have an engineer’s inspection, a final inspection and a one year warranty, the property may not be eligible for FHA financing until 12 months from the date of the repair.

604.22 – Termite Report Statement

In areas prone to infestation, Termite and other Wood Destroying Insect Reports may be required. The common and customary use of such inspections typically follows climate and geographic patterns.

In addition to termites, the report will indicate the presence of other forms of wood destroying organisms, such as fungus, water damage due to poor drainage, etc., as well as the presence of other insects or pests. All problems noted on the inspection report must be addressed; the date of the termite report may not exceed 30 days at time of funding. The underwriter must review the inspection.

When the termite report indicates:

- Active infestation, evidence of treatment must be provided.
- Damage from previous or current infestation, the damage must be repaired, it is essential to determine the extent of the damage by contacting the inspector if the report is unclear. Correction of minor damage may be evidenced by a paid work order listing the repairs.
- Structural damage, a structural engineer’s report will be required to determine the needed repairs.

On FHA, a termite/pest infestation report or soil poisoning treatment is only required if the appraiser conditions for it and notes it on the appraisal. When soil poisoning treatment is a requirement, treatment must be made by a licensed, reputable company and must be accompanied by a five year guaranty. On new construction, this will usually be a requirement.

The licensed pest control company must use the correct form for reporting pest inspections and/or treatment, by use of the National Pest Control Association form. If a state mandated form is required by local law, it should be completed and attached to the NPCA form.

604.23 – Overhead / High Voltage Power Lines

The appraiser must indicate whether the dwelling or related property improvements is located within the easement serving a high-voltage transmission line, radio/TV transmission tower, cell phone tower, microwave relay dish or tower, or satellite dish (radio, TV cable, etc).

1. If the dwelling or related property improvement is located within such an easement, the lender must obtain a letter from the owner or operator of the tower indicating that the dwelling and its related property improvements are not located within the tower’s (engineered) fall distance in order to waive this requirement.
2. If the dwelling and related property improvements are located outside the easement, the property is considered eligible and no further action is necessary. The appraiser, however, is instructed to note and comment on the effect on marketability resulting from the proximity to such site hazards and nuisances.

604.24 – Zoning

The appraiser is responsible for reporting the specific zoning classification for the subject property on the Uniform Residential Appraisal Report. The appraiser is required to provide a statement indicating if the improvements
represent a legal use; a legal, non-conforming use or an illegal use under the zoning regulations; or state if there are no local zoning regulations.

For a one to four unit family property or a unit in a PUD project that represents a legal but non-conforming, use of the land, the appraiser’s analysis must reflect any adverse effect that the non-conforming use has on the value and marketability of the property. Further, it must be determined (and documented) that the property, if partially or completely destroyed, can be rebuilt as the same structure. Example: A single family residence with an added mother-in-law suite, complete with kitchen and garage may be a legal, but non-conforming use of the property. The loan file must indicate that the property as it exists (at loan underwriting) can be rebuilt as the same structure.

Note: If the property represents an illegal use under the zoning regulations, it is ineligible for financing.

604.25 – Zero Lot Line

An acceptable maintenance easement must be provided for the zero lot line side of the dwelling which provides for space from the subject’s wall to perform repairs and maintenance of that wall. The easement must be recorded and binding of all successors in title.

On new construction, FHA is requiring a minimum of five (5) feet of space for repairs and maintenance.

604.26 – Underground Fuel Tanks

Home heating oil tanks are not regulated by federal law. The Environmental Protection Agency (EPA) has established guidelines concerning abandoned, underground home heating fuel oil tanks,

If a tank is to remain on the property, the following procedures are recommended:

- Tank should be emptied of any fuel oil or water. Contents should be treated as contaminated and should be removed by a specialist in the removal of contaminated materials.
- All piping and spouts should be disconnected and removed.
- Vent line should be plugged or capped, preferably below ground level.
- Tank should be filled with sand, concrete, foam or other inert material that will not interact with the metal from which the tank is constructed.

If a tank is to be removed, the following procedures are recommended:

- Tank should be removed by a professional who will remove and dispose of the tank in an appropriate manner. (Homeowner remains responsible for the tank until disposed tank is accepted by a scrap or salvage yard).
- The hole should be examined for any contaminates (visual check) and then filled with clean soil.

When an appraisal indicates an underground fuel tank, the Underwriter must review the local guidelines with the appraiser and with local environmental officials to determine if removal or other procedure should be required.

The Lender will accept the procedures authorized by the local environmental authorities for the removal or disposal of underground fuel oil tanks.

A release of oil or other contaminates into the soil is regulated by law. If any evidence of soil contaminates is indicated, the property is not eligible for financing.

604.27 – Properties Located Next to Gas Stations

Properties located near gas stations are eligible for FHA insurance. The lender is required to provide a written disclosure to the borrower if the property is located within 300 feet of a gas station.

If the property is within 300 feet of any stationary, above ground storage tank(s) containing more than 1,000 gallons of flammable or explosive material, the property is ineligible for FHA financing.
SECTION 605.00 – SEWAGE SYSTEMS

605.01 – Cesspools

Cesspools may be acceptable if all of the following occur:

- All appraisal comparables must have the same system (cesspools);
- The cesspool must be common and customary for area; and
- The cesspool must be acceptable to and inspected by local governmental authority such as health department, environmental department, etc.

605.02 – Community Sewage Systems

- A community sewage system is a central system which is owned, operated, and maintained by a private corporation or non-profit property owners association.
- HUD no longer maintains a list of approved systems. The appraiser must note on the URAR the name of the community system(s). The lender is responsible to ensure the community system(s) are licensed and adequate to service the property.

605.03 – Septic Systems

An individual septic system must be located on the subject property. The property owner is responsible for maintenance as well as compliance with the regulations imposed by state or local health authorities.

An individual septic system may be acceptable in areas where soil conditions are satisfactory for the proper installation and usage and public or community systems are not available. The property must be connected to a public or community sewage system where available and if costs are feasible (3% or less of the value of the property). The individual septic system must be located on the subject property.

Individual septic systems on new construction will require inspection. Sewage systems must be inspected by an engineer who holds a current State License which authorizes them to perform such inspections. The inspection must be performed in accordance with state or local health authority standards and requirements and the laboratory used must be State certified and meet EPA standards.

Inspections on existing property may also be required where indicated by the FHA appraisal, the property Sales Contract, the property inspection made by a home inspection company or other circumstances as determined by the DE Underwriter.

605.04 – Minimum Distances Between a Well and Septic Tank

For an existing property, FHA requires that a well be located a minimum of 100 feet from the septic tank's drain field and a minimum of 10 feet from any property line. If State or local laws require greater distances, those distances must be met.

If State or local law permits distances that are less than those prescribed by FHA, the property may be considered eligible provided that the lender submits evidence in the case binder that the property is in compliance with the applicable local or State distance requirements and meets the conditions stated below:

1. Domestic Well from Septic Tank Drain Field: FHA will recognize State/local distance requirements provided they do not allow for less than 75 feet of separation.
2. Domestic Well from Property Line: FHA will recognize State/local distance requirements provided that the well is not within 10 feet of any roadway or the property line of other than a single-family residential property, i.e., the well cannot be within 10 feet of a commercial, industrial, or multifamily building.

If the appraiser notes on the appraisal report that the minimum distances have not been met, the lender must obtain satisfactory evidence from a qualified party that the distance requirements (between the two systems, and from the well to the property line) have been met. (HOC Reference Guide, chapter 1 / ML 2002-25).
If a property has a well only (no septic) do not have to verify it is at least 10 feet from the property line (or meets local code if it is less)

SECTION 606.00 – WATER SUPPLY SYSTEMS

606.01 – Community Water System

A community water system is a central system which is owned, operated, and maintained by a private corporation or non-profit property owners association.

HUD no longer maintains a list of approved systems. If on community water, the appraiser must note on the URAR the name of the water company. The lender is responsible to ensure the community system(s) are licensed and adequate to service the property.

606.02 – Individual Wells

- An individual well must be located on the subject property.
- The property owner is responsible for maintenance as well the regulations imposed by state or local health authorities.
- A Chemical analysis will be required when there is a history of ground water contamination in the area.
- In all cases, when an inspection or water test is required, it may not be dated more than 90 days prior to the date of loan funding.

Whenever feasible, connection shall be made to a publicly owned or publicly controlled water supply system that is adequate to serve the subject property or project. If the connection costs are 3% or less of the value of the property, then it is feasible and the underwriter must condition for connection. In the event public water is not available, connection shall be made to a community system acceptable to HUD and approved by the local health authority.

When public or community water is unavailable, an individual well will be acceptable if there is assurance of a continuing adequate supply of safe potable water for domestic needs, and shall also include auxiliary uses for lawn and garden maintenance.

- Provide evidence of adequate water pressure.
- The well may not be located within 50 feet of a septic system lateral line or 100 feet of an absorption field. Clearance may be increased or decreased depending upon the soil and rock penetrated by the well and aquifer conditions.
- The well must be or have been constructed to prevent the entrance of contaminants or surface water.
- The well may not be located within the foundation walls of the dwelling except in Arctic or sub-arctic regions.
- If required by the appraiser, well water must be tested in accordance with the latest local and State drinking water regulations for private wells. This includes all microbiological and chemical test parameters in the regulations. If there are no local or adequate State requirements and standards then water must be tested for lead and acute contaminants, including nitrates/nitrites and microbial contaminants and, if of local concern, other contaminants.

Maximum Contaminants Levels (MCL). The test may be conducted by a local health authority or a state EPA approved laboratory in accordance with State regulations.

606.03 – Individual Springs/Cisterns as a Water Source

In some locations water sources other than a public system, a community system or a well may have approval of the local FHA office. It will be the responsibility of the Regional Underwriting Department to be familiar with local conditions and agency requirements.
Properties served by spring lakes, rivers or cisterns are unacceptable water well conditions and therefore are not eligible for FHA Mortgage Insurance. However, the regional HOC’s have the authority to consider waivers in areas where cistern’s are typical. It is the responsibility of the underwriter to request the waiver.

Denver Regional HOC is currently the only HOC that will consider granting exception requests to Spring Water and/or Cisterns. The subject property must be located in a state serviced by the Denver HOC in order to request an exception. Their process is to fax the information listed below to fax number 303-672-5007, attention: Technical Support Branch.

Fax in the following items:

1) Letter on letterhead requesting the waiver on Spring Water and/or Cistern (which ever applies). If a cistern; within the letter the size of cistern must be specified and if above ground or below ground. Underwriter must include all contact information so that Denver HOC may be able to contact the underwriter.
2) Include a copy of the Appraisal.
3) Include a copy of the Water Tests.

606.04 – Shared Wells

Shared wells may serve existing properties that cannot feasibly be connected to an acceptable public or community water supply system.

- A shared well shall have a valve on each dwelling service line as it leaves the well.
- A shared well shall service no more than four living units or properties.
- A shared well must have a shared well agreement and shall be binding upon signatory and their successors in title.

SECTION 607.00 – CONDOMINIUMS

FHA requires that condominium projects be approved by FHA prior to individual unit loan approval or loan closing. It is not acceptable to circumvent or waive this. FHA may insure a mortgage on an individual unit in a condominium project that has not received HUD approval, however, the individual unit and project must meet all of the following spot condominium criteria:

Project completion including common elements and those of any Master Association must be 100% complete. There should be no addition of unit, common elements or facilities:

- Two to Four unit projects are not eligible
- There must be no special assessments pending
- There must be no legal action pending against the HOA, its officers or directors.
- Units must have 51% owner occupancy
- No single entity may own more than 10% of the project
- Project having more than 30 units; no more than 10% may have FHA insured loans
- Project have 30 units or less; no more than 20% may have FHA insured loans
- 90% pre-sale of units is required
- This list is not all-inclusive. Please refer to Spot Condo Approval Checklist for a complete list of requirements

Under certain circumstances lenders may approve an individual unit within an existing condominium project without HUD's prior project approval. Lenders are encouraged to submit the complete approval package to HUD so that the project can be processed and ready for the next applicant seeking a loan in that project.

Lenders must perform an underwriting analysis and CERTIFY that the project satisfies the eligibility criteria for a spot loan approval. To determine if the unit is eligible under the spot loan procedure, lenders may use information from the appraiser, the owners association, the management company, the real estate broker, or the project developer. The lender is not required to search public records or provide documentation reflecting the total number of FHA insured mortgages within the project in supporting the spot loan approval; however, it remains the lenders responsibility to ensure the accuracy of the information it relies upon in making its certification. If the
lender is not able to obtain sufficient information to determine the percentage of FHA insured mortgages in the project they may make the statement that the percentage is unknown. The completed checklist, certified by the lender, must be included in the insuring binder.

Individual units within a condominium project that has been previously approved, rejected or withdrawn by HUD are not eligible under the spot approval process.

SECTION 608.00 – ENERGY EFFICIENT PROPERTIES

An energy efficient property is one that uses home design, site orientation, construction materials and equipment to both conserve nonrenewable fuels (energy) and to reduce the cost of nonrenewable fuels. Special energy savings items should be recognized in the appraisal.

There are two different loan scenarios where energy efficiency can make a difference:

- qualifying ratios for all loan types may be increased when the subject home is documented to be energy efficient and
- an FHA loan amount may be increased above the appraised value or sales price to cover cost of energy efficient improvements.

Mortgage loans are available to applicants wanting to purchase or refinance a principal residence and incorporate the cost of energy efficient improvements into the mortgage.

608.01 – FHA Energy Efficient Mortgages

**FHA Energy Efficient Mortgage Product**

The EEM program allows a borrower to finance 100 percent of the expense of a cost-effective “energy package,” i.e., the property improvements to make the house more energy efficient. A cost-effective energy package is one where the cost of the improvements, including maintenance, is less than the present value of the energy saved over the useful life of those improvements. The borrower does not need to qualify for the additional financing or provide additional downpayment. There is also no need for a second appraisal that reflects the expense of the energy package and the improvements may be applied to retrofit an existing house or improve the energy efficiency of proposed construction. The present value test is a statutory requirement and, thus, actual energy savings cannot be used to determine cost effectiveness in lieu of the present value calculation of the energy savings.

The EEM may be used with Sections 203(b), 234(c)(units in condominium projects), and 203(h)(mortgages for disaster victims) loans for both purchases and refinances, including streamline refinances. Both new and existing 1-4 family unit properties are eligible, including 1-unit condominiums and manufactured housing. The allowable EEM dollar amount is for the entire property and not based on a per unit basis for multiple unit properties.

**How is the energy package designed?**

The energy package is the set of improvements agreed to by the borrower based on recommendations and analysis performed by a qualified home energy rater using a tool known as a Home Energy Rating System (HERS). The HERS must both meet the minimum requirements of the Department of Energy (DOE) approved ratings guidelines and must have achieved passing results from DOE's Building Energy Simulation Test (BESTTEST) or subsequent testing requirements.

The home energy rater must be trained to perform the physical inspection and/or diagnostic test that provide the data on the home used to develop the energy package. The home energy rater using the HERS prepares a written home energy rating report. The report, which must be provided to the homebuyer/homeowner as well as the mortgage lender, is based on the information developed from a physical inspection of the existing property to be retrofitted, or from the plans and specifications of the house to be built. It provides estimates of both the costs of the improvements and the expected energy savings.
For new construction, the energy package includes those cost-effective energy improvements over and above the requirements of the 2000 International Energy Conservation Code, formerly known as the Model Energy Code. More information on this energy code can be obtained from the Department of Energy’s website at http://www.energycodes.gov. The details of the energy package and supporting information are presented in a HERS Rating Report.

**How is the EEM underwritten?**

The mortgage is initially underwritten as if the energy package did not exist, i.e., by using standard FHA underwriting standards, qualifying income ratios, and maximum mortgage/minimum cash investment requirements without regard to the energy package. For an EEM on new construction, as well as those homes that were built to the 2000 IECC or are being retrofitted to that standard, the borrower, in addition to the cost of the improvements, can get “stretch ratios” of 33% and 45%. Also, for new construction, when qualifying the borrower, the cost of the energy package should be subtracted from the sales price (since the builder has included those improvements in the sales price) and the qualifying ratios calculated on this lower amount.

Once it is determined that both the borrower and the property qualify for a mortgage to be insured by FHA, the mortgage lender, using the energy rating report and an EEM worksheet¹ will determine the dollar amount of the cost-effective energy package that may be added to the loan amount. This dollar amount cannot exceed 5 percent of the property’s value (not to exceed $8,000) or $4,000, which ever is greater. Regardless of the property’s value, every borrower who otherwise qualifies can finance at least $4,000 of the costs of the Energy Package if the cost exceeds $4,000. The calculated amount will be added to the approved base loan amount to total the final FHA insured loan amount before adding any upfront mortgage insurance premium. The FHA maximum loan limit for the area may be exceeded by the cost of the energy efficient improvements.

For a streamline refinance, the borrower’s principal and interest (P&I) payment on the new loan including the energy package may be greater than the principal and interest (P&I) payment on the current loan, provided the estimated monthly energy savings as shown on the HERS report exceeds the increase in the P&I.

**FHA’s TOTAL mortgage scorecard** may also be used for underwriting EEM’s. If the lender obtains an "accept" or “approve” on a mortgage loan application, FHA will recognize the risk rating from TOTAL and permit the increase to the mortgage payment without re-underwriting or rescoring provided that the lender’s Direct Endorsement (DE) underwriter attests that he or she has reviewed the calculations associated with the energy efficient improvements, and found the mortgage and the property to be in compliance with FHA’s underwriting instructions.

The appraisal does not need to reflect the value of the energy package that will be added to the property for either new or existing construction. On a streamline refinance made without an appraisal, the original principal balance substitutes for an appraised value.

For existing properties, energy-related weatherization items (see handbook HUD 4155.1, Rev 5,1-7(C)(2) for maximum additions to the mortgage amount) may be combined with the Energy Efficient Mortgage, where the maximum dollar amount allowed under an EEM does not cover the cost of the entire energy package. The weatherization amount would be the cost of the improvements not covered by the EEM amount.

**When is the EEM mortgage eligible for endorsement?**

On existing properties, the FHA EEM is insurable immediately after closing. The installation of the energy package does not need to be completed before FHA insures the mortgage. However, for new construction the energy package must be completed before the mortgage is eligible for insurance.

**What are FHA’s requirements for escrow accounts under the EEM Program?**
For existing properties, the lender at closing is to establish an escrow account for the energy improvements. Any funds remaining in the escrow account at the end of the construction period must be applied to pay down the loan principal. For new construction, there will not be an escrow account as the energy package is to be installed as part of the total construction, which must be completed prior to loan closing.

In all cases, the lender is to execute form HUD 92300, Mortgagor Assurance of Completion, to indicate that the escrow for the energy efficient improvements has been established.

What are the requirements for installing the energy package?

On existing construction, the energy package is to be installed within 90 days of the loan closing. If the work is not completed within 90 days, the lender must apply the EEM funds to a prepayment of the mortgage principal. The borrower cannot be paid for labor (sweat equity) on work that they perform, and the borrower cannot receive cash back from the mortgage transaction. On new construction, the installation of the energy package is included in the total construction of the house, and therefore is to be complete at loan settlement.

If the work that is done differs from the approved energy package, a change order along with a revised HERS Report must be submitted to the DE Underwriter for approval. If the changes still meet the cost-effectiveness test, no further analysis is required. If not, the funds for the work not included in the approval energy package must be used to pay down the loan principal.

What are the requirements for assuring completion of the energy package as proposed?

The lender is responsible for notifying FHA through the FHA Connection or equivalent that the improvements have been made and that the escrow has been cleared. The lender, the rater, or an FHA fee inspector may inspect the installation of the improvements. The borrower may be charged an inspection fee in accordance with the appropriate Homeownership Center (HOC) fee schedule.

What is included in the Report on the energy package?

The energy package report must provide the following information:

- Address of the Property
- Name of client
- FHA Case number (if applicable)
- Name of Lender (if applicable)
- Type of Property
- Whether the property is new construction or existing
- Date of the physical inspection of the existing property or, for new construction, the date of the plan review.
- Description of the current energy features of the property or proposed features if new construction. This must include, at a minimum, a description of the insulation R values in ceilings, walls, and floors; infiltration levels and barriers (caulking, weather-stripping, and sealing); a description of the windows (storm windows, double pane, triple pane, etc.) and doors; and a description of the heating (including water heating) and cooling systems.
- Description of the energy package - For existing properties, those cost-effective improvements recommended to improve the energy efficiency of the property. For new construction, those cost-effective improvements to be included in the home that are over and above the requirements of 2000 IECC.
- Estimated cost of the energy package, the useful life, and the costs of any maintenance over the useful life of the improvements.
- The estimated present annual utility cost before the installation of the energy package (for existing property). For new construction, the estimated annual utility costs of a reference house built to 2000 IECC.
- Estimated expected annual utility costs after the installation of the energy package.
- Estimated annual savings in utility costs after the installation of the energy package, including the present value of the savings.
- Names and signatures of the person(s) who inspected the property and of the person(s) who prepared the report and the date the report was prepared.
• The following Certification, signed by the person(s) who inspected the property and the person(s) who prepared the report:

“I certify to the best of my knowledge and belief, the information contained in this report is true and accurate and I understand that the information in this report may be used in connection with an application for an Energy Efficient Mortgage to be insured by the Federal Housing Administration of the U.S. Department of Housing and Urban Development.”

**Are there additional fees associated with the EEM program?**

FHA does not set the fees for the Home Energy Rating, including the physical inspection, the HERS Report, and any post-installation tests. The fees charged to the borrower for the Home Energy Rating must be customary and reasonable for the area. These fees may be included and financed as part of the energy package if the entire package, including those fees, is cost-effective. If not, such fees are considered allowable closing costs.

**How will FHA know that this is an EEM?**

There are two EEM designations in the FHA Connection and each is described below; additionally, a copy of the HERS report is to be included in the case binder submitted for endorsement and placed behind the mortgage credit analysis worksheet (MCAW). In the Remarks section of the MCAW, the lender is to indicate that the loan is for an EEM, show the cost of the energy package and the final loan calculations.

The categories of EEM’s available in the FHA Connection are:

- **New Construction/HERS Improvements**: For homebuyers purchasing a home to be built and financing the cost of eligible energy efficient improvements into the mortgage. The borrower is also eligible for stretch ratios when manually underwriting the loan application if the property is built according to the 2000 IECC.

- **Existing Construction/HERS Improvements**: For homebuyers and those refinancing their mortgages and financing the eligible energy efficient improvement into the mortgage. The borrower is also eligible for stretch ratios when manually underwriting the loan application if the property was built to or is now being retrofitted to the 2000 IECC.

**SECTION 609.00 – ESCROWS**

The use of completion escrows for repairs or improvements is dictated by FHA and will be limited to those instances where it is impossible to complete the required work prior to closing the loan. The lack of a final inspection delays the insurability or sales ability of the loan and is not to be considered lightly.

When the applicant or seller fails to complete repairs within the specified time frame of the escrow agreement, The Lender may choose to either complete the repairs or apply the funds to the outstanding principal balance.

**609.01 – Escrows for New Construction**

Escrows are allowed but limited to those improvements where completion is prohibited due to winter weather conditions (such as final grade, sod or seeding, pouring concrete for walks & patios, etc.) On a case by case basis:

- The repairs or improvements must be a requirement of the appraisal or included in the terms of the sales contract.
- The completion cost of the repairs or improvements is limited to 3% of the lesser of the sales price or appraised value.
- All repairs must be completed within a maximum of 120 days, but no later than May 31. (Extensions beyond these terms must be approved by National Underwriting Department).
- Escrows are not permitted on refinances.
- Escrows and escrow agreements must be completed in accordance with agency guidelines.
609.02 – Escrow for Repairs or Improvements Existing Construction

Requirements for establishing a repair escrow are:

- The safety and soundness of the dwelling and ability to inhabit the dwelling cannot be adversely affected by the incomplete items.
- Copies of bids or contracts must be provided to establish the amount of funds to escrow.
- Funds equal to 150% of the cost to complete the repairs or improvements must be withheld by the escrow agent and an escrow account established.
- Escrows for FHA loans must be completed in the agency described manner.
- All improvements must be completed within the specified time frame and a final inspection (evidencing completion of all escrow items) must be performed by the original appraiser prior to disbursement of the escrow funds.

Escrows for repairs are limited to those items where completion is prohibited due to weather conditions:

- The repairs or improvements must be a requirement of the appraisal or included in the terms of the sales contract.
- All repairs must be completed within a maximum of 120 days, but no later than May 31. (Extensions beyond these terms must be approved by Regional Underwriting Center.
- Funds escrowed must be 1-1/2 times (150%) the estimated or contracted cost of the repairs.
- Escrows are not permitted on refinances.