CHAPTER 2
REQUIREMENTS FOR INITIAL AND CONTINUING FHA APPROVAL

## Part A. Requirements for all Mortgagees

2-1 Introduction. A mortgagee must meet the following general requirements to be approved for participation in the FHA mortgage insurance programs. A mortgagee also must meet the specific requirements that apply to the type of mortgagee for which it seeks approval. The additional requirements are specified in Part B of this chapter.

2-2 Business Form. A mortgagee seeking approval must be a corporation, partnership, or other chartered institution, and must be a permanent organization having succession. A sole proprietorship or trust is not an acceptable business form for approval as a FHA mortgagee.

A. Corporation. To be approved as a FHA mortgagee a corporation must be an entity, chartered in the United States; and meet all applicable laws regarding corporations.

The corporation must be able to survive the death or incapacity of an officer or shareholder. In determining official capacity or ownership, the Department, while accepting familial relationships, requires that there be a bona fide intent to share responsibilities and duties. If a related individual has no substantive role in the management or operation of the mortgagee, ownership interest by that related party is aggregated with that of the individual having the operational or management role. However, in determining ownership, all classes of stock for each owner must be aggregated to determine someones ownership interest.

B. Partnership. A partnership may be approved as a FHA mortgagee. However, each general partner that is a corporation or other chartered institution that consists of two or more persons. An individual person or a personal corporation is not eligible as a general partner in an approved mortgagee.

1. Managing General Partner. One general partner must be designated as the managing general partner. The managing general partner must have as its principal activity the management of one or more partnerships, all of which are mortgage lenders, property improvement or manufactured home lenders; and must have exclusive authority to deal with FHA on behalf of each partnership. The managing general partner, if itself a FHA approved mortgagee, may only be an investing mortgagee. The managing general partner must meet the requirements with respect to officers.

2. Partnership Agreement. The partnership agreement must specify that the partnership will exist for a minimum term of 10 years. In the event that a partner withdraws, the partnership must be specifically authorized to continue its existence.

C. Limited Liability Company (LLC). A limited liability company is an unincorporated legal entity created under applicable State law combining legal and tax attributes of corporations and partnerships. The owners are referred to as members and generally have their liability limited to their investment. A LLC is neither a partnership nor a corporation but rather a different kind of legal entity formed and operated under the States LLC laws. Some States do not allow LLCs to be used in certain businesses. For

FHA, the key factors as to whether an LLC may be approved are permanence and succession of the LLC. The LLCs Articles of Organization and/or Operating Agreement must:

* Specify that the LLC consist of two or more members. A single member LLC is acceptable only if the member is a corporation consisting of two or more persons;
* Specify a minimum term of existence of at least ten years;
* Provide for succession;
* Authorize continuance in the event of the withdrawal or death of a member; and
* Specify that the LLC will not terminate until all FHA-insured mortgages have been transferred to another approved mortgagee.

The LLC must submit its Operating Agreement. Some States LLC laws may conflict with FHA requirements, thus precluding approval of an LLC as a FHA lender in those States. Also, there is the possibility that an LLC formed in one State may not have the same legal standing in another State. State laws must be considered in both the application and approval processes. A managing member must be designated as the FHA contact. A single-member LLC is an acceptable form of business for approval as a FHA mortgagee only if the single member is a corporation consisting of two or more persons.

2-3 State Licensing Requirements. A mortgagee must obtain all required business licenses prior to, or in conjunction with, approval as a FHA mortgagee. Except for a supervised mortgagee, copies of all required licenses must be submitted with the application. A state-licensed mortgagee must also submit a letter certifying to the Department that it has not been refused a license or sanctioned. If the mortgagee has been subject to an action against its license, it must submit documentation concerning the action.

2-4 Mortgagee Name. All applicants must submit documentation that they have State approval for both their legal name and any doing business as name they use. All applications for approval as a non-supervised mortgagee, non-supervised loan correspondent, or investing mortgagee whose legal or dba name includes national, Federal, or another restricted word, must as part of their application provide documentation that they have a legal right to its use (see 18 U.S.C. º709. False advertising or misuse of names to indicate Federal agency). Generally, this right is only available to applicants that are a wholly owned subsidiary of a federally regulated financial institution.

2-5 Net Worth Requirements. Except for investing mortgagees and government institutions, mortgagees must meet specified net worth requirements for initial approval and to maintain approval. Adjusted net worth is owners equity in the mortgagee less unacceptable assets. Adjusted net worth must equal or exceed the minimum requirement for the mortgagee. The net worth requirement for a supervised mortgagee or a non-supervised mortgagee increases after approval according to its FHA-insured single-family mortgage volume.

A. Requirements.

1. Supervised and Non-supervised Mortgagees.

a.   Initial Approval.  For initial approval, any supervised mortgagee or non-supervised mortgagee must have an adjusted net worth of not less than $250,000.  Supervised applicants are not required to verify adjusted net worth in their application, but may be asked to verify compliance during application processing.

b.   Continued Approval.  For continued approval, any supervised mortgagee or non-supervised mortgagee must maintain an adjusted net worth of one percent of the volume of FHA single family insured mortgages the mortgagee originated, purchased, or serviced during the prior fiscal year, but not less than $250,000, up to a maximum requirement of $1 million.  Supervised mortgagees are not required to verify adjusted net worth to renew their approval, but may be asked to verify compliance during the renewal process.

c.   Mortgage Volume.  In calculating mortgage volume, only single-family FHA-insured mortgages are counted.  The mortgage volume for a sponsor of a loan correspondent includes the aggregate original principal amount of mortgages purchased from its loan correspondents during the mortgagees fiscal year.  HECMs are included at their maximum claim amount irrespective of outstanding principal.

To determine mortgage volume at the end of the fiscal year under audit:
* Start with the aggregate unpaid principal balance in the servicing portfolio as of the end of the mortgagees fiscal year;
* Add the aggregate original principal amount of insured mortgages endorsed during the fiscal year;
* Add the aggregate original principal amount of insured mortgages purchased from sponsored loan correspondents during the fiscal year; and
* Subtract from this total the aggregate outstanding principal balance of insured mortgages originated by the mortgagee or purchased from its loan correspondent(s) during the mortgagees fiscal year that were retained for servicing.

Examples of calculations to determine net worth requirements are included in chapter 7 of the most recent version of HUD IG Handbook 2000.04, Consolidated Audit Guide for Audits of HUD Programs.

2.   Mortgagee Approved Only for Multifamily Programs.  Any mortgagee approved for participation only in the multifamily mortgage insurance programs must have an adjusted net worth of not less than $250,000, but is not subject to net worth requirements based on mortgage volume.

3.   Supervised and Non-supervised Loan Correspondents.  For initial approval and for continued approval, a loan correspondent must have and maintain an adjusted net worth of at least $63,000, plus $25,000 for each registered branch office up to a maximum required adjusted net worth of $250,000.  Loan correspondents are not subject to net worth requirements based on mortgage volume.  Supervised entities are not required to verify adjusted net worth, but may be asked to verify compliance during the approval or renewal process.

4.   Investing Mortgagee.  There is no specific net worth requirement for this type of mortgagee.  However, it must have funds or funding arrangements for investment.  See paragraph 2-30 for details.

5. Governmental Institution. There is no specific net worth requirement for this type of mortgagee.

B. Calculation of Adjusted Net Worth. All calculations must be prepared by a CPA pursuant to chapter 7 of the most recent version of HUD IG Handbook 2000.04, Consolidated Audit Guide for Audits of HUD Programs. Applicants seeking approval as a non-supervised mortgagee or non-supervised loan correspondent must also submit to the FHA a CPA certified audit report; see paragraph 3 2(A)(6) for details.

2-6 Liquid Assets.

A. Requirement. A supervised or non-supervised mortgagee or loan correspondent must maintain liquid assets of 20 percent of its adjusted net worth or $100,000 whichever is lesser. Supervised applicants are not required to verify liquid assets in their application, but may be asked to verify compliance during application processing.

B. Acceptable. Cash and cash equivalents constitute liquid assets. Cash includes cash on hand, checking accounts, savings accounts, and certificates of deposit. Cash equivalents are readily marketable investments, e.g. securities readily convertible into cash. To be considered a liquid asset, the cash or cash equivalent must not be restricted or otherwise reserved for any purpose other than the payment of a current liability.

C. Unacceptable. FHA does not consider a line of credit or loans or mortgages held for resale by the mortgagee to be liquid assets.

2.7 Application Fees. All fees are nonrefundable

A.. Fee Amount.

1. Mortgagee Approval. The fee is $1,000 except for those entities already approved as a Title I lender, governmental institutions or non-depository not-for profit entities.

2. Branch Office Registration. The fee is $300, except for governmental institutions or non-depository not-for profit entities.

B. Fee Payment. The application fee must be mailed to HUDs lockbox together with the HUD form, Application Fee for Title II Mortgagee Approval to the following address:

U.S. Department of HUD
P.O. Box 198619
Atlanta, GA 30384

Copies of the check and application fee form must accompany the FHA lender application form. If not, a copy of the front and back of the cancelled check will be requested.

2-8 Operating Expenses. A mortgagee must pay all its own operating expenses. This includes expenses of its main and branch offices involved in originating or servicing any FHA insured mortgages. Operating expenses include, but are not limited to, equipment, furniture, office rent, overhead, employee compensation, and similar expenses.

2-9 Employees and Officers. An approved mortgagee must employ trained personnel that are competent to perform their assigned responsibilities.

A. Employees. Employees are those individuals who are under the direct supervision and control of an FHA approved mortgagee and where the individuals are exclusively employed by the FHA approved mortgagee in the mortgage lending and real estate fields. The mortgagee must demonstrate the essential characteristics of the employer-employee relationship upon inquiry by the Department. [See also paragraphs 2-9(D) and 2-9(G)]

Compensation of employees may be on a salary, salary plus commission, or commission only basis and includes bonuses. All compensation must be reported on Form W-2. Employees who perform underwriting and loan servicing activities may not receive commissions.

B. Officers. Individuals are officers for the purposes of FHA requirements if they bear the corporate title of Vice President or higher and also include Branch Managers. A mortgagee must have one or more officers with authority over the mortgagees loan origination and servicing operations. An officer is either a corporate officer, or a principal of a non-corporate entity, who has authority to legally bind the corporation or entity. In the case of a government institution, this role would be filled by a designated staff person(s). At least one officer must spend full time managing and directing the mortgagees operations. That officer must have a minimum of three years acceptable experience in the mortgage activities for which the mortgagee is seeking approval. Relevant training may be substituted for some of the required experience. An applicant must submit, with its application, current resumes documenting this experience. In determining the acceptability of an officers experience, the Department will consider:

* Experience in originating single family and multifamily mortgages;
* Experience in servicing single family and multifamily mortgages;
* Experience in investing funds in real estate mortgages;
* Experience in managing other individuals performing these services; and

* Experience in real estate sales or brokerage does not qualify.

A Branch Managers compensation may be based upon the net profit of the branch. For example, the FHA approved mortgagee may collect the revenue from the branch, pay the branch expenses, and then pay the branch manager the remaining revenues, if any, as a commission. Such an arrangement is, essentially, an alternative compensation program for the branch manager and is an acceptable arrangement if all other branch requirements are met.

C. Companies with Joint Officers. If a mortgagee has any of the same officers, stockholders, partners, or members as another entity, the officers may represent more than one entity if:

1. There is a clear and effective separation of the two entities, and mortgagors know at all times exactly with which entity they are doing business.

2. There is a duly appointed or elected senior officer, with the required minimum three years of acceptable experience, designated to conduct exclusively the affairs of the mortgagee during normal business hours.

D. Control and Supervision of Staff. A mortgagee must exercise control and responsible management supervision over its home office and branch employees. Control and supervision must include, at a minimum, regular and ongoing reviews of employee performance and of work performed.

E. Signatory Authority. Any employee who signs applications for mortgage insurance on behalf of the mortgagee must be a Vice President, or be authorized to bind the mortgagee in matters involving the origination and servicing of insured mortgages.

F. Conducting Mortgagee Business. During his/her normal duty hours, employees, who are involved with FHA transactions, may conduct only the business of the mortgagee.

G. Full Time, Part Time and Outside Employment. A mortgagee may employ staff full time or part time (less than the normal 40 hour work week). They may have other employment including self employment. However, such outside employment may not be in mortgage lending, real estate, or a related field. Direct endorsement underwriters are included in this provision. An underwriter may not work on a part time basis for any other mortgagee, even underwriting conventional mortgage loans. An underwriter may not underwrite loans for a parent or subsidiary of the underwriters approved employer. A direct endorsement underwriters authority is through the employer and does not extend under any corporate umbrella.

2-10 Ineligible Participants. An applicant is ineligible for approval if the mortgagee or any officer, partner, director, principal, or employee of the applicant mortgagee is:

A. Suspended, debarred, under a limited denial of participation (LDP), or otherwise restricted under 24áCFRáPart 24 or 25 or under similar provisions of any other Federal agency;

B. Under indictment for, or has been convicted of, an offense that reflects adversely upon the applicants integrity, competence or fitness to meet the responsibilities of an approved mortgagee;

C. Subject to unresolved findings contained in a HUD or other governmental audit, investigation, or review;

D. Engaged in business practices that do not conform to generally accepted practices of prudent mortgagees or that demonstrate irresponsibility; and

E. Under investigation for any HUD-related violation.

2-11 Office Facilities. The mortgagee may conduct its loan origination and/or servicing activities from any approved and adequately staffed office. A mortgagee is fully responsible for the actions of its offices. Mortgagees that lease space from a real estate agent must assure compliance with RESPA requirements.

A. Home office. Each applicant must identify which location they consider their main or home office for FHA mortgage activities. It doesnt have to be the entitys corporate office. A mortgagees home office facilities must:

1. Have adequate office space and equipment;

2. Be in a location conducive to mortgage lending;

3. Be located in a commercial space that is separate and apart from any other entity. A mortgagee may share general reception-type entrances or lobbies with another business;

4. Be clearly identified to the public so that loan applicants and mortgagors will know, at all times, exactly with whom they are doing business. This includes a permanently affixed business sign and other common means of identification used by a business entity;

5. Display a fair housing poster;

B. Traditional branch office. A traditional branch office is a separately located unit of the mortgagee in commercial space. A traditional branch office must:

1. Have adequate office space and equipment;

2. Be in a location conducive to mortgage lending;

3. Be separated from any other entity by walls or partitions. (Entrances and reception areas may be shared.);

4. Be identified to the public;

5. Display a fair housing poster;

6. Provide privacy for conducting interviews; and

C. Nontraditional branch office. A nontraditional branch office is required to meet branch office staffing requirements and the following requirements concerning office facilities:

1. It may be located in non-commercial space, but it must have adequate office space and equipment and must conform to the local government use requirements.

2. It must display a fair housing poster if the public is ever received.

D. Direct lending branch office. A direct lending branch is an office whose origination operation only uses a call center and/or the Internet for contacting consumers. It must meet the office facilities and staff requirements of a traditional branch office except that it must have a separate manager and can be collocated with a lenders home office or one of its traditional branches. See paragraph 5-8 for the approval criteria of a direct lending branch.

2-12 Staffing Requirements. An approved mortgagee must have sufficient staff or permitted contractor support for loan origination, processing, underwriting, servicing, and collection activities, to the extent that the mortgagee engages in these activities.

A. Home office. The mortgagee must have a home office staff of at least two full time employees. A shared receptionist, while permitted, may not be used to meet this requirement.

B. Branch office. A mortgagee must have at least one full time employee at each branch office. A manager must be assigned to each traditional and nontraditional branch office. A separate manager must be located at each direct lending branch.

C. Branch Managers, Loan Officers and Underwriters. Loan officers (also known as loan originators) of FHA-insured mortgages must be employees of the mortgagee. Underwriters of FHA-insured mortgages must be employees of the mortgagee; its authorized agent; or, if the mortgagee is a loan correspondent, its sponsors. Managers, loan originators and underwriters may not be independent contractors or contract employees.

D. Centralized Centers. Processing and/or underwriting functions may be centralized in any office(s) of the mortgagee or performed at each office of the mortgagee.

2-13 Outsourcing. A mortgagee may contract out certain administrative and clerical functions that do not materially affect underwriting decisions or increase the risk to FHA. However, the mortgagee is still responsible for the quality of the mortgages and must ensure compliance with program requirements and RESPA requirements. The management, underwriting, and loan originator functions may not be contracted out.

A. Types of functions that may be contracted out are:

* Clerical Assistance;
* Loan processing: typing of loan documents, mailing out and collecting verification forms, ordering credit reports, and/or preparing for endorsement and shipping loans to investors;
* Loan servicing: ministerial processing of a foreclosure action, preservation and protection, and/or tax services;
* Legal functions;
* Quality control reviews; and
* Such other functions as may be approved in advance by the Department.

B. Provider Requirements. The functions listed above in paragraph 2-13(A) may not be contracted out to third party loan originators, real estate brokers, or similar entities. An approved mortgagee may own or have an ownership interest in a separate business entity that offers such contract services. An affiliated business arrangement, in which affiliated or related companies make referrals to each other, is regulated under RESPA. (See RESPA [12 U.S.C. º2602]: (7) the term affiliated business arrangement means an arrangement in which (A) a person who is in a position to refer business incident to or a part of a real estate settlement service involving a federally related mortgage loan, or an associate of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a provider of settlement services; and (B) either of such persons directly or indirectly refers such business to that provider or affirmatively influences the selection of that provider.)

Mortgagees may not contract with entities or persons that are suspended, debarred, or under a relevant LDP or have agreed to a voluntary exclusion under 24 CFR part 24.

C. Costs of Outsourced Services. The costs of such services may not be imposed on a FHA borrower or mortgagor as allowed in the various FHA loan programs.

2-14 Prohibited Branch Arrangement. An approved mortgagee may not originate or service FHA insured mortgages from branches that do not meet FHA requirements.

A. Separate Entities Acting as a Branch Office. An approved mortgagee is prohibited from engaging an existing, separate mortgage company or broker to function as a branch of the approved mortgagee and allowing that separate entity to originate insured mortgages under the approved mortgagees FHA mortgagee number. This constitutes a prohibited branch arrangement. Separate entities may not operate as branches or DBAs of a FHA approved mortgagee. If the separate entity was purchased and legally merged into the approved mortgagee in compliance with applicable state law(s), the approved mortgagee must provide a copy of the merger documents and state license(s) to FHAs Lender Approval and Recertification Division, as described in paragraph 6-17.

B. Certain Employment Agreements. A FHA approved mortgagee must pay all of its operating expenses including the compensation of all employees of its main and branch offices. Other operating expenses that must be paid by the FHA approved mortgagee include, but are not limited to, equipment, furniture, office rent, utilities and other similar expenses incurred in operating a mortgage lending business. A branch compensation plan that includes the payment of operating expenses by the branch manager, any other employee or by a third party is a prohibited arrangement. The following includes some, but not all, examples of unacceptable provisions in employment agreements:

* Require all contractual relationships with vendors such as leases, telephones, utilities, and advertising to be in the name of the employee (branch) and not in the name of the FHA approved mortgagee;
* Require the employee (branch) to indemnify the FHA approved mortgagee if it incurs damages from any apparent, express, or implied agency representation by or through the employees (branchs) actions; and
* Require the employee (branch) to issue a personal check to cover operating expenses if funds are not available from an operating account.

2-15 Communications Capability and Responsibility. Except for a mortgagee that only services multifamily mortgages, a mortgagees home office and each branch office must be able to provide prompt responses to applicant or mortgagor inquiries by one of the following methods:

* The office staff need not maintain complete records on each mortgage in it area, but it must be able to secure such information for the applicant or mortgagor;
* Have toll-free telephone service at an office that can provide needed information; and
* Accept collect telephone calls from mortgagors at an office that can

provide the same sort of information as that described above.

To ensure equal opportunity for persons with hearing or speech impairments, it may be necessary for offices to purchase a TTY (telecommunications device for hearing and speech impaired persons) or provide equally effective communication systems. If an office offers a toll-free telephone number for non-disabled persons, it must also offer a toll-free opportunity for hearing and speech impaired persons, e.g., a relay system.

2-16 Fair Housing and Other Federal Laws.

A. A mortgagee must comply with the Fair Housing Act, Executive Order 11063 on Equal Opportunity in Housing, the Equal Credit Opportunity Act (ECOA), the Real Estate Settlement Procedures Act (RESPA), the Home Mortgage Disclosure Act (HMDA), and all other Federal laws relating to the lending or investing of funds in real estate mortgages.

B. A mortgagee must fully cooperate with any investigations brought by HUD pursuant to the any authority. A mortgagee must make all officers and employees available for interviews and must promptly provide (within not more than 30 days) information and documents requested by HUD, in the format HUD requests. Failure to fully cooperate may result in administrative action by the Mortgagee Review Board and possible referral to the U.S. Department of Justice for further action.

C. Fair housing posters. A mortgagee must post and maintain a fair housing poster at each place of business that participates in activities covered by Section 805 of the Fair Housing Act (i.e. making or purchasing of loans or providing other financial assistance: a) for purchasing, constructing, improving, repairing, or maintaining a dwelling; or b)ásecured by residential real estate). Fair housing posters must be prominently displayed so as to be readily apparent to all persons seeking residential real estate related transactions or brokerage services.

2-17 Misrepresentative Advertising. An approved mortgagee may not use misrepresentative advertising. If a mortgagee determines its branches or employees have engaged in such activity, then mortgagees must take action necessary to ensure that such practices do not occur again. All advertisements must emphasize the name of the company and not the government. See 18áU.S.C. º709 False advertising or misuse of names to indicate Federal agency and 18 U.S.C. º1017 Government seals wrongfully used.

A. Examples. This list is illustrative and should not be considered all-inclusive.

* Improperly using the name or seal of FHA or HUD to imply that the advertisement is from or is endorsed by FHA or HUD;
* Improperly advertising on a government type form designed to simulate an official Federal government document; and
* Stating that the advertisement will serve as your official MIP account notice.

B. Actions. When HUD finds advertising abuses by mortgagees, it will take prompt action, as appropriate:

* The Mortgagee Review Board may sanction the mortgagee and/or impose civil money penalties; or
* A referral may be made to the Departments Inspector General for its review; or further referral to the Department of Justice which has jurisdiction over criminal prosecution; or a referral may be made to the Federal Trade Commission which has jurisdiction over deceptive trade practices.

2-18 Loan Origination Requirement. All mortgagees must follow all applicable statutes, regulations and HUD written instructions, including program handbooks and mortgagee letters on loan originations. Non-FHA approved mortgage brokers meeting the requirements in Mortgagee Letter 00-10 may participate in the origination of a FHA Insured Reverse Mortgages (HECMs).

With few exceptions, a mortgagee must originate, close, fund, and submit mortgages for FHA insurance endorsement in its own name. A mortgagee may not perform only a part of the loan origination process, such as taking the loan application, and routinely transfer the underwriting package (appraisal report and/or mortgage credit package) to another mortgagee except between a loan correspondent and its sponsor, and a principal and its authorized agent. A loan correspondent may process an application and submit it to one of its sponsors for underwriting. The loan correspondent must close the loan in its own name, or in the name of the sponsor that underwrote the loan. An Authorized Agent may perform any part of the loan origination process, including underwriting, on behalf of its Principal; however the loan must be closed in the name of the Principal. For further information on the Principal-Authorized Agents, see chapter 5, Part B.

2-19 Geographic Restrictions for Loan Origination and Underwriting. Each office of a mortgagee (main office or branch office) is authorized to operate only in those states, the District of Columbia, and/or Puerto Rico as designated by the Department. Geographic restrictions apply to the loan origination component of taking a loan application and underwriting. The processing of loan applications can be done at any office of a mortgagee. Approved mortgagees may purchase, hold, service, and sell insured FHA mortgages without regard to geographic restrictions. Offices must not be located so as to avoid receiving applications from, or providing assistance to, minority loan applicants.

A. Origination Lending Area for Home Offices, Traditional Branches and Nontraditional Branches: The single family origination lending area of each office is based on its geographic location and is composed of one or more States. This lending area is also known as the Area Approved for Business (AAFB) and can be verified via the FHA Connection. A complete table of all lending areas is included in the Lender Approval FAQs in the FHA Connection FAQ section.

B. Origination Lending Area for Direct Lending Branches: The single family origination lending area of these branches are determined on a case-by-case basis, but normally contain all of the HUD Field Office jurisdictions in all States where the lender is State approved, registered or exempt to conduct direct lending. See paragraph 5-8 for the approval criteria of a direct lending branch.

C.   Underwriting Area of a DE Mortgagee.  A DE mortgagees initial approval to underwrite is granted by its respective HOC and covers all HUD Field Office jurisdictions within its AAFB plus those of any loan correspondents it sponsors and the AAFB for mortgagee that it established an Authorized Agent-Principal relationship.

D.   Streamline Refinance.  There are no geographic restrictions on the origination of streamline refinanced single-family loans.  See HUD Handbook 4155.1 for details on streamline refinancing.

E.   Sponsoring Loan Correspondents.  DE Mortgagees may sponsor loan correspondents operating in any HUD Field Office jurisdiction, whether or not they have origination approval for the same office.  The DE mortgagee uses their FHA Connection account to add a loan correspondent they want to sponsor.

F.   Multifamily Mortgagees.  A mortgagee participating in the Departments multifamily mortgage insurance programs may originate project mortgages in the jurisdiction of any Field Office.  The mortgagee must request and receive written permission from each Field Office in whose jurisdiction it seeks to do business.

2-20 Loan Servicing Responsibility.  Each mortgagee that services or sub services FHA insured single-family mortgages must be an approved mortgagee and must follow the requirements of HUD Handbook 4330.1, Administration of Insured Home Mortgages.  Multifamily servicing mortgagees must meet the requirements of HUD Handbook 4350.4, Insured Multifamily Mortgagee and Field Office Remote Monitoring.

A Title II mortgagee may assign or otherwise transfer an insured Title II mortgage only to another approved Title II mortgagee.  The transferee or assignee may be any lender type except a non-supervised loan correspondent.

2-21 Escrow Funds.

A.   Use of Escrow Funds.  Mortgagees may not use mortgagor escrow funds for any purpose other than for which they were received.  Escrow commitment deposits, work completion deposits, and all periodic payments received by the mortgagee, including ground rents, taxes, assessments, and insurance premiums, must be deposited with one or more financial institutions in a special account or accounts fully insured by the FDIC or the NCUA.  This requirement may be modified only with the written permission of the Department.  See HUD Handbook 4330.1 for details on escrow accounts.

B.   Reporting of Escrow Funds.  If escrow funds are reported on the balance sheet, they must be fully offset by a corresponding liability and must be segregated on the balance sheet.  A mortgagee may not report escrows as its own assets.  The annual audit of non-supervised mortgagees and loan correspondents must cover such fiduciary accounts.

2-22 Prohibited and Permissible Payments.  A mortgagee may not pay any fee, kickback, compensation or thing of value (including a fee representing all or part of the mortgagees origination fee) to any person or entity in connection with a FHA insured mortgage transaction, except for services actually performed and permitted by the Department.

A. Prohibited Payments. A mortgagee is not permitted to:

1. Advance funds to a real estate agent, real estate broker, mortgage broker, or packager as an advance of anticipated commissions on sales to be financed with a FHA-insured mortgage loan to be provided by the mortgagee.

2. Make low interest or no interest loans to a real estate broker, real estate agent, mortgage broker, packager, builder or any other party from whom the mortgagee accepts proposals involving FHA-insured mortgages.

3. Pay a gratuity or make a gift valued above items that are customarily distributed in the normal course of advertising, public relations, or as a general promotion device, to any person or entity involved in FHA-insured mortgage transactions of the mortgagee.

4. Pay any compensation or fee that is prohibited by RESPA.

B. Permissible Payments for Services Performed. In connection with FHA insured mortgages and mortgage insurance applications, a mortgagee may pay fees permitted by program policy as identified in HUD Handbooks, Mortgagee Letters or Circular Letters. Generally, the policy for:

1. Single Family Origination is in HUD Handbook 4000.2 , Mortgagees Handbook, Application Through Insurance (Single Family), HUD HUD Handbook 4000.4, Single Family Direct Endorsement Program, or HUD Handbook 4155.1, Mortgage Credit Analysis for Mortgage Insurance on One to Four-Family Properties.

2. Single Family Servicing is in HUD Handbook 4330.1, Administration of Insured Home Mortgages.

3. Multifamily Development is in HUD Handbook 4430.1, Initial Closing Requirements for Project Mortgage Insurance..

4. Multifamily Servicing is in HUD Handbook 4350.4, Insured Multifamily Mortgagee and Field Office Remote Monitoring.

2-23 Quality Control. A mortgagee must maintain a written Quality Control Plan for the origination and servicing of FHA insured mortgages. The Quality Control Plan and its implementation must meet the requirements set forth in chapter 7. Mortgagees are required to report to HUD any fraud, illegal acts, irregularities or unethical practices.

2-24 Requirement to Notify HUD of Changes Subsequent to Approval. A mortgagee must notify the Department in writing within a specific number of days of any business change that affects its standing as an approved institution, or which changes the information on which it was originally approved, including: corporation conversion, merger, consolidation, succession, liquidation, termination; or a change in its charter provisions, name, bylaws, location, ownership, character of business, or senior officers; or a significant reduction in its revenues, assets or net worth. See chapter 6 for details.

## Part B. Additional Requirements for Specific Mortgagee Types

2-25 Introduction. A mortgagee may be approved to participate in the Departments mortgage insurance programs as one of the following designated types of mortgagee. In addition to the general approval requirements of Part A of this chapter, it must meet specific requirements for its particular mortgagee type.

2-26 Supervised Mortgagees. A supervised mortgagee is a financial institution that is a member of the Federal Reserve System or an institution whose accounts are insured by the FDIC or the NCUA. Such a mortgagee is not required to have mortgage lending as a principal activity as described in paragraph 2 29(C). A subsidiary or an affiliate of a supervised financial institution is not considered to be supervised for approval as an FHA mortgagee. Examples of supervised mortgagees are banks, savings associations, and credit unions.

A. Permissible Mortgage Lending Activities. A supervised mortgagee may originate, underwrite, purchase, hold, service, and sell FHA insured mortgages and submit applications for mortgage insurance.

B. Branch Offices. A supervised mortgagee may maintain FHA registered branch offices that originate insured mortgages. Specific approval requirements are in chapter 5. The mortgagee is fully responsible to HUD for the actions of its offices.

C. Fiduciary Relationships. Approval of a financial institution as a supervised mortgagee constitutes approval for it to act in a fiduciary capacity in investing fiduciary funds, which are under its individual or joint control. When such a fiduciary relationship is ended, any insured mortgages held in the fiduciary estate must be transferred to an approved supervised mortgagee; the fiduciary relationship must permit the transfer.

2-27 Non-supervised Mortgagees. A non-supervised mortgagee is a financial entity that has as its principal activity the lending or investing of funds in real estate mortgages.

A. Permissible Mortgage Lending Activities. A non-supervised mortgagee may originate, underwrite, purchase, hold, service, and sell FHA insured mortgages and submit applications for mortgage insurance.

B. Branch Offices. A non-supervised mortgagee may maintain FHA approved branch offices for the origination of FHA insured mortgages as described in chapter 5.

C. Warehouse Line of Credit Requirement. A non-supervised mortgagee, except a mortgagee approved for participation only in the multifamily mortgage insurance programs, must maintain a warehouse line of credit or other mortgage-funding program acceptable to the Department. Acceptable programs include table funding and concurrent funding arrangements. The program must be adequate to fund the mortgagees average 60-day origination production pipeline, but not less than a $1 million warehouse line of credit or funding program. The line of credit must be issued directly to the mortgagee. In lieu of a warehouse line of credit, a mortgagee may have a letter from a financial institution stating that it will fund all mortgages originated by the mortgagee.

D. Principal Activity. A non-supervised mortgagee must spend a majority of its time and assets in the production of real estate mortgages and in the lending or investment of funds in real estate mortgages, or a directly related field. For FHA purposes, the principal activity of a non-supervised mortgagee, other than one organized as a not-for-profit entity, must contribute at least one-half of the entitys gross revenues, unless otherwise approved by FHA.

E. Annual Certified Audit Report. For continued approval, a non-supervised mortgagee must submit to the Department an acceptable audit report within 90 days after the close of the mortgagees fiscal year. The audit report must be prepared in accordance with the requirements of the most recent off HUD IG Handbook 2000.04, Consolidated Audit Guide for Audits of HUD Programs.

2-28 Supervised Loan Correspondents. A mortgagee that meets the Departments definition of a supervised mortgagee may apply for and receive approval as a loan correspondent. The approval must be requested by at least one Sponsor. An approved loan correspondent is required to have at least one qualified sponsor at all times.

A. Sponsor. A sponsor of a loan correspondent must be a DE mortgagee.

1. Responsibility for Loan Correspondents. The Sponsor is responsible to the Department for the actions of each of its loan correspondents in originating FHA-insured mortgages. A Sponsor must supervise and perform quality control reviews of each of its loan correspondents. See chapter 7 for details.

2. Underwriting. The Sponsor performs loan underwriting on behalf of a loan correspondent. All mortgages originated by the loan correspondent must be closed in the name of the loan correspondent or the sponsor underwriting the loan.

B. Permissible Mortgage Lending Activities. A supervised loan correspondent may originate FHA insured mortgages and submit applications for mortgage insurance.

1. Sale only to Sponsor(s). It may not sell or otherwise transfer any FHA mortgage to any mortgagee other than its registered Sponsor that underwrote the loan, without prior written approval from the Department.

2. Servicing. A supervised loan correspondent may service FHA-insured mortgages in its own portfolio with the prior permission of the Department. Such requests should be submitted to the Lender Approval and Recertification Division.

C. Funding agreement. A supervised loan correspondent must have a letter or written agreement from each of its Sponsors that the Sponsor will purchase all FHA mortgages that the loan correspondent originates and that the Sponsor underwrites.

D. Branch Offices. A supervised loan correspondent may maintain FHA registered branch offices for the origination of insured mortgages as described in chapter 5, PartáA.

2-29 Non-supervised Loan Correspondents. A non-supervised loan correspondent is a financial entity that has as its principal activity the origination of mortgages for sale or transfer to one or more registered Sponsors. An approved loan correspondent is required to have at least one qualified sponsor at all times.

A. Selection of a Sponsor. A Sponsor of a loan correspondent must be a DE mortgagee.

1. Responsibility for Loan Correspondents. The Sponsor is responsible to the Department for the actions of each of its loan correspondents in originating FHA-insured mortgages. A Sponsor must supervise and perform quality control reviews of each of its loan correspondents. See chapter 7 for details.

2. Underwriting. The Sponsor performs the loan underwriting function on behalf of the loan correspondent. All mortgages originated by the loan correspondent must be closed in the name of the loan correspondent or the Sponsor underwriting the loan.

B. Permissible Mortgage Lending Activities. A non-supervised loan correspondent may originate FHA insured mortgages and submit applications for mortgage insurance.

1. Sale only to Sponsor(s). It may not sell or otherwise transfer any FHA mortgage to any mortgagee other than its registered Sponsor that underwrote the loan, without prior written approval from the Department.

2. May not hold, purchase, or service. It may not hold, purchase, or service FHA-insured mortgages.

C. Principal Activity. A non-supervised loan correspondent must spend a majority of its time and assets in the production of real estate mortgages and in the lending or investment of funds in real estate mortgages, or a directly related field. For FHA purposes, the principal activity of a non-supervised loan correspondent, other than one organized as a not-for-profit entity, must contribute at least one-half of the entitys gross revenues, unless otherwise approved by FHA.

D. Funding agreement. It must have a written agreement with each of its Sponsors to fund all mortgages that it originates and that the Sponsor underwrites

E. Branch Offices. A loan correspondent may maintain FHA registered branch offices for the origination of insured mortgages as described in chapter 5, Part A.

2-30 Investing Mortgagees. An investing mortgagee is an organization, including a charitable or not-for-profit institution or pension fund, that invests funds under its own control.

A. Permissible Mortgage Lending Activities. An investing mortgagee may purchase, hold, and sell FHA-insured mortgages. It may not submit applications for mortgage insurance. It may not service insured mortgages without the prior approval of the Department, and must arrange for an approved mortgagee to service all insured mortgages the investing mortgagee acquires and monitor the performance of any service they hire.

B. Special Requirements. An investing mortgagee must meet the following requirements:

1. It must have lawful authority to purchase insured mortgages in its own name.

2. It must have available, or have arranged for, funds sufficient to support a projected investment in real estate mortgages of at least $1 million. For example, a $1 million line of credit is acceptable.

2-31 Governmental Institutions. Any of the following may be approved as a mortgagee:

* A Federal, State or municipal government agency;
* A Public Housing Authority or State Housing Agency;
* A Federal Reserve Bank;
* A Federal Home Loan Bank;
* Freddie Mac; and
* Fannie Mae.

A. Permissible Mortgage Lending Activities. A governmental institution may originate, underwrite, purchase, hold, service, and sell FHA insured mortgages and submit applications for mortgage insurance to the extent authorized by Federal, State, or local law.

B. Branch Offices. These mortgagees may maintain branch offices that originate and service insured mortgages as described in chapter 5, Part A.

C. Audit Requirements. Except upon request, a governmental institution is not required to submit an audit to obtain or retain approval to participate in the Departments mortgage insurance programs. The Single Audit Act Amendments of 1996 placed State and local governments, colleges and universities, and other not-for-profit grantees under the same audit process. As a result of this modification of the Single Audit Act, the Office of Management and Budget (OMB) issued uniform standards for the audit of such entities receiving Federal financial assistance, in Circular A 133, Audits of States, Local Governments, and Non-Profit Organizations. For additional information see HUD IG Handbook 2000.04, Consolidated Audit Guide for Audits of HUD Programs and AICPA Statement of Position 98 3, Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards.