1. GENERAL. As of November 1, 1976, all Field Offices were authorized to accept for processing applications for mortgage insurance under Section 245. This Handbook details the procedures to be followed to insure a mortgage under Section 245. Field Office staffs must become thoroughly familiar with the new Section 245 Program. Where a change in processing is not specifically identified, outstanding instructions established for mortgages insured under the Section 203(b) or Section 234(c) programs shall apply.

2. BACKGROUND. Section 245 of the National Housing Act, under which the Graduated Payment Mortgage (GPM) Plan was implemented, was enacted as a part of the Housing and Community Development Act of 1974. Legislative amendments were also provided in the Housing and Community Development Act of 1977.

3. OBJECTIVE. HUD's objective has been to develop and promote new methods of mortgage financing which will help meet the needs of the potential homebuyer presently priced out of the housing market because of the cost of housing. By the development of the Graduated Payment Mortgage Program, HUD has taken steps to meet this objective.

4. MAJOR FEATURES OF THE PROGRAM.

   a. Mortgages shall be insured under Section 203(b) or 234(c) pursuant to Section 245 and must meet the requirements of these sections except as specifically modified below.

   b. Five specific plans are authorized. Three plans will permit five years of increasing payments at 2-1/2, 5, and 7-1/2 percent annually. However, during each year, the monthly payments will be level. Increases will occur annually. Starting in the sixth year (for the five-year plans) or the eleventh year (for the 10-year plans), the monthly payments will be level for the remaining term.

   c. Description of Plans I, II, III, IV, and V.

      Plan I Monthly mortgage payments increase 2-1/2 percent each year for five years.

      Plan II Monthly mortgage payments increase 5 percent each year for five years.

      Plan III Monthly mortgage payments increase 7-1/2 percent each year for five years.

      Plan IV Monthly mortgage payments increase 2 percent each year for ten years,

      Plan V Monthly mortgage payments increase 3 percent each year for ten years.

5. APPLICATION FOR MORTGAGE APPROVAL.

a. Except as modified herein, the mortgage credit underwriting determination shall be applied in accordance with the instructions in Handbook 4155.1 or Handbook 4265.1 for Section 203(b) or Section 234(c), respectively.

b. Factors for computing monthly installments to amortize a loan for each of the five plans are shown in Appendix 1. Appendix 2 contains factors for computing the annual mortgage insurance premium for each of the five plans. In computing the monthly payments, the monthly installments should be increased to the next highest penny. This will ensure that the actual deferred interest is always less than the amount shown in the note.

c. Occupant mortgagor. The program is limited to owner-occupant mortgagors. The application for approval of the mortgagor shall be made on Form FHA 2900, Mortgagee's Application for Mortgagor Approval and Commitment for Mortgage Insurance under the National Housing Act. The submittal must include a certification from the mortgagors that they are aware that the plan chosen provides for increasing monthly payments for a period of five or ten years. Under Item 2 of Form 2900, insert along with the case number, the specific plan selected (i.e., PLAN I, PLAN II, PLAN III, PLAN IV, or PLAN V).

d. The following certification shall be attached to each Form FHA 2900 submitted pursuant to Section 245;

"I/we certify that I/we fully understand the obligation I/we are undertaking, that my/our mortgage payment to principal

and interest will start at $__________ and will increase by _____% each year for ______ years to a maximum payment of $__________ and the mortgage balance will increase to no more than $__________ at the end of the ________ year. The maximum total amount by which the deferred interest shall increase the principal is $__________. Monthly installments shall be due according to the following schedule:

(For use with Plans I, II, or III)

Principal & Interest	Mortgage Insurance Premium
$_________ during the 1st note year	$________ during the 1st note year
_________ during the 2nd note year	________ during the 2nd note year
_________ during the 3rd note year	________ during the 3rd note year
_________ during the 4th note year	________ during the 4th note year
_________ during the 5th note year	________ during the 5th note year
_________ during the 6th note year	________ during the 6th note year

and thereafter | and will continue to decline thereafter

OR

(For use with Plans IV or V)

Principal & interest		Mortgage Insurance Premium	
$__________	during the 1st note year	$_________	during the 1st note year
__________	during the 2nd note year	_________	during the 2nd note year
__________	during the 3rd note year	_________	during the 3rd note year
__________	during the 4th note year	_________	during the 4th note year
__________	during the 5th note year	_________	during the 5th note year
__________	during the 6th note year	_________	during the 6th note year
__________	during the 7th note year	_________	during the 7th note year
__________	during the 8th note year	_________	during the 8th note year
__________	during the 9th note year	_________	during the 9th note year
__________	during the 10th note year	_________	during the 10th note year
__________	during the 11th note year and thereafter	_________	during the 11th note year and will continue to decline thereafter

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In addition I/we will be required to make payments toward taxes, hazard insurance and other costs of homeownership.

Signed:

____
Mortgagor

____
Mortgagor

The above certification shall be prepared in duplicate. The mortgagor shall retain a copy and the original shall remain in the case binder.

6. MORTGAGE CREDIT PROCESSING.

a. The application for approval of the mortgagor shall be processed pursuant to outstanding mortgage credit guidelines established for Section 203(b) or Section 234(c) cases. In addition, care should be taken to assure that the applicant being approved has reasonable expectations of increased income to pay the mortgage payment increases specified under the plan selected.

b. The minimum cash investment will be the greater of: (1) 3% of the first $25,000 plus 5 percent of the balance of acquisition cost above $25,000; or (2) that amount necessary to cover the difference between the maximum insurable loan amount and the acquisition cost.

c. Amount and amortization period of loan.

(1) Occupant mortgagor. The program is limited to owner-occupant mortgagors. The principal amount of the mortgage cannot exceed the lesser of:

(a) 97 percent of the first $25,000 of value and closing costs, plus 95 percent of the remainder, but not exceeding $60,000; or

(b) An amount which, when added to all deferred interest pursuant to the financing plan selected, shall not exceed 97 percent of the appraised value of the property

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covered by the mortgage as of the date the mortgage is accepted for insurance. However, if the mortgagor is a veteran, the mortgage amount, when added to all deferred interest pursuant to the financing plan selected, shall not exceed the applicable limits prescribed for veterans under Section 203(b).

(2) Term. The term of the loan shall be limited to 30 years or 3/4 of the estimated remaining economic life of the property, whichever is lesser.

(3) Assumptions. Assumptions under this program are permitted as in all other programs. When an assumptor has been identified, the mortgagee should attempt to obtain from the new mortgagor a certification, in duplicate, see paragraph 5. d. The mortgagor shall retain a copy and the mortgagee shall place the original in its records.

(4) Program Limitations.

(a) The program is limited to owner-occupant mortgagors and single family dwelling units.

(b) The program is not available for the purchase of two to four-family units.

(c) Refinancing of an existing mortgage with level annuity payments to a GPM plan is not permitted. However, mortgagors with a GPM plan may refinance at any time to a level annuity mortgage.

d. Computing the maximum loan amount. Since the maximum mortgage amount cannot exceed the lesser of (a) or (b) cited above, it will be necessary to compute the allowable loan amount both on the basis of the method applicable to Section 203(b) as well as on the basis of 97 percent of the value including deferred interest.

Example: Assume a HUD value of $49,000 and closing costs of $1,000 and the cost of acquisition is $50,000. The mortgagor has requested a 30-year term at 8-1/2 percent and selected a GPM plan with increasing payments of 7-1/2 percent a year for the first five years of the mortgage term (Plan III). Referring to Appendix 3, page 17, the principal amount of the mortgage reaches the greatest amount after the 48th monthly payment, the

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end of four years. The highest outstanding balance factor is 1037.3747 or the mortgage amount will increase by approximately 3.7 percent from the amount disbursed at origination.

NOTE: Under all plans, the maximum outstanding balance will always occur at the end of a year unless no negative amortization is involved.

Regular GPM

Criterion I: 97 percent of $25,000 = $24,250
95 percent of $25,000 = 23,750
$48,000 Maximum Loan

Criterion II: 97 percent of $50,000 = $48,500

$48,500 divided by 1037.3747 (the highest outstanding balance factor) = $46.7526

$46.7526 x 1000 = $46,752 Maximum Loan

Maximum Allowable Loan (lesser of I or II): $46,750

GPM for Veterans

Criterion I: 100 percent of $25,000 = $25,000
95 percent of $25,000 = 23,750
$48,750 Maximum Loan

Criterion II: 100 percent of $25,000 = $25,000
95 percent of $25,000 = 23,750
$48,750

$48,750 divided by 1037.3747 (the highest outstanding balance factor) = $46.9936

$46.9936 x 1000 = $46,993 Maximum Loan

Maximum Allowable Loan (lesser of I or II): $46,950

GPM for Property Under Construction or Completed Less than One Year

Criterion I: 90 percent of $50,000 = $45,000 Maximum Loan

Criterion II: 97 percent of $50,000 = $48,500

$48,500 divided by 1037.3747 (the highest

outstanding balance factor) = $46.7526

$46.7526 x 1000 = $46,752 Maximum Loan

Maximum Allowable Loan (lesser of I or II): $45,000

e. Because of the negative amortization feature of the Section 245 program, it is possible for the outstanding principal balance on a mortgage insured under this section to exceed $60,000. No violation of Section 245 of the National Housing Act nor the regulations issued pursuant thereto occurs when the outstanding balance on a mortgage loan exceeds $60,000 pursuant to one of the financing plans approved by FHA.

f. Effect of interest rate increase on outstanding firm commitments. With respect to the Graduated Payment Mortgage Program, closing a loan at an interest rate higher than that specified in the firm commitment could result in the mortgage amount exceeding the statutory maximum. Therefore, after an interest rate increase, if a mortgagee desires to close at the new maximum based on a firm commitment issued under Section 245 prior to the effective date of the higher interest rate, the mortgagee must surrender the outstanding commitment to the local Field office in order that an appropriate change can be made in the maximum mortgage amount. If the mortgagee decides to close the loan at an interest rate equal to or less than that stated in the outstanding firm commitment, the local Field Office will not have to recalculate the mortgage amount.

7. COMPLIANCE WITH STATE AND LOCAL LAWS. Prior to the origination of any mortgage under this Section, each mortgagee is responsible for ascertaining whether the mortgage provisions outlined herein are permissible under local and State law. The Housing and Community Development Act of 1977 provides for a limited preemption of those State restrictions which would be applicable to Section 245 mortgages solely because of the method provided for payment of principal and interest. Section 206 of the Housing and Community Development Act of 1977 which amends Section 245 of the National Housing Act states in part "any mortgage or loan insured pursuant to this section which contains or sets forth any graduated mortgage provisions (including but not limited to provisions for adding

deferred interest to principal) which are authorized under this section and applicable regulations or which have been insured on the basis of their being so authorized, shall not be subject to any State Constitution, statute, court decree, common law, or rule or public policy limiting the amount of interest which may be

charged, taken, received, or reserved, or the manner of calculating such interest (including but not limited to prohibitions against the charging of interest on interest), if such statute, court decree, common law, or rule would not apply to the mortgage or loan in the absence of such graduated payment mortgage provisions."

* 8. NOTE AND MORTGAGE INSTRUMENT. Instructions and examples of the modifications to a note and mortgage instrument for loans insured under Section 245 are set forth in Appendix 4. *

9. CODE IDENTIFICATION.

a. For the purpose of identification and tracking, the Section of the Act codes shall be identified as follows:

Insurance Program by Section	Suffix Code
203(b)	270
234(c)	271

b. When a case is submitted for insurance endorsement pursuant to this program, the mortgagee shall include the plan number in parentheses following the FHA Case Number on the Mortgage Insurance Certificate Form FHA 9100-1.

10. STATISTICAL REPORTING REQUIREMENTS

a. To evaluate the effectiveness of the GPM program, close scrutiny of the program is necessary and essential. Consequently, on the first working day after the 15th and last day of each month, the Records Clerk shall prepare and submit a semimonthly report on program activity to:

Management Information Systems Division
Single Family Insured Branch
Room 9249
451 Seventh Street, S. W.
Washington, D. C. 20410

(1) The required information should be reported on Form FHA 2498 Rev. 11/77. Firm commitment applications under the program can be determined from Form FHA 2900-1, Box 2. The Receiving Clerk shall count all firm applications which have a plan number designated in Box 2 for the purposes of this report (see paragraph 5c). It is important that the number of firm applications be counted by Section of the Act, i.e., Section 203(b) or Section 234(c) and plan option within those sections. To compile the number of firm commitments issued during a reporting period for this program, the same procedure as outlined above applies. The Commitment Clerk shall examine Form FHA 2900-4, Box 2, to obtain this information.

(2) The number of Endorsements Completed can be determined from the Form FHA 9100-1 which indicates the FHA Case Number and Plan Number (see paragraph 9b). Cases insured under Section 203 pursuant to Section 245 will be identified by the suffix code 270 and cases insured under Section 234(c) pursuant to Section 245 will be distinguished by the suffix code 271. The Endorsement Clerk should count those Mortgage Insurance Certificates, Form FHA 9100-1, which have the suffix codes. Again, it will be necessary for the clerk to separate the cases by Section of the Act and plan number for record-keeping purposes.

(3) With regard to Reconsideration Requests, the Receiving Clerk shall count all requests received which are reconsiderations of previously received applications under Section 245.