

www.hudclips.org

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

MORTGAGEE LETTER 92-33
OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER
September 28, 1992
TO: ALL APPROVED MORTGAGEES
SUBJECT: Single Family Loan Production - Clarifications and
Modifications to the 203(k) Rehabilitation Program
Procedures

The purpose of this Mortgagee Letter is to make clarifications and modifications to the Department's policies described in HUD Handbook 4240.4 REV-2, dated December 6, 1991.

1. ACCOUNTING OF 203(k) REHABILITATION FUNDS. In Handbook 4240.4 (para. 1-20), the lender is required to provide to the local HUD Field Office the method(s) they will use to account for the release of Rehabilitation Escrow Funds. The accounting system acceptable to HUD must properly record all transactions from the escrow account. An accounting of the escrowed funds must be made on each Draw Request and copies of the record of transactions must be distributed to the originating lender, the borrower and to HUD.

The accounting system must show the amount escrowed for each category listed below. The total amount of all categories should agree with line B-14 of Form HUD 92700. The accounting system must provide:

- (1) Borrowers name and property address; (2) FHA case number; (3) Closing date; (4) Scheduled completion date (no more than 6 months from the closing date); and (5) Amount of funds in the rehabilitation escrow account (line B-14 of Form HUD 92700).

A. Repairs. Show the total amount in the Repair escrow. Provide a description and date of each draw request and include the total amount released at each Draw. Show the amount of Holdback on each Draw and the amount of funds disbursed (the difference between the total amount released and the 10 percent holdback amount). The balance remaining in the repair amount must be properly shown.

B. Contingency Reserve. Indicate the percent of repair funds

allocated for contingency reserve. Also indicate the total amount of funds in the Contingency Reserve Account and if they were paid by the borrower or out of mortgage proceeds. Provide

a

description and date of each Change Order (Form HUD 92577) approved for contingency reserve. Show the amount of funds disbursed and the balance remaining in the Contingency Reserve Account.

C. Inspection Fees. Show the total amount of inspection fees. Also show the number of inspections scheduled and the cost of each inspection. Provide a description and date of each inspection. Show the amount of funds disbursed and the balance remaining in the Inspection Account.

D. Title Update Fees. Show the total amount of Title Update fees. Also show the number of updates scheduled and the cost of each update. Provide a description and date of each update. Show the amount of funds disbursed and the balance remaining in the Title Update Account.

E. Mortgage Payments. Show the total amount of Mortgage Payment funds (PITI) that are escrowed. Indicate the number of months scheduled for mortgage payments as long as the property is not occupied. Provide a description and date of each payment. Show the amount of funds disbursed and the balance remaining in the Mortgage Payment Account.

F. Other Fees. The amount of allowable fees (i.e., Architectural and Engineering fees, Independent Consultant fees, Permits, Plan Review fees, Supplemental Origination fee and Discount Points on repair costs) necessary for the rehabilitation work, broken down by category. These fees may be released at closing with sufficient documentation (i.e., paid receipt for permits, bills from an Architect or consultant, etc.), but cannot exceed the accepted costs on the 203(k) Maximum Mortgage Worksheet, Form HUD 92700. Show the cost allowed for each item, the amount of funds disbursed and the balance remaining for each item in the account.

G. Final Accounting of the rehabilitation escrow account must be made after the final inspection and final draw. Any amount

remaining in the categories listed above must be properly disbursed to paydown the outstanding principal balance of the mortgage where applicable. The final accounting should show the payout of any holdback according to handbook procedures.

H. Interest on Escrow. Since the escrow funds must be placed in an interest bearing account, the interest earned must be accounted for and distributed to the borrower. Show the interest rate provided on the escrow account. For each draw on the escrow account, show the number of days in escrow and the amount of money in the account. Also show the interest earned for the applicable time period. List disbursements accordingly and the balance of interest remaining in the account.

2. REVISION TO FORM HUD 92700, 203(k) MAXIMUM MORTGAGE WORKSHEET.

Form HUD 92700, Section 203(k) Maximum Mortgage Worksheet (Attachment

1) has been revised. In particular, the Discount Points on Refinance in line D-3 was removed. This was placed on the form in error. The only time discount points can be included in the mortgage is in line B-12 (discount points on repair costs and fees) and D-1 (discount points on refinance when existing debt is the controlling factor).

Additional changes to the Form HUD 92700 have also been made to make it easier to use with the sale of a HUD-owned home. The new form should be used immediately to ensure compliance with program procedures.

The value placed on Form HUD 92800.5B should be (1) for a purchase transaction, line C-3 or (2) for a refinance transaction, the lesser of line D-1 minus the closing costs and discount points or line D-2. The lender should provide the Maximum Mortgage Worksheet to the

Field Office with information such as the contract sales price, amount of discount points on the loan, estimated closing costs, how many inspections are requested, title updates, and how many mortgage payments will be escrowed. The Maximum Mortgage Worksheet must be completed and signed by a HUD representative or the DE Underwriter

and attached to the Conditional Commitment/ DE Statement of Appraised Value (Form HUD 92800.5B). Also, for the firm commitment (Form HUD 92900), the Maximum Mortgage Worksheet should be revised and

attached to the Firm Commitment. These forms must be carefully prepared to ensure the rehabilitation escrow account is properly established and the loan is properly closed by the lender. On the Mortgage Credit Analysis Worksheet, Form HUD 92900-WS, lines 14a through 14d and

14f(1) and (2) will be left blank. For a purchase transaction, the total acquisition costs (sum of C3 + C4 on Form HUD 92700) is placed in line 14e; the maximum mortgage amount (line C5 on Form HUD 92700) is put in line 14g.

3. ALLOWABLE DISCOUNT POINTS. It has come to our attention that some lenders processing Section 203(k) rehabilitation loans are manipulating their discount fee structure to take advantage of the program's feature permitting discount points on the rehabilitation portion of the loan to be financed into the mortgage. Although Handbook 4240.4 (para. 1-10.B) permits borrowers to include

"discounts

... on that portion of the mortgage proceeds allocated to the rehabilitation," it does not permit lenders to charge a higher discount percentage on the rehabilitation portion (which may be financed) as opposed to a lower discount on that portion of the mortgage not attributable to rehabilitation (which may not be financed).

HUD will not permit, for example, a lender to obtain a yield of two (2) discount points on a \$100,000 loan by charging five (5) points

on

the \$40,000 rehabilitation cost rather than applying discounts to

the

entire mortgage amount. While the Department recognizes that the seller of the property may be paying discount points (and only on

that

portion attributable to the borrower's acquisition of the property), the loan transaction may not allocate discount points to the rehabilitation costs to simply reduce the borrower's cash requirements.

Consequently, the number of discount points charged to repair costs and fees (line B-12 of the Section 203(k) Maximum Mortgage

Worksheet,

Form HUD 92700) may not exceed the number of discount points charged to the non-rehabilitation portion of the mortgage. The borrower is not obligated to include discount points on rehabilitation costs in the loan, and can decide to pay all or part of the discount points. The HUD-1 must show the amount of discount points to be paid out-of-pocket by the borrower or seller, because the discounts on rehabilitation are already included in the loan proceeds. The Firm Commitment (Form HUD 92900) or the Addendum (For HUD 92900-A) must show the total of all discount points allowed on the loan.

Sales and financing concessions must be properly applied to reduce the

sales price or discount points prior to placing the allowable amounts

on the 203(k) Maximum Mortgage Worksheet, Form HUD 92700. See Handbook 4155.1 REV-4 (para. 1-7B) for additional information.

4. MAXIMUM MORTGAGE AMOUNTS ON SALES OF HUD-OWNED PROPERTIES.
When HUD's Property Disposition (PD) Branch decides to allow sales incentives (e.g., prepaids for excessive property taxes) as part of the mortgage, then Form HUD 92700 can be modified to reflect this policy.

The award letter must clearly state which incentives are allowed. The maximum mortgage is calculated based upon the sum of the sales price, the cost of repairs, and any incentives the borrower is allowed to include into the loan amount as stated in the award letter. If the seller (HUD) pays part of the closing costs, the estimated closing costs in C-4 should be reduced to reflect only those costs paid by the borrower at closing. The downpayment requirements, as shown in the HUD accepted sales contract, are then applied. The total mortgage amount cannot exceed the local maximum loan limits.

The following hypothetical mortgage calculation (for a HUD-owned property only) for Form HUD 92700 is provided for your information:

C.1. Lesser of Sales Price (A1) or As-is Value (A2).....	\$63,000
(Use the sales price agreed to between the HUD PD Branch and the purchaser of a HUD-owned property (shown in item 3, Contract, Form HUD 9548). No "As-is" appraisal is required a HUD-owned property sale)	
C.2. Total Rehabilitation Cost (B14).....	14,000
C.3. Lesser of Sum of C1 + C2 (\$77,000) or 110% of After-Improved Value (A4).....	77,000
C.4. Estimated Closing Costs (\$3,845 (A5) - 1,250 paid by HUD (item 5, sales contract)) + Prepaids for Excessive Property Taxes Required Upfront Prior to Closing (\$1,075).....	3,670
C.5. Maximum Mortgage Amount: Sum of C3 + C4 (\$80,670) less \$500 (downpayment shown on sales contract).....	80,170

Maximum Mortgage Amount cannot exceed \$80,150, rounded down

to the nearest \$50. This amount cannot exceed the local maximum loan limits.

5. PLAN REVIEWER CERTIFICATION. The following certification must be completed prior to returning the exhibits to the lender or forwarding them to the appraiser. The plan reviewer can certify on their own letterhead or on the Draw Request, Form HUD 9746-A. The appraisal cannot be made without this certification.

"I certify that I have carefully inspected the property located at _____ on _____ (date). I have reviewed the attached architectural exhibits and the estimated rehabilitation costs listed in column two below; they are acceptable for the rehabilitation of this property. I have no personal interest, present or prospective, in the property, applicant, or proceeds of the mortgage. To the best of my knowledge, I have reported all items requiring correction and that the rehabilitation proposal now meets all HUD requirements for 203(k) Rehabilitation Mortgage Insurance."

6. "CASH BACK" FROM REHABILITATION FUNDS. HUD Field Offices have noticed several cases where investors have received excessive "cash back" as a result of over-estimating the rehabilitation costs.

Handbook 4240.4 REV-2 (para. 3-2.F.) discusses the use of cost data publications from R.S. Means "Repair and Remodeling Cost Data" book and the "Home-Tech Remodeling and Renovation Cost Estimator." The cost estimates include overhead and profit for a contractor or a mortgagor doing their own work. Where the HUD Field Office has determined that these cost estimating books are excessive for certain localities in their jurisdiction, they now have the authority to require further justification from borrowers to ensure the cost estimates are reasonable. The Field Office will notify the 203(k) lender and plan reviewer if additional information is required for a particular case.

To guard against over-estimates of rehabilitation costs, the amount of funds requested for a draw inspection cannot exceed the actual cost of rehabilitation and/or the actual percent of completion of the rehabilitation. On each draw, the mortgagor must certify the actual

costs and completion percentage for each line item used on the revised Draw Request, Form HUD 9746-A (Attachment 2).

Where costs savings occur, the savings can be allocated to items that have experienced cost overruns or to pay for additional improvements to the property that are approved by a Change Order on Form HUD 92577.

The 10 percent holdback is still applicable on all draws. The mortgagor can be paid for their own labor, where it was approved by the lender prior to closing the loan. On the final draw:

A mortgagor acting as the general contractor can receive the holdback and request an additional 10 percent for the cost of administering the rehabilitation of the property, not to exceed the estimated cost of rehabilitation. On any line item where

the borrower is doing their own work or has an "identity of interest"

with the contractor (or subcontractor), the additional cost of administering the loan is not allowed, because the profit and overhead is already their estimated cost of rehabilitation for that line item. Any remaining cost savings must be applied to

the mortgage principal. For an investor/builder who is using the Escrow Commitment Procedure, the cost savings will

be added to the escrow amount that is held by the lender for release when an acceptable owner-occupant assumes the loan.

Cost savings that are not used must be applied to prepay the mortgage principal to create greater equity in the property for the investor. For the investor/builder using the Escrow Commitment Procedure, the cost savings will be added to the escrow amount that is held by the lender for release when an acceptable owner-occupant assumes the loan.

The Draw Request, Form HUD 9476-A (Attachment 2), is being revised to include a certification of actual costs. Columns 4 and 5 cannot exceed the actual cost of rehabilitation. The columns should show the percentage for the completion of construction. In column 6, the inspector will verify the percentage of completion and approve an amount no greater than that percentage, and no greater than what is requested. The following certification must be provided prior to the release of any inspection draws:

"I hereby certify that the actual costs of rehabilitation are as shown on the Draw Request, Form HUD 9746-A. I understand I cannot obtain additional monies from the rehabilitation account without the approval of the lender. After the final inspection, the monies in the escrow account will be distributed as required by the 203(k) program procedures."

Mortgagor's signature

Date

Lenders are responsible to assure the mortgagor certifies to the actual cost of rehabilitation on each draw request. Although the mortgagor is not required to submit documentation to substantiate the actual cost, the lender may request such documentation where there is a question as to the validity of the amounts.

7. SECONDARY LENDERS. The volume of 203(k) activity continues to increase. In fiscal year 1988, the Department issued Mortgage Insurance Certificates (MIC) on 432 loans. In fiscal year 1992, which ends September 30th, the activity has increased to about 3000 mortgages. The reason for the increase is attributed to more lenders processing 203(k) insured loans.

The Department continues to get calls from originating lenders requesting information about which secondary lenders buy 203(k) insured loans. A list of secondary lenders that have indicated an interest in purchasing Section 203(k) insured mortgages is attached as Exhibit 4 to this letter. If other lenders would like to be added to the list, please contact Kenneth Crandall of my staff at the telephone number listed below.

7

If you have any questions concerning this letter, please call your local HUD Office or the Valuation and Technical Support Branch in Headquarters at (202) 708-2720.

Very sincerely yours,

Arthur J. Hill
Assistant Secretary of Housing
- Federal Housing Commissioner

Attachments

203(k) SECONDARY LENDERS
(September 1, 1992)

1. Broadview Mortgage (Ohio Lenders Only)
965 High Street
Columbus, OH 43215

Contact: Lenny Zangardi (614) 436-2008
2. Federal Savings Bank and Mortgage
2800 Cantrell Road, Suite 500
Little Rock, AR 72202

Contact: Dennis Mills (501) 280-3500
(800) 395-6001
3. Liberty Mortgage Company
473 E. Rich Street
Columbus, OH 43215

Contact: Vickie Harmon (614) 224-4000
4. MLA, Incorporated
24315 Northwestern Highway
Southfield, MI 48075

Contact: Jack Goodman (800) 877-2130
Jim Milliken (800) 366-6522
5. Simmons First Mortgage Company
11101 Anderson Drive
Little Rock, AR 72212

Contact: Renee White (501) 223-4200
(800) 847-0058
6. Miami Valley Bank
P.O. Box 5000
Lakeview, OH 43331-5000

Contact: Bill Gibson (513) 843-4000
7. Malone Mortgage Corporation
8214 Westchester, Suite 606
Dallas, TX 75225

Contact: Ron Evans (214) 696-0386
8. Statewide Funding Corporation

P.O. Box 390
Clifton Park, NY 12065

Contact: Jane King (518) 877-3500
(800) 755-5851
(800) 726-5626

Attachment 1

203(K) Maximum Mortgage
Worksheet

* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *
* * * * *

GRAPHICS MATERIAL IN ORIGINAL DOCUMENT OMITTED

(09/09/92)

ref: Handbook 4240.4

form HUD-927000
