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

April 16, 1996

MORTGAGEE LETTER 96-18

TO: ALL APPROVED MORTGAGEES

SUBJECT: Single Family Loan Production - Refinance Transactions,
Property
Inspections and Other Credit Policy Issues

This Mortgagee Letter is to advise lenders regarding revised policy on several important issues.

I. REFINANCE TRANSACTIONS. In the recently revised mortgage credit analysis handbook (HUD 4155.1 REV-4 Change 1), we modified instructions on refinance transactions with appraisals (paragraphs 1-11A and 12B) to more adequately accommodate a greater range of situations. Since that time, we have been advised that additional information was needed to bring about more consistency in interpretation among lenders especially with regard to calculating the maximum insurable mortgage.

Specifically, in our instructions "existing first lien" may include the interest charged by the servicing lender when the payoff is not received on the first day of the month, as is typically assessed on FHA mortgages, as well as prepayment penalties such as those on certain conventional mortgages and FHA Title I home improvement loans. It may not, however, include delinquent interest, late charges or escrow shortages and does not permit a borrower to obtain "cash back" through not making the mortgage payment when due.

Further, "prepaid expenses" may include the per diem interest to the end of the month on the new loan, hazard insurance premium deposits, and any real estate tax deposits. This should more easily accommodate those transactions where the new originator is not the current servicer of the mortgage being refinanced.

Any upfront MIP refund must be subtracted from existing indebtedness in calculating the new mortgage amount and the amounts used to determine the new mortgage must be reasonable reflections of the actual payoff and closing costs at loan settlement. The maximum mortgage may not exceed the least of the following calculations: 1) appraised value plus costs multiplied by the appropriate loan-to-value ratio; 2) sum of existing first lien and other permitted costs as described in the handbook; and 3) appraised value exclusive of closing costs multiplied by 97.75 percent (or 98.75 percent if \$50,000 or less).

If the new loan amount on a streamline refinance with an appraisal will exceed the original principal of the loan being refinanced, the lender must document that the mortgagor's record of payment on the existing mortgage is satisfactory, and the borrower has not otherwise exhibited a disregard for credit obligations. Lenders are not to permit refinance transactions where additional mortgage debt is incurred if the borrower's record of payment is unsatisfactory. (Refinancing delinquent mortgages is separately addressed in paragraph 1-12D(7) of the mortgage credit handbook as well as Mortgagee Letter 94-30.)

ARM to ARM. Paragraph 1-12D(16) (a) should have indicated that the maximum interest rate of the new mortgage may not exceed the maximum interest rate of the old mortgage being refinanced. Please make a note of this.

Loan Applications on Streamline Refinances. On streamline refinances, lenders may use an abbreviated version of the URLA that omits sections IV, V, VI, and a-k of VIII provided all other required information is captured. Further, while the lender must assure itself that it is in compliance with ECOA and all other regulations, the loan application need not be signed by the borrower(s) until loan closing.

Termite Inspections. We do not require termite inspections on streamline refinances, with or without appraisals. The lending institution may, of course, require a termite inspection on a streamline refinance as part of its credit policy.

Transferring Cases Between Lenders on Streamline Refinances. As originally expressed in Mortgagee Letter 94-7 (ML 94-7), lenders are expected to cooperate in the assignment of streamline refinance cases upon the request of the borrower. We are especially concerned with lenders that obtain case number assignments without the homeowner's knowledge. Failure to cooperate may jeopardize the lender's participation in the DE program. Please also be advised that FHA's local offices are authorized to cancel case number assignments and issue new case numbers on behalf of the borrower when a lender refuses to reassign the case number.

II. PROPERTY-RELATED ISSUES.

"Early Start" Letters for Newly Constructed Properties. ML 95-57, which eliminated the builder approval process, also terminated the use of the Early Start Letter. However, in order to accommodate those builders that wish to begin construction before either the appraisal is completed or the lender issues the Statement of Appraised Value, the lender may continue to provide Early Start Letters as described in HUD Handbook 4145.1. This permits the borrower to obtain greater than 90 percent financing. An Early Start Letter is not required if the builder is providing a FHA-accepted ten-year warranty.

Lender Selected Inspectors. Effective immediately, FHA is discontinuing the practice of assigning inspectors on both new construction and existing houses. Lenders are to select inspectors from a panel of inspectors approved by FHA.

Since most states do not license inspectors, and because we wish to maintain management and training of inspector panel members, the local FHA office will continue to maintain an appropriately sized inspector panel in its jurisdiction. While the local office will continue to establish criteria for being listed on this panel, in those states where a license is required, new inspectors placed on the panel must be licensed. Our local offices will advertise its need to fill vacancies and/or expand the size of the inspector panel within its jurisdiction.

Lenders may select any inspector from the list via HUD Query from CLAS (CHUMS Lender Access System). HUD Query allows the lender to locate inspectors by field office number, inspector's name, city or state.

Lenders are advised not to continually select the same individual to inspect houses from the same builder. Lenders are to rotate inspectors, particularly in large subdivisions. If the local FHA office finds that an inspector tends to inspect for the same builder for more than a four-month period, the lender may be required to select a different inspector for future cases.

Local Inspections. In jurisdictions where the local FHA office has determined that the local code is adequately enforced and appropriate inspections are made by a local building department, FHA will accept these inspections for the first and second inspection on a newly constructed property. The final inspection must still be made by a FHA panel inspector. A certificate of occupancy or similar approval by the local building department is required at closing.

Lenders may contact the local FHA office for a list of jurisdictions which have been determined acceptable to make the first and second inspections in lieu of a FHA inspection. Lenders and builders are encouraged to nominate to the local FHA office those jurisdictions which provide adequate code enforcement and inspection services. In these communities, the first and second inspections may be performed by the local building officials rather than a FHA inspector; copies of these need not be submitted in the case binder. In such circumstances, the builder is only required to obtain a FHA-accepted 10-year warranty for greater than 90 percent financing if the property was not approved by the lender prior to the beginning of construction or an Early Start Letter was not issued prior to the issuance of the statement of appraised value.

Evidence of Completed Repairs. For non-structural repairs on existing houses, including new roof coverings, we will accept receipts from licensed contractors as evidence of completion. This will eliminate the need for and cost of a separate inspection. The lender is responsible for accepting the quality of all repairs. Also, for all repairs, we will accept inspections from licensed architects and engineers even if the individual is not on FHA's inspector panel.

Appraisals Completed before Case Number Assignment. CHUMS has been modified to accommodate appraisals that are assigned or completed before the FHA case number is assigned. This revision stems from several realities of the marketplace. First, under extreme time pressures, we do not believe that an appraisal assignment should be delayed until such time as the case number is assigned, even if that is only a few days such as what occurred during the recent government shutdown. Second, financing does not always start FHA but rather may move into that category for various reasons. We do not believe borrowers should be forced to pay for another appraisal or even a "re-type" fee.

From a risk management standpoint, we recognize the possibility of "value shopping" and will take appropriate measures should a lender be discovered engaging in such practices. Similarly, we will also take action if it is determined that real estate brokers are mandating the use of particular appraisers to the lender. The lender remains responsible for assuring that the appraisal adequately supports the value reported. The mortgage must also close within prescribed time limits determined by the date of the appraisal.

Testing of Individual Wells. ML 95-34, paragraph 2 states "If State or local standards are inadequate or non-existent, testing should be done in accordance with HUD's requirements which are based on EPA's recommendation for private wells." This statement simply means that testing should be performed utilizing either State or HUD requirements, whichever are more stringent. The minimum testing level for individual wells are those described in ML 95-34.

Energy Efficient Mortgage Program. Several pages of attachments to ML 95-46 were left out of the package mailed by the printer. Specifically, a blank borrower qualifying worksheet and the present value factor sheet were omitted; both are attached to this mortgagee letter.

Additionally, the last column of the Energy Efficient Premium Table (Page 3 of Attachment B1, ML 95-46) should read "EE Premium (Yearly Savings x Present Value Factor)." An updated chart is attached.

Plans and Specifications for Master Appraisal Reports (MAR). Instructions in ML 95-11 for the lender to maintain construction

exhibits for new and proposed construction cases also apply to master appraisal reports where the builder is providing a master set of construction exhibits for houses being built in one subdivision.

III. SECTION 203(k) ISSUES.

Authorized Agents may underwrite 203(k) loans. Approved supervised and nonsupervised mortgagees, as well as government institutions, with the prior approval of FHA, may designate another approved lender as its authorized agent(s) to process and/or underwrite FHA insured mortgages. ML 96-12 describes how to obtain FHA approval.

This permits a lender with or without Section 203(k) experience to use a DE lender with Section 203(k) experience for processing and underwriting loans it originates. However, loan correspondents may not use authorized agents.

Chain of Title. The chain of title requirement described in ML 95-40 is designed to help us manage the insurance risk by reducing the likelihood that property values were influenced by speculation and/or by "flipping" of properties. While multiple sales of the same property within one year may be completely legitimate, our experience indicates that in the vast majority of cases such value increases have been derived artificially and are not recognized in the marketplace. We are similarly concerned that the value not be derived more from the type of financing available than from the property itself, especially when values increase before the rehabilitation has even started.

In discussions with various mortgage lenders, there was also concern expressed that individual values and sales prices were not being adequately determined and that the profit margins being generated were greatly in excess of that normally seen in the marketplace. This, of course, could increase the FHA's insurance risk while at the same time depriving the eventual homeowner of the full benefit of an "affordable" housing program.

Escrow Commitments and Assumptions. Assumptions by owner-occupants under the Section 203(k) program may not occur until all work on the

property has been satisfactorily completed. In addition, a non-profit agency may not assume a Section 203(k) mortgage that was closed using the escrow commitment procedure.

Using Section 203(k) for Disaster Relief. The requirement that a dwelling be completed more than one year before it becomes eligible for Section 203(k) rehabilitation mortgage insurance is hereby waived for damaged properties in Presidentially-declared disaster areas also eligible for Section 203(h) financing. In these areas, damaged residences that have been completed will be eligible for Section 203(k) mortgage insurance regardless of the age of the property. Please note that the percentage of financing is determined by the type of mortgage being made, i.e., normal loan-to-value ratios apply to Section 203(k) mortgages made within these areas.

IV. ADDITIONAL INFORMATION

Multiple Employers. With the exception of receptionists, and technical staff such as appraisers and inspectors, lender employees may not work for more than one company engaged in the real estate finance business at the same time. This also includes working as a real estate agent or broker as well as originating or underwriting loans for more than one lending institution. Further, although FHA no longer approves lender underwriters, "contract" underwriting is not permitted.

CLAS Version 8.0. CLAS Version 8.0 may be used to update underwriter information in the registry, access CAIVRS, and extend refinance authorizations. Please note that it may also be used for updating branch office information.

To assure security, only FHA-approved lending institutions may access CHUMS via CLAS. This precludes credit bureaus from obtaining CAIVRS information on behalf on the lender as well as other second parties from obtaining case number assignments, etc. Lenders are to protect their CHUMS numbers and passwords.

Downpayment Assistance Programs. We are increasingly concerned with

those situations where a builder or developer either establishes a non-profit agency or provides direct or indirect contributions to a non-profit or governmental agency for eventual use by a homebuyer.

While we recognize the important contributions that governmental agencies, non-profit agencies and other charitable organizations can provide in helping first-time homebuyers and encourage these partnerships with

FHA, we also do not believe it to be appropriate to approve quid pro quo arrangements whereby assistance is only available if the buyer obtains

financing with a particular lender or buys a particular builder's property. Similarly, a non-profit or other organization that

provides bona fide gifts to eligible participants should not compel the beneficiary to purchase only properties owned by the donor of the funds.

Such scenarios cloud the motivations of the purchaser/borrower as well as the donor.

Therefore, in evaluating downpayment and other assistance plans administered by non-profit agencies and units of government, lenders and

the local FHA office will consider whether there is an identity-of-interest between the donor (e.g., builder, developer, etc.) and recipient of the funds (e.g., non-profit agency) as well as the amount

of discretion afforded the homebuyer in using the assistance provided.

The source of funds for a gift to the borrower must be totally unrelated

to the loan transaction. If the homebuyer may only use the builder, developer, lender, real estate firm, etc., that contributed the funds,

the program will in all likelihood be unacceptable for FHA mortgage insurance. On the other hand, acceptable programs would include one which has several donors contributing separately to a fund with the prospective homebuyer not compelled to use only the services of any particular donor.

Discounted Sales Prices. In determining the maximum mortgage on a property purchased at a discounted price, such as those sold to non-profit agencies from FHA's REO inventory, the lender must take into consideration such discounts or rebates provided by the seller. If

the property is ultimately to be financed with a FHA-insured mortgage within

one year of its acquisition, the original, discounted price must be used

in determining the maximum mortgage amount. As an example, on a \$50,000

of sales price with a 30 percent discount, the discounted actual price of \$35,000 must be used in calculating the maximum mortgage. Seller-paid closing costs, of course, need not be considered provided the buyer does not pocket cash from the transaction.

Further, the discounts or rebates may not be used for the required cash investment on any FHA-insured mortgage, including Section 203(k) loans.

On Section 203(k) mortgages, any discounts or rebates given after closing the loan must be maintained in an escrow account to pay for standard reserve requirements (i.e., mortgage payments, inspection fees, contingency reserve, etc). Any unused funds would pay down the principal balance of the mortgage and cannot otherwise be credited to the buyer. When completing the Section 203(k) maximum mortgage worksheet, the contract sales price shown on line A1 must reflect the discounting price (i.e., asking price less the discounted amount), which must include any rebates given after closing on the property except when maintained in an escrow account.

V. HUD HANDBOOK 4165.1 REV-1 CHG-3 (MORTGAGE AND NOTE FORMS). ML 96-6 established a June 1, 1996 date for implementation. The following are additional revisions to the handbook change.

New York. An additional paragraph (I) should be added to the New York discussion on Page 4-11, □ 4-12, as follows:

In New York, FHA permits a lender to modify and extend a previously-recorded Security Instrument to secure new financing for the same property, instead of discharging the Security Instrument of record upon prepayment of existing financing.

The borrower and lender must execute a new Note and either a HUD-approved Modification Agreement (for refinancing with no increase in principal amount) or a Consolidation, Extension and Modification Agreement (for other situations). Copies of these agreements are available from FHA Offices in Albany, Buffalo, and New York City. Fannie Mae/Freddie Mac Form 3172, "Consolidation, Extension and Modification Agreement," should not be used.

Appendix III (Model Mortgage Form).

Page 2, □ 2. Correct the heading, "Monthly Payment of Taxes, Insurance, and Other Charges" by capitalizing "Payment".

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Page 2, □ 2, part 2. ML 95-20 provided the replacement for paragraph 2 of the Model Mortgage Form. In the handbook, extremely important phrase was omitted from end of the second of paragraph 2. The second part of this paragraph should be corrected to read, "... except that the cushion or reserve permitted by RESPA for unanticipated disbursements or disbursements before the Borrower's payments are available in account may not be based on amounts due for the mortgage premium."

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Page 2, □ 2, part 3. The last sentence in part 3 of paragraph should be corrected to read, "If the amounts of funds held by Lender at any time are not sufficient to pay the Escrow Items due, Lender may notify the Borrower and require Borrower to up the shortage as permitted by RESPA." In other words, "shortage" should replace "deficiency." Under the RESPA regulation, 24 CFR □3500.17, a slight distinction is made between "shortage" and "deficiency". "Shortage" is the better term in this context.

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Appendix XIV, page 2, □ B. The following language should be added to the end of paragraph B: "... to a purchaser or grantee who does not occupy the Property as his or her principal residence."

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Missing Appendices. We have been informed that some of the earlier printings of Handbook 4165.1 REV-1 CHG-1 mailed to lenders are missing Appendices V-XVI. These appendices include the Model Adjustable Rate Note Form and other important Note Allonges and Mortgage Riders. If you are missing these Appendices you should obtain copies through your local FHA office.

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If you have any questions regarding these issues, please contact your local FHA Office.

Sincerely yours,

Nicolas P. Retsinas
Assistant Secretary for Housing-
Federal Housing Commissioner

Attachments