

# HUD 4155.1, Mortgage Credit Analysis for Mortgage Insurance

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## Chapter 1. Underwriting Overview

### 1. General Information on the Underwriting Process

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<b>Introduction</b>	<p>This topic contains general information on the underwriting process, including</p> <ul style="list-style-type: none"> <li>• the purpose of underwriting</li> <li>• the four C's of credit, and</li> <li>• the Federal Housing Administration's (FHA's) general credit policy.</li> </ul>
<b>Change Date</b>	May 10, 2009
<b>4155.1 1.1.a Purpose of Underwriting</b>	<p>The purpose of underwriting is to</p> <ul style="list-style-type: none"> <li>• determine a borrower's ability and willingness to repay a mortgage debt to limit the probability of default and collection difficulties, and</li> <li>• examine the property offered as security for the loan to determine if it is sufficient collateral.</li> </ul>
<b>4155.1 1.1.b Four C's of Credit</b>	<p>During the underwriting process, the four C's of credit are evaluated to determine a borrower's creditworthiness. The four C's include a borrower's</p> <ul style="list-style-type: none"> <li>• credit history</li> <li>• capacity to repay the loan</li> <li>• cash assets available to close the mortgage, and</li> <li>• collateral.</li> </ul>
<b>4155.1 1.1.c FHA General Credit Policy</b>	<p>The Federal Housing Administration's (FHA's) general credit policy requirements for underwriting a mortgage involve</p> <ul style="list-style-type: none"> <li>• considering the type of income for qualifying a borrower</li> <li>• analyzing the liabilities to determine creditworthiness, and</li> <li>• reviewing debt-to-income ratios and compensating factors.</li> </ul>

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## 2. General Documentation Standards

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### Introduction

This topic contains general documentation standards for mortgage loan application and mortgage credit analysis documentation, including

- signature requirements and use of a power of attorney for application forms
  - borrower authorization for verification of information
  - the policy prohibiting documents signed in blank
  - the policy prohibiting the use of documents handled by third parties
  - verification of employment and asset information received via fax or the Internet, and
  - the requirement that all transactions are scored through TOTAL Mortgage Scorecard.
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### Change Date

March 10, 2010

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### 4155.1 1.2.a Signature Requirements and Use of Power of Attorney for Application Forms

All borrowers applying for the mortgage and assuming responsibility for the mortgage debt must sign the *Uniform Residential Loan Application* (URLA), and all addenda.

A power of attorney may be used for closing documents, including

- page four of the URLA Addendum, and
- the final URLA, if signed at closing.

Any specific or general power of attorney must comply with state law, and allow for legal enforcement of the mortgage Note in the jurisdiction.

**Note:** The initial loan application may not be executed by power of attorney except for military personnel and incapacitated borrowers as referenced in [HUD 4155.2 3.C.3.d](#).

**References:** For additional information on the use of a power of attorney

- for loan closing, see [HUD 4155.2 6.A.1.f](#), and
  - when executing loan applications, see [HUD 4155.2 3.C.3.d](#).
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## 2. General Documentation Standards, Continued

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### 4155.1 1.2.b Borrower Authorization for Verification of Information

Rather than requiring borrowers to sign multiple verification forms, the lender may ask the borrower to sign a general authorization form that gives the lender blanket authority to verify information needed to process the mortgage loan application, such as

- past and present employment records
- bank accounts, and
- stock holdings.

If a blanket authorization is used, the lender

- must attach a copy of the authorization to each verification sent, and
  - *may* use self-adhesive signature labels for laser printed verifications, but each label *must*
    - completely and clearly indicate its use, and
    - contain the Privacy Act notification.
- 

### 4155.1 1.2.c Policy Prohibiting Documents Signed in Blank

Lenders may *not* have borrowers sign

- documents in blank
  - incomplete documents, or
  - on blank sheets of paper.
- 

### 4155.1 1.2.d Policy Prohibiting the Use of Documents Handled by Third Parties

Lenders may not accept or use documents relating to the credit, employment, or income of borrowers that have been handled by, or transmitted from or through the equipment of, interested third parties, such as

- real estate agents
  - builders, or
  - sellers.
- 

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## 2. General Documentation Standards, Continued

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### 4155.1 1.2.e Verification of Employment and Asset Information Sent Via Fax or Internet

Income/employment or asset documents sent to the lender by fax must clearly identify the

- employer or depository/investment firm's name and source of information, and
- name and telephone number of the individual at the employer or financial institution responsible for verifying the accuracy of the data.

The lender is accountable for determining the authenticity of faxed documents by examining the information included at the top or banner portion of the fax.

Likewise, income/employment or asset documentation from an Internet web site must clearly identify the employer or depository/investment firm's name and source of information. Documentation from an Internet website for depository accounts must provide the same information as a standard original statement, including account holder, account number, detailed transaction history and account balance.

Portions of the printouts downloaded from the Web pages must be examined for authenticity. Printed Web pages must

- be placed in the case binder
  - show the uniform resource locator (URL) address, and the date and time the documents were printed, and
  - be derived from a web site that has been verified by the lender to have existed.
- 

### 4155.1 1.2.f Requirement That All Transactions Are Scored Through TOTAL Mortgage Scorecard

TOTAL (Technology Open To Approved Lenders) Mortgage Scorecard has proven to be a successful tool for lenders to more efficiently determine borrower creditworthiness. Based on FHA's positive experience with TOTAL, the agency requires all transactions to be scored through TOTAL Mortgage Scorecard except streamline refinance transactions and transactions involving borrowers without a credit score.

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### 3. Required Documents for Mortgage Credit Analysis

**Introduction** This topic contains information on the documents that are generally required for mortgage credit analysis in all transactions, except for certain streamline refinances, including

- general mortgage credit analysis documents
- evidence of Social Security number
- verification of deposit
- evidence of employment
- alternative verification of employment (VOE) documentation
- TOTAL Scorecard Accept/Refer Feedback Certificate for VOE
- federal income tax returns, and
- appraisal documentation.

**Change Date** March 10, 2010

**4155.1 1.3.a General Mortgage Credit Analysis Documents** The documents listed in the table below are the general documents required for mortgage credit analysis.

*Note:* This is not a complete listing. Additional documentation may be required.

Document	Requirements
Loan Application	<ul style="list-style-type: none"> <li>• URLA signed and dated by all borrowers and the lender, and</li> <li>• Form <a href="#">HUD-92900-A</a>, Addendum to the URLA</li> </ul>
Loan Underwriting and Transmittal Summary	<a href="#">HUD-92900-LT</a> , <i>FHA Loan Underwriting and Transmittal Summary</i> , for both purchase and refinance transactions.
Credit Report	<p>The lender must obtain a credit report on all borrowers who will be obligated on the mortgage note, except in cases involving certain streamline refinance transactions.</p> <p><i>Reference:</i> For more information on</p> <ul style="list-style-type: none"> <li>• credit reports, see <a href="#">HUD 4155.1 1.4</a>, and</li> <li>• credit report review guidelines, see <a href="#">HUD 4155.1 4.C.2</a>.</li> </ul>

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### 3. Required Documents for Mortgage Credit Analysis, Continued

#### 4155.1 1.3.a General Mortgage Credit Analysis Documents (continued)

Document	Requirements
Sales Contract	The lender must obtain the sales contract and any amendments or other agreements and certifications.
Real Estate Certification	<p>If not contained within the purchase agreement, the lender must provide the real estate certification, signed by the</p> <ul style="list-style-type: none"> <li>• buyer</li> <li>• seller, and</li> <li>• selling real estate agent or broker.</li> </ul> <p><b>Reference:</b> For more information on the real estate certification, see</p> <ul style="list-style-type: none"> <li>• <a href="#">HUD 4155.2 6.A.5.f</a>, and</li> <li>• <a href="#">HUD 4155.2 6.A.5.g</a>.</li> </ul>
Amendatory Clause	<p>The lender must provide the amendatory clause, signed by the borrower and seller, if it is not contained in the purchase agreement.</p> <p><b>Reference:</b> For more information on the amendatory clause, see</p> <ul style="list-style-type: none"> <li>• <a href="#">HUD 4155.2 6.A.5.d</a>, and</li> <li>• <a href="#">HUD 4155.2 6.A.5.e</a>.</li> </ul>
Verification of Rent or Payment History on Past/Previous Mortgages	<p>This document must be in the form of</p> <ul style="list-style-type: none"> <li>• direct written verification from the landlord or mortgage servicer</li> <li>• information shown on the credit report, or</li> <li>• the most recent 12 months of cancelled checks or receipts for payment of the rent/mortgage.</li> </ul> <p><b>TOTAL Scorecard Accept recommendation:</b> A separate rental reference is not required.</p> <p><b>Reference:</b> For information on the TOTAL Scorecard, see the <i>TOTAL Mortgage Scorecard User Guide</i> at <a href="http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm">http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm</a>.</p>
Explanatory Statement	The lender must include, in the case binder, any explanatory statements or additional documentation necessary to make a sound underwriting decision.

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### 3. Required Documents for Mortgage Credit Analysis,

Continued

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**4155.1 1.3.b  
Evidence of  
Social Security  
Number**

All individuals, including United States (U.S.) citizens, must have a valid Social Security number (SSN) and must provide evidence of that SSN to the lender.

The lender is responsible for

- documenting an SSN for each borrower, coborrower, and cosigner on the mortgage
- validating each SSN either through
  - entering the borrower’s name, date of birth and SSN in the borrower/address validation screen through the FHA Connection (FHAC) or its functional equivalent
  - examination of the borrower’s pay stubs, W-2, valid tax returns direct from the Internal Revenue Service (IRS), or other documentation acceptable to FHA, or
  - use of a service provider, including those with direct access to the Social Security Administration (SSA), and
- resolving, if necessary, any inconsistencies or multiple SSNs for individual borrowers that are revealed during loan processing and underwriting.

**Note:** These requirements apply to purchase money loans and all refinances, including streamline refinances.

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### 3. Required Documents for Mortgage Credit Analysis,

Continued

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**4155.1 1.3.c  
Verification of  
Deposit**

The lender must obtain a written Verification of Deposit (VOD) and the borrower's most recent statements for all asset accounts to be used in qualifying.

"Most recent" means at the time the loan application is made. If the document is not more than 120 days old when the loan closes (180 days old on new construction), it does not have to be updated.

***Alternative Documentation***

As an alternative to obtaining a written VOD, the lender may obtain from the borrower original asset statements covering the most recent three-month period. Provided that the asset statement shows the previous month's balance, this requirement is met by obtaining the two most recent, consecutive statements.

***TOTAL Scorecard Accept Recommendation***

If a written VOD is not obtained, then obtain a statement showing the previous month's ending balance for the most recent month. If the previous month's balance is not shown, obtain statement(s) for the most recent two months to verify that there are sufficient funds to close.

***References:*** For additional information on

- the TOTAL Scorecard Accept Recommendation, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm), and
- asset information, see [HUD 4155.1.1.2](#).

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**4155.1 1.3.d  
Evidence of  
Employment**

The lender must obtain a Verification of Employment (VOE), and the borrower's most recent pay stub.

"Most recent" refers to the most recent pay stub at the time the loan application is made. If the document is not more than 120 days old when the loan closes (180 days old on new construction), it does not have to be updated.

***Reference:*** For more information on employment information, see [HUD 4155.1 1.2](#).

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### 3. Required Documents for Mortgage Credit Analysis,

Continued

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**4155.1 1.3.e  
Alternative  
VOE  
Documentation**

As an alternative to obtaining a written VOE, the lender may obtain the borrower's

- original pay stub(s) covering the most recent 30-day period, and
- the original IRS W-2 forms from the previous two years. (*Note:* Any copy of the IRS W-2 not submitted with the borrower's tax return is considered an "original." The original may be photocopied and returned to the borrower.)

The lender must also

- verify by telephone all current employers
- include in the loan file a certification stating that original documents were examined and the name, title, and telephone number of the person with whom employment was verified
- sign and date the verification, and
- for all loans processed in this manner, obtain a signed copy of [IRS 4506](#), *Request for Copy of Tax Form*, Form [IRS 8821](#), or a document that is appropriate for obtaining tax returns directly from the IRS.

**Notes:**

- The lender may also use an electronic retrieval service for obtaining W-2 and tax return information.
- Standard employment documentation must be used if
  - the employer will not provide telephone confirmation of employment, or
  - the W-2(s) and/or pay stub(s) indicates inconsistencies (for example, Federal Insurance Contributions Act (FICA) payments not reflecting earnings).

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### 3. Required Documents for Mortgage Credit Analysis,

Continued

**4155.1 1.3.f**  
**TOTAL**  
**Scorecard**  
**Accept/Refer**  
**Feedback**  
**Certificate for**  
**VOE**

The lender must obtain the most recent pay stub showing year-to-date earnings of at least one month, and obtain one of the following to verify current employment:

- a written VOE
- verbal verification of employment, or
- electronic verification acceptable to FHA.

The table below outlines additional requirements based on the TOTAL Scorecard Accept/Refer Feedback Certificate.

Total Recommendation	Requirements for VOE
TOTAL Accept Recommendation	<p>The lender is required to verify the applicant's employment history for the previous two years.</p> <p>However, direct verification is <i>not</i> required if all of the following conditions are met:</p> <ul style="list-style-type: none"> <li>• the current employer confirms a two-year employment history (this may include a pay stub indicating a hiring date)</li> <li>• only base pay is used for qualification (no overtime or bonus pay), and</li> <li>• the borrower signs Form <a href="#">IRS 4506</a> or Form <a href="#">IRS 8821</a> for the previous two tax years.</li> </ul> <p>Borrower Not Employed with Same Employer:            If the borrower was <i>not</i> employed with the same employer for the previous two years, and/or the above conditions <i>cannot</i> be met, the lender must verify the most recent two years of employment history by obtaining</p> <ul style="list-style-type: none"> <li>• copies of W2s</li> <li>• written VOEs, or</li> <li>• electronic verification acceptable to FHA.</li> </ul> <p>No explanation is required for gaps in employment of six months or less during the most recent two years.</p>

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### 3. Required Documents for Mortgage Credit Analysis, Continued

**4155.1 1.3.f TOTAL Scorecard Accept/Refer Feedback Certificate for VOE (continued)**

<b>Total Recommendation</b>	<b>Requirements for VOE</b>
TOTAL Refer Recommendation	<p>The lender is required to verify the applicant’s employment history for the previous two years. For the most recent two years the lender must obtain</p> <ul style="list-style-type: none"> <li>• copies of W-2s</li> <li>• written VOEs, or</li> <li>• electronic verification acceptable to FHA.</li> </ul> <p>Borrower Not Employed with Same Employer AND Has Employment Gap: If the borrower was <i>not</i> employed with the same employer for the previous two years, and has an employment gap of 30 days or greater, the borrower must provide a written explanation for the employment gap.</p> <p><b>Reference:</b> For information on the TOTAL Scorecard, see <a href="#">HUD 4155.1 6.A.1.</a></p>

**Reference:** For information on the TOTAL Scorecard, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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### 3. Required Documents for Mortgage Credit Analysis,

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**4155.1 1.3.g  
Federal Income  
Tax Returns**

The lender must obtain

- Federal income tax returns for the most recent two years, both individual and business, including all applicable schedules, for self-employed borrowers, and
- individual Federal tax returns for commissioned individuals.

The lender must obtain signed forms [IRS 4506](#), [IRS 8821](#), or whatever form or electronic retrieval service is appropriate for obtaining tax returns directly from the IRS for any loan for which the borrower's tax returns are required.

***TOTAL Scorecard Accept Recommendation***

Business tax returns are *not* required if all of the following conditions are met:

- individual Federal income tax returns show increasing self-employed income over the past two years
- funds to close are not coming from business accounts, and
- the FHA-insured mortgage is not a cash out refinance.

**Note:** If tax transcripts are obtained directly from the IRS or an electronic retrieval service, the loan approval must be based on the transcript data. Any discrepancies between the transcripts and the borrower provided tax returns must be resolved prior to loan approval.

**References:** For information on

- reviewing a borrower's tax returns, see [HUD 4155.1 4.D.5](#), and
- the TOTAL Scorecard Accept Recommendation, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm)

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*Continued on next page*

### 3. Required Documents for Mortgage Credit Analysis, Continued

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**4155.1 1.3.h**  
**Appraisal**  
**Documentation**

The lender must obtain

- Fannie Mae [Form 1004MC](#), *Market Conditions Addendum to the Appraisal Report*, for all appraisals of properties that are to be security for FHA-insured mortgages performed on or after April 1, 2009, **and**
- one of the following Fannie Mae forms, as appropriate, and any attachments and exhibits, completed and dated by the appraiser:
  - Fannie Mae [Form 1004](#), March 2005, *Uniform Residential Appraisal Report* – required to report an appraisal of a one-unit property, or a one-unit property with an accessory unit
  - Fannie Mae Form [1004C](#), March 2005, *Manufactured Home Appraisal Report* – required to report an appraisal of a one-unit manufactured home
  - Fannie Mae [Form 1073](#), March 2005, *Individual Condominium Unit Appraisal Report* – required to report an appraisal of a unit in a condominium project, or a condominium unit in a planned unit development (PUD), or
  - Fannie Mae [Form 1025](#), *Small Residential Income Property Appraisal Report* – required to report an appraisal of a two- to four-unit property.

**Exception:** This requirement does *not* apply to streamline refinance transactions made without an appraisal.

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## 4. General Information on Traditional and Non-Traditional Credit Reports

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**Introduction** This topic contains general information on traditional and non-traditional credit reports, including

- required credit report information
  - types of traditional credit reports
  - use of non-traditional credit reports
  - developing credit information, and
  - credit report retention and discrepancy reconciliation, and
  - use of truncated Social Security numbers on credit reports.
- 

**Change Date** March 10, 2010

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**4155.1 1.4.a  
Required  
Credit Report  
Information**

Credit reports submitted with each loan application must contain all credit information available in the accessed repositories. Additionally, for each borrower responsible for the mortgage debt, the report must contain all of the information available in the credit repositories pertaining to

- credit
- residence history, and
- public records information.

**Note:** One report is required for each borrower. A joint report can be obtained for a married couple.

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*Continued on next page*

## 4. General Information on Traditional and Non-Traditional Credit Reports, Continued

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### 4155.1 1.4.b Types of Traditional Credit Reports

The two types of traditional credit reports are the

- “three repository merged” credit report, also known as a “tri-merged” credit report (TRMCR), and
- Residential Mortgage Credit Report (RMCR).

The minimum credit report required by FHA is the TRMCR. When required, an RMCR from an independent consumer-reporting agency may also be used.

*Note:* An RMCR is generally required when a borrower disputes information on the TRMCR.

*References:* For more information on the

- TRMCR, see [HUD 4155.1 1.5](#), and
  - RMCR, see [HUD 4155.1 1.6](#).
- 

### 4155.1 1.4.c Use of Non- Traditional Credit Reports

A Non-Traditional Mortgage Credit Report (NTMCR) is

- designed to access the credit history of a borrower without the types of trade references normally appearing on a traditional credit report, and
- used either as a
  - substitute for a TRMCR or an RMCR, or
  - supplement to a traditional credit report that has an insufficient number of trade items reported.

*Note:* A NTMCR may *not* be used to

- enhance the credit history of a borrower with a poor payment record
- manufacture a credit report for a borrower without verifiable credit history, or
- offset derogatory references on the borrower’s traditional credit, such as collections and judgments.

*Reference:* For more information on the NTMCR, see [HUD 4155.1 1.7](#).

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*Continued on next page*

## 4. General Information on Traditional and Non-Traditional Credit Reports, Continued

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**4155.1 1.4.d**  
**Developing**  
**Credit**  
**Information**

A lender must develop credit information separately for any open debt listed on the loan application but not referenced in the credit report.

Accounts listed as “rate by mail only” or “need written authorization” require separate written notification for traditional credit reports.

---

**4155.1 1.4.e**  
**Credit Report**  
**Retention and**  
**Discrepancy**  
**Reconciliation**

Lenders must

- retain all copies of all credit reports
  - document in writing an analysis of the reasons for any discrepancies between the credit reports, and
  - reconcile inconsistencies if he/she receives any information that is not consistent with information on the credit report.
- 

**4155.1 1.4.f**  
**Use of**  
**Truncated**  
**Social Security**  
**Numbers on**  
**Credit Reports**  
**(Reference)**

For information on the use of truncated Social Security numbers on credit reports, see [HUD 4155.1 4.C.2.j](#).

---

## 5. Three Repository Merged Credit Report (TRMCR)

---

**Introduction** This topic contains information on the TRMCR, including

- methods of TRMCR submission
  - required TRMCR format
  - required demographic information, and
  - required TRMCR borrower credit information
- 

**Change Date** March 10, 2010

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**4155.1 1.5.a Methods of TRMCR Submission** When the lender submits the TRMCR, it must

- be the original, and
  - either be
    - sent electronically, and printed on the lender’s printer, or
    - delivered by the credit-reporting agency.
- 

**4155.1 1.5.b Required TRMCR Format** The TRMCR must be in an easy-to-read and understandable format, and should not require code translations.

Whiteouts, erasures, or alterations are *not* permitted.

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**4155.1 1.5.c Required Demographic Information** The TRMCR must include

- the name of the company ordering the report
  - the name, address, and telephone number of the consumer-reporting agency
  - each borrower’s name and SSN, and
  - for each account listed, the primary repository from which the particular information was pulled.
- 

*Continued on next page*

## 5. Three Repository Merged Credit Report (TRMCR), Continued

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**4155.1 1.5.d**  
**Required**  
**TRMCR**  
**Borrower**  
**Credit-Related**  
**Information**

The TRMCR must include

- all inquiries made within the last 90 days
- all credit and legal information not considered obsolete under the Fair Credit Reporting Act (FCRA), including information for the last seven years regarding
  - bankruptcies
  - judgments
  - law suits
  - foreclosures, and
  - tax liens, and
- for each borrower debt listed, the
  - date the account was opened
  - high credit amount
  - required payment
  - unpaid balance, and
  - payment history.

*Notes:*

- A corrected credit report *must* supplement the TRMCR if the report *does not* verify legal actions such as bankruptcies, judgments, lawsuits, foreclosures, and tax liens.
  - For any open debt listed on the loan application, but not referenced on the TRMCR, the lender must develop credit information separately.
-

## 6. Residential Mortgage Credit Report (RMCR)

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**Introduction** This topic contains information on the RMCR, including

- when a RMCR is required, and
- required RMCR information.

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**Change Date** May 10, 2009

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**4155.1 1.6.a  
When an  
RMCR Is  
Required** An RMCR is required when the

- borrower(s) disputes the ownership of accounts on the TRMCR
- borrower(s) claims that collections, judgments, or liens listed as open are paid and supporting documentation supporting the claim is unavailable
- borrower claims that certain debts on the TRMCR have different balances and/or payments and current statements less than 30 days old confirming the claim are unavailable, or
- lender's underwriter determines that it is more prudent to use an RMCR in lieu of the TRMCR to underwrite the loan.

---

**4155.1 1.6.b  
Required  
RMCR  
Information** RMCRs must access at least two named repositories and meet all the requirements for the TRMCR, as described in [HUD 4155.1 1.5](#). In addition, the RMCR must

- provide a detailed account of the borrower's employment history
- verify each borrower's current employment and income, if obtainable
- contain a statement attesting to the certification of employment for each borrower and the date verified, and
- include a check with the creditor within 90 days of the credit report for each borrower's account with a balance.

**Note:** If the certification of employment is not obtained through an interview with the borrower(s) employer, the credit-reporting agency must state the reason for not completing this interview.

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## 7. Non-Traditional Credit Report (NTMCR) Requirements

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**Introduction** This topic contains information on FHA requirements for non-traditional credit reports, including

- FHA preference for verification of nontraditional credit references
  - the purpose of non-traditional credit reports
  - the format for credit references on an NTMCR
  - when use of an NTMCR is not permitted
  - insufficient credit report information, and
  - consideration of credit that requires periodic payments.
- 

**Change Date** March 10, 2010

---

**4155.1 1.7.a  
FHA  
Preference for  
Verification of  
Nontraditional  
Credit  
References**

FHA prefers that all nontraditional credit references be verified by a credit bureau and reported back to the lender as a nontraditional mortgage credit report (NTMCR) in the same manner as traditional credit references.

*Note:* Only if an NTMCR is impractical or such a service is unavailable may a lender choose to obtain independent verification of trade references.

*Reference:* For more information on

- verifying and documenting nontraditional credit providers, see [HUD 4155.1 4.C.1.e](#), and
  - use of nontraditional credit reports provided by credit-reporting agencies, see [HUD 4155.1 4.C.1.f](#).
- 

**4155.1 1.7.b  
Purpose of  
NTMCRs**

A NTMCR is designed to assess the credit history of a borrower without the types of trade references normally appearing on a traditional credit report. A NTMCR can be used as a

- substitute for a TRMCR or an RMCR for a borrower without a credit history with traditional credit grantors, or
- supplement to a traditional credit report having an insufficient number of trade items reported.

*Reference:* For more information on using an NTMCR as a supplement when there is insufficient credit information, see [HUD 4155.1 1.7.e](#).

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*Continued on next page*

## 7. Non-Traditional Credit Report (NTMCR) Requirements, Continued

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### 4155.1 1.7.c Format for Credit References on an NTMCR

Trade references appearing on an NTMCR should be formatted in a similar fashion to traditional references, including the

- creditor's name
- date of opening
- high credit
- current status of the account
- required payment
- unpaid balance, and
- a payment history in the delinquency categories (for example, 0x30, 0x60, and so on).

**Note:** The report should not include subjective statements such as “satisfactory” or “acceptable.”

---

### 4155.1 1.7.d When Use of an NTMCR Is Not Permitted

A NTMCR *cannot* be used to

- enhance the credit history of a borrower with a poor payment record
  - manufacture a credit report for a borrower without a verifiable credit history, or
  - offset derogatory references found in the borrower's traditional credit report, such as collections and judgments.
- 

### 4155.1 1.7.e Use of an NTMCR When There Is Insufficient Credit Report Information

Lenders may use an NTMCR developed by a credit-reporting agency that documents all non-traditional credit references when the information in the standard credit report is not sufficient for the lender to make a prudent underwriting decision.

If an NTMCR is not available, the lender must develop his/her own non-traditional credit history consistent with the traditional credit report requirements described in [HUD 4155.1 1.5](#).

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*Continued on next page*

## 7. Non-Traditional Credit Report (NTMCR) Requirements,

Continued

**4155.1 1.7.f  
Guidelines for  
Determining  
That a  
Borrower Has  
Sufficient  
Credit  
References**

In order to determine that a borrower has sufficient credit references to be able to evaluate bill paying habits, the credit history must

- include three credit references, including at least one from Group I (below), and
- exhaust all Group I references prior to considering Group II for eligibility purposes (as Group I is considered more indicative of a borrower's future housing payment performance).

The table below lists the Group I and Group II categories of credit references that can be used for determining if a borrower has a sufficient credit history.

Group Number	Types of Credit References
Group I	<ul style="list-style-type: none"> <li>• Rental housing payments (subject to independent verification if the borrower is a renter),</li> <li>• Utility company reference (if not included in the rental housing payment), including               <ul style="list-style-type: none"> <li>– gas</li> <li>– electricity</li> <li>– water</li> <li>– land-line home telephone service, and</li> <li>– cable TV.</li> </ul> </li> </ul> <p><i>Note:</i> If the borrower is renting from a family member, request independent documents to prove regularity of payments, such as cancelled checks.</p>

*Continued on next page*

## 7. Non-Traditional Credit Report (NTMCR) Requirements, Continued

**4155.1 1.7.f Guidelines for Determining That a Borrower Has Sufficient Credit References**  
(continued)

Group Number	Types of Credit References
Group II	<ul style="list-style-type: none"> <li>• Insurance premiums (for example, medical, auto, life, renter’s insurance (not payroll deducted))</li> <li>• payment to child care providers – made to a business providing such services</li> <li>• school tuition</li> <li>• retail stores – department, furniture, appliance stores, specialty stores</li> <li>• rent to own – (for example, furniture, appliances)</li> <li>• payment of that part of medical bills not covered by insurance</li> <li>• Internet/cell phone services</li> <li>• a documented 12 month history of saving by regular deposits (at least quarterly/non-payroll deducted/no NSF checks reflected), resulting in an increasing balance to the account</li> <li>• automobile leases, or</li> <li>• a personal loan from an individual with repayment terms in writing and supported by cancelled checks to document the payments.</li> </ul>

*Note:* Borrowers with no Group I trade references must be underwritten using the criteria set forth in

- [HUD 4155.1 4.C.3.b](#), and
- [HUD 4155.1 4.C.3.c](#).

## Chapter 2. Maximum Mortgage Amounts/Cash Investment Requirements on Purchase Transactions

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## Section A. Calculating Maximum Mortgage Amounts on Purchase Transactions

### Overview

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**In This Section** This section contains the topics listed in the table below.

Topic	Topic Name	See Page
1	Maximum Mortgage Amounts on Purchases	2-A-2
2	Calculating Maximum Mortgage Amounts on Purchases	2-A-4
3	Interested Third Party Contributions	2-A-6
4	Inducements to Purchase	2-A-8
5	Additions to the Mortgage Amount for Repair and Improvement	2-A-11

---

## 1. Maximum Mortgage Amounts on Purchases

---

**Introduction** This topic contains information on maximum mortgage amounts for purchasing property, including

- the maximum insurable mortgage
  - up-front mortgage insurance payments (UFMIP)
  - statutory loan limits, and
  - loan-to-value (LTV) limits.
- 

**Change Date** March 10, 2010

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**4155.1 2.A.1.a  
Maximum  
Insurable  
Mortgage**

The maximum insurable mortgage is the lesser of the

- statutory loan limit for the area (typically a county, or metropolitan statistical area (MSA), or
- applicable loan-to-value (LTV) limit, applied to the lesser of
  - the sales price, or
  - the appraised value.

The Department of Housing and Urban Development (HUD) issues a Mortgagee Letter (ML) announcing the new mortgage limits every year.

---

**4155.1 2.A.1.b  
Up-Front  
Mortgage  
Insurance  
Payments**

Most Federal Housing Administration (FHA) mortgages require the payment of an up-front mortgage insurance premium (UFMIP). The statutory loan amounts and LTV limits discussed in this handbook do not include the UFMIP.

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*Continued on next page*

## 1. Maximum Mortgage Amounts on Purchases, Continued

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**4155.1 2.A.1.c  
Statutory Loan  
Limits** Statutory loan amount limits vary by program and the number of family units within the dwelling.

**References:**

- For current FHA standard and high-cost area mortgage limits, see
    - the Department of Housing and Urban Development (HUD) Web site at [www.hud.gov](http://www.hud.gov), or
    - the FHA Connection at <https://entp.hud.gov/clas/>.
  - For information on the effect that secondary financing has on loan limits, see [HUD 4155.1 5.C](#).
- 

**4155.1 2.A.1.d  
LTV Limits** The determination of the maximum LTV percentage available to the borrower is influenced by

- the particular mortgage insurance program
- the property type (for example, new or existing construction), and
- various transactions that affect the maximum mortgage calculation, as described in [HUD 4155.1 2.B](#).

Once determined, the LTV percentage is then applied to the lesser of the sales price or the appraised value in order to determine the maximum insurable mortgage.

**References:** For more information on

- calculating maximum mortgage amounts, see [HUD 4155.1 2.A.2](#)
  - transactions that affect maximum mortgage calculations, see [HUD 4155.1 2.B](#), and
  - the effect of secondary financing on LTV limits, see [HUD 4155.1 5.C.5](#).
-

## 2. Calculating Maximum Mortgage Amounts on Purchases

---

**Introduction** This topic contains information on how to calculate maximum mortgage amounts on purchases, including

- the maximum mortgage calculation
- maximum LTV percentages for purchase transactions for proposed/existing construction
- the borrower required investment on a purchase transaction
- the policy on closing costs, and
- credit card payment for the appraisal/credit report.

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**Change Date** March 10, 2010

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**4155.1 2.A.2.a  
Maximum  
Mortgage  
Amount  
Calculation** The maximum mortgage amount that FHA will insure is calculated by multiplying the appropriate LTV factor by the lesser of the property's

- sales price, subject to certain required adjustments, or
- appraised value.

In order for FHA to insure this maximum loan amount, the borrower must make a required investment of at least 3.5 percent of the lesser of the appraised value of the property or the sales price.

**References:** For more information on

- required adjustments to the sales price, see
    - [HUD 4155.1 2.A.3](#)
    - [HUD 4155.1 2.A.4](#), and
    - [HUD 4155.1 2.A.5](#)
  - the maximum LTV percentage on purchases for proposed and existing construction, see [HUD 4155.1 2.A.2.b](#), and
  - requirements for the borrower minimum cash investment, see [HUD 4155.1 2.A.2.c](#).
- 

*Continued on next page*

## 2. Calculating Maximum Mortgage Amounts on Purchases, Continued

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**4155.1 2.A.2.b  
Maximum LTV  
for Proposed/  
Existing  
Construction**

For purchase transactions, the maximum LTV is 96.5 percent (that is, the reciprocal of the 3.5 percent required investment).

---

**4155.1 2.A.2.c  
Borrower  
Required  
Investment on a  
Purchase  
Transaction**

The borrower must make a required investment at least equal to 3.5 percent of the lesser of the appraised value of the property or the sales price.

---

**4155.1 2.A.2.d  
Policy on  
Closing Costs**

Closing costs (non-recurring closing costs, pre-paid expenses, and discount points) may *not* be used to help meet the minimum 3.5 percent required investment.

---

**4155.1 2.A.2.e  
Credit Card  
Payment for  
the Appraisal/  
Credit Report**

The borrower may use a credit card to pay for the appraisal and credit report. These costs cannot be considered to help meet the required investment.

---

### 3. Interested Third Party Contributions

---

**Introduction** This topic contains information on the effect of contributions by interested third parties on calculating the maximum mortgage amount, including

- a definition of third party contribution
  - interested third party contribution amounts
  - charges not considered interested third party contributions, and
  - treatment of amounts exceeding contribution limit.
- 

**Change Date** March 10, 2010

---

**4155.1 2.A.3.a Definition: Third Party Contribution** A *Third Party Contribution* is a payment by a seller and/or an interested third party, or a combination of parties toward the borrower's costs to close.

**Reference:** For a more detailed definition of the term third party contribution, see [HUD 4155.1 9](#) (Glossary).

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*Continued on next page*

### 3. Interested Third Party Contributions, Continued

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**4155.1 2.A.3.b  
Interested  
Third Party  
Contribution  
Amounts**

The seller and/or third party may contribute up to six percent of the *lesser of* the property's sales price or the appraised value toward the buyer's closing costs, prepaid expenses, discount points and other financing concessions.

The six percent limit also includes

- third party payment for permanent and temporary interest rate buydowns, and other payment supplements
- payments of mortgage interest for fixed rate mortgages
- mortgage payment protection insurance, and
- payment of UFMIP.

*Note:* Contributions exceeding six percent are considered inducements to purchase.

*Reference:* For information on inducements to purchase, see [HUD 4155.1 2.A.4.](#)

---

**4155.1 2.A.3.c  
Charges Not  
Considered  
Interested  
Third Party  
Contributions**

Payment of real estate commissions or fees, typically paid by the seller under local or state law or local custom, is not considered an interested third party contribution.

---

**4155.1 2.A.3.d  
Treatment of  
Amounts  
Exceeding  
Contribution  
Limit**

Each dollar that exceeds the 6 percent limit discussed in [HUD 4155.1 2.A.3.b](#) must be subtracted from the property's sales price before applying the appropriate LTV factor.

*Reference:* For information on the maximum LTV percentage on purchases for existing and proposed construction, see [HUD 4155.1 2.A.2 b.](#)

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## 4. Inducements to Purchase

---

**Introduction** This topic contains information on inducements to purchase that are used when calculating the maximum mortgage amounts, including

- payments considered inducements to purchase
  - personal property inducements, and
  - conditions for subtracting sales commissions.
- 

**Change Date** March 10, 2010

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**4155.1 2.A.4.a Payments Considered Inducements to Purchase** Certain expenses, paid by the seller and/or an interested third party, on behalf of the borrower, are considered “inducements to purchase” and result in a dollar-for-dollar reduction to the *lesser of* the sales price or appraised value of the property before applying the appropriate LTV factor. These expenses include

- contributions exceeding 6 percent of the sales price
- contributions exceeding the actual cost of prepaid expenses, discount points, and other financing concessions
- decorating allowances
- repair allowances
- moving costs, and
- other costs as determined by the appropriate HOC.

**Note:** A dollar-for-dollar sales price reduction is also required for

- excess rent credit, as described in [HUD 4155.1 5.B.6.f](#), and
  - gift funds not meeting the requirements described in [HUD 4155.1 5.B.5](#).
- 

*Continued on next page*

## 4. Inducements to Purchase, Continued

**4155.1 2.A.4.b  
Personal  
Property  
Inducements**

Personal property given by a seller and/or an interested third party to consummate the sale of a property results in a reduction in the mortgage amount. The value of the item(s) *must* be deducted from the *lesser of* the sales price or appraised value of the property before applying the LTV factor.

Depending on local custom or law, certain items may be considered as part of the real estate transaction with no adjustment to the sales price or appraised value. The table below describes how to determine if personal property affects the sales price or appraised value.

If the personal property item is a ...	Then ...
<ul style="list-style-type: none"> <li>• car</li> <li>• boat</li> <li>• riding lawn mower</li> <li>• furniture, or</li> <li>• television</li> </ul>	deduct the value of the item(s) from the sales price and appraised value before applying the LTV factor.
<ul style="list-style-type: none"> <li>• range</li> <li>• refrigerator</li> <li>• dishwasher</li> <li>• washer</li> <li>• dryer</li> <li>• carpeting</li> <li>• window treatment, or</li> <li>• other items determined appropriate by the Homeownership Center (HOC)</li> </ul>	the HOC determines if the items are considered customary and affect the value of the property before applying the LTV factor.  <i>Exception:</i> Replacement of existing equipment or other realty items by the seller before closing, such as carpeting or air conditioners, does not require a value adjustment provided that a cash allowance is <i>not</i> given to the borrower.

*Continued on next page*

## 4. Inducements to Purchase, Continued

### 4155.1 2.A.4.c Conditions for Subtracting Sales Commissions

Sales commissions paid by an interested third party on a borrower's present residence can be considered inducements to purchase, and should be subtracted from the sales price before applying the LTV factor.

The table below describes the conditions under which a sales commission is subtracted from the sales price before applying the LTV factor.

If ...	Then ...
<p>the seller and/or interested third party agrees to pay any portion of the borrower's sales commission on the sale of the borrower's present residence</p>	<ul style="list-style-type: none"> <li>• treat the amount paid by the interested third party as an inducement to purchase, and</li> <li>• subtract dollar-for-dollar the amount paid by the seller or builder from the <i>lesser of</i> the sales price or appraised value before applying the LTV factor.</li> </ul>
<ul style="list-style-type: none"> <li>• a borrower is not paying a real estate commission on the sale of his/her present home</li> <li>• the same real estate broker or agent is involved in both transactions, and</li> <li>• the seller of the property being purchased by the buyer is paying a real estate commission that exceeds what is typical for the area</li> </ul>	<ul style="list-style-type: none"> <li>• treat the amount of commission paid by the seller that exceeds what is typical for the area as an inducement to purchase, and</li> <li>• deduct that amount, dollar-for-dollar, from the <i>lesser of</i> the sales price or appraised value before applying the LTV factor.</li> </ul>

## 5. Additions to the Mortgage Amount for Repair and Improvement

---

**Introduction** This topic contains information on adjustments to the mortgage amount, either through allowable additions to the sales price or direct additions to the mortgage amount, including

- the policy on adding repair and improvement costs to the sales price
  - the repair and improvement amount that can be added to the sales price
  - repair and improvement exclusions
  - energy-related weatherization items
  - calculating the energy-related mortgage amount
  - when repairs and energy-related items cannot be completed prior to closing
  - adding solar energy system costs
  - a reference for more information on the mortgage amount on HUD REO sales with repair escrow, and
  - energy efficient mortgage calculation.
- 

**Change Date** July 6, 2009

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**4155.1 2.A.5.a  
Policy on  
Adding Repair  
and  
Improvement  
Costs to Sales  
Price**

Repairs and improvements may be added to the sales price before calculating the mortgage amount when

- the repairs and improvements are
  - required by the appraiser as essential for property eligibility, and
  - paid by the borrower, and
- the sales contract or addendum identifies the borrower as responsible for
  - payment, and
  - completion of the repairs.

**Important:** Only repairs and improvements *required* by the appraiser may be included.

**References:** For information on

- the repair and improvement amount that can be added to the sales price, see [HUD 4155.1 2.A.5.a](#), and
  - repair and improvement exclusions, see [HUD 4155.1 2.A.5.c](#).
- 

*Continued on next page*

## 5. Additions to the Mortgage Amount for Repair and Improvement, Continued

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### 4155.1 2.A.5.b Repair and Improvement Amount That Can Be Added to Sales Price

The repair and improvement amount that may be added to the sales price before calculating the maximum mortgage amount is the lowest of the

- amount that the value of the property exceeds the sales price
  - the appraiser's estimate of repairs and improvements, or
  - the amount of the contractor's bid, if available.
- 

### 4155.1 2.A.5.c Repair and Improvement Exclusions

Repairs and improvements completed by the borrower *before* the appraisal are *not* eligible to be included when calculating the maximum mortgage. This amount becomes part of the borrower's required cash investment.

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### 4155.1 2.A.5.d Energy-Related Weatherization Items

The mortgage amount may be increased if the cost of energy-related weatherization items paid by the borrower is added to the property. Examples of energy-related weatherization items include

- thermostats
- insulation
- storm windows and doors, and
- weather stripping and caulking.

These items may be added to both the sales price and the appraised value before determining the maximum mortgage amount.

**Note:** A contractor's statement of the cost of work completed, or a buyer's estimate of the cost of materials must be submitted.

**Reference:** For information on cost estimates and statements of costs of work for weatherization items, see [HUD 4150.1 REV-1](#), *Valuation Analysis for Home Mortgage Insurance*.

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*Continued on next page*

## 5. Additions to the Mortgage Amount for Repair and Improvement, Continued

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### 4155.1 2.A.5.e Calculating the Energy-Related Mortgage Amount

The energy-related amount that can be added when calculating the maximum mortgage amount is either

- \$2,000 without a separate value determination
  - up to \$3,500, if supported by a value determination by an approved FHA roster appraiser or Direct Endorsement (DE) Underwriter, or
  - more than \$3,500
    - subject to a value determination by an approved FHA roster appraiser or DE Underwriter, and
    - with a separate on-site inspection made by a FHA-approved fee inspector or DE staff appraiser.
- 

### 4155.1 2.A.5.f When Energy Related Items Cannot Be Completed Prior to Closing

If repairs and energy-related items cannot be completed before loan closing due to weather-related delays, the lender *must* establish an escrow account to ensure all required repairs are eventually completed.

**References:** For more information on

- repairs and improvements, see [HUD 4145.1, REV-2, Architectural Processing and Inspections for Home Mortgage Insurance](#), and
  - satisfying repair requirements, see [HUD 4155.2 4.6](#).
- 

*Continued on next page*

## 5. Additions to the Mortgage Amount for Repair and Improvement, Continued

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### 4155.1 2.A.5.g Adding Solar Energy System Costs

The cost of solar energy systems may be added directly to the mortgage amount before adding the UFMIP, and after applying the LTV factor limits.

The amount added is limited to the lesser of the solar energy system's

- replacement cost, or
- effect on the property's market value.

The statutory mortgage limit for the area also may be exceeded by 20 percent to accommodate the cost of the system.

**Note:** Active and passive solar systems, as well as wind-driven systems are acceptable.

**Reference:** For more information on adding solar energy system costs, see [HUD 4150.1 REV-1](#), *Valuation Analysis for Home Mortgage Insurance*.

---

### 4155.1 2.A.5.h Mortgage Amount for HUD REO Sales With Repair Escrow (Reference)

For information on calculating the mortgage amount for HUD REO sales with repair escrow, see [HUD 4155.1 6.A.10.a](#).

---

### 4155.1 2.A.5.i Energy Efficient Mortgage Calculation

If the energy efficient improvements are “cost effective” as determined by the lender based upon the report from the HERS or energy consultant, 100 percent of the cost of the energy efficient improvements (subject to certain limits) may be added to the mortgage amount.

**Reference:** For more information on the mortgage calculation for the Energy Efficient Mortgage Program, see [HUD 4155.1 6.D](#).

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## Section B. Transactions Affecting Maximum Mortgage Calculations

### Overview

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**In This Section** This section contains the topics listed in the table below.

Topic	Topic Name	See Page
1	General Information on Transactions Affecting Maximum Mortgage Calculations	2-B-2
2	Identity of Interest Transactions	2-B-3
3	Non Occupying Borrowers	2-B-6
4	Transactions Involving Three and Four Unit Properties	2-B-8
5	Loan Transactions for Building on Own Land	2-B-10
6	Loan Transactions for Paying Off Land Contracts	2-B-12
7	Transactions Involving Properties for Proposed Construction, Under Construction or Existing Construction Less Than One Year Old	2-B-15
8	Manufactured Home Construction-Permanent Loans	2-B-17

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## 1. General Information on Transactions Affecting Maximum Mortgage Calculations

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**Change Date**      May 10, 2009

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**4155.1 2.B.1.a  
Types of  
Transactions**

Certain types of loan transactions affect the amount of financing available to a borrower, and determine how to calculate the maximum mortgage amount.

The types of transactions include

- identity-of-interest
- properties with non-occupying coborrowers
- three- and four-unit properties
- properties where a house will be constructed by a borrower
  - on his/her land, and/or
  - as a licensed general contractor
- payoffs of land contracts, and
- transactions involving properties
  - under construction, or
  - less than a year old.

*Note:* Unless otherwise stated in this handbook, the mortgage calculation procedures described in [HUD 4155.1 2.A.2](#) also apply.

---

## 2. Identity of Interest Transactions

---

**Introduction** This topic contains information on identity-of-interest transactions, including

- the definition of the term identity-of-interest transaction
  - maximum LTV factor on identity-of-interest transactions, and
  - exceptions to the maximum LTV factor for identity-of-interest transactions.
- 

**Change Date** March 10, 2010

---

**4155.1 2.B.2.a  
Definition:  
Identity of  
Interest  
Transaction** An *identity of interest transaction* is a sales transaction between parties with family or business relationships.

**Reference:** For a more detailed definition of identity of interest transaction, see [HUD 4155.1 9](#) (Glossary).

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**4155.1 2.B.2.b  
Maximum LTV  
Factor on  
Identity of  
Interest  
Transactions** The maximum LTV factor for identity of interest transactions on principal residences is restricted to 85 percent.

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*Continued on next page*

## 2. Identity of Interest Transactions, Continued

### 4155.1 2.B.2.c Exceptions to the Maximum LTV Factor for Identity of Interest LTV Transactions

Maximum financing above the 85 percent is permitted under certain circumstances. The table below describes circumstances in which financing above the 85 percent is permitted.

Exception	Description
Family Member Purchase	<p>A family member purchases another family member's home as a principal residence. If the property is sold from one family member to another and is the seller's investment property, the maximum mortgage is the lesser of</p> <ul style="list-style-type: none"> <li>• 85 percent of the appraised value, or</li> <li>• the appropriate LTV factor percentage applied to the sales price, plus or minus required adjustments.</li> </ul> <p><i>Note:</i> The 85% limit may be waived if the family member has been a tenant in the property for at least six months immediately predating the sales contract. A lease or other written evidence must be submitted to verify occupancy.</p> <p><i>Reference:</i> For a definition of the term "family member," see <a href="#">HUD 4155.1 9</a> (Glossary).</p>
Builder's Employee Purchase	An employee of a builder purchases one of the builder's new homes or models as a principal residence.

*Continued on next page*

## 2. Identity of Interest Transactions, Continued

### 4155.1 2.B.2.c Exceptions to the Maximum LTV Factor for Identity of Interest LTV Transactions (continued)

Exception	Description
<p>Tenant Purchase</p>	<p>A current tenant, including a family member tenant, purchases the property where he/she has rented for at least six months immediately predating the sales contract.</p> <p><i>Note:</i> A lease or other written evidence to verify occupancy is required.</p> <p>The maximum mortgage calculation is not affected by a sales transaction between a tenant and a landlord with no identity of interest relationship.</p>
<p>Corporate Transfer</p>	<p>A corporation</p> <ul style="list-style-type: none"> <li>• transfers an employee to another location</li> <li>• purchases the employee's home, and</li> <li>• sells the home to another employee.</li> </ul>

### 3. Non Occupying Borrowers

---

**Introduction** This topic contains information on non-occupying borrowers, including

- the definition of the term “non-occupying borrower transaction”
  - maximum LTV factor for non-occupying borrower transaction
  - security instrument and note signature requirement
  - LTV for two to four unit properties, and
  - underwriting criteria for non-occupying borrowers.
- 

**Change Date** March 10, 2010

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**4155.1 2.B.3.a  
Definition: Non  
Occupying  
Borrower  
Transaction** A *non occupying borrower transaction* is a transaction involving two or more borrowers where one or more borrower(s) will not occupy the property as his/her primary residence.

**Reference:** For a more detailed definition of “non-occupying borrower transaction,” see [HUD 4155.1 9](#) (Glossary).

---

**4155.1 2.B.3.b  
Maximum LTV  
Factor for Non  
Occupying  
Borrower  
Transaction** When there are two or more borrowers, but one or more will *not* occupy the property as a principal residence, the maximum mortgage is limited to a 75 percent LTV. However, maximum financing, as described in [HUD 4155.1 2.A.2](#), is available for

- borrowers related by blood, marriage, or law, such as
  - spouses
  - parent-child
  - siblings
  - stepchildren
  - aunts-uncles, and
  - nieces-nephews, or
- unrelated individuals that can document evidence of a family-type, longstanding, and substantial relationship *not arising out of the loan transaction*.

**Note:** If a parent is selling to a child, the parent cannot be the coborrower with the child, unless the LTV is 75 percent or less.

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*Continued on next page*

### 3. Non Occupying Borrowers, Continued

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**4155.1 2.B.3.c  
Security  
Instrument and  
Note Signature  
Requirement**

All borrowers, regardless of occupancy status, must sign the security instrument and mortgage note.

*Note:* Cosigners do not execute the security instrument or take title, but they must sign the mortgage note.

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**4155.1 2.B.3.d  
LTV for Two to  
Four Unit  
Properties**

To reduce risk exposure, mortgages with non-occupying borrowers are limited to one-unit properties if the LTV exceeds 75 percent. The non-occupying borrower arrangement to assist in financing a property may *not* be used to develop a portfolio of rental properties. The financial contribution by the non-occupying borrower and the number of properties owned may indicate that the family members are acting as “strawbuyers.”

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**4155.1 2.B.3.e  
Underwriting  
Criteria for  
Non Occupying  
Borrowers**

FHA does not require that additional underwriting criteria, such as specific qualifying ratios, be met by either

- non-occupying borrowers, or
- occupying borrowers with sufficient credit.

However, additional FHA underwriting criteria *does* apply to occupying borrowers with insufficient credit.

*Note:* Lenders must judge each transaction on its merits.

*Reference:* For information on underwriting criteria for borrowers with insufficient credit, see [HUD 4155.1 4.C.3.c](#).

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## 4. Transactions Involving Three and Four Unit Properties

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**Introduction** This topic contains information on transactions involving three- and four-unit properties, including

- three and four unit property mortgage limit/self-sufficiency test
  - what is included in the monthly payment calculation for three and four unit properties
  - net rental income calculation for three and four unit properties, and
  - three and four unit property mortgage reserves.
- 

**Change Date** March 10, 2010

---

**4155.1 2.B.4.a  
Three and Four  
Unit Property  
Mortgage  
Limit/Self-  
Sufficiency Test** The maximum mortgage for three and four unit properties is limited, so that the ratio of the monthly mortgage payment, divided by the monthly net rental income does not exceed 100 percent, regardless of the occupancy status.

Form [HUD 92561](#), *Borrower's Contract with Respect to Hotel and Transient Use of Property* is required at application for all multi-unit properties.

**Note:** The calculations described in the remainder of this topic are *in addition* to the calculations found in [HUD 4155.1 2.A.](#)

---

**4155.1 2.B.4.b  
What Is  
Included in the  
Monthly  
Payment  
Calculation for  
Three and Four  
Unit Properties** The monthly mortgage payment calculation for three and four unit properties includes the following:

- principal
- interest
- taxes
- insurance (Principle, Interest, Taxes, and Insurance - PITI), including monthly mortgage insurance, and
- homeowner association dues computed at the note rate, if applicable.

**Reference:** For more information on the maximum mortgage amounts, see

- [HUD 4155.1 2.A.1](#), and
  - [HUD 4155.1 2.A.2](#).
- 

*Continued on next page*

## 4. Transactions Involving Three and Four Unit Properties, Continued

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### 4155.1 2.B.4.c Net Rental Income Calculation for Three and Four Unit Properties

Net rental income for three and four unit property is calculated using the following formula:

- the appraiser's estimate of fair market rent from all units, including the unit the borrower chooses for occupancy, and
- minus the greater of the
  - appraiser's estimate for vacancies, or
  - vacancy factor used by the jurisdictional HOC.

This net rental income calculation is used to determine the maximum loan amount. Borrowers must still qualify for the mortgage based on

- income
- credit
- cash to close, and
- projected rents received from remaining units.

Projected rent may only be considered gross income for qualifying purposes. It cannot be used to offset the monthly mortgage payment.

---

### 4155.1 2.B.4.d Three and Four Unit Property Mortgage Reserves

For three- and four-unit properties, the borrower *must* have personal reserves equivalent to three months' PITI after closing on purchase transactions. Reserves cannot be derived from a gift.

**Reference:** For information on

- mortgage reserves, see
    - [HUD 4155.1 4.E.5.d](#), and
    - [HUD 4155.1 4.F.3.b](#), and
  - TOTAL Scorecard and mortgage reserves, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).
-

## 5. Loan Transactions for Building on Own Land

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**Introduction** This topic contains information on loan transactions for building on land the borrower already owns, including

- financing limits when building on own land
  - LTV limits when building on own land, and
  - using equity when building on own land.
- 

**Change Date** July 6, 2009

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**4155.1 2.B.5.a  
Financing  
Limits When  
Building on  
Own Land** A borrower is eligible for maximum financing when he/she

- acts as a licensed general contractor and is building a home on land that he/she already owns or acquires separately, and
- receives no cash from the settlement.

---

**4155.1 2.B.5.b  
LTV Limits  
When Building  
on Own Land** When building on a borrower's own property, the appropriate LTV limits are applied to the lesser of the

- appraised value of the proposed home and land, or
- documented cost of the property.

The documented cost of property includes the following:

- the builder's price, or sum of all subcontractor bids and materials
  - cost of the land (if the land has been owned more than six months or was received as an acceptable gift, the *value* of the land may be used instead of its cost), and
  - interest and other costs associated with any construction loan obtained by the borrower to fund construction of the property.
- 

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## 5. Loan Transactions for Building on Own Land, Continued

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### 4155.1 2.B.5.c Using Equity When Building on Own Land

Equity in the land (value or cost, as appropriate, minus the amount owed) may be used for the borrower's entire cash investment. However, if the borrower receives more than \$500 cash at closing, the loan is limited to 85 percent of the appraised value.

Replenishing the borrower's own cash expended during construction is *not* considered as "cash back," provided that the borrower can substantiate with cancelled checks and paid receipts all out-of-pocket funds used for construction.

---

### 4155.1 2.B.5.d Determining If the Borrower Has Made the Required Down Payment When Building on Own Land

In order to determine if a borrower has made the required 3.5 percent cash investment, or its equivalent in land equity when building on his/her own land, all such mortgage transactions must be summarized using only [HUD-92900-LT](#), *FHA Loan Underwriting and Transmittal Summary*.

Lenders are reminded that they must record the sum total of the *documented* cost of the property, including

- the builder's price, or the sum of all subcontractor costs, materials, etc.
- the cost of the land or, if owned for more than six months or was received as an acceptable gift, its appraised value, and
- interest and other costs associated with any construction loan obtained by the borrower to fund construction of the property.

Additionally, the calculated loan-to-value ratio (which is to be the same value used when seeking a risk clarification from FHA's TOTAL), must reflect, as it does on other purchase transactions, the lesser of

- the sales price, or
  - the appraised value.
-

## 6. Loan Transactions for Paying Off Land Contracts

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**Introduction** This topic contains information on loan transactions to pay off land contracts, including

- financing limit when paying off land contracts
  - LTV factor when paying off land contracts, and
  - using equity when paying off land contracts.
- 

**Change Date** March 10, 2010

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**4155.1 2.B.6.a  
Financing  
Limit When  
Paying Off  
Land Contracts** If a borrower does *not* receive cash at closing, his/her new mortgage may be processed as a purchase or refinance transaction with maximum FHA-insured financing if he/she uses the loan to

- complete payment on a land contract
  - contract for deed, or
  - other similar type of financing arrangement in which the borrower does not have title to the property.
- 

**4155.1 2.B.6.b  
LTV Factor  
When Paying  
Off Land  
Contracts** When the loan proceeds are used to pay the outstanding balance on the land contract and eligible repairs and renovations, if the property was acquired less than 12 months the LTV factor is applied to the *lesser* of the

- appraised value of the land and improvements, or
- total cost to acquire the property, which includes the original purchase price, plus any documented costs the borrower incurs for rehabilitation, repairs, renovation, or weatherization, closing costs and reasonable discount points, if treated as a refinance.

**References:** For additional information on

- refinances, see [HUD 4155.1 3.B.1](#), and
  - use of rent credits, see [HUD 4155.1 5.B.6.f](#).
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*Continued on next page*

## 6. Loan Transactions for Paying Off Land Contracts, Continued

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### 4155.1 2.B.6.c Using Equity When Paying Off Land Contracts

Equity in the property (original sales price minus the amount owed) may be used for the borrower's entire cash investment. However, if the borrower receives more than \$500 cash at closing, the loan is limited to 85 percent of the *lesser of*, if the property was acquired less than 12 months,

- appraised value of the land and improvements, or
- total cost to acquire the property, which includes the original purchase price, plus any documented costs the borrower incurs for rehabilitation, repairs, renovation, weatherization, closing costs and reasonable discount points, if treated as a refinance.

Replenishing the borrower's own cash expended for repairs, improvements, renovation, or weatherization is *not* considered as "cash back," provided that the borrower can substantiate with cancelled checks and paid receipts all out-of-pocket funds for the improvements.

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## 7. Transactions Involving Properties for Proposed Construction, Under Construction or Existing Construction Less Than One Year Old

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**Introduction** This topic contains information on transactions involving properties for proposed construction, under construction or with existing construction less than one year old, including

- financing limit, and
  - criteria for maximum financing.
- 

**Change Date** March 10, 2010

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**4155.1 2.B.7.a Financing Limit** Properties that are proposed, under construction or existing construction less than one year old are limited to 90 percent financing.

The 90 percent financing for properties proposed, under construction, or existing construction less than one year old is calculated by using the *lesser* of the

- appraiser's estimate of value, or
- sales price, plus or minus required adjustments for
  - seller contributions
  - inducements to purchase, and/or
  - additions to the mortgage amount.

**Reference:** For more information on required adjustments, see [HUD 4155.1 2.A.](#)

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*Continued on next page*

## 7. Transactions Involving Properties for Proposed Construction, Under Construction or Existing Construction Less Than One Year Old, Continued

**4155.1 2.B.7.b  
Criteria for  
Maximum  
Financing**

The table below describes the criteria that properties must meet to be eligible for greater than 90 percent financing, whether or not the property has been previously occupied.

One of those criteria must be evidenced in order for the borrower to be eligible for a high ratio mortgage.

Criteria	Description
Approval of Dwelling Site Plans	The dwelling’s site plans and materials were approved before construction began by <ul style="list-style-type: none"> <li>• the Department of Veterans Affairs (VA)</li> <li>• an eligible DE underwriter, i.e. Conditional Commitment issued prior to framing, or</li> <li>• an early start letter issued by a DE underwriter.</li> </ul>
Local Jurisdiction Building Permit and Certificate of Occupancy	The local jurisdiction has issued both a <ul style="list-style-type: none"> <li>• building permit or equivalent prior to construction, and</li> <li>• Certificate of Occupancy or equivalent.</li> </ul> <p><i>Note:</i> This does not apply to condominiums or manufactured housing. These properties have special circumstances for financing approval.</p>
Builder’s Warranty	The dwelling is covered by a builder’s ten-year insured warranty plan that is acceptable to HUD.
Dwelling Relocation	The dwelling <ul style="list-style-type: none"> <li>• will be moved to a new location, and</li> <li>• is eligible for an insured mortgage at the new location based on approval of the dwelling site plan criteria listed previously in this table.</li> </ul>

## 8. Manufactured Home Construction-Permanent Loans

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<b>Introduction</b>	<p>This topic contains information on construction-permanent (CP) loans for manufactured homes, including</p> <ul style="list-style-type: none"><li>• manufactured home CP loan is a purchase transaction</li><li>• basic criteria for determining maximum mortgage amount for manufactured home CP loan</li><li>• determining property status for a manufactured home</li><li>• determining length of ownership for a manufactured home</li><li>• formulas for determining maximum mortgage amount on a manufactured home CP loan</li><li>• maximum mortgage calculation for manufactured home CP loan based on total cost or itemized value</li><li>• maximum mortgage calculation for manufactured housing CP loan based on allowable LTV</li><li>• maximum mortgage calculation for manufactured home CP loan based on existing indebtedness, and</li><li>• additional concerns for calculating the maximum mortgage amount on manufactured home CP loan.</li></ul>
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<b>Change Date</b>	October 26, 2009
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<b>4155.1 2.B.8.a Manufactured Home CP Loan is a Purchase Transaction</b>	<p>For purposes of underwriting and calculating the maximum mortgage amount, the CP loan on a newly-constructed manufactured home should be considered a purchase loan transaction, requiring a minimum 3.5% cash investment of the Total Cost or Value (including land).</p>
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To maintain consistency with FHA Connection data requirements and the Uniform Residential Loan Application, the purpose of the loan transaction should be designated as “CP.”

**Reference:** For more information on Construction Permanent loan characteristics and requirements, see [HUD 4155.1 6.A.](#)

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*Continued on next page*

## 8. Manufactured Home Construction-Permanent Loans,

Continued

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<p><b>4155.1 2.B.8.b</b>  <b>Basic Criteria for Determining Maximum Mortgage Amount for Manufactured Home CP Loan</b></p>	<p>To determine the maximum insurable mortgage amount for a manufactured housing CP transaction, the lender must consider the</p> <ul style="list-style-type: none"> <li>• property status</li> <li>• length of ownership, and</li> <li>• accepted formula to determine value.</li> </ul> <p>The length of time the property was owned in a given property status will determine whether a transaction is considered a CP or refinance transaction. CP transactions involve manufactured homes with acceptable property status that are</p> <ul style="list-style-type: none"> <li>• proposed for construction</li> <li>• under construction, or</li> <li>• existing construction less than 12 months old.</li> </ul> <p><b>References:</b> For more information on maximum mortgage amount calculations on refinance transactions see</p> <ul style="list-style-type: none"> <li>• <a href="#">HUD 4155.1 3.A.1.i</a>, and</li> <li>• <a href="#">HUD 4155.1 6.A.</a></li> </ul>
<p><b>4155.1 2.B.8.c</b>  <b>Determining Property Status for a Manufactured Home</b></p>	<p><i>Property status</i> refers to whether or not the property is classified or taxed as real property and whether the personal property title has been purged in compliance with state law.</p> <p><b>Reference:</b> For more information on purging personal property title on a manufactured home, see <a href="#">HUD 4155.2 6.A.1.j</a>.</p>
<p><b>4155.1 2.B.8.d</b>  <b>Determining Length of Ownership for a Manufactured Home</b></p>	<p><i>Length of ownership</i> refers to how long the prospective borrower has held an ownership interest in the manufactured housing unit and land.</p>

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*Continued on next page*

## 8. Manufactured Home Construction-Permanent Loans, Continued

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### 4155.1 2.B.8.e Formulas for Determining Maximum Mortgage Amount on a Manufactured Home CP Loan

The accepted *formula to determine total cost or itemized value* refers to calculating the mortgage amount based on

- total cost or itemized value
- maximum allowable loan-to-value (LTV) percentages, and
- existing indebtedness.

The maximum insurable mortgage amount is determined by the lowest of the three calculations using the three formulas above.

In a CP transaction, itemized value should be applied when the manufactured home unit, the land, or both have been owned for 6 months or more, and less than 12 months. If either the unit or the land has been owned for less than 6 months, the lesser of total cost or itemized value should be applied.

Evidence must be provided to certify how long the borrower has owned the land and/or manufactured unit. A contract or payoff statement for the land is required if it is currently encumbered by a lien payable by the borrower.

**References:** For more information on the formulas used to determine the maximum mortgage amount on a manufactured home CP loan based on

- total cost or itemized value, see [HUD 4155.1 2.B.8.f](#)
- maximum allowable loan-to-value (LTV) percentages see [HUD 4155.1 2.B.8.g](#), and
- existing indebtedness, see [HUD 4155.1 2.B.8.h](#).

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*Continued on next page*

## 8. Manufactured Home Construction-Permanent Loans, Continued

4155.1 2.B.8.f  
Maximum  
Mortgage  
Calculation for  
Manufactured  
Home CP Loan  
Based on Total  
Cost or  
Itemized Value

### 1. Mortgage Amount based on Total Cost or Itemized Value

#### a. Total Cost or Itemized Value:

Unit \_\_\_\_\_  
Land \_\_\_\_\_

**OR**

Combined \_\_\_\_\_  
Construction \_\_\_\_\_

Hard Costs \_\_\_\_\_  
Soft Costs \_\_\_\_\_

Total Cost or Itemized Value Cost \_\_\_\_\_

#### b. Minimum Cash Investment:

Total Cost or Itemized Value from 1a  
x 3.5% Required Statutory Investment \_\_\_\_\_

#### c. Subtract Minimum Cash Investment from Total Cost or Itemized Value

Amount based on Total Cost or Itemized Value (1a-1b) \_\_\_\_\_

4155.1 2.B.8.g  
Maximum  
Mortgage  
Calculation for  
Manufactured  
Home CP Loan  
Based on  
Allowable LTV

### 2. Amount based on Maximum Allowable Loan-to-Value Percentages

Lesser of Total Cost or Itemized Value or Appraised Value x Applicable  
Maximum Loan-to-Value Percentage: 96.5% for purchase transactions

Amount based on Maximum Allowable Loan-to-Value Percentages \_\_\_\_\_

*Continued on next page*

## 8. Manufactured Home Construction-Permanent Loans, Continued

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4155.1 2.B.8.h **3. Amount Based on Existing Indebtedness**  
**Maximum**  
**Mortgage**  
**Calculation for**  
**Manufactured**  
**Home CP Loan**  
**Based on**  
**Existing**  
**Indebtedness**

Unit		_____
Less Trade-in		( _____ )
Land		_____
Construction		
Hard Costs	_____	
Soft Costs	_____	
Borrower Paid:		
Discount Points	_____	
Prepays	_____	
Closing Costs	_____	

Amount Based on Existing Indebtedness =====

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*Continued on next page*

## 8. Manufactured Home Construction-Permanent Loans,

Continued

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**4155.1 2.B.8.i  
Additional  
Concerns for  
Calculating the  
Maximum  
Mortgage  
Amount on  
Manufactured  
Home CP Loan**

Financing on a manufactured home being constructed and installed is considered a construction loan or construction line-of-credit. Associated construction financing costs are to be itemized on a draw request or cost breakdown form. The file must include the contract or sales invoice for the manufactured home unit and the contract for the land.

The construction loan [hard] costs and construction loan financing [soft] costs must be identified. Lenders may obtain and provide information from the general contractor or another party who has knowledge of the related costs for completion of required work items.

The major installation charges require supporting documentation and separate invoices for the manufactured unit and the contractor's foundation and set-up costs. Razing and removing existing properties is considered part of the site preparation and may be included in the calculations as a component of the construction costs.

If the manufactured home dealer is the general contractor for the foundation and installation, the cost of the unit and additional charges must be itemized on an invoice. Aggregate amounts for total costs are not acceptable.

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## Chapter 3. Maximum Mortgage Amounts on Refinance Transactions

### Table of Contents

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## Section A. Refinance Transaction Overview

### Overview

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**In This Section** This section contains the topic “*General Information on Refinance Transactions.*”

---

# 1. General Information on Refinance Transactions

---

**Introduction** This topic contains general information on refinancing transactions, including

- the purpose of a refinance transaction
  - the maximum percentage of financing
  - types of refinances
  - the maximum refinancing term
  - re-using an appraisal
  - refinance authorization numbers for FHA-to-FHA refinances
  - maximum LTV factors and UFMIP for various types of refinance transactions
  - skipped payments are not acceptable,
  - refinance transactions on manufactured homes, and
  - requirements for obtaining pay-off statements for liens held against subject property
- 

**Change Date** March 10, 2010

---

**4155.1 3.A.1.a Purpose of a Refinance Transaction** A refinance transaction is used to pay off an existing real estate debt with the proceeds of a new mortgage

- for borrower(s) with legal title, and
- on the same property.

*Note:* The borrower is eligible to refinance the loan, as long as he/she has legal title, even if he/she was not originally on the loan.

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*Continued on next page*

## 1. General Information on Refinance Transactions, Continued

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### 4155.1 3.A.1.b Maximum Percentage of Financing

The maximum percentage of financing is governed by

- the occupancy status of the property
- the use of the loan proceeds, and
- how and when the property was purchased.

Generally, the maximum mortgage may never exceed the statutory limit, except by the amount of any new upfront mortgage insurance premium (UFMIP). However, the maximum mortgage may exceed the statutory limit on certain specialty products.

**Note:** Most Federal Housing Administration (FHA) mortgages require payment of an UFMIP. The statutory loan amount and loan-to-value (LTV) limits described in this handbook do *not* include UFMIP.

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### 4155.1 3.A.1.c Types of Refinances

FHA insures several different types of refinance transactions, including

- streamline refinances of existing FHA-insured mortgages made with and without appraisals
- no cash out refinances (rate and term) of conventional and FHA-insured mortgages, where all proceeds are used to pay existing liens and costs associated with the transactions, and
- cash out refinances.

**References:** For information on

- streamline refinances
    - with an appraisal, see [HUD 4155.1 3.C.3](#), and
    - without an appraisal, see [HUD 4155.1 3.C.2](#)
  - no cash out refinances, see [HUD 4155.1 3.B.1](#), and
  - cash out refinances, see [HUD 4155.1 3.B.2](#).
- 

*Continued on next page*

## 1. General Information on Refinance Transactions, Continued

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**4155.1 3.A.1.d**  
**Maximum**  
**Refinancing**  
**Term**

The maximum term of any refinance with an appraisal is 30 years.

The maximum term of a streamline refinance without an appraisal is limited to the lesser of

- the remaining term of the existing mortgage, plus 12 years, or
- 30 years.

**Reference:** For more information on streamline refinances, see [HUD 4155.1 3.C](#).

---

**4155.1 3.A.1.e**  
**Re-Using an**  
**Appraisal**

FHA appraisals on existing properties are valid for six months. However, appraisals cannot be reused

- during the six month validity period once the mortgage for which the appraisal was ordered has closed, or
- for a subsequent refinance, even if six months have not passed.

A new appraisal is required for each refinance transaction requiring an appraisal.

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**4155.1 3.A.1.f**  
**Refinance**  
**Authorization**  
**Numbers for**  
**FHA-to-FHA**  
**Refinances**

A lender *must* obtain a Refinance Authorization Number from the FHA Connection, or functional equivalent, for all FHA-to-FHA refinances.

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*Continued on next page*

# 1. General Information on Refinance Transactions, Continued

**4155.1 3.A.1.g  
Maximum LTV  
Factors and  
UFMIP for  
Various Types  
of Refinance  
Transactions**

The table below lists the maximum LTV factors and UFMIP for various types of refinance transactions.

**References:** For more information on

- no cash out (rate and term) refinances with an appraisal, see [HUD 4155.1 3.B.1](#)
- streamline refinances with an appraisal, see [HUD 4155.1 3.C.3](#)
- streamline refinances without an appraisal, see [HUD 4155.1 3.C.2](#), and
- cash out refinances, see [HUD 4155.1 3.B.2](#).

Type of Refinance	Maximum LTV	UFMIP
Rate and Term	97.75%	1.75%
FHA-to-FHA Streamline w/Appraisal	97.75%	1.50%
FHA-to-FHA Streamline w/o Appraisal	N/A	1.50%
	<i>Reference:</i> For more information, see <a href="#">HUD 4155.1 3.C.2</a> .	
Cash Out Refinance	85%	1.75%

*Continued on next page*

## 1. General Information on Refinance Transactions, Continued

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### 4155.1 3.A.1.h Skipped Payments Are Not Acceptable

Lenders are not permitted to allow borrowers to “skip” payments. The borrower must either

- make the payment when it is due, or
- bring the monthly mortgage payment check to settlement.

When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments “skipped” by the borrower in the new mortgage amount..

---

### 4155.1 3.A.1.i Refinance Transactions on Manufactured Homes

For a transaction involving a manufactured home to be considered a refinance, the manufactured home must

- have acceptable property status
- be complete, and
- have been permanently erected on a site for more than one year (12 months) prior to the date of the application for mortgage insurance.

Standard maximum mortgage calculations apply.

**References:** For more information on determining

- property status on a manufactured home, see [4155.1 2.B.8.c](#), and
  - maximum mortgage amount for a manufactured home less than 12 months old, see [4155.1 2.B.8.b](#).
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*Continued on next page*

## 1. General Information on Refinance Transactions, Continued

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**4155.1 3.A.1.j  
Pay-Off  
Statements For  
Liens Held  
Against Subject  
Property**

A lender must obtain pay-off statements for all liens which are to be satisfied from the proceeds of a refinance transaction. It is the responsibility of the lender to review and ascertain any lien against the subject property which is subject to payments, that the lien/loan/mortgage is current for the month due for streamline and cash-out refinance transactions.

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## Section B. Maximum Mortgage Amounts on No Cash Out/Cash Out Refinance Transactions

### Overview

---

**In This Section** This section contains the topics listed in the table below.

<b>Topic</b>	<b>Topic Name</b>	<b>See Page</b>
1	No Cash Out Refinance Transactions With an Appraisal	3-B-2
2	Cash Out Refinance Transactions	3-B-6

---

# 1. No Cash Out Refinance Transactions With an Appraisal

---

**Introduction** This topic contains information on no cash out refinance transactions with an appraisal, including

- the maximum mortgage calculation
  - calculating the existing debt
  - subordinate liens
  - refinancing to buy out ex-spouse or coborrower equity
  - the mortgage calculation for a property acquired less than one year before the loan application, and
  - short pay offs.
- 

**Change Date** March 10, 2010

---

**4155.1 3.B.1.a  
Maximum  
Mortgage  
Calculation** The maximum mortgage for a no cash out refinancing with an appraisal (credit qualifying) is the *lesser* of the

- 97.75% LTV factor applied to appraised value of the property, or
- existing debt.

The total FHA first mortgage is limited to 100% of the appraised value, *including* any financed upfront mortgage insurance premium (UFMIP).

Most FHA mortgages require payment of an UFMIP. The statutory loan amounts and LTV limits described in this handbook do not include the UFMIP.

Generally, the maximum mortgage may *never* exceed the statutory limit, except by the amount of any new UFMIP. However, the maximum mortgage may exceed the statutory limit on certain specialty products.

**Note:** The borrower must comply with any appraisal requirements, including repairs, before the mortgage is eligible for insurance endorsement.

**Reference:** For more information on maximum LTV factors, see [HUD 4155.1 2.A.2.b.](#)

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*Continued on next page*

# 1. No Cash Out Refinance Transactions With an Appraisal, Continued

**4155.1 3.B.1.b  
Calculating the  
Existing Debt  
on a No Cash  
Out Refinance  
With an  
Appraisal**

Follow the steps in the table below to calculate the existing debt.

*Note:* On this type of refinance transaction, the borrower may not receive cash back in excess of \$500 at closing.

Step	Action
1	Determine the amount of the existing first mortgage. The existing first mortgage must be current for the month due and <ul style="list-style-type: none"> <li>• <i>may</i> include                             <ul style="list-style-type: none"> <li>– the interest charged by the servicing lender when the payoff will not likely be received on the first day of the month (as is typically assessed on FHA-insured mortgages), and</li> <li>– any prepayment penalties assessed on a conventional mortgage or FHA Title I loan</li> <li>– late charges, and</li> <li>– escrow shortages, and</li> </ul> </li> <li>• <i>may not</i> include delinquent interest.</li> </ul>
2	Determine the prepaid expenses, which may include <ul style="list-style-type: none"> <li>• the per diem interest to the end of the month on the new loan</li> <li>• hazard insurance premium deposits</li> <li>• monthly mortgage insurance premiums, and</li> <li>• any real estate tax deposits needed to establish the escrow account.</li> </ul>

*Continued on next page*

# 1. No Cash Out Refinance Transactions With an Appraisal, Continued

## 4155.1 3.B.1.b Calculating the Existing Debt on a No Cash Out Refinance With an Appraisal (continued)

Step	Action
3	<p>Add the following to the existing first mortgage amount:</p> <ul style="list-style-type: none"> <li>• any purchase money second mortgage</li> <li>• any junior liens over 12 months old</li> <li>• closing costs</li> <li>• prepaid expenses (even if the mortgagee refinancing the loan is the servicing lender)</li> <li>• borrower paid repairs required by the appraisal, and</li> <li>• discount points.</li> </ul> <p><i>Note:</i> If the balance or any portion of an equity line of credit in excess of \$1000 was advanced within the past 12 months and was for purposes <i>other</i> than repairs and rehabilitation of the property, that portion above and beyond \$1,000 of the line of credit is <i>not</i> eligible for inclusion in the new mortgage.</p>
4	<p>Subtract any refund of UFMIP.</p> <p><b>Result:</b> The resulting figure is the existing debt.</p>

### 4155.1 3.B.1.c Subordinate Liens

Subordinate liens, including lines of credit, regardless of when taken, may remain outstanding (but subordinate to the FHA-insured mortgage), provided the FHA insured mortgage meets the eligibility criteria for mortgages with secondary financing outlined in [HUD 4155.1 5.C.](#)

*Continued on next page*

## 1. No Cash Out Refinance Transactions With an Appraisal,

Continued

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### 4155.1 3.B.1.d Refinancing to Buy Out Ex- Spouse or Coborrower Equity

When the purpose of the new loan is to refinance an existing mortgage in order to buy out an ex-spouse's or other coborrower's equity, the specified equity to be paid is

- considered property-related indebtedness, and
- eligible to be included in the new mortgage calculation.

The divorce decree, settlement agreement, or other bona fide equity agreement must be provided to document the equity awarded to the ex-spouse or coborrower.

---

### 4155.1 3.B.1.e Mortgage Calculation for a Property Acquired Less Than One Year Before Loan Application

If the property was acquired less than one year before the loan application, and is not already FHA-insured, in addition to the calculations described previously in this topic, the original sales price of the property must also be considered in determining the maximum mortgage.

Using conclusive documentation, expenditures for repairs and rehabilitation incurred after the purchase of the property may be added to the original sales price in calculating the mortgage amount.

The maximum mortgage amount will be based off of the *lesser* of the

- total cost to acquire the property, which includes the original purchase price plus any
    - documented costs incurred for rehabilitation, repairs, renovation, or weatherization
    - closing costs, and
    - reasonable discount points, **or**
  - current appraised value, **or**
  - total of all mortgage liens held against the subject property.
- 

*Continued on next page*

## 1. No Cash Out Refinance Transactions With an Appraisal,

Continued

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### 4155.1 3.B.1.f Short Pay Offs

To be eligible for refinancing with a short pay off, borrowers must be current on their mortgages.

FHA will insure the first mortgage where the existing note holder(s) write off the amount of the indebtedness that cannot be refinanced into the new FHA-insured mortgage if

- there is insufficient equity in the home based on its current appraised value, and/or
- the borrower has experienced a reduction in income and does not have the capacity to repay the existing indebtedness against the property.

For instances where the existing note holders are reluctant to write down indebtedness, a new subordinate lien may be executed for the amount by which the payoff is short.

If payments on subordinate financing are required, they must be included in the qualifying ratios unless payments have been deferred for no less than 36 months. This policy applies *only* to no cash-out (rate and term) refinances with short pay offs.

**References:** For more information on

- mortgage payment history required for refinancing, see [HUD 4155.1 4.C.2.b](#),
  - new subordinate financing see [HUD 4155.1 3.B.1.c](#), and
  - short sales, see [HUD 4155.1 4.C.2.1](#).
-

## 2. Cash Out Refinance Transactions

---

**Introduction** This topic contains general information for cash out refinance transactions, including

- eligibility for cash out refinances
- ineligibility of delinquent borrowers for cash out refinances
- restriction on addition of non-occupant coborrower for credit underwriting compliance
- borrower must be current with no delinquencies on mortgage for previous 12 months to be eligible for a cash out refinance
- subordinate liens and CLTV ratios on cash out refinances
- maximum mortgage amount calculation based on length of ownership
- the risk on cash out refinancing for debt consolidation, and
- a reference for borrower use of non-approved broker to assist in obtaining mortgage financing.

---

**Change Date** March 10, 2010

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**4155.1 3.B.2.a Eligibility for Cash Out Refinances** Cash out refinance transactions are only permitted on owner occupied principal residences.

Properties owned free and clear *may* be refinanced as cash out transactions.

**References:** For more information on

- three and four unit properties, including self-sufficiency requirements see [HUD 4155.1 2.B.4](#), and
- eligibility and mortgage payment history, see [HUD 4155.1 3.B.2.d](#).

---

**4155.1 3.B.2.b Ineligibility of Delinquent Borrowers for Cash Out Refinances** Borrowers who are delinquent, in arrears or have suffered any mortgage delinquencies within the most recent 12 month period under the terms and conditions of their mortgage are *not* eligible for cash out refinances.

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*Continued on next page*

## 2. Cash Out Refinance Transactions, Continued

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**4155.1 3.B.2.c  
Restriction on  
Addition of  
Non-Occupant  
Coborrower for  
Credit  
Underwriting  
Compliance**

Non-occupant coborrowers may *not* be added in a cash out refinance transaction in order to meet FHA's credit underwriting guidelines for the mortgage. Any coborrower or cosigner being added to the Note must be an occupant of the property.

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**4155.1 3.B.2.d  
Borrower Must  
Be Current  
With No  
Delinquencies  
on Mortgage  
for Previous 12  
Months to Be  
Eligible for a  
Cash Out  
Refinance**

If a property is encumbered by a mortgage, the borrower must have made all of his/her mortgage payments on time within the month due for the previous 12 months.

**Reference:** For information on the ineligibility of delinquent borrowers, see [HUD 4155.1 3.B.2.b](#).

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*Continued on next page*

## 2. Cash Out Refinance Transactions, Continued

**4155.1 3.B.2.e  
Subordinate  
Liens and  
CLTV Ratios  
on Cash Out  
Refinances**

The table below lists the policy requirements regarding subordinate financing and CLTVs.

<b>Type of Subordinate Lien</b>	<b>Policy Requirement</b>
New subordinate financing	If new subordinate financing is being offered by the lender or other permitted entity, the CLTV is limited to 85% (the FHA-insured first mortgage and any new junior liens when added together)
Existing subordinate financing	Existing subordinate financing may remain in place, but subordinate to the FHA-insured first mortgage, regardless of the total indebtedness or CTLV ratio, provided the borrower qualifies for making scheduled payments on all liens.
Modified subordinate lien	Many subordinate lien holders request modifications to the terms of the lien (typically a reduction in the amount of the lien) in exchange for remaining in a subordinate position. Modifying the subordinate lien in this manner often results in re-executing the lien at closing, which is acceptable to FHA. In this case, FHA does not consider the lien a new subordinate lien.

*Continued on next page*

## 2. Cash Out Refinance Transactions, Continued

**4155.1 3.B.2.f**  
**Maximum**  
**Mortgage**  
**Amount**  
**Calculation**  
**Based on**  
**Length of**  
**Ownership**

The table below describes policy guidance on the maximum mortgage amount calculation for cash out refinance transactions, based on the length of ownership.

<b>If the property has been owned by the borrower as his/her principal residence for ...</b>	<b>Then the mortgage ...</b>
<i>12 months or more</i> preceding the date of the loan application	is eligible for the maximum amount of 85% of the appraiser’s estimate of value.
<i>less than 12 months</i> preceding the date of the loan application	is limited to the <i>lesser</i> of 85% of the <ul style="list-style-type: none"> <li>• appraiser’s estimate of value, and</li> <li>• sales price of the property when acquired</li> </ul> <p><i>Note:</i> The sales price does not need to be considered if the property was acquired as the result of inheritance and is, or will become, the heir’s principal residence.</p>

*Continued on next page*

## 2. Cash Out Refinance Transactions, Continued

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**4155.1 3.B.2.g**  
**Risk on Cash**  
**Out**  
**Refinancing for**  
**Debt**  
**Consolidation**

Cash out refinancing for debt consolidation represents considerable risk, especially if the borrowers have not had a corresponding increase in income.

Careful evaluation of this type of transaction is required.

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**4155.1 3.B.2.h**  
**Borrower Use**  
**of Non-**  
**Approved**  
**Broker to**  
**Assist in**  
**Obtaining**  
**Mortgage**  
**Financing**  
**(Reference)**

For information on FHA policy regarding a borrower engaging a broker who is not FHA-approved to assist in obtaining financing, see

- [HUD 4155.2 1.A.3.a](#), and
- [HUD 4155.2 1.A.3.b](#).

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## Section C. Maximum Mortgage Amounts on Streamline Refinances

### Overview

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**In This Section** This section contains the topics listed in the table below

Topic	Topic Name	See Page
1	General Information on Streamline Refinances	3-C-2
2	Streamline Refinances Without an Appraisal	3-C-3
3	Streamline Refinances With an Appraisal (No Credit Qualifying)	3-C-6

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## 1. General Information on Streamline Refinances

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**Introduction** This topic contains general information on streamline refinances, including

- the purpose of a streamline refinance, and
- where to locate additional policies and instructions on streamline refinances.

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**Change Date** May 10, 2009

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**4155.1 3.C.1.a  
Purpose of a  
Streamline  
Refinance** Streamline refinances

- are designed to lower the monthly principal and interest payments on a current FHA-insured mortgage, and
- must involve no cash back to the borrower, except for minor adjustments at closing, not to exceed \$500.

Streamline refinances can be made with or without an appraisal.

**References:** For information on streamline refinances

- without an appraisal, see [HUD 4155.1 3.C.2](#) , and
  - with an appraisal, see [HUD 4155.1 3.C.3](#).
- 

**4155.1 3.C.1.b  
Additional  
Streamline  
Refinance  
Policies and  
Instructions  
Reference** For additional policies, processing guidelines, and underwriting instructions for streamline refinances, see [HUD 4155.1 6.C](#).

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## 2. Streamline Refinances Without an Appraisal

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**Introduction** This topic contains information about streamline financing without an appraisal, including

- streamline refinancing mortgage limits
  - maximum mortgage term
  - maximum insurable mortgage calculation
  - applicability of the mortgage calculation process
  - streamline refinances for non owner occupant properties, and
  - policy on subordinate financing on streamline refinances.
- 

**Change Date** March 10, 2010

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**4155.1 3.C.2.a Streamline Refinancing Mortgage Limits** Generally, the streamline refinance mortgage amount may never exceed the statutory limits, except by the amount of any new UFMIP. However, the maximum mortgage may exceed the statutory limits on certain specialty products.

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**4155.1 3.C.2.b Maximum Mortgage Term for Streamline Refinances** The streamline refinance mortgage term is the *lesser* of

- 30 years, or
- the remaining term of the mortgage plus 12 years.

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## 2. Streamline Refinances Without an Appraisal, Continued

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### 4155.1 3.C.2.c Maximum Insurable Mortgage Calculation for Streamline Refinances Without an Appraisal

The maximum insurable mortgage for streamline refinances without an appraisal cannot exceed the outstanding principal balance

- *minus* the applicable refund of the Upfront Mortgage Insurance Premium (UFMIP),
- *plus* the new UFMIP that will be charged on the refinance.

**Note:** The outstanding principal balance

- *may* include interest charged by the servicing lender when the payoff is not received on the first day of the month, but
- *may not* include delinquent interest, late charges or escrow shortages.

**Reference:** For step-by-step instructions on calculating the existing debt, see [HUD 4155.1 3.B.1.b](#).

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### 4155.1 3.C.2.d Applicability of the Mortgage Calculation Process

The mortgage calculation process described in [HUD 4155.1 3.C.2.c](#) applies *only* to owner occupied properties. Non owner occupant properties, even if originally acquired as principal residences by the current borrowers, may only be refinanced for the outstanding principal balance.

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*Continued on next page*

## 2. Streamline Refinances Without an Appraisal, Continued

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### 4155.1 3.C.2.e Streamline Refinances For Non Owner Occupant Properties

Streamline financing by investors, or for secondary residences may *only* be made without an appraisal. The loan must be made solely in the business entity's name, if the residence was previously insured in the business entity's name.

The new security instruments must contain FHA's standard provision permitting acceleration of the mortgage when assumed by an investor, or as a secondary residence. However, FHA does *not* authorize the lender to exercise the acceleration provision if the investor assumptor is found to be creditworthy.

Although a property purchased as a principal residence, under certain circumstances as described in the security instruments, *may* be rented or become a secondary residence, a streamline refinance without an appraisal does *not* "convert" the mortgage to one eligible for assumption by an investor.

**References:** For more information on refinancing non owner occupant properties, see

- [4155.1 4.B.3](#)
  - [4155.1 4.B.4](#)
  - [4155.1 6.C.5.a](#), and
  - [4155.1 6.C.5.b](#).
- 

### 4155.1 3.C.2.f Policy on Subordinate Financing on Streamline Refinances Without an Appraisal

Subordinate liens, including credit lines, regardless of when taken, may remain outstanding, but must be subordinate to the FHA-insured mortgage.

If subordinate financing remains in place, the

- maximum combined loan-to-value (CLTV) is 125 percent
  - CLTV is based on the original appraised value of the property, and
  - maximum CLTV is calculated by taking the original FHA base loan amount (the original FHA principal balance excluding financed UFMIP), adding all other financed liens still outstanding, and dividing by the appraised value. This calculation may not exceed 125 percent.
- 

*Continued on next page*

### 3. Streamline Refinances With an Appraisal (No Credit Qualifying)

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**Introduction** This topic contains information about streamline refinancing with an appraisal, including

- the maximum insurable mortgage calculation
- the policy on subordinate financing on streamline refinances with an appraisal, and
- the restriction on borrower cash back at closing on streamline refinances with an appraisal.

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**Change Date** December 8, 2009

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*Continued on next page*

### 3. Streamline Refinances With an Appraisal (No Credit Qualifying), Continued

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**4155.1 3.C.3.a  
Maximum  
Insurable  
Mortgage  
Calculation for  
Streamline  
Refinances  
With An  
Appraisal**

The maximum insurable mortgage for streamline refinances with an appraisal is the *lesser* of

- the existing principal balance
  - *minus* the applicable refund of UFMIP
  - *plus* closing costs, prepaid items to establish the escrow account, and the new UFMIP that will be charged on the refinance transaction, or
- 97.75 percent of the appraised value of the property plus the new UFMIP that will be charged on the refinance.

*Notes:*

- The outstanding principal balance
  - *may* include interest charged by the servicing lender when the payoff is not received on the first day of the month, but
  - *may not* include delinquent interest, late charges or escrow shortages.
- Prepaid expenses may include
  - per diem interest to the end of the month on the new loan
  - hazard insurance premium deposits
  - monthly mortgage insurance premiums, and
  - any real estate tax deposits needed to establish the escrow account, regardless of whether the lender refinancing the existing loan is also the servicing lender for that mortgage.
- Discount points may not be included in the new mortgage. If the borrower has agreed to pay discount points, the lender must verify that the borrower has the assets to pay them, along with any other financing costs not included in the new mortgage amount.

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*Continued on next page*

### 3. Streamline Refinances With an Appraisal (No Credit Qualifying), Continued

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**4155.1 3.C.3.b  
Policy on  
Subordinate  
Financing on  
Streamline  
Refinances  
With An  
Appraisal**

Subordinate liens, including credit lines, regardless of when taken, may remain outstanding, but must be subordinate to the FHA-insured mortgage.

If subordinate financing remains in place, the

- maximum combined loan-to-value (CLTV) is 125 percent, and
- CLTV is based on the new appraised value.

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**4155.1 3.C.3.c  
Restriction on  
Borrower Cash  
Back at Closing  
on a Streamline  
Refinance With  
an Appraisal**

A streamline refinance transaction with an appraisal must involve no cash back to the borrower, except for minor adjustments at closing, not to exceed \$500.

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## Chapter 4. Borrower Eligibility and Credit Analysis

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## Section A. Borrower Eligibility Requirements

### Overview

**In This Section** This section contains the topics listed in the table below.

<b>Topic</b>	<b>Topic Name</b>	<b>See Page</b>
1	Borrower, Coborrower, and Cosigner Eligibility Requirements	4-A-2
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# 1. Borrower, Coborrower and Cosigner Eligibility Requirements

---

**Introduction** This topic contains information on borrower, coborrower, and cosigner eligibility requirements, including

- who is eligible for Federal Housing Administration (FHA) mortgage insurance
  - borrower age limits
  - determination of creditworthiness
  - borrower and coborrower requirements
  - cosigner requirements
  - additional coborrower and cosigner requirements
  - military personnel eligibility,
  - veteran eligibility documentation requirements, and
  - title issues regarding non-borrowing spouses or other parties in interest.
- 

**Change Date** March 29, 2010

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**4155.1 4.A.1.a  
Who Is Eligible  
for FHA  
Mortgage  
Insurance**

FHA insures mortgages made

- to individuals with a valid Social Security number (SSN), and
- under the conditions described in this section, to
  - state and local government agencies, and
  - approved nonprofit organizations.

**Note:** Employees of the World Bank, foreign embassies, etc., may not be required to have an SSN. Conclusive evidence of this exception must be provided.

**Reference:** For more information on evidence of Social Security Number, see [HUD 4155.1 1.3.b](#).

---

**4155.1 4.A.1.b  
Borrower Age  
Limits**

There is no *maximum* age limit for a borrower. The *minimum* age is the age for which a mortgage note can be legally enforced in the state, or other jurisdiction where the property is located.

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*Continued on next page*

# 1. Borrower, Coborrower and Cosigner Eligibility Requirements, Continued

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## 4155.1 4.A.1.c Determination of Credit Worthiness and Minimum Credit Score Requirement

When determining the mortgage creditworthiness of borrowers, coborrowers, or cosigners, the underwriter takes the following into consideration:

- income
- assets
- liabilities, and
- credit history.

Borrowers with decision credit scores below 500 and with loan-to-value ratios at or above 90 percent are not eligible for FHA-insured mortgage financing.

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## 4155.1 4.A.1.d Borrower and Coborrower Requirements

Both occupying and non-occupying borrowers and coborrowers

- take title to the property at settlement
- are obligated on the mortgage note, and
- must sign all security instruments.

**Reference:** For additional information on borrower and coborrower eligibility requirements, see [HUD 4155.1 4.A.1.f](#).

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## 4155.1 4.A.1.e Cosigner Requirements

Cosigners

- do *not* hold ownership interest in a property
- *are* obligated on the mortgage note and liable for repaying the obligation, and
- must complete and sign all loan documents except the security instruments.

**Reference:** For additional cosigner eligibility requirements, see [HUD 4155.1 4.A.1.f](#).

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*Continued on next page*

## 1. Borrower, Coborrower and Cosigner Eligibility Requirements, Continued

### 4155.1 4.A.1.f Additional Borrower and Coborrower Eligibility

The table below describes additional requirements and conditions for coborrowers and cosigners.

Condition/Requirement	Description
Financial Interest Prohibited	<p>A party who has a financial interest in the mortgage loan transaction, such as the seller, builder, or real estate agent, may <i>not</i> be a coborrower or a cosigner.</p> <p><b>Exception:</b> Exceptions may be granted when the party with the financial interest is related to the borrower by blood, marriage, or law.</p> <p><b>Reference:</b> For more information on identity of interest transactions, see <a href="#">HUD 4155.1 2.B.2.</a></p>
Basic Ineligibility for Participation	<p>An individual signing the loan application must not be otherwise ineligible for participation in the mortgage loan transaction for reasons as described in <a href="#">HUD 4155.1 4.C.</a></p> <p><b>Note:</b> This condition applies to all borrowers, regardless of occupancy status.</p>
Principal United States (U.S.) Residence	<p>Non-occupying coborrowers or cosigners must have a principle residence in the U.S., unless exempted</p> <ul style="list-style-type: none"> <li>• due to military service with overseas assignments, or</li> <li>• as a U.S. citizen living abroad.</li> </ul>

*Continued on next page*

## 1. Borrower, Coborrower and Cosigner Eligibility Requirements, Continued

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### 4155.1 4.A.1.g Military Personnel Eligibility

Military personnel are considered occupant-owners, and eligible for maximum financing if a member of the immediate family will occupy a property as the principal residence, whether or not the military person is stationed elsewhere.

**Reference:** For information on eligibility documentation requirements for FHA-insured mortgages to veterans, see [HUD 4155.1 4.A.1.h](#).

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### 4155.1 4.A.1.h Veteran Eligibility Documentation Requirements

A completed Certificate of Veteran Status (CVS, VA Form 26-8261) issued to a veteran borrower is the only document that may be used for program eligibility. The Department of Veterans Affairs is solely responsible for determining eligibility for a CVS and its subsequent issuance.

Requests for a CVS must be sent on VA Form 26-8261a, along with proof of military service, to the appropriate VA Eligibility Center. This form is available at <http://www.va.gov/vaforms/>.

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### 4155.1 4.A.1.i Title Issues Regarding Non- Borrowing Spouses or Other Parties in Interest

If two or more parties have an ownership interest in the property, but one of the parties is applying for the loan (and credit qualifies for the loan on his/her own), it is not required that the non-applicant individual(s) execute the mortgage note and mortgage, deed of trust, or security deed.

The lender is still required to ensure a valid and enforceable first lien on the property under applicable State law, which may require the execution of the mortgage, deed of trust, or security deed (but typically not the note) by all parties who have an ownership interest in the property.

If the party in question executes the mortgage, deed of trust, or security deed only and not the note, he/she is not considered a borrower for FHA purposes, and therefore need not sign the loan application or be considered in credit underwriting.

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## 2. Ineligible Borrowers

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<b>Introduction</b>	<p>This topic contains information on ineligible borrowers, including</p> <ul style="list-style-type: none"> <li>• reasons for mandatory rejection of a borrower</li> <li>• waiting period for borrowers with past delinquencies and defaults, and</li> <li>• lender responsibility for screening borrowers.</li> </ul>
<b>Change Date</b>	March 29, 2010
<b>4155.1 4.A.2.a Reasons for Mandatory Rejection of a Borrower</b>	<p>A borrower seeking to obtain an FHA-insured mortgage <i>must</i> be rejected if he/she is</p> <ul style="list-style-type: none"> <li>• suspended, debarred, or otherwise excluded from participation in HUD’s programs and appears on either the <ul style="list-style-type: none"> <li>– <a href="#">HUD Limited Denial of Participation</a> (LDP) list, or</li> <li>– General Services Administration’s (GSA’s) “<a href="#">List of Parties Excluded from Federal Procurement or Nonprocurement Programs</a>,” or</li> </ul> </li> <li>• presently delinquent on any Federal debt or has a lien placed against his/her property for a debt owed to the United States Government.</li> </ul> <p><b>Notes:</b></p> <ul style="list-style-type: none"> <li>• A borrower who is delinquent on a Federal debt may become eligible once he/she brings the account current or enters into a satisfactory repayment plan with the Federal agency.</li> <li>• A mortgage loan is not eligible for insurance if <i>any party</i> involved in the transaction is on either of the above lists. An exception exists for a seller on the list who is selling his/her principal residence.</li> </ul> <p><b>References:</b> For more information on</p> <ul style="list-style-type: none"> <li>• loan transactions that are ineligible for insurance due to <i>any party</i> being on either of the above lists, see <a href="#">HUD 4155.1 4.A.7.c</a></li> <li>• exceptions to the requirement that a party on one of the above lists must be considered ineligible, see <a href="#">HUD 4155.1 4.A.8.e</a>, and</li> <li>• using CAIVRS to determine borrower eligibility, see <a href="#">HUD 4155.1 4.A.2.c</a> and <a href="#">HUD 4155.1 4.A.8</a>.</li> </ul>

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## 2. Ineligible Borrowers, Continued

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### 4155.1 4.A.2.b Waiting Period for Borrowers With Past Delinquencies and Defaults

FHA has a three-year waiting period to regain eligibility for another FHA-insured mortgage when the borrower has had past delinquencies or has defaulted on an FHA-insured loan.

The three-year waiting period begins when FHA pays the initial claim to the lender. This includes deed-in-lieu of foreclosure, as well as judicial and other forms of foreclosures.

Lenders should contact the HOC having jurisdiction over the area where the property subject to default is located for information such as the

- date the claim was paid, and
  - date of the initial default.
- 

### 4155.1 4.A.2.c Lender Responsibility for Borrower Screening

Lenders are responsible for screening all borrowers using HUD's Credit Alert Interactive Voice Response System (CAIVRS). A borrower is *not* eligible for an FHA-insured mortgage if CAIVRS indicates that the borrower

- is presently delinquent, or
- has had a claim paid within the previous three years on a loan made or insured by FHA.

**Reference:** For additional information on lender responsibility for using CAIVRS to screen borrowers, see [HUD 4155.1 4.A.8.](#)

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### 3. Citizenship and Immigration Status

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**Introduction** This topic contains information on citizen and immigration status, including

- residency requirements
- lawful permanent resident aliens
- non-permanent resident aliens
- Employment Authorization Document (EAD) required as evidence of work status, and
- non-lawful residency.

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**Change Date** March 29, 2010

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**4155.1 4.A.3.a Residency Requirements** U.S. citizenship is not required for mortgage eligibility.

The lender must determine residency status of the borrower, based on

- information provided on the loan application, and
- other applicable documentation.

---

**4155.1 4.A.3.b Lawful Permanent Resident Aliens** FHA insures mortgages for borrowers with *lawful permanent resident alien status* using the same terms and conditions as those for U.S. citizens.

The mortgage file *must*

- include evidence of the permanent residency, and
- indicate that the borrower is a lawful permanent resident alien on the Uniform Residential Loan Application (URLA).

**Note:** The U.S. Citizenship and Immigration Services (USCIS) within the Department of Homeland Security provides evidence of lawful, permanent residency status.

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*Continued on next page*

### 3. Citizenship and Immigration Status, Continued

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#### 4155.1 4.A.3.c Non-Permanent Resident Aliens

FHA insures mortgages made to non-permanent resident aliens provided that the

- property will be the borrower's principal residence
- borrower has a valid SSN, and
- borrower is eligible to work in the U.S., as evidenced by an EAD issued by the USCIS.

**Note:** The Social Security card *cannot* be used as evidence of work status.

**Reference:** For more information on the requirement to use the EAD as evidence of work status, see [HUD 4155.1 4.A.3.d](#).

---

#### 4155.1 4.A.3.d EAD Required as Evidence of Work Status

Although Social Security cards may indicate work status, such as “not valid for work purposes,” an individual's work status may change without the change being reflected on the actual Social Security card. For this reason, the Social Security card must not be used as evidence of work status, and the EAD must be used instead.

If the EAD will expire within one year and a prior history of residency status renewals exists, the lender may assume that continuation will be granted. If there are not prior renewals, the lender must determine the likelihood of renewal, based on information from the USCIS.

**Note:** Borrowers residing in the U.S. by virtue of refugee or asylee status granted by the USCIS are automatically eligible to work in this country. An EAD is *not required*.

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#### 4155.1 4.A.3.e Non-Lawful Residency

Non-U.S. citizens that do *not* have lawful residency in the U.S. are *not* eligible for FHA-insured mortgages.

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## 4. Living Trusts

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**Introduction** This topic contains information on living trusts, including

- property held in living trusts, and
  - living trusts and security instruments.
- 

**Change Date** March 29, 2010

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**4155.1 4.A.4.a  
Property Held  
in Living  
Trusts** Property held in a living trust is eligible for FHA mortgage insurance when an individual borrower

- remains the beneficiary, and
- occupies the property as a principal residence.

The lender must be satisfied that the trust provides reasonable means to assure that the lender will be notified of any changes to the trust regarding

- occupancy changes, or
  - transfer of beneficial interest.
- 

**4155.1 4.A.4.b  
Living Trusts  
and Security  
Instruments** The name of the living trust must appear on the security instrument, such as the mortgage, deed of trust, or security deed.

The individual borrower must appear on the security instrument when required to create a valid lien under State law. The owner-occupant, and other borrowers if any, must also appear on the Note with the trust.

The individual borrower is not required to appear on the property deed or title.

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## 5. Non-Purchasing Spouses

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**Introduction** This topic contains information on non-purchasing spouses, including

- valid first liens
  - non-purchasing spouse debt, and
  - non-purchasing spouse credit history.
- 

**Change Date** March 29, 2010

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**4155.1 4.A.5.a  
Valid First  
Liens** If required by State law in order to perfect a valid and enforceable first lien, the non-purchasing spouse may be required to sign either the security instrument or documentation indicating that the individual is relinquishing all rights to the property.

When the security instrument is executed for this reason, the non-purchasing spouse is

- *not* considered a borrower, and
- *not* required to sign the loan application.

**Note:** Non-applicant individuals can have an ownership interest in the property at the time of settlement without executing the mortgage note and mortgage, deed of trust, or security deed, regardless of whether the transaction is a purchase or a refinance.

**Reference:** For more information on title issues regarding non-borrowing spouses or other parties in interest, see [HUD 4155.1 4.A.1.i](#).

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## 5. Non-Purchasing Spouses, Continued

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### 4155.1 4.A.5.b Non- Purchasing Spouse Debt

Except for obligations specifically excluded by State law, the debts of non-purchasing spouses *must* be included in the borrower's qualifying ratios, if the

- borrower resides in a community property state, or
  - property being insured is located in a community property state.
- 

### 4155.1 4.A.5.c Non- Purchasing Spouse Credit History

The non-purchasing spouse's credit history is not considered a reason to deny a loan application. However, the non-purchasing spouse's obligations must be considered in the debt-to-income ratio unless excluded by State law. A credit report that complies with the requirements of [HUD 4155.1 4.C.2](#) must be provided for the non-purchasing spouse in order to determine the debts that must be counted in the debt-to-income ratio.

*Note:* This requirement is applicable if the subject property or the borrower's principal residence is located in a community property state.

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## 6. Eligibility Requirements for Nonprofit Organizations and State and Local Government Agencies

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**Introduction** This topic contains information on eligibility requirements for nonprofit organizations and state and local government agencies to obtain an FHA-insured mortgage, including

- the general policy on the eligibility of nonprofit organizations
- the percentage of financing available
- the Homeownership Center (HOC) and Direct Endorsement (DE) lender responsibilities for determining eligibility
- the requirements for nonprofit approval by the Department for Housing and Urban Development (HUD)
- nonprofit organizations not meeting HUD approval requirements, and
- eligibility of state and local government agencies.

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**Change Date** October 26, 2009

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**4155.1 4.A.6.a  
General Policy  
on the  
Eligibility of  
Nonprofit  
Organizations** Nonprofit organizations are eligible to purchase rental properties with FHA-insured mortgages, provided that they

- intend to sell or lease the property to low- or moderate-income individuals (generally defined as income not exceeding 115 percent of the applicable median income), and
- meet the requirements for HUD approval listed in [HUD 4155.1 4.A.6.d](#).

Nonprofit organizations may only obtain FHA-insured *fixed rate* mortgages. Only an existing FHA-insured mortgage is eligible for refinancing and may never result in equity withdrawal.

---

**4155.1 4.A.6.b  
Percentage of  
Financing  
Available** Nonprofit organizations are eligible for the same percentage of financing available on owner-occupied principal residences.

**Reference:** For more information on the percentage of financing available, see [HUD 4155.1 2.A](#).

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*Continued on next page*

## 6. Eligibility Requirements for Nonprofit Organizations and State and Local Government Agencies, Continued

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### 4155.1 4.A.6.c HOC and DE Lender Responsibilities for Determining Eligibility and Verifying HUD Approval

The appropriate HOC is responsible for determining a nonprofit organization's eligibility to participate in FHA programs.

The DE lender is responsible for determining

- the organization's financial capacity for repayment, and
- that the organization, at the time of underwriting, is approved by HUD as a participating nonprofit organization, as described in [HUD 4155.1 4.A.6.d](#).

**Note:** Lenders can verify nonprofit approval status by visiting the HUD Web site at [www.hud.gov](http://www.hud.gov).

---

### 4155.1 4.A.6.d Requirements for Nonprofit Approval by HUD

HUD must approve the nonprofit organization for it to be eligible to

- purchase properties with
  - FHA-insured mortgages, and
  - the same percentage of financing available to owner-occupants, and
- provide secondary financing.

In order to receive HUD approval, the nonprofit organization must

- be of the type described in Section 501(c)(3) as exempt from taxation under Section 501(a) of the Internal Revenue Code of 1986
- have a voluntary board, and no part of the net earnings of the organization or funds from the transaction may benefit any board member, founder, contributor, or individual, and
- have two years' experience as a provider of housing for low and moderate-income persons.

**References:** For more information on

- approved instrumentalities of government providing secondary financing, see [HUD 4155.1 5.C.4](#), and
  - *temporary* waivers of two of the above requirements for approval, see [ML 09-38](#).
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*Continued on next page*

## 6. Eligibility Requirements for Nonprofit Organizations and State and Local Government Agencies, Continued

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### 4155.1 4.A.6.e Nonprofit Organizations Not Meeting HUD Approval Requirements

A nonprofit organization not meeting any of the requirements listed in [HUD 4155.1 4.A.6.d](#), including religious and charitable organizations, may only purchase properties backed by FHA mortgage insurance under the conditions described for other investors in [HUD 4155.1 4.A.6.b](#).

**Note:** Questions concerning a nonprofit organization's approval should be directed to the appropriate HOC.

**Reference:** For detailed instructions on qualifying nonprofit organizations as borrowers, including documentation requirements, see [ML 02-01](#).

---

### 4155.1 4.A.6.f Eligibility of State and Local Government Agencies

State and local government agencies involved in the provision of housing may obtain FHA-insured financing provided that the agency provides evidence from its legal counsel that

- the agency has the legal authority to become the borrower
- the particular state or local government is not in bankruptcy, and
- there is no legal prohibition that would prevent the lender from obtaining a deficiency judgment (if permitted by State law for other types of borrowers) on FHA's behalf in the event of foreclosure or deed-in-lieu of foreclosure.

Loan applications from entities meeting the above requirements may be processed under the DE program without prior approval from the appropriate HOC.

**Note:** FHA does not require credit reports, financial statements, bank statements, or CAIVRS/LDP/GSA checks.

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## 7. Eligibility for Federally Related Credit

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**Introduction** This topic contains information on determining eligibility for Federally-related credit, including

- the definition of the term ‘Federal debt’
  - basis for rejecting federally related credit
  - ineligible mortgage transactions
  - lender responsibility for verifying borrower eligibility
  - location of federal lists
  - delinquent federal debts
  - waiting period for borrowers with past delinquencies and defaults
  - tax liens affecting eligibility for federally-related credit, and
  - how to determine creditworthiness for federally-related credit.
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**Change Date** March 29, 2010

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**4155.1 4.A.7.a  
Definition:  
Federal Debt** For a definition of the term *Federal debt*, see [HUD 4155.1 9](#).

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*Continued on next page*

## 7. Eligibility for Federally Related Credit, Continued

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### 4155.1 4.A.7.b Basis for Rejecting a Borrower for Federally Related Credit

A borrower is *not* eligible to participate in FHA-insured mortgage transactions if he/she is suspended, debarred, or otherwise excluded from participating in the HUD programs.

A lender *must* reject a borrower from participation if he/she is on the

- [HUD Limited Denial of Participation](#) (LDP) list
- U.S. General Services Administration (GSA) [List of Parties Excluded from Federal Procurement or Non-procurement Programs](#), and/or
- HUD's Credit Alert Interactive Voice Response System (CAIVRS), unless an exception exists as noted in [HUD 4155.1 4.A.7.c](#)

**Note:** A borrower must also be rejected if he/she is presently delinquent on any Federal debt or has a lien placed against his/her property for a debt owed to the United States Government.

**Reference:** For information on

- delinquent Federal debt, see [HUD 4155.1 4.A.7.f](#), and
  - using CAIVRS to determine eligibility, see [HUD 4155.1 4.A.8](#).
- 

### 4155.1 4.A.7.c Ineligible Mortgage Transactions

A mortgage loan application is *not* eligible for FHA mortgage insurance if the name of any of the following parties to the mortgage transaction is found on the [HUD LDP list](#) or the GSA [List of Parties Excluded from Federal Procurement or Non-procurement Programs](#):

- borrower
- seller
- listing or selling real estate agent, or
- loan officer.

**Exception:** A seller on the GSA list is exempt if the property being sold is the seller's principal residence.

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*Continued on next page*

## 7. Eligibility for Federally Related Credit, Continued

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### 4155.1 4.A.7.d Lender Responsibility for Verifying Borrower Eligibility

To determine whether a borrower is eligible to participate in an FHA mortgage loan transaction or must be rejected, the lender *must*

- examine [HUD's LDP list](#) and the GSA [List of Parties Excluded from Federal Procurement or Non-procurement Programs](#), and
  - document the review on the [HUD-92900-LT, FHA Loan Underwriting and Transmittal Summary](#).
- 

### 4155.1 4.A.7.e Location of the LDP and GSA Lists

The HUD LDP list can be found on the [HUD website](#) or on the FHA Connection.

The GSA *List of Parties Excluded from Federal Procurement and Non-Procurement Programs* can be found at <http://epls.arnet.gov> or on the FHA Connection.

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### 4155.1 4.A.7.f Delinquent Federal Debts

If, after checking public records, credit information, or the Credit Alert Interactive Voice Response System (CAIVRS) a borrower is found to be presently delinquent on any Federal debt or has a lien (including taxes) placed against his/her property for a debt owed to the Federal government, he/she is *not* eligible for an FHA mortgage until

- the delinquent account is brought current, paid, or otherwise satisfied, or
- a satisfactory repayment plan is established between the borrower and the Federal agency owed and is verified in writing.

Tax liens may remain unpaid provided the lien holder subordinates the tax lien to the FHA-insured mortgage.

**Reference:** For more information on tax liens affecting eligibility for federally related credit, [HUD 4155.1 4.A.7.h](#).

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*Continued on next page*

## 7. Eligibility for Federally Related Credit, Continued

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### 4155.1 4.A.7.g Waiting Period for Borrowers With Past Delinquencies and Defaults

FHA has a three-year waiting period to regain eligibility for another FHA-insured mortgage when the borrower has had past delinquencies or has defaulted on an FHA-insured loan.

The three-year waiting period begins when FHA pays the initial claim to the lender. This includes deed-in-lieu of foreclosure, as well as judicial and other forms of foreclosures.

Lenders should contact the HOC having jurisdiction over the area where the property subject to default is located for information such as the

- date the claim was paid, and
  - date of the initial default.
- 

### 4155.1 4.A.7.h Tax Liens Affecting Eligibility for Federally Related Credit

The Internal Revenue Service (IRS) routinely takes a second lien position without the need for independent documentation. For this reason, eligibility for FHA mortgage insurance is *not* jeopardized by outstanding IRS tax liens remaining on the property, unless the lender has information that the IRS has demanded a first-lien position.

Tax liens may remain unpaid if the lien holder subordinates the tax lien to the FHA-insured mortgage.

**Note:** If any regular payments are to be made, they must be included in the qualifying ratios.

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### 4155.1 4.A.7.i Consideration of a Borrower's Past Payment History on Federally Related Debt

Although a borrower's eligibility for an FHA-insured mortgage may be established by performing the actions described previously in this topic, the overall analysis of the borrower's creditworthiness must

- consider a borrower's previous failure to make payments to the Federal agency in the agreed-to manner, and
  - document the lender's analysis as to how the previous failure does not represent a risk of mortgage default.
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## 8. Using Credit Alert Interactive Voice Response System (CAIVRS) to Determine Eligibility for FHA-Insured Mortgage Transactions

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**Introduction** This topic contains information on using Credit Alert Interactive Voice Response System (CAIVRS) to determine a borrower's eligibility for an FHA-insured mortgage transaction, including

- a description of CAIVRS
  - lender responsibility for borrower screening using CAIVRS
  - documenting CAIVRS authorization
  - accessing CAIVRS
  - exceptions to the eligibility rule
  - handling incorrect CAIVRS information, and
  - lender responsibility for resolving conflicting information.
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**4155.1 4.A.8.a Description of CAIVRS** The Credit Alert Interactive Voice Response System (CAIVRS) is a Federal government-wide repository of information on

- those individuals with delinquent or defaulted Federal debt, and
  - those for whom a payment of an insurance claim has occurred.
- 

**4155.1 4.A.8.b Lender Responsibility for Borrower Screening Using CAIVRS** Lenders must use CAIVRS to screen all borrowers (except those involved in a streamline refinance), including nonprofit agencies acting as borrowers. The borrower is *not* eligible for Federally-related credit, if CAIVRS indicates that he/she

- is presently delinquent on a Federal debt, or
- has had a claim paid within the previous three years on a loan made and insured on his/her behalf by HUD.

**Exception:** Certain exceptions to this eligibility rule exist, and are described in [HUD 4155.1 4.A.8.e](#).

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*Continued on next page*

## 8. Using Credit Alert Interactive Voice Response System (CAIVRS) to Determine Eligibility for FHA-Insured Mortgage Transactions, Continued

**4155.1 4.A.8.c  
Documenting  
CAIVRS  
Authorization**

Lenders *must* write the CAIVRS authorization code for each borrower on Form [HUD-92900-LT](#), *FHA Loan Underwriting and Transmittal Summary*.

**4155.1 4.A.8.d  
Obtaining  
Internet Access  
to CAIVRS**

The table below contains guidelines for FHA-approved lenders to use in order to access CAIVRS via the Internet.

*Note:* As of October 1, 2008, HUD discontinued telephone access to CAIVRS.

<b>If the lender’s staff ...</b>	<b>Then ...</b>
currently <i>have</i> FHA Connection User IDs	they should request that their FHA Connection Application Coordinator update their FHA Connection profile to include CAIVRS.
does not have FHA Connection User IDs	they should <ul style="list-style-type: none"> <li>• access the FHA Connection at <a href="https://entp.hud.gov/clas/index.cfm">https://entp.hud.gov/clas/index.cfm</a>, and</li> <li>• select <i>Registering to Use the FHA Connection</i> to request a User ID and access to CAIVRS.</li> </ul>

**Access by Non-FHA Participating Agency Lenders:** Non-FHA lender staff should

- request access from HUD’s Internet site at <https://entp.hud.gov/caivrs/public/home.html>
- select “Registering Lender User ID” from the main menu, and
- request at least one Application Coordinator User ID, as well as a Standard User ID for each individual user.

## 8. Using Credit Alert Interactive Voice Response System (CAIVRS) to Determine Eligibility for FHA-Insured Mortgage Transactions, Continued

### 4155.1 4.A.8.e Exceptions to the Eligibility Rule

The table below describes exceptions to the CAIVRS eligibility rule for an FHA-insured mortgage.

Exception	Description
Legal Assumptions	<p>The borrower is eligible for an FHA-insured mortgage if he/she sold the property, with or without a release of liability, to an individual who subsequently defaulted.</p> <p>The borrower <i>must</i> prove that the loan was current at the time of the assumption.</p>
Divorce	<p>The borrower may be eligible for an FHA-insured mortgage if the divorce decree or legal separation agreement awarded the property and responsibility for payment to the former spouse.</p> <p>The borrower is <i>not</i> eligible if FHA paid a claim on his/her mortgage in default prior to the divorce.</p>
Bankruptcy	<p>The borrower <i>may</i> be eligible for an FHA-insured mortgage if</p> <ul style="list-style-type: none"> <li>• the property was included in a bankruptcy caused by circumstances beyond the borrower's control, such as the <ul style="list-style-type: none"> <li>– the death of the principal wage earner, or</li> <li>– a serious long-term uninsured illness, and</li> </ul> </li> <li>• the borrower meets the requirements described in <ul style="list-style-type: none"> <li>– <a href="#">HUD 4155.1 4.C.2.g</a> for Chapter 7 bankruptcy, and</li> <li>– <a href="#">HUD 4155.1 4.C.2.h</a> for Chapter 13 bankruptcy.</li> </ul> </li> </ul>

*Continued on next page*

## 8. Using Credit Alert Interactive Voice Response System (CAIVRS) to Determine Eligibility for FHA-Insured Mortgage Transactions, Continued

### 4155.1 4.A.8.e Exceptions to the Eligibility Rule (continued)

Exception	Description
Seller Who Is Selling Principal Residence	<p>A mortgage loan is generally not eligible for insurance if <i>any party</i> to the transaction is on either the</p> <ul style="list-style-type: none"> <li>• <a href="#">HUD Limited Denial of Participation (LDP)</a> list, or</li> <li>• General Services Administration’s (GSA’s) “<a href="#">List of Parties Excluded from Federal Procurement or Nonprocurement Programs</a>.”</li> </ul> <p>However, an exception exists for a seller on the GSA list who is selling his/her principal residence.</p>
Disaster Victims (in Presidentially-Declared Disaster Areas)	<p>For information on the eligibility of disaster victims, see <a href="#">HUD 4155.1 6.A.6.j.</a></p>

**IMPORTANT:** FHA does not require a *clear* CAIVRS authorization number as a condition for mortgage endorsement. However, the lender must document and justify mortgage approval based on these exceptions.

*Continued on next page*

## 8. Using Credit Alert Interactive Voice Response System (CAIVRS) to Determine Eligibility for FHA-Insured Mortgage Transactions, Continued

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### 4155.1 4.A.8.f Handling Incorrect CAIVRS Information

FHA may delete erroneous CAIVRS information falsely indicating that a borrower has defaulted on an FHA mortgage, such as incorrect social security number reporting. However, FHA will *not*

- remove correct CAIVRS information, even if the borrower is judged eligible for Federally-related credit, or
- alter or delete CAIVRS information reported from other Federal agencies, such as the
  - Department of Education, or
  - Department of Veterans Affairs.

The borrower and/or lender must contact those Federal agencies directly to correct or remove erroneous or outdated information.

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### 4155.1 4.A.8.g Lender Responsibility for Resolving Conflicting Information

Lenders may not rely on a clear CAIVRS approval when there is independent evidence of conflicting delinquent Federal obligations. The lenders must

- document the resolution of any conflicting information, and
- contact the appropriate HOC for instructions or documentation to support the borrower's eligibility if the
  - CAIVRS message seems erroneous, or
  - date of claim payment needs to be established.

The HOC may provide lenders with

- information about
    - when the three-year waiting period will elapse
    - erroneous social security numbers, and
  - instructions on processing requirements for other-HUD related defaults and claims, such as Title I loans.
-

## Section B. Property Ownership Requirements and Restrictions

### Overview

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**In This Section** This section contains the topics listed in the table below.

<b>Topic</b>	<b>Topic Name</b>	<b>See Page</b>
1	General Information on Property Requirements and Restrictions	4-B-2
2	Eligibility Requirements for Principal Residences	4-B-5
3	Eligibility Requirements for Secondary Residences	4-B-8
4	Investment Property Eligibility and Underwriting Requirements	4-B-10

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# 1. General Information on Property Requirements and Restrictions

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**Introduction** This topic contains general information on property requirements and restrictions, including

- what FHA insures
  - description of a condominium
  - requirements for condominium eligibility
  - the seven unit limitation for investors
  - locating additional information on property eligibility and valuation
  - manufactured housing condominium projects (MHCP), and
  - requirements for site condominiums.
- 

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**4155.1 4.B.1.a** Except as otherwise stated in this handbook, FHA’s single family programs are limited to owner-occupied principal residences only.  
**What FHA Insures**

*Reference:* For more information on what FHA will and will not insure, see [HUD 4155.2 1.A.1.b](#).

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**4155.1 4.B.1.b**  
**Description of a Condominium**

A condominium is a multi-unit project that

- has individually-owned units that may be either
  - attached in one or more structures, or
  - detached from each other, and
- is essentially residential in use (for FHA purposes).

A condominium regime is created by state or local law and is characterized by fee simple ownership of a unit which is defined in the condominium documents, together with common areas. The property interest in these areas is both common and undivided on the part of all unit owners, each of whom belong to the Homeowners’ Association (HOA) that typically maintains the property and collects assessments or dues from each unit owner.

*Reference:* For more information on condominiums, see [HUD 4910.1](#), *Minimum Property Standards for Housing*.

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*Continued on next page*

## 1. General Information on Property Requirements and Restrictions, Continued

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**4155.1 4.B.1.c Requirements for Condominium Eligibility** FHA must approve condominium projects before a mortgage on an individual condominium unit can be insured.

***Exception:***

In specific circumstances, a loan on a single unit in an unapproved condominium project, known as a “spot” loan, may qualify for mortgage insurance. The lender must certify that the project satisfies the eligibility criteria for a “spot” loan condominium project that has *not* been approved by FHA.

***Reference:*** For more information on condominiums, including condominium project approval requirements, see

- [HUD 4150.2](#), *Valuation Analysis for Single Family One- to Four-Unit Dwellings*, and
  - [HUD 4265.1](#), *Section 234(c), Home Mortgage Insurance for Condominium Units*.
- 

**4155.1 4.B.1.d Seven Unit Limitation for Investors** Entities purchasing investment properties are limited to a financial interest in seven rental dwelling units.

***Reference:*** For additional information on

- investment property requirements, see [HUD 4155.1 4.B.4](#), and
  - the seven unit limitation, see [HUD 4155.1 4.B.4.d](#).
- 

**4155.1 4.B.1.e Additional Information on Property Eligibility and Valuation** For more information on property eligibility and valuation, see [HUD 4155.2 4](#).

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## 1. General Information on Property Requirements and Restrictions, Continued

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### 4155.1 4.B.1.f Manufactured Housing Condominium Projects (MHCP)

Individual manufactured housing units in condominium projects are eligible for FHA insurance, on both Home Equity Conversion Mortgages (HECM) and forward mortgages. All manufactured housing condominium project (MHCP) approval requests must be processed by the Homeownership Center (HOC) that has authority over the location in which the property is located.

The Spot Loan Approval process as defined in Mortgagee Letter 1996-41 is not applicable to manufactured housing in condominium projects.

MHCPs may not be processed as site condominiums.

**References:** For more information on

- MHCP approval, see [HUD 4150.1](#), *Valuation Analysis for Home Mortgage Insurance*, and
  - site condominiums, see [4155.1 4.B.1.g](#).
- 

### 4155.1 4.B.1.g Site Condominiums Requirements

Site Condominiums are single family detached dwellings encumbered by a declaration of condominium covenants or condominium form of ownership.

Condominium project approval is not required for Site Condominiums; however, the Condominium Rider must be included in the FHA case binder.

**Note:** Manufactured housing condominium projects may not be processed as site condominiums.

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## 2. Eligibility Requirements for Principal Residences

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<b>Introduction</b>	<p>This topic contains information on eligibility requirements on principal residences, including</p> <ul style="list-style-type: none"> <li>• the definition of principal residence</li> <li>• the FHA requirement for establishing owner-occupancy</li> <li>• limitation on the number of FHA-insured mortgages per borrower, and</li> <li>• exceptions to the FHA policy limiting the number of mortgages per borrower.</li> </ul>
<b>Change Date</b>	March 29, 2010
<b>4155.1 4.B.2.a Definition: Principal Residence</b>	A <i>principal residence</i> is a property that will be occupied by the borrower for the majority of the calendar year.
<b>4155.1 4.B.2.b FHA Requirement for Establishing Owner- Occupancy</b>	<p>At least one borrower must occupy the property and sign the security instrument and the mortgage note in order for the property to be considered owner-occupied.</p> <p>FHA security instruments require a borrower to establish bona fide occupancy in a home as the borrower's principal residence within 60 days of signing the security instrument, with continued occupancy for at least one year.</p>
<b>4155.1 4.B.2.c Limitation on Number of FHA-Insured Mortgages Per Borrower</b>	<p>To prevent circumvention of the restrictions on FHA-insured mortgages to investors, FHA <i>generally</i> will not insure more than one principal residence mortgage for any borrower. FHA will <i>not</i> insure a mortgage if it is determined that the transaction was designed to use FHA mortgage insurance as a vehicle for obtaining investment properties, even if the property to be insured will be the <i>only</i> one owned using FHA mortgage insurance</p> <p>Any person individually or jointly owning a home covered by an FHA-insured mortgage in which ownership is maintained may <i>not</i> purchase another principal residence with FHA insurance, <i>except</i> in certain situations as described in <a href="#">HUD 4155.1 4.B.2.d</a>.</p> <p><b>Exception:</b> Properties previously acquired as investment properties are <i>not</i> subject to these restrictions.</p>

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## 2. Eligibility Requirements for Principal Residences, Continued

### 4155.1 4.B.2.d Exceptions to the FHA Policy Limiting the Number of Mortgages Per Borrower

The table below describes the “exception” situations in which FHA does *not* object to borrowers obtaining multiple FHA-insured mortgages.

**Note:** Considerations in determining the eligibility of a borrower for one of the exceptions in the table below include the

- length of time the previous property was owned by the borrower, and
- circumstances that compel the borrower to purchase another residence with an FHA-insured mortgage.

**Important:** In all cases other than those listed below, the borrower is **not** eligible to acquire another FHA-insured mortgage until he/she has either

- paid off the FHA-insured mortgage on the previous residence, or
- terminated ownership of that residence.

Policy Exception	Eligibility Requirements
Relocation	<p>A borrower may be eligible to obtain another mortgage using FHA insurance, without being required to sell an existing property covered by an FHA-insured mortgage, <i>if</i> the borrower is</p> <ul style="list-style-type: none"> <li>• relocating, and</li> <li>• establishing residency in an area not within reasonable commuting distance from the current principal residence.</li> </ul> <p>If the borrower subsequently returns to the area where he/she owns a property with an FHA-insured mortgage, he/she is <i>not</i> required to re-establish primary residency in that property in order to be eligible for another FHA-insured mortgage.</p> <p><b>Note:</b> The relocation need not be employer mandated to qualify for this exception.</p>

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## 2. Eligibility Requirements for Principal Residences, Continued

### 4155.1 4.B.2.d Exceptions to the FHA Policy Limiting the Number of Mortgages Per Borrower (continued)

Policy Exception	Eligibility Requirements
Increase in family size	<p>A borrower may be eligible for another home with an FHA-insured mortgage if the number of legal dependents increases to the point that the present house no longer meets the family’s needs. The borrower must provide satisfactory evidence</p> <ul style="list-style-type: none"> <li>• of the increase in dependents and the property’s failure to meet family needs, and</li> <li>• the LTV ratio based on the outstanding mortgage balance and a current appraisal equals 75% or less. If it does not, the borrower must pay the loan down to 75% LTV or less.</li> </ul> <p><i>Note:</i> A current residential appraisal <i>must</i> be used to determine LTV compliance. Tax assessments and market analyses by real estate brokers are <i>not</i> acceptable proof of LTV compliance.</p>
Vacating a jointly owned property	<p>A borrower may be eligible for another FHA-insured mortgage if he/she is vacating a residence that will remain occupied by a coborrower.</p> <p><i>Example:</i> An example of an acceptable situation is one in which there is a divorce and the vacating ex-spouse will purchase a new home.</p>
Non-occupying coborrower	<p>A borrower may be qualified for an FHA-insured mortgage on his/her own principal residence even if he/she is a non-occupying coborrower with a joint interest in a property being purchased by other family members as a principal residence with an FHA-insured mortgage.</p>

**Important:** Under *no* circumstances may investors use the exceptions described in the table above to circumvent FHA’s ban on loans to private investors and acquire rental properties through purportedly purchasing “principal residences.”

### 3. Eligibility Requirements for Secondary Residences

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**Introduction** This topic contains information on eligibility requirements for secondary residences, including

- a definition of secondary residence
  - the requirement for a HOC determination of undue hardship
  - requesting a hardship exception
  - limitation on the number of secondary residences, and
  - secondary residence requirements.
- 

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**4155.1 4.B.3.a  
Definition:  
Secondary  
Residence** A *secondary residence* is a property that a borrower occupies in addition to his/her principal residence.

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**4155.1 4.B.3.b  
Requirement  
for HOC  
Determination  
of Undue  
Hardship** Secondary residences are *only* permitted when

- the appropriate HOC agrees that an undue hardship exists, meaning that affordable rental housing that meets the needs of the family is not available for lease in the area or within reasonable commuting distance of work, and
- the maximum loan amount is 85 percent of the *lesser* of the appraised value or sales price.

**Note:** DE lenders are *not* authorized to grant hardship exceptions. Only the HOC may make the determination that an undue hardship exists.

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**4155.1 4.B.3.c  
Requesting a  
Hardship  
Exception** Any request for a hardship exception must be submitted, in writing, by the lender to the appropriate HOC.

**Reference:** For information on HOC jurisdictions, see [HUD 4155.1 8.1](#).

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### 3. Eligibility Requirements for Secondary Residences, Continued

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**4155.1 4.B.3.d  
Limitation on  
the Number of  
Secondary  
Residences**

A borrower may have only *one* secondary residence at any time.

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**4155.1 4.B.3.e  
Requirements  
for Secondary  
Residences**

Secondary residences must meet all of the following requirements:

- the secondary residence must *not* be a vacation home or be otherwise used primarily for recreational purposes
  - the borrower must obtain the secondary residence because of seasonal employment, employment relocation, or other circumstances not related to recreational use of the residence, and
  - there must be a demonstrated lack of affordable rental housing meeting the needs of the borrower in the area or within a reasonable commuting distance of the borrower's employment, and the borrower must provide supporting documentation of this, including
    - a satisfactory explanation by the borrower of the need for a secondary residence and the lack of available rental housing, and
    - written evidence from local real estate professionals who verify a lack of acceptable housing in the area.
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## 4. Investment Property Eligibility and Underwriting Requirements

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<b>Introduction</b>	<p>This topic contains information on eligible investment properties, including</p> <ul style="list-style-type: none"> <li>• a definition of investment property</li> <li>• loan transactions in which an investor may obtain an FHA-insured mortgage</li> <li>• underwriting considerations on investment properties</li> <li>• seven unit-limitation on investment properties, and</li> <li>• restriction on investment properties for hotel and transient use.</li> </ul>
<hr/>	
<b>Change Date</b>	March 29, 2010
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<b>4155.1 4.B.4.a Definition: Investment Property</b>	<p>An <i>investment property</i> is a property that is <i>not</i> occupied by the borrower as a principal or secondary residence.</p>
<hr/>	
<b>4155.1 4.B.4.b Loan Transactions in Which a Private Investor May Obtain an FHA-Insured Mortgage</b>	<p>With permission from the appropriate HOC, private investors, including nonprofit organizations that do <i>not</i> meet the criteria described in <a href="#">HUD 4155.1 4.A.6.a</a>, may obtain an FHA-insured mortgage when</p> <ul style="list-style-type: none"> <li>• purchasing HUD Real Estate Owned (REO) properties, or</li> <li>• obtaining a streamline refinance without an appraisal.</li> </ul> <p><b>Note:</b> In HUD REO transactions, owner occupancy is not required when the jurisdictional HOC sells the property and permits the purchaser to obtain FHA-insured financing on the investment property.</p> <p><b>Reference:</b> For additional qualifying information on streamline refinances without an appraisal, see <a href="#">HUD 4155.1.3.C.2</a>.</p>

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## 4. Investment Property Eligibility and Underwriting Requirements, Continued

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### 4155.1 4.B.4.c Underwriting Considerations on Investment Properties

Underwriting considerations on investment properties are listed below.

- Individual investors who credit qualify may assume mortgages made on investment properties. This applies to the transactions described in [HUD 4155.1 4.B.4.b](#), as well as to investment properties purchased before the 1989 ban on investors that have been subsequently streamline refinanced.
- Underwriting considerations regarding such issues as qualifying ratios and the treatment of projected rental income are described in [HUD 4155.1.4.E.4](#).
- Adjustable rate mortgages (ARMs) and graduated payment mortgages (GPMs) are *not* permitted on investment properties.
- For investment properties, FHA will not insure loans made solely in the name of a business entity (such as a corporation, partnership, or sole proprietorship), *except* for streamline refinances in which the mortgage was originally insured in the name of a business. Additionally, FHA requires that
  - one or more individuals, along with the business entity or trust, must be analyzed for creditworthiness
  - the individual(s) and business entity or trust must appear on the mortgage note, and
  - if all parties appear on the property deed or title, they must also appear on the security instrument (such as the mortgage, deed of trust, or security deed).
- For purchases of HUD REO properties, owner occupancy is *not* required when the jurisdictional HOC sells the property and permits the purchaser to obtain FHA-insured financing on the investment property.
- Streamline refinancing without an appraisal is permitted on investment properties.
- Base mortgage calculation is 75% LTV applied to the lesser of the appraised value or the sales price.

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## 4. Investment Property Eligibility and Underwriting Requirements, Continued

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### 4155.1 4.B.4.d Seven Unit Limitation for Investors

Qualified investor entities are limited to a financial interest (that is, any type of ownership, regardless of the type of financing) in seven rental dwelling units, when the subject property is part of, adjacent to, or contiguous to, a property, subdivision or group of properties owned by the investor.

The units that count toward this limitation include

- *each* dwelling unit in a two, three, and four family property, and
- the rental units in an owner-occupied two, three, or four unit property.

*Notes:*

- The lender is responsible for ensuring compliance with this regulation.
  - Waivers to the seven unit limitation can only be initiated by the jurisdictional HOC for good cause.
- 

### 4155.1 4.B.4.e Restriction on Investment Properties for Hotel and Transient Use

Investors must assure FHA that investment properties purchased will not be used for hotel or transient purposes, or otherwise rented for periods of less than 30 days.

Completion of Form [HUD 92561](#), *Hotel and Transient Use Certification*, provides this assurance and is required on every application for

- two, three, or four family dwellings, and
  - single family dwellings that are one of a group of five or more dwellings held by the same borrower.
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## Section C. Borrower Credit Analysis

### Overview

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**In This Section** This section contains the topics listed in the table below.

<b>Topic</b>	<b>Topic Name</b>	<b>See Page</b>
1	General Guidelines for Analyzing Borrower Credit	4-C-2
2	Guidelines for Credit Report Review	4-C-6
3	Evaluating Non Traditional Credit and Insufficient Credit	4-C-12
4	Borrower Liabilities: Recurring Obligations	4-C-14
5	Borrower Liabilities: Contingent Liabilities	4-C-16
6	Borrower Liabilities: Projected Obligations and Obligations Not Considered Debt	4-C-18

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## 1. General Guidelines for Analyzing Borrower Credit

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**Introduction** This topic contains information on the general guidelines for analyzing borrower credit, including

- past credit performance
  - analyzing credit history
  - documenting analysis of delinquent accounts
  - developing a credit history
  - documenting non-traditional credit providers, and
  - non-traditional mortgage credit report.
- 

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**4155.1 4.C.1.a  
Past Credit  
Performance** Past credit performance is the most useful guide to use when

- determining a borrower's attitude toward credit obligations, and
- predicting a borrower's future actions.

Borrowers who have made payments on previous and current obligations in a timely manner represent a reduced risk. Conversely, if a borrower's credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, significant compensating factors will be necessary to approve the loan.

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**4155.1 4.C.1.b  
Analyzing  
Credit History** When analyzing a borrower's credit history, examine the overall pattern of credit behavior, not just isolated occurrences of unsatisfactory or slow payments.

A period of past financial difficulty does not necessarily make the risk unacceptable, if the borrower has maintained a good payment record for a considerable time period since the financial difficulty.

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## 1. General Guidelines for Analyzing Borrower Credit, Continued

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### 4155.1 4.C.1.c Documenting an Analysis of Delinquent Accounts

The lender *must* document the analysis of delinquent accounts, including whether late payments were based on

- a disregard for financial obligations
- an inability to manage debt, or
- factors beyond the borrower's control, such as
  - delayed mail delivery, or
  - disputes with creditors.

Minor derogatory information occurring two or more years in the past does not require an explanation. Major indications of derogatory credit, such as judgments, collections, and other recent credit problems, require sufficient written explanation from the borrower. The explanation must make sense, and be consistent with other credit information in the file.

#### ***TOTAL Scorecard Accept/Refer Recommendation***

The TOTAL Scorecard Accept recommendation does not require an explanation for adverse credit, or other derogatory information; however, there must be evidence of payoff for any outstanding judgments shown on the credit report.

The TOTAL Scorecard Refer recommendation requires an explanation for major indications of derogatory credit, such as

- judgments and collections, and
- any minor indications within the past two years.

***Reference:*** For more information on the TOTAL Scorecard recommendations, see Pages 18 & 19 of the *TOTAL Mortgage Scorecard User Guide* at

[http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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## 1. General Guidelines for Analyzing Borrower Credit, Continued

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### 4155.1 4.C.1.d Developing a Credit History

The lack of a credit history, or the borrower's decision to not use credit, may *not* be used as the basis for rejecting the loan application.

Some prospective borrowers may not have an established credit history. For these borrowers, including those who do not use traditional credit, the lender must obtain a non traditional merged credit report (NTMCR) from a credit reporting company or develop a credit history from

- utility payment records
- rental payments
- automobile insurance payments, and
- other means of direct access from the credit provider.

#### ***TOTAL Scorecard Accept Recommendation***

If TOTAL Scorecard has issued an Accept recommendation, additional development of credit history is *not* required.

***Reference:*** For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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## 1. General Guidelines for Analyzing Borrower Credit, Continued

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### **4155.1 4.C.1.e Verifying and Documenting Non Traditional Credit Providers**

Only if a NTMCR does not exist or such a service is unavailable may a lender choose to obtain independent verification of credit references. Lenders must document that the providers of non traditional credit do exist, and verify the credit information. Documents confirming the existence of a non traditional credit provider may include

- public records from the state, county, or city, or
- other documents providing a similar level of objective information.

To verify credit information, lenders must use a published address or telephone number for the credit provider and not rely solely on information provided by the applicant.

Rental references from management companies with payment history for the most recent 12 months may be used in lieu of 12 months cancelled checks. Credit references may also be developed via independent verification directly to the creditor. If a method other than NTMCR is used to verify credit information or rental references, all references obtained from individuals should be backed up with the most recent 12 months cancelled checks

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## 1. General Guidelines for Analyzing Borrower Credit, Continued

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**4155.1 4.C.1.f**  
**Non**  
**Traditional**  
**Mortgage**  
**Credit Report**

Lenders may use a non traditional mortgage credit report developed by a credit reporting agency as an alternative method for developing a credit history. Use of this type of report requires that the credit reporting agency has verified

- the existence of the credit providers
- that the non-traditional credit was actually extended to the borrower, and the creditor has a published address or telephone number.

*Reference:* For more information on non traditional credit reports, see [HUD 4155.1 1.7.](#)

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## 2. Guidelines for Credit Report Review

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<b>Introduction</b>	<p>This topic contains information on the credit report items for lenders to review, including</p> <ul style="list-style-type: none"><li>• the hierarchy of credit review</li><li>• the review of previous rental or mortgage payment history</li><li>• recent and/or undisclosed debts and inquiries</li><li>• collections and judgments</li><li>• paying off collections and judgments</li><li>• previous mortgage foreclosure</li><li>• Chapter 7 bankruptcy</li><li>• Chapter 13 bankruptcy</li><li>• consumer credit counseling payment plans</li><li>• use of truncated SSNs on credit reports, and</li><li>• a reference for information on evaluating non-traditional/insufficient credit.</li></ul>
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<b>Change Date</b>	March 29, 2010
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<b>4155.1 4.C.2.a Hierarchy of Credit Review</b>	<p>The basic hierarchy for evaluating credit involves reviewing how payments were made on the following:</p> <ul style="list-style-type: none"><li>• previous housing expenses, including utilities, then</li><li>• payment history on installment debts, then</li><li>• payment history on revolving accounts.</li></ul>
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Generally, a borrower is considered to have an acceptable credit history if he/she does not have late housing or installment debt payments, unless there is major derogatory credit on his/her revolving accounts.

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## 2. Guidelines for Credit Report Review, Continued

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### 4155.1 4.C.2.b Reviewing Previous Rental or Mortgage Payment History

The borrower's housing obligation payment history holds significant importance when evaluating credit. The lender must determine the borrower's housing obligation payment history through the

- credit report
- verification of rent directly from the landlord (for landlords with no identity-of-interest with the borrower)
- verification of the mortgage directly from the mortgage servicer, or
- the review of canceled checks that cover the most recent 12-month period.

**Note:** The lender must verify/document the previous 12 months housing history even if the borrower states he/she is living rent free.

#### ***TOTAL Scorecard Accept Recommendation***

Waive the housing/rental history requirement.

**Reference:** For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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## 2. Guidelines for Credit Report Review, Continued

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**4155.1 4.C.2.c**  
**Recent and/ or**  
**Undisclosed**  
**Debts and**  
**Inquiries**

Lenders *must* determine the purpose of any recent debts as the indebtedness may have been incurred to obtain the required cash investment.

A borrower *must* provide a satisfactory explanation for any significant debt that is shown on the credit report, but not listed on the loan application. Written explanation is required for all inquiries shown on the credit report for the last 90 days.

***TOTAL Scorecard Accept Recommendation***

- Verify the actual monthly payment amount.
- Include the monthly payment amount and resubmit the loan if the liability is greater than \$100 per month.
- Determine that any funds borrowed were not/will not be used for the homebuyer's cash investment in the transaction.

**Note:** Explanation is not required for inquiries.

**Reference:** For more information on the TOTAL Scorecard recommendations, see Page 17 of the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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## 2. Guidelines for Credit Report Review, Continued

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### 4155.1 4.C.2.d Collections and Judgments

Collections and judgments indicate a borrower's regard for credit obligations, and *must* be considered in the creditworthiness analysis.

The lender must document reasons for approving a mortgage when the borrower has collection accounts or judgments. The borrower *must* explain, in writing, all collections and judgments.

**Note:** Compliance with the requirements specified in [HUD 4155.1 4.C.2.e](#) is applicable to judgments.

#### ***TOTAL Scorecard Accept Recommendation***

Collection accounts trigger neither an explanation requirement nor a hypothetical monthly payment to be used in qualifying borrowers. The presence of collection accounts in the borrower's credit history already result in lowering the credit bureau scores used in TOTAL and, thus, no further information need be provided by the borrower.

**References:** For information on

- paying off collections and judgments, see [HUD 4155.1 4.C.2.e](#) and
- the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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## 2. Guidelines for Credit Report Review, Continued

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**4155.1 4.C.2.e**  
**Paying off**  
**Collections and**  
**Judgments**

FHA does *not* require that collection accounts be paid off as a condition of mortgage approval. However, court-ordered judgments *must* be paid off before the mortgage loan is eligible for FHA insurance endorsement.

**Exception:** An exception on a court-ordered judgment may be made if the borrower

- has an agreement with the creditor to make regular and timely payments, and
- has provided documentation indicating that payments have been made according to the agreement.

***TOTAL Scorecard Accept/Refer Recommendation***

TOTAL Scorecard Accept and Refer recommendations require that the lender obtain evidence of payoff for any outstanding judgments shown on the credit report.

**Reference:** For more information on the TOTAL Scorecard recommendations, see Page 18 of the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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## 2. Guidelines for Credit Report Review, Continued

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### 4155.1 4.C.2.f Previous Mortgage Foreclosure

A borrower is generally *not* eligible for a new FHA-insured mortgage when, during the previous three years

- his/her previous principal residence or other real property was foreclosed, or
- he/she has given a deed-in-lieu of foreclosure.

**Exception:** The lender may grant an exception to the three-year requirement if the foreclosure was the result of documented extenuating circumstances that were beyond the control of the borrower, such as a serious illness or death of a wage earner, and the borrower has re-established good credit since the foreclosure. Divorce is *not* considered an extenuating circumstance. However, the situation in which a borrower whose loan was current at the time of a divorce in which the ex-spouse received the property and the loan was later foreclosed qualifies as an exception.

**Note:** The inability to sell the property due to a job transfer or relocation to another area does not qualify as an extenuating circumstance.

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### 4155.1 4.C.2.g Chapter 7 Bankruptcy

A Chapter 7 bankruptcy (liquidation) does not disqualify a borrower from obtaining an FHA-insured mortgage, if at least two years have elapsed since the date of the discharge of the bankruptcy. During this time, the borrower must

- have reestablished good credit, or
- chosen not to incur new credit obligations.

An elapsed period of less than two years, but not less than 12 months may be acceptable for an FHA-insured mortgage, if the borrower

- can show that the bankruptcy was caused by extenuating circumstances beyond his/her control, and
- has since exhibited a documented ability to manage his/her financial affairs in a responsible manner.

**Note:** The lender must document that the borrower's current situation indicates that the events that led to the bankruptcy are not likely to recur.

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## 2. Guidelines for Credit Report Review, Continued

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### 4155.1 4.C.2.h Chapter 13 Bankruptcy

A Chapter 13 bankruptcy does not disqualify a borrower from obtaining an FHA-insured mortgage, provided that the lender documents that

- one year of the payout period under the bankruptcy has elapsed, and
- the borrower's payment performance has been satisfactory and all required payments have been made on time.

The borrower *must* receive written permission from the court to enter into the mortgage transaction.

#### ***TOTAL Scorecard Accept Recommendation***

Lender documentation must show two years from the discharge date of a Chapter 13 bankruptcy.

If the Chapter 13 bankruptcy has not been discharged for a minimum period of 2 years, the loan must be downgraded to a Refer and be evaluated by a Direct Endorsement (DE) underwriter.

**Reference:** For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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### 4155.1 4.C.2.i Consumer Credit Counseling Payment Plans

Participating in a consumer credit counseling program does not disqualify a borrower from obtaining an FHA mortgage, provided the lender documents that

- one year of the pay-out period has elapsed under the plan, and
- the borrower's payment performance has been satisfactory and all required payments have been made on time.

The borrower *must* receive written permission from the counseling agency to enter into the mortgage transaction.

#### ***TOTAL Scorecard Accept Recommendation***

The borrower's decision to participate in consumer credit counseling does not trigger a requirement for additional documentation since the credit scores already reflect the degradation in credit history. The borrower's credit history, not voluntary participation in consumer credit counseling, is the important variable in scoring the mortgage and, thus, no explanation or other documentation is needed.

**Reference:** For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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## 2. Guidelines for Credit Report Review, Continued

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**4155.1 4.C.2.j**  
**Use of**  
**Truncated**  
**SSNs on Credit**  
**Reports**

In an effort to reduce the risk of identity theft and other forms of financial fraud, some providers of consumer credit reports have begun using a truncated version of an individual's Social Security Number (SSN) on the credit report product that is offered.

A truncated SSN, that contains as few as the last four digits of a borrower's full number, is acceptable for FHA mortgage insurance purposes provided that

- the loan application captures the full 9-digit SSN, and
  - the borrower's name, SSN and date of birth are validated through the FHA Connection or its functional equivalent.
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**4155.1 4.C.2.k**  
**Evaluating Non**  
**Traditional/**  
**Insufficient**  
**Credit**  
**Reference**

For guidelines for evaluating borrowers with non traditional or insufficient credit histories, see [HUD 4155.1 4.C.3.](#)

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### 3. Evaluating Non Traditional Credit and Insufficient Credit

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<b>Introduction</b>	<p>This topic contains information on</p> <ul style="list-style-type: none"><li>• evaluating borrowers with<ul style="list-style-type: none"><li>– non traditional credit histories, and</li><li>– insufficient credit histories, and</li></ul></li><li>• underwriting guidance for borrowers with insufficient credit histories.</li></ul>
<b>Change Date</b>	March 29, 2010
<b>4155.1 4.C.3.a Evaluating Non Traditional Credit</b>	<p>When evaluating borrowers with non traditional credit histories, a satisfactory credit history, at least 12 months in duration, must include:</p> <ul style="list-style-type: none"><li>• no history of delinquency on rental housing payments</li><li>• no more than one 30-day delinquency on payments due to other creditors, and</li><li>• no collection accounts/court records reporting (other than medical) filed within the past 12 months.</li></ul>
<b>4155.1 4.C.3.b Evaluating Borrowers With Insufficient Credit</b>	<p>When evaluating borrowers with no credit references, or otherwise having only Group II references as outlined in <a href="#">HUD 4155.1 1.7.f</a>, a satisfactory credit history, at least 12 months in duration, must include:</p> <ul style="list-style-type: none"><li>• no more than one 30-day delinquency on payments due to any Group II reference, and</li><li>• no collection accounts/court records reporting (other than medical) filed within the past 12 months.</li></ul>

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### 3. Evaluating Non Traditional Credit and Insufficient Credit, Continued

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**4155.1 4.C.3.c  
Underwriting  
Guidance for  
Borrowers  
With  
Insufficient  
Credit**

In order to enhance the likelihood of homeownership sustainability for borrowers with insufficient credit histories, the underwriting guidance below is provided.

- Qualifying ratios are to be computed *only* on those occupying the property and obligated on the loan, and may not exceed 31 percent for the payment-to-income ratio and 43 percent for the total debt-to-income ratio. Compensating factors are not applicable for borrowers with insufficient credit references.
- Borrowers should have two months of cash reserves following mortgage loan settlement from their own funds (no cash gifts from any source should be counted in the cash reserves for borrowers in this category).

**Reference:** For more information on the restriction on the addition of non-occupant co-borrowers for credit underwriting, see [HUD 4155.1 3.B.2.c](#).

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## 4. Borrower Liabilities: Recurring Obligations

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**Introduction** This topic contains information on borrower recurring obligations, including

- types of recurring obligations
  - debt to income ratio computation for recurring obligations
  - revolving account monthly payment calculation, and
  - reduction of alimony payments for qualifying ratio calculation.
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**4155.1 4.C.4.a** Recurring obligations include

**Types of  
Recurring  
Obligations**

- all installment loans
  - revolving charge accounts
  - real estate loans
  - alimony
  - child support, and
  - other continuing obligations.
- 

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## 4. Borrower Liabilities: Recurring Obligations, Continued

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**4155.1 4.C.4.b**  
**Debt to Income**  
**Ratio**  
**Computation**  
**for Recurring**  
**Obligations**

The lender must include the following when computing the debt to income ratios for recurring obligations:

- monthly housing expense, and
- additional recurring charges extending ten months or more, such as
  - payments on installment accounts
  - child support or separate maintenance payments
  - revolving accounts, and
  - alimony.

Debts lasting *less* than ten months *must* be included if the amount of the debt affects the borrower's ability to pay the mortgage during the months immediately after loan closing, especially if the borrower will have limited or no cash assets after loan closing.

**Note:** Monthly payments on revolving or open-ended accounts, regardless of the balance, are counted as a liability for qualifying purposes even if the account appears likely to be paid off within 10 months or less.

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## 4. Borrower Liabilities: Recurring Obligations, Continued

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**4155.1 4.C.4.c  
Revolving  
Account  
Monthly  
Payment  
Calculation**

If the credit report shows any revolving accounts with an outstanding balance but no specific minimum monthly payment, the payment must be calculated as the greater of

- 5 percent of the balance, or
- \$10.

*Note:* If the actual monthly payment is documented from the creditor or the lender obtains a copy of the current statement reflecting the monthly payment, that amount may be used for qualifying purposes.

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**4155.1 4.C.4.d  
Reduction of  
Alimony  
Payment for  
Qualifying  
Ratio  
Calculation**

Since there are tax consequences of alimony payments, the lender may choose to treat the monthly alimony obligation as a reduction from the borrower's gross income when calculating qualifying ratios, rather than treating it as a monthly obligation.

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## 5. Borrower Liabilities: Contingent Liability

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**Introduction** This topic contains information on borrower contingent liabilities, including

- the definition of the term ‘contingent liability’
  - application of contingent liability policies
  - contingent liability on mortgage assumptions
  - exemption from contingent liability policy on mortgage assumptions, and
  - contingent liability on cosigned obligations.
- 

**Change Date** March 29, 2010

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**4155.1 4.C.5.a  
Definition:  
Contingent  
Liability** A *contingent liability* exists when an individual is held responsible for payment of a debt if another party, jointly or severally obligated, defaults on the payment.

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**4155.1 4.C.5.b  
Application of  
Contingent  
Liability  
Policies** The contingent liability policies described in this topic apply *unless* the borrower can provide conclusive evidence from the debt holder that there is no possibility that the debt holder will pursue debt collection against him/her should the other party default.

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**4155.1 4.C.5.c  
Contingent  
Liability on  
Mortgage  
Assumptions** Contingent liability must be considered when the borrower remains obligated on an outstanding FHA-insured, VA-guaranteed, or conventional mortgage secured by property that

- has been sold or traded within the last 12 months without a release of liability, or
- is to be sold on assumption *without* a release of liability being obtained.

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## 5. Borrower Liabilities: Contingent Liability, Continued

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### 4155.1 4.C.5.d Exemption From Contingent Liability Policy on Mortgage Assumptions

When a mortgage is assumed, contingent liabilities need not be considered *if*

- the originating lender of the mortgage being underwritten obtains, from the servicer of the assumed loan, a payment history showing that the mortgage has been current during the previous 12 months, or
- the value of the property, as established by an appraisal or the sales price on the HUD-1 Settlement Statement from the sale of the property, minus the Up-Front Mortgage Insurance Premium (UFMIP) results in an LTV of 75% or less.

#### ***TOTAL Scorecard Accept Recommendation***

Obtain either

- a copy of the divorce decree ordering the spouse to make payments, or
- the assumption agreement and deed showing transfer of title out of the borrower's name. (*Note:* A 12-month history is *not* required.)

***Reference:*** For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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### 4155.1 4.C.5.e Contingent Liability on Cosigned Obligations

Contingent liability applies, and the debt must be included in the underwriting analysis, if an individual applying for an FHA-insured mortgage is a cosigner/co-obligor on a

- car loan
- student loan
- mortgage, or
- any other obligation.

If the lender obtains documented proof that the primary obligor has been making regular payments during the previous 12 months, and does not have a history of delinquent payments on the loan during that time, the payment does not have to be included in the borrower's monthly obligations.

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## 6. Borrower Liabilities: Projected Obligations and Obligations Not Considered Debt

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**Introduction** This topic contains information on borrower

- projected obligations, and
  - obligations not considered debt.
- 

**Change Date** March 29, 2010

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**4155.1 4.C.6.a Projected Obligations** Debt payments, such as a student loan or balloon note scheduled to begin or come due within 12 months of the mortgage loan closing, must be included by the lender as anticipated monthly obligations during the underwriting analysis.

Debt payments do *not* have to be classified as projected obligations if the borrower provides written evidence that the debt will be deferred to a period outside the 12-month timeframe.

Balloon notes that come due within one year of loan closing must be considered in the underwriting analysis.

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**4155.1 4.C.6.b Obligations Not Considered Debt** Obligations not considered debt, and therefore not subtracted from gross income, include

- Federal, state, and local taxes
- Federal Insurance Contributions Act (FICA) or other retirement contributions, such as 401(k) accounts (including repayment of debt secured by these funds)
- commuting costs
- union dues
- open accounts with zero balances
- automatic deductions to savings accounts
- child care, and
- voluntary deductions.

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## Section D. Borrower Employment and Employment Related Income

### Overview

**In This Section** This section contains the topics listed in the table below.

Topic	Topic Name	See Page
1	Stability of Income	4-D-2
2	Salary, Wage and Other Forms of Income	4-D-4
3	Borrowers Employed by a Family Owned Business	4-D-10
4	General Information on Self Employed Borrowers and Income Analysis	4-D-11
5	Income Analysis: Individual Tax Returns (IRS Form 1040)	4-D-16
6	Income Analysis: Corporate Tax Returns (IRS Form 1120)	4-D-19
7	Income Analysis: "S" Corporation Tax Returns (IRS Form 1120S)	4-D-21
8	Income Analysis: Partnership Tax Returns (IRS Form 1065)	4-D-22

# 1. Stability of Income

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**Introduction** This topic contains information on determining a borrower's income stability, including

- determining effective income
  - verifying employment history
  - analyzing a borrower's employment record, and
  - addressing a borrower's returning to work after an extended absence.
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**4155.1 4.D.1.a Effective Income** Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue.

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## 1. Stability of Income, Continued

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### 4155.1 4.D.1.b Verifying Employment History

To be eligible for a mortgage, FHA does not require a minimum length of time that a borrower must have held a position of employment. However, the lender must verify the borrower's employment for the most recent two full years, and the borrower must

- explain any gaps in employment that span one or more months, and
- indicate if he/she was in school or the military for the recent two full years, providing evidence supporting this claim, such as
  - college transcripts, or
  - discharge papers.

Allowances can be made for seasonal employment, typical for the building trades and agriculture, if documented by the lender.

#### ***TOTAL Scorecard Accept Recommendation***

The TOTAL Scorecard Accept recommendation does not require an explanation for gaps in employment of six months or less, during the most recent two years.

**Note:** A borrower with a 25 percent or greater ownership interest in a business is considered self employed and will be evaluated as a self employed borrower for underwriting purposes.

**References:** For more information on

- seasonal employment, see [HUD 4155.1 4.D.2.e](#)
- self employed borrowers and income analysis, see [HUD 4155.1 4.D.4](#), and
- the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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## 1. Stability of Income, Continued

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### 4155.1 4.D.1.c Analyzing a Borrower's Employment Record

When analyzing the probability of continued employment, lenders must examine

- the borrower's past employment record
- qualifications for the position
- previous training and education, and
- the employer's confirmation of continued employment.

Favorably consider a borrower for a mortgage if he/she changes jobs frequently within the same line of work, but continues to advance in income or benefits. In this analysis, income stability takes precedence over job stability.

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### 4155.1 4.D.1.d Borrowers Returning to Work After an Extended Absence

A borrower's income may be considered effective and stable when recently returning to work after an extended absence if he/she

- is employed in the current job for six months or longer, and
- can document a two year work history prior to an absence from employment using
  - traditional employment verifications, and/or
  - copies of W-2 forms or pay stubs.

**Note:** An acceptable employment situation includes individuals who took several years off from employment to raise children, then returned to the workforce.

**Important:** Situations not meeting the criteria listed above may *only* be considered as compensating factors. Extended absence is defined as six months.

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## 2. Salary, Wage and Other Forms of Income

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<b>Introduction</b>	<p>This topic contains information on qualifying a borrower using salary, wage, and other forms of income, including</p> <ul style="list-style-type: none"> <li>• general policy on borrower income analysis</li> <li>• overtime and bonus income</li> <li>• overtime and bonus income earning trend</li> <li>• qualifying part-time income</li> <li>• income from seasonal employment</li> <li>• primary employment less than 40 hour work week</li> <li>• commission income</li> <li>• qualifying commission income earned for less than one year</li> <li>• employer differential payments</li> <li>• retirement income</li> <li>• Social Security income, and</li> <li>• automobile allowances and expense account payments.</li> </ul>
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<b>4155.1 4.D.2.a General Policy on Borrower Income Analysis</b>	<p>The income of each borrower who will be obligated for the mortgage debt <i>must</i> be analyzed to determine whether his/her income level can be reasonably expected to continue through at least the first three years of the mortgage loan.</p> <p>In most cases, a borrower's income is limited to salaries or wages. Income from other sources can be considered as effective, when properly verified and documented by the lender.</p> <p><b>Notes:</b></p> <ul style="list-style-type: none"> <li>• Effective income for borrowers planning to retire during the first three-year period <i>must</i> include the amount of             <ul style="list-style-type: none"> <li>– documented retirement benefits</li> <li>– Social Security payments, or</li> <li>– other payments expected to be received in retirement.</li> </ul> </li> <li>• Lenders <i>must not</i> ask the borrower about possible, future maternity leave.</li> </ul>
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## 2. Salary, Wage and Other Forms of Income, Continued

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### 4155.1 4.D.2.b Overtime and Bonus Income

Overtime and bonus income can be used to qualify the borrower if he/she has received this income for the past two years, and it will likely continue. If the employment verification states that the overtime and bonus income is unlikely to continue, it may not be used in qualifying.

The lender must develop an average of bonus or overtime income for the past two years. Periods of overtime and bonus income less than two years may be acceptable, provided the lender can justify and document in writing the reason for using the income for qualifying purposes.

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### 4155.1 4.D.2.c Establishing an Overtime and Bonus Income Earning Trend

The lender *must* establish and document an earnings trend for overtime and bonus income. If either type of income shows a continual decline, the lender *must* document in writing a sound rationalization for including the income when qualifying the borrower.

A period of more than two years must be used in calculating the average overtime and bonus income if the income varies significantly from year to year.

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## 2. Salary, Wage and Other Forms of Income, Continued

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### 4155.1 4.D.2.d Qualifying Part-Time Income

Part-time and seasonal income can be used to qualify the borrower if the lender documents that the borrower has worked the part-time job uninterrupted for the past two years, and plans to continue. Many low and moderate income families rely on part-time and seasonal income for day to day needs, and lenders should not restrict consideration of such income when qualifying these borrowers.

Part-time income received for less than two years may be included as effective income, provided that the lender justifies and documents that the income is likely to continue.

Part-time income not meeting the qualifying requirements may be considered as a compensating factor only.

*Note:* For qualifying purposes, “part-time” income refers to employment taken to supplement the borrower’s income from regular employment; part-time employment is not a primary job and it is worked less than 40 hours.

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### 4155.1 4.D.2.e Income From Seasonal Employment

Seasonal income is considered uninterrupted, and may be used to qualify the borrower, if the lender documents that the borrower

- has worked the same job for the past two years, and
- expects to be rehired the next season.

Seasonal employment includes

- umpiring baseball games in the summer, or
  - working at a department store during the holiday shopping season.
- 

*Continued on next page*

## 2. Salary, Wage and Other Forms of Income, Continued

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### 4155.1 4.D.2.f Primary Employment Less Than 40 Hour Work Week

When a borrower's primary employment is less than a typical 40-hour work week, the lender should evaluate the stability of that income as regular, on-going primary employment.

*Example:* A registered nurse may have worked 24 hours per week for the last year. Although this job is less than the 40-hour work week, it is the borrower's primary employment, and should be considered effective income.

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### 4155.1 4.D.2.g Commission Income

Commission income *must* be averaged over the previous two years. To qualify commission income, the borrower must provide

- copies of signed tax returns for the last two years, and
- the most recent pay stub.

Commission income showing a decrease from one year to the next requires significant compensating factors before a borrower can be approved for the loan.

Borrowers whose commission income was received for more than one year, but less than two years may be considered favorably if the underwriter can

- document the likelihood that the income will continue, and
- soundly rationalize accepting the commission income.

*Notes:*

- Unreimbursed business expenses must be subtracted from gross income.
  - A commissioned borrower is one who receives more than 25 percent of his/her annual income from commissions.
  - A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns, and the cost of the transcript may be charged to the borrower.
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*Continued on next page*

## 2. Salary, Wage and Other Forms of Income, Continued

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### 4155.1 4.D.2.h Qualifying Commission Income Earned for Less Than One Year

Commission income earned for less than one year is *not* considered effective income. Exceptions may be made for situations in which the borrower's compensation was changed from salary to commission within a similar position with the same employer.

A borrower may also qualify when the portion of earnings *not* attributed to commissions would be sufficient to qualify the borrower for the mortgage.

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### 4155.1 4.D.2.i Employer Differential Payments

If the employer subsidizes a borrower's mortgage payment through direct payments, the amount of the payments

- is considered gross income, and
  - cannot be used to offset the mortgage payment directly, even if the employer pays the servicing lender directly.
- 

### 4155.1 4.D.2.j Retirement Income

Retirement income must be verified from the former employer, or from Federal tax returns. If any retirement income, such as employer pensions or 401(k)s, will cease within the first full three years of the mortgage loan, the income may *only* be considered as a compensating factor.

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### 4155.1 4.D.2.k Social Security Income

Social Security income must be verified by the Social Security Administration or on Federal tax returns. If any benefits expire within the first full three years of the loan, the income source may be considered *only* as a compensating factor.

**Notes:**

- The lender must obtain a complete copy of the current awards letter.
- Not all Social Security income is for retirement-aged recipients; therefore, documented continuation is required.
- Some portion of Social Security income may be "grossed up" if deemed nontaxable by the IRS

**Reference:** For information on "grossing up" income, see HUD [4155.1.4.E.5.b](#).

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*Continued on next page*

## 2. Salary, Wage and Other Forms of Income, Continued

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### 4155.1 4.D.2.1 Automobile Allowances and Expense Account Payments

Only the amount by which the borrower's automobile allowance or expense account payments *exceed* actual expenditures may be considered income.

To establish the amount to add to gross income, the borrower must provide the following:

- [IRS Form 2106](#), *Employee Business Expenses*, for the previous two years, and
- employer verification that the payments will continue.

If the borrower uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income.

Expenses that must be treated as recurring debt include

- the borrower's monthly car payment, and
  - any loss resulting from the calculation of the difference between the actual expenditures and the expense account allowance.
-

### 3. Borrowers Employed by a Family Owned Business

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**Change Date**      March 29, 2010

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**4155.1 4.D.3.a  
Income  
Documentation  
Requirement**

In addition to normal employment verification, a borrower employed by a family owned businesses are required to provide evidence that he/she is not an owner of the business, which may include

- copies of signed personal tax returns, or
- a signed copy of the corporate tax return showing ownership percentage.

*Note:* A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns, and the cost of the transcript may be charged to the borrower

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## 4. General Information on Self Employed Borrowers and Income Analysis

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**Introduction** This topic contains general information on self employed borrowers and the analysis of self employed borrower income, including

- the definition of the term ‘self employed’
  - types of business structures
  - the minimum length of self employment
  - general documentation requirements for self employed borrowers
  - establishing a borrower’s earnings trend
  - profit and loss TOTAL Scorecard Accept/Refer requirements, and
  - analyzing a business’s financial strength.
- 

**Change Date** March 29, 2010

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**4155.1 4.D.4.a  
Definition: Self  
Employed  
Borrower** A borrower with a 25 percent or greater ownership interest in a business is considered self employed for FHA loan underwriting purposes.

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**4155.1 4.D.4.b  
Types of  
Business  
Structures** There are four basic types of business structures. They include

- sole proprietorships
- corporations
- limited liability or “S” corporations, and
- partnerships.

**Reference:** For more information on analyzing income for

- sole proprietorships, see [HUD 4155.1 4.D.5](#)
  - corporations, see [HUD 4155.1 4.D.6](#)
  - “S” corporations, see [HUD 4155.1 4.D.7](#), and
  - partnerships, see [HUD 4155.1 4.D.8](#).
- 

*Continued on next page*

## 4. General Information on Self Employed Borrowers and Income Analysis, Continued

**4155.1 4.D.4.c  
Minimum  
Length of Self  
Employment**

Income from self employment is considered stable, and effective, if the borrower has been self employed for two or more years.

Due to the high probability of failure during the first few years of a business, the requirements described in the table below are necessary for borrowers who have been self employed for less than two years.

<b>If the period of self employment is ...</b>	<b>Then ...</b>
between one and two years	to be eligible for a mortgage loan, the individual must have at least two years of documented previous successful employment in the line of work in which the individual is self employed, or in a related occupation.  <i>Note:</i> A combination of one year of employment and formal education or training in the line of work in which the individual is self employed or in a related occupation is also acceptable.
less than one year	the income from the borrower may not be considered effective income.

*Continued on next page*

## 4. General Information on Self Employed Borrowers and Income Analysis, Continued

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**4155.1 4.D.4.d  
General  
Documentation  
Requirements  
for Self  
Employed  
Borrowers**

Self employed borrowers must provide the following documentation:

- signed, dated individual tax returns, with all applicable tax schedules for the most recent two years
- for a corporation, “S” corporation, or partnership, signed copies of Federal business income tax returns for the last two years, with all applicable tax schedules
- year to date profit and loss (P&L) statement and balance sheet, and
- business credit report for corporations and “S” corporations.

***TOTAL Scorecard Accept Recommendation***

No business tax returns are required if all of the following conditions are met:

- individual Federal income tax returns show increasing self employed income over the past two years
- funds to close are not coming from business accounts, and
- the proposed FHA-insured mortgage is not a cash out refinance.

**Note:** A business credit report for corporations or “S” corporations is *not* required for the TOTAL Scorecard Accept recommendation.

**Reference:** For additional information on TOTAL Scorecard recommendations for corporations or “S” corporations, see Page 13 of the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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## 4. General Information on Self Employed Borrowers and Income Analysis, Continued

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### 4155.1 4.D.4.e Establishing a Borrower's Earnings Trend

When qualifying a borrower for a mortgage loan, the lender must establish the borrower's earnings trend from the previous two years using the borrower's tax returns.

If a borrower

- provides quarterly tax returns, the income analysis may include income through the period covered by the tax filings, or
- is *not* subject to quarterly tax returns, or does not file them, then the income shown on the P&L statement may be included in the analysis, provided the income stream based on the P&L is consistent with the previous years' earnings.

If the P&L statements submitted for the current year show an income stream considerably *greater* than what is supported by the previous year's tax returns, the lender must base the income analysis solely on the income verified through the tax returns.

If the borrower's earnings trend for the previous two years is *downward* and the most recent tax return or P&L is *less than the prior year's tax return*, the borrower's most recent year's tax return or P&L must be used to calculate his/her income.

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*Continued on next page*

## 4. General Information on Self Employed Borrowers and Income Analysis, Continued

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### 4155.1 4.D.4.f P&L TOTAL Scorecard Accept/Refer Requirements

The TOTAL Scorecard Accept recommendation does not require a P&L and Balance Sheet, unless the income used to qualify the borrower exceeds that of the two-year average, based on tax returns. In such a case, either an audited P&L statement, or signed quarterly tax return is used to support the greater income stream.

The TOTAL Scorecard Refer recommendation requires a P&L and Balance Sheet, or income information directly from the IRS if both of the following conditions exist:

- more that seven months have elapsed since the business tax year's ending date, and
- income to the self employed borrower from each individual business is greater than 5 percent of his/her stable monthly income.

**Reference:** For additional information on TOTAL Scorecard recommendations, see Page 13 of the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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### 4155.1 4.D.4.g Analyzing the Business's Financial Strength

To determine if the business is expected to generate sufficient income for the borrower's needs, the lender must carefully analyze the business's financial strength, including the

- source of the business's income
- general economic outlook for similar businesses in the area.

Annual earnings that are stable or increasing are acceptable, while businesses that show a significant decline in income over the analysis period are not acceptable, even if the current income and debt ratios meet FHA guidelines.

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## 5. Income Analysis: Individual Tax Returns (IRS Form 1040)

**Introduction** This topic contains information on analyzing income for self employed borrowers through the review of IRS Form 1040. It includes information on

- the general policy on adjusting income based on a review of IRS Form 1040
- guidelines for analyzing IRS Form 1040, and
- earned income credit.

**Change Date** May 10, 2009

**4155.1 4.D.5.a General Policy on Adjusting Income Based on a Review of IRS Form 1040** The amount shown on a borrower’s [IRS Form 1040](#) as *adjusted gross income* must either be increased or decreased based on the lender’s analysis of the individual tax return and any related tax schedules.

**Reference:** For information on particular items to analyze on IRS Form 1040, see [HUD 4155.1 4.D.5.b](#).

**4155.1 4.D.5.b Guidelines for Analyzing IRS Form 1040** The table below contains guidelines for analyzing [IRS Form 1040](#).

IRS Form 1040 Heading	Description
Wages, Salaries and Tips	<p>An amount shown under this heading may indicate that the individual</p> <ul style="list-style-type: none"> <li>• is a salaried employee of a corporation, or</li> <li>• has other sources of income.</li> </ul> <p>This section may also indicate that the spouse is employed, in which case the spouse’s income must be subtracted from the borrower’s adjusted gross income.</p>

*Continued on next page*

## 5. Income Analysis: Individual Tax Returns (IRS Form 1040), Continued

### 4155.1 4.D.5.b Guidelines for Analyzing IRS Form 1040 (continued)

IRS Form 1040 Heading	Description
Business Income and Loss (from Schedule C)	<p>Sole proprietorship income calculated on Schedule C is business income.</p> <p>Depreciation or depletion may be added back to the adjusted gross income.</p>
Rents, Royalties, Partnerships (from Schedule E)	Any income received from rental properties or royalties may be used as income, after adding back any depreciation shown on Schedule E.
Capital Gain and Losses (from Schedule D)	<p>Capital gains or losses generally occur only one time, and should not be considered when determining effective income.</p> <p>However, if the individual has a constant turnover of assets resulting in gains or losses, the capital gain or loss must be considered when determining the income. Three years' tax returns are required to evaluate an earning trend. If the trend</p> <ul style="list-style-type: none"> <li>• results in a gain, it may be added as effective income, or</li> <li>• consistently shows a loss, it must be deducted from the total income.</li> </ul> <p>Lender must document anticipated continuation of income through verified assets.</p> <p><b>Example:</b> A lender can consider the capital gains for an individual who purchases old houses, remodels them, and sells them for profit.</p>

Continued on next page

## 5. Income Analysis: Individual Tax Returns (IRS Form 1040), Continued

**4155.1 4.D.5.b Guidelines for Analyzing IRS Form 1040** (continued)

<b>IRS Form 1040 Heading</b>	<b>Description</b>
Interest and Dividend Income (from Schedule B)	<p>This taxable/tax-exempt income may be added back to the adjusted gross income only if it</p> <ul style="list-style-type: none"> <li>• has been received for the past two years, and</li> <li>• is expected to continue.</li> </ul> <p>If the interest-bearing asset will be liquidated as a source of the cash investment, the lender must appropriately adjust the amount.</p>
Farm Income or Loss (from Schedule F)	Any depreciation shown on Schedule F may be added back to the adjusted gross income.
IRA Distributions, Pensions, Annuities, and Social Security Benefits	The non-taxable portion of these items may be added back to the adjusted gross income, if the income is expected to continue for the first three years of the mortgage.
Adjustments to Income	<p>Adjustments to income may be added back to the adjusted gross income if they are</p> <ul style="list-style-type: none"> <li>• IRA and Keogh retirement deductions</li> <li>• penalties on early withdrawal of savings</li> <li>• health insurance deductions, and</li> <li>• alimony payments.</li> </ul>
Employee Business Expenses	Employee business expenses are actual cash expenses that must be deducted from the adjusted gross income.

## 6. Income Analysis: Corporate Tax Returns (IRS Form 1120)

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**Introduction** This topic contains information on analyzing corporate tax returns submitted on IRS Form 1120. It includes

- a description of a *corporation*
  - the need to obtain borrower percentage of ownership information, and
  - analyzing corporate tax returns.
- 

**Change Date** May 10, 2009

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**4155.1 4.D.6.a Description: Corporation** A *Corporation* is a state-chartered business owned by its stockholders.

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**4155.1 4.D.6.b Need to Obtain Borrower Percentage of Ownership Information** Corporate compensation to the officers, generally in proportion to the percentage of ownership, is shown on the

- corporate tax return [IRS Form 1120](#), and
- individual tax returns.

When a borrower's percentage of ownership does not appear on the tax returns, the lender *must* obtain the information from the corporation's accountant, along with evidence that the borrower has the right to any compensation.

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*Continued on next page*

## 6. Income Analysis: Corporate Tax Returns (IRS Form 1120), Continued

**4155.1 4.D.6.c  
Analyzing  
Corporate Tax  
Returns**

In order to determine a borrower’s self employed income from a corporation the adjusted business income must

- be determined, and
- multiplied by the borrower’s percentage of ownership in the business.

The table below describes the items found on [IRS Form 1120](#) for which an adjustment must be made in order to determine adjusted business income.

Adjustment Item	Description of Adjustment
Depreciation and Depletion	Add the corporation’s depreciation and depletion back to the after-tax income.
Taxable Income	Taxable income is the corporation’s net income before Federal taxes. Reduce taxable income by the tax liability.
Fiscal Year vs. Calendar Year	If the corporation operates on a fiscal year that is different from the calendar year, an adjustment must be made to relate corporate income to the individual tax return.
Cash Withdrawals	The borrower’s withdrawal of cash from the corporation may have a severe negative impact on the corporation’s ability to continue operating.

## 7. Income Analysis: “S” Corporation Tax Returns (IRS Form 1120S)

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**Introduction** This topic contains information on analyzing a borrower’s self employed income from an “S” corporation. It includes

- a description of an “S” corporation, and
  - information on analyzing “S” corporation tax returns.
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**Change Date** March 29, 2010

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**4155.1 4.D.7.a  
Description:  
“S”  
Corporation** An “S” *Corporation* is generally a small, start-up business, with gains and losses passed to stockholders in proportion to each stockholder’s percentage of business ownership.

Income for owners of “S” corporations comes from W-2 wages, and is taxed at the individual rate. The [IRS Form 1120S](#), *Compensation of Officers* line item is transferred to the borrower’s individual [IRS Form 1040](#).

**Reference:** For information on reviewing and analyzing IRS Form 1040, see [HUD 4155.1 4.D.5](#).

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**4155.1 4.D.7.b  
Analyzing “S”  
Corporation  
Tax Returns** “S” corporation depreciation and depletion may be added back to income in proportion to the borrower’s share of the corporation’s income.

In addition, the income must also be reduced proportionately by the total obligations payable by the corporation in less than one year.

**IMPORTANT:** The borrower’s withdrawal of cash from the corporation may have a severe negative impact on the corporation’s ability to continue operating, and must be considered in the income analysis.

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## 8. Income Analysis: Partnership Tax Returns (IRS Form 1065)

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**Introduction** This topic contains information on analyzing a self employed borrower's income from a partnership through the analysis of IRS Form 1065, including

- a description of a partnership, and
  - information on analyzing partnership tax returns.
- 

**Change Date** March 29, 2010

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**4155.1 4.D.8.a Description: Partnership** A *Partnership* is formed when two or more individuals form a business, and share in profits, losses, and responsibility for running the company.

Each partner pays taxes on his/her proportionate share of the partnership's net income.

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**4155.1 4.D.8.b Analyzing Partnership Tax Returns** Both general and limited partnerships report income on [IRS Form 1065](#), and the partners' share of income is carried over to Schedule E of [IRS Form 1040](#).

The lender must review IRS Form 1065 to assess the viability of the business. Both depreciation and depletion may be added back to the income in proportion to the borrower's share of income.

Income must also be reduced proportionately by the total obligations payable by the partnership in less than one year.

**IMPORTANT:** Cash withdrawals from the partnership may have a severe negative impact on the partnership's ability to continue operating, and must be considered in the income analysis.

**Reference:** For information on reviewing IRS Form 1040, see [HUD 4155.1 4.D.5](#).

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## Section E. Non Employment Related Borrower Income

### Overview

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**In This Section** This section contains the topics listed in the table below.

Topic	Topic Name	See Page
1	Alimony, Child Support, and Maintenance Income	4-E-2
2	Investment and Trust Income	4-E-4
3	Military, Government Agency, and Assistance Program Income	4-E-7
4	Rental Income	4-E-10
5	Non-Taxable and Projected Income	4-E-15

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## 1. Alimony, Child Support, and Maintenance Income

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**Introduction** This topic contains information on alimony, child support, and maintenance income requirements, including

- criteria for alimony, child support, and maintenance income, and
  - alimony and support requirements for TOTAL Scorecard Accept/Refer recommendations.
- 

**Change Date** March 29, 2010

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**4155.1 4.E.1.a Alimony, Child Support and Maintenance Income Criteria** Alimony, child support, or maintenance income may be considered effective, if

- payments are likely to be received consistently for the first three years of the mortgage
- the borrower provides the required documentation, which includes a copy of the
  - final divorce decree
  - legal separation agreement,
  - court order, or
  - voluntary payment agreement, and
- the borrower can provide acceptable evidence that payments have been received during the last 12 months, such as
  - cancelled checks
  - deposit slips
  - tax returns, or
  - court records.

**Notes:**

- Periods less than 12 months may be acceptable, provided the lender can adequately document the payer’s ability and willingness to make timely payments.
- Child support may be “grossed up” under the same provisions as non-taxable income sources.

**Reference:** For more information on “grossing up,” see [HUD 4155.1 4.E.5.a](#).

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*Continued on next page*

## 1. Alimony, Child Support, and Maintenance Income, Continued

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**4155.1 4.E.1.b**  
**TOTAL**  
**Scorecard**  
**Accept/Refer**  
**Recommendati**  
**on**

The TOTAL Scorecard Accept and Refer recommendation for alimony, child support, and maintenance income requires evidence

- of receipt, using deposits on bank statements or cancelled checks for the most recent three months that support the amount used when qualifying, and
- that the claimed income will continue for at least three years.

For the financial details, use the front and pertinent pages of the divorce decree, settlement agreement and/or court order.

**Reference:** For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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## 2. Investment and Trust Income

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**Introduction** This topic contains information on analyzing investment and trust income, including

- analyzing interest and dividends
  - trust income
  - notes receivable income, and
  - calculating qualifying ratios for investment properties.
- 

**Change Date** March 29, 2010

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**4155.1 4.E.2.a Analyzing Interest and Dividends** Interest and dividend income may be used as long as tax returns or account statements support a two-year receipt history. This income must be averaged over the two years.

Subtract any funds that are derived from these sources, and are required for the cash investment, before calculating the projected interest or dividend income.

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**4155.1 4.E.2.b Trust Income** Income from trusts may be used if guaranteed, constant payments will continue for at least the first three years of the mortgage term.

Required trust income documentation includes a copy of the Trust Agreement or other trustee statement, confirming the

- amount of the trust
- frequency of distribution, and
- duration of payments.

Trust account funds may be used for the required cash investment if the borrower provides adequate documentation that the withdrawal of funds will not negatively affect income. The borrower may use funds from the trust account for the required cash investment, but the trust income used to determine repayment ability cannot be affected negatively by its use.

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*Continued on next page*

## 2. Investment and Trust Income, Continued

**4155.1 4.E.2.c**  
**Notes**  
**Receivable**  
**Income**

In order to include notes receivable income to qualify a borrower, he/she must provide

- a copy of the note to establish the amount and length of payment, and
- evidence that these payments have been consistently received for the last 12 months through
  - deposit slips
  - cancelled checks, or
  - tax returns.

If the borrower is not the original payee on the note, the lender must establish that the borrower is now a holder in due course, and able to enforce the note.

**4155.1 4.E.2.d**  
**Calculating**  
**Qualifying**  
**Ratios for**  
**Eligible**  
**Investment**  
**Properties**

Follow the steps in the table below to calculate an investment property’s income or loss if the property to be insured is

- an eligible investment property, or
- sold through FHA’s REO program.

Step	Action
1	Subtract the monthly payment (PITI) from the monthly net rental income of the subject property.  <i>Note:</i> Calculate the monthly net rental by taking the gross rents, and subtracting the 25 percent reduction or the HOC’s percentage reduction for vacancies and repairs.
2	Does the calculation in Step 1 yield a positive number? <ul style="list-style-type: none"> <li>• If <i>yes</i>, add the number to the borrower’s monthly gross income.</li> <li>• If <i>no</i>, and the calculation yields a negative number, consider it a recurring monthly obligation.</li> </ul>

*Continued on next page*

## 2. Investment and Trust Income, Continued

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### 4155.1 4.E.2.d Calculating Qualifying Ratios for Eligible Investment Properties (continued)

Step	Action
3	Calculate the mortgage payment-to-income ratio (top or front-end ratio) by dividing the borrower's current housing expense (principal residence) by the monthly gross income.  <i>Note:</i> The monthly gross income includes any positive cash flow from the subject investment property.
4	Calculate the total fixed payment-to-income ratio (bottom or back-end ratio) by dividing the borrower's total monthly obligations, including any net loss from the subject investment property, by the borrower's total monthly gross income.

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### 3. Military, Government Agency, and Assistance Program Income

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**Introduction** This topic contains information on analyzing military, government agency, and assistance program income, including

- military income
  - VA benefits
  - government assistance programs
  - mortgage credit certificates, and
  - Section 8 home ownership vouchers.
- 

**Change Date** March 29, 2010

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**4155.1 4.E.3.a Military Income** Military personnel not only receive base pay, but often times are entitled to additional forms of pay, such as

- income from variable housing allowances
- clothing allowances
- flight or hazard pay
- rations, and
- proficiency pay.

These types of additional pay are acceptable when analyzing a borrower's income as long as the probability of such pay to continue is verified in writing.

**Note:** The tax-exempt nature of some of the above payments should also be considered.

**Reference:** For information about non-taxable income, see [HUD 4155.1 4.E.5](#).

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*Continued on next page*

### 3. Military, Government Agency, and Assistance Program Income, Continued

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**4155.1 4.E.3.b  
VA Benefits** Direct compensation for service-related disabilities from the Department of Veterans Affairs (VA) is acceptable, provided the lender receives documentation from the VA.

Education benefits used to offset education expenses are *not* acceptable.

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**4155.1 4.E.3.c  
Government Assistance Programs** Income received from government assistance programs is acceptable as long as the paying agency provides documentation indicating that the income is expected to continue for at least three years.

If the income from government assistance programs will not be received for at least three years, it may be considered as a compensating factor.

Unemployment income *must* be documented for two years, and there must be reasonable assurance that this income will continue. This requirement may apply to seasonal employment.

**Reference:** For information on analyzing income from seasonal employment, see [HUD 4155.1.4.D.2.e](#).

---

**4155.1 4.E.3.d  
Mortgage Credit Certificates** If a government entity subsidizes the mortgage payments either through direct payments or tax rebates, these payments may be considered as acceptable income.

Either type of subsidy may be added to gross income, or used directly to offset the mortgage payment, before calculating the qualifying ratios.

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*Continued on next page*

### 3. Military, Government Agency, and Assistance Program Income, Continued

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**4155.1 4.E.3.e**  
**Section 8 Home**  
**Ownership**  
**Vouchers**

A monthly subsidy may be treated as income, if a borrower is receiving subsidies under the housing choice voucher home ownership option from a Public Housing Agency (PHA). Although continuation of the home ownership voucher subsidy beyond the first year is subject to Congressional appropriation, FHA has agreed that it will assume, for the purposes of underwriting, that the subsidy will continue for at least three years.

If the borrower is receiving the subsidy directly, the amount received is treated as income. The amount received may also be treated as non taxable income and be “grossed up” by 25 percent, which means that the amount of the subsidy, plus 25 percent of that subsidy may be added to the borrower’s income from employment and/or other sources.

Lenders may treat this subsidy as an “offset” to the monthly mortgage payment (that is, reduce the monthly mortgage payment by the amount of the home ownership assistance payment before dividing by the monthly income to determine the payment-to-income and debt-to-income ratios). The subsidy payment must not pass through the borrower’s hands. The assistance payment must be

- paid directly to the servicing lender, or
- placed in an account that only the servicing lender may access.

**Note:** Assistance payments made directly to the borrower *must* be treated as income.

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## 4. Rental Income

---

**Introduction** This topic contains information on analyzing rental income, including

- analyzing the stability of rental income
- rental income from borrower-occupied property
- income from roommates
- documentation required to verify rental income
- analyzing IRS Form 1040 Schedule E
- using current leases to analyze rental income
- the exclusion of rental income from a property being vacated by the borrower, and
- the policy exceptions to the exclusion of rental income from a principal residence being vacated by a borrower.

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**Change Date** March 29, 2010

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**4155.1 4.E.4.a Analyzing the Stability of Rental Income** Rent received for properties owned by the borrower is acceptable as long as the lender can document the stability of the rental income through

- a current lease
- an agreement to lease, or
- a rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal, or military renters, or property rehabilitation).

A separate schedule of real estate is not required for rental properties as long as all properties are documented on the URLA.

**Note:** The underwriting analysis may *not* consider rental income from any property being vacated by the borrower, except under the circumstances described in [HUD 4155.1 4.E.4.h](#).

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*Continued on next page*

## 4. Rental Income, Continued

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### 4155.1 4.E.4.b Rental Income From Borrower Occupied Property

The rent for multiple unit property where the borrower resides in one or more units and charges rent to tenants of other units may be used for qualifying purposes.

Projected rent for the tenant-occupied units *only* may

- be considered gross income, only after deducting the HOC's vacancy and maintenance factor, and
- *not* be used as a direct offset to the mortgage payment.

**Reference:** For information about the HOC vacancy and maintenance factor, see the *HOC Reference Guide* at [www.hud.gov/offices/hsg/sfh/ref/hmgrcont.cfm](http://www.hud.gov/offices/hsg/sfh/ref/hmgrcont.cfm).

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### 4155.1 4.E.4.c Income from Roommates in a Single Family Property

Income from roommates in a single family property occupied as the borrower's primary residence is *not* acceptable. Rental income from boarders however, *is* acceptable, if the boarders are related by blood, marriage, or law.

The rental income may be considered effective, if shown on the borrower's tax return. If not on the tax return, rental income paid by the boarder

- may be considered a compensating factor, and
  - must be adequately documented by the lender.
- 

### 4155.1 4.E.4.d Documentation Required to Verify Rental Income

Analysis of the following required documentation is necessary to verify all borrower rental income:

- [IRS Form 1040](#) Schedule E, as described in [HUD 4155.1 4.D.5.b](#), and
  - current leases/rental agreements, as described in [HUD 4155.1 4.E.4.f](#).
- 

*Continued on next page*

## 4. Rental Income, Continued

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### 4155.1 4.E.4.e Analyzing IRS Form 1040 Schedule E

The [IRS Form 1040](#) Schedule E is required to verify all rental income. Depreciation shown on Schedule E may be added back to the net income or loss.

Positive rental income is considered gross income for qualifying purposes, while negative income must be treated as a recurring liability.

The lender *must* confirm that the borrower still owns each property listed, by comparing Schedule E with the real estate owned section of the URLA. If the borrower owns six or more units in the same general area, a map must be provided disclosing the locations of the units as evidence of compliance with FHA's seven-unit limitation.

**Reference:** For information about the FHA seven unit rental limitation, see [HUD 4155.1 4.B.4.d](#).

---

### 4155.1 4.E.4.f Using Current Leases to Analyze Rental Income

The borrower can provide a current signed lease or other rental agreement for a property that was acquired since the last income tax filing, and is not shown on Schedule E.

In order to calculate the rental income

- reduce the gross rental amount by 25 percent (or the percentage developed by the jurisdictional HOC) for vacancies and maintenance
  - subtract PITI and any homeowners' association dues, and
  - apply the resulting amount to
    - income, if positive, or
    - recurring debts, if negative.
- 

*Continued on next page*

## 4. Rental Income, Continued

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**4155.1 4.E.4.g  
Exclusion of  
Rental Income  
From Property  
Being Vacated  
by the  
Borrower**

Underwriters may *not* consider any rental income from a borrower's principal residence that is being vacated in favor of another principal residence, except under the conditions described in [HUD 4155.1 4.E.4.h](#)

*Notes:*

- This policy assures that a borrower either has sufficient income to make both mortgage payments without any rental income, or has an equity position not likely to result in defaulting on the mortgage on the property being vacated.
- This applies *solely* to a principal residence being vacated in favor of another principal residence. It does *not* apply to existing rental properties disclosed on the loan application and confirmed by tax returns (Schedule E of form IRS 1040).

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*Continued on next page*

## 4. Rental Income, Continued

**4155.1 4.E.4.h  
Policy  
Exceptions  
Regarding the  
Exclusion of  
Rental Income  
From a  
Principal  
Residence  
Being Vacated  
by a Borrower**

When a borrower vacates a principal residence in favor of another principal residence, the rental income, reduced by the appropriate vacancy factor as determined by the jurisdictional FHA HOC, *may* be considered in the underwriting analysis under the circumstances listed in the table below.

**Reference:** For information on jurisdictional HOC vacancy factors, see <http://www.hud.gov/offices/hsg/sfh/ref/sfh2-21u.cfm>.

Exception	Description
Relocations	<p>The borrower is relocating with a new employer, or being transferred by the current employer to an area not within reasonable and locally-recognized commuting distance.</p> <p>A properly executed lease agreement (that is, a lease signed by the borrower and the lessee) of at least one year's duration after the loan is closed is required.</p> <p><b>Note:</b> FHA recommends that underwriters also obtain evidence of the security deposit and/or evidence the first month's rent was paid to the homeowner.</p>
Sufficient Equity in Vacated Property	<p>The borrower has a loan-to-value ratio of 75% percent or less, as determined either by</p> <ul style="list-style-type: none"> <li>• a current (no more than six months old) residential appraisal, or</li> <li>• comparing the unpaid principal balance to the original sales price of the property.</li> </ul> <p><b>Note:</b> The appraisal, in addition to using forms Fannie Mae1004/Freddie Mac 70, may be an exterior-only appraisal using form Fannie Mae/Freddie Mac 2055, and for condominium units, form Fannie Mae1075/Freddie Mac 466.</p>

## 5. Non Taxable and Projected Income

---

**Introduction** This topic contains information on analyzing non-taxable and projected income, including

- types of non-taxable income
  - regular, non-taxable income
  - analyzing projected income, and
  - projected income for a new job.
- 

**Change Date** March 29, 2010

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**4155.1 4.E.5.a  
Types of Non  
Taxable Income** Certain types of regular income may not be subject to Federal tax. Such types of non taxable income include

- some portion of Social Security, some Federal government employee retirement income, Railroad Retirement Benefits, and some state government retirement income
  - certain types of disability and public assistance payments
  - child support
  - military allowances, and
  - other income that is documented as being exempt from Federal income taxes.
- 

**4155.1 4.E.5.b  
Adding Non  
Taxable Income  
to a Borrower's  
Gross Income** The amount of continuing tax savings attributed to regular income not subject to Federal taxes may be added to the borrower's gross income.

The percentage of non-taxable income that may be added *cannot* exceed the appropriate tax rate for the income amount. Additional allowances for dependents are *not* acceptable.

The lender

- must document and support the amount of income *grossed up* for any non-taxable income source, and
- should use the tax rate used to calculate the borrower's last year's income tax.

**Note:** If the borrower is not required to file a Federal tax return, the tax rate to use is 25 percent.

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*Continued on next page*

## 5. Non Taxable and Projected Income, Continued

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### 4155.1 4.E.5.c Analyzing Projected Income

Projected or hypothetical income is *not* acceptable for qualifying purposes. However, exceptions are permitted for income from the following sources:

- cost-of-living adjustments
- performance raises, and
- bonuses.

For the above exceptions to apply, the income must be

- verified in writing by the employer, and
  - scheduled to begin within 60 days of loan closing.
- 

### 4155.1 4.E.5.d Projected Income for a New Job

Projected income is acceptable for qualifying purposes for a borrower scheduled to start a new job within 60 days of loan closing if there is a guaranteed, non-revocable contract for employment.

The lender *must* verify that the borrower will have sufficient income or cash reserves to support the mortgage payment and any other obligations between loan closing and the start of employment. Examples of this type of scenario are teachers whose contracts begin with the new school year, or physicians beginning a residency after the loan closes fall under this category.

The loan is *not eligible for endorsement* if the loan closes more than 60 days before the borrower starts the new job. To be eligible for endorsement, the lender must obtain from the borrower a pay stub or other acceptable evidence indicating that he/she has started the new job.

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## Section F. Borrower Qualifying Ratios

### Overview

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**In This Section** This section contains the topics listed in the table below.

<b>Topic</b>	<b>Topic Name</b>	<b>See Page</b>
1	General Information on Borrower Qualifying	4-F-2
2	Debt to Income Ratios	4-F-3
3	Compensating Factors	4-F-6

---

## 1. General Information on Borrower Qualifying

---

**Introduction** This topic contains general information on qualifying borrowers for a mortgage loan, including

- lender responsibility when qualifying a borrower, and
  - the importance of careful underwriting analysis.
- 

**Change Date** May 10, 2009

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**4155.1 4.F.1.a Lender Responsibility When** The lender is responsible for adequately analyzing the probability that a borrower will be able to repay the mortgage obligation according to the terms of the loan.

**Qualifying a Borrower** This responsibility includes using debt-to-income ratios and compensating factors when qualifying a borrower. Qualifying ratios can be exceeded when significant compensating factors exist.

---

**4155.1 4.F.1.b Importance of Careful Underwriting Analysis** Underwriting requires a careful analysis of many aspects of the mortgage.

Each loan is a separate and unique transaction, and there may be multiple factors that demonstrate a borrower's ability and willingness to make timely mortgage payments.

Simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting. When qualifying a borrower, it is important to avoid the danger of "layering flexibilities" when assessing the mortgage insurance risk.

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## 2. Debt to Income Ratios

---

**Introduction** This topic contains information on using debt-to-income ratios to qualify a borrower, including

- general information about debt-to-income ratios
- mortgage payment expense to effective income ratio, and
- total fixed payment to effective income ratio.

---

**Change Date** March 29, 2010

---

**4155.1 4.F.2.a  
General  
Information  
About Debt to  
Income Ratios** Debt to income ratios are used to determine whether the borrower can reasonably be expected to meet the expenses involved in home ownership, and provide for his/her family. In order to make this determination, the lender must complete the following two ratios:

- the Mortgage Payment Expense to Effective Income ratio, as described in [HUD 4155.1 4.F.2.b](#), and
- the Total Fixed Payment to Effective Income ratio, as described in [HUD 4155.1 4.F.2.c](#).

**Note:** For loans to be scored through the TOTAL Scorecard, the debt-to-income ratios must be calculated for entry into the Automated Underwriting System (AUS) to be evaluated by TOTAL.

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*Continued on next page*

## 2. Debt to Income Ratios, Continued

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**4155.1 4.F.2.b**  
**Mortgage**  
**Payment**  
**Expense to**  
**Effective**  
**Income Ratio**

The relationship of the mortgage payment to income is considered acceptable if the total mortgage payment does not exceed 31 percent of the gross effective income.

A ratio exceeding 31 percent may be acceptable only if significant compensating factors, as discussed in [HUD 4155.1 4.F.3](#), are documented and recorded on Form [HUD-92900-LT](#), *FHA Loan Underwriting and Transmittal Summary*.

For those borrowers who qualify under FHA's Energy Efficient Homes (EEH), the ratio is set at 33 percent.

**Note:** The total mortgage payment includes

- principal and interest
- escrow deposits for real estate taxes
- hazard insurance
- the mortgage insurance premium
- homeowners' association dues
- ground rent
- special assessments, and
- payments for any acceptable secondary financing.

---

**4155.1 4.F.2.c**  
**Total Fixed**  
**Payment to**  
**Effective**  
**Income Ratio**

The relationship of total obligations to income is considered acceptable if the total mortgage payment and all recurring charges do not exceed 43 percent of the gross effective income.

A ratio exceeding 43 percent may be acceptable only if significant compensating factors, as discussed in [HUD 4155.1 4.F.3](#), are documented and recorded on Form [HUD-92900-LT](#), *FHA Loan Underwriting and Transmittal Summary*. For those borrowers who qualify under FHA's EEH, the ratio is set at 45 percent.

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*Continued on next page*

## 2. Debt to Income Ratios, Continued

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**4155.1 4.F.2.d**  
**Estimating Real**  
**Estate Taxes**  
**When**  
**Determining**  
**Debt to Income**  
**Ratios**

For real estate taxes, lenders must use accurate estimates of monthly property tax escrows when qualifying borrowers. In new construction cases, property tax estimates must be based on the land and completed improvements, not just on the land value.

*Reference:* For information on projecting and collecting real estate tax payments, see [HUD 4155.2 6.A.1.i](#).

---

### 3. Compensating Factors

---

**Introduction** This topic contains information on using compensating factors to qualify a borrower, including

- documentation of the use of compensating factors, and
- compensating factors benchmark guidelines.

---

**Change Date** March 29, 2010

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**4155.1 4.F.3.a Documentation of the Use of Compensating Factors** Compensating factors that are used to justify approval of mortgage loans with ratios that exceed benchmark guidelines must be recorded on the *Underwriter Comments* section of Form [HUD-92900-LT](#), *FHA Loan Underwriting and Transmittal Summary*. Any compensating factor used to justify mortgage approval must also be supported by documentation.

***TOTAL Scorecard Accept Recommendation***

The TOTAL Scorecard Accept recommendation does not require documented compensating factors, even if qualifying ratios have exceeded FHA benchmark guidelines.

**Reference:** For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm).

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**4155.1 4.F.3.b Compensating Factors Benchmark Guidelines** The table below describes the compensating factors that may be used to justify approval of mortgage loans with ratios that exceed FHA benchmark guidelines.

Compensating Factor	Guideline Description
Housing Expense Payments	The borrower has successfully demonstrated the ability to pay housing expenses greater than or equal to the proposed monthly housing expenses for the new mortgage over the past 12-24 months.

*Continued on next page*

### 3. Compensating Factors, Continued

**4155.1 4.F.3.b Compensating Factors Benchmark Guidelines** (continued)

<b>Compensating Factor</b>	<b>Guideline Description</b>
Down Payment	The borrower makes a large down payment of 10 percent or higher toward the purchase of the property.
Accumulated Savings	The borrower has demonstrated <ul style="list-style-type: none"> <li>• an ability to accumulate savings, and</li> <li>• a conservative attitude toward using credit.</li> </ul>
Previous Credit History	A borrower’s previous credit history shows that he/she has the ability to devote a greater portion of income to housing expenses.
Compensation or Income Not Reflected in Effective Income	The borrower receives documented compensation or income that is not reflected in effective income, but directly affects his/her ability to pay the mortgage.  This type of income includes food stamps, and similar public benefits.
Minimal Housing Expense Increase	There is only a minimal increase in the borrower’s housing expense.

*Continued on next page*

### 3. Compensating Factors, Continued

#### 4155.1 4.F.3.b Compensating Factors Benchmark Guidelines (continued)

Compensating Factor	Guideline Description
Substantial Cash Reserves	<p>The borrower has substantial documented cash reserves (at least three months worth) after closing. The lender must judge if the substantial cash reserve asset is liquid or readily convertible to cash, and can be done so absent retirement or job termination, when determining if the asset can be included as cash reserves, or cash to close.</p> <p>Funds and/or “assets” that are <i>not</i> to be considered as cash reserves include</p> <ul style="list-style-type: none"> <li>• equity in other properties, and</li> <li>• proceeds from a cash-out refinance.</li> </ul> <p>Lenders may use a portion of a borrower's retirement account, subject to the conditions stated below. To account for withdrawal penalties and taxes, only 60% of the vested amount of the account may be used. The lender must document the existence of the account with the most recent depository or brokerage account statement. In addition, evidence must be provided that the retirement account allows for withdrawals for conditions other than in connection with the borrower's employment termination, retirement, or death. If withdrawals can only be made under these circumstances, the retirement account may not be included as cash reserves. If any of these funds are also to be used for loan settlement, that amount must be subtracted from the amount included as cash reserves. Similarly, any gift funds that remain in the borrower's account following loan closing, subject to proper documentation, may be considered as cash.</p> <p><b>Note:</b> Reserves from retirement accounts and gifts as described above may be considered as cash reserves when scoring the mortgage application through TOTAL.</p> <p><b>Reference:</b> For information on acceptable sources of cash reserve funding, see <a href="#">HUD 4155.1 5.B.</a></p>

*Continued on next page*

### 3. Compensating Factors, Continued

**4155.1 4.F.3.b Compensating Factors Benchmark Guidelines** (continued)

<b>Compensating Factor</b>	<b>Guideline Description</b>
Substantial Non-Taxable Income	<p>The borrower has substantial non-taxable income.</p> <p><i>Note:</i> This applies if no adjustment was previously made when computing ratios.</p>
Potential for Increased Earnings	<p>The borrower has a potential for increased earnings, as indicated by job training or education in his/her profession.</p>
Primary Wage-Earner Relocation	<p>The home is being purchased because the primary wage-earner is relocating, and the secondary wage-earner</p> <ul style="list-style-type: none"> <li>• has an established employment history</li> <li>• is expected to return to work, and</li> <li>• has reasonable prospects for securing employment in a similar occupation in the new area.</li> </ul> <p><i>Note:</i> The underwriter must document the availability of the potential employment.</p>

## Chapter 5. Borrower Funds to Close

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## Section A. Settlement Requirements

### Overview

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**In This Section** This section contains the topics listed in the table below.

<b>Topic</b>	<b>Topic Name</b>	<b>See Page</b>
1	General Information on Settlement Requirements	5-A-2
2	Settlement Requirements Needed to Close	5-A-4

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## 1. General Information on Settlement Requirements

---

**Introduction** This topic contains general information on settlement requirements, including

- lender responsibility for estimating settlement requirements
  - disclosure of origination charges on the GFE, and
  - determining the amount needed for closing.
- 

**Change Date** February 22, 2010

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**4155.1 5.A.1.a  
Lender  
Responsibility  
for Estimating  
Settlement  
Requirements**

For each transaction, the lender must provide a [Good Faith Estimate](#) (GFE) and [HUD-1](#) Settlement Statement, consistent with the Real Estate Settlement Procedures Act (RESPA) to determine the cash requirements to close the mortgage transaction.

In addition to the minimum down payment described in [HUD 4155.1 2.A.2.c](#), additional borrower expenses must be included in the total amount of cash that the borrower must provide at mortgage settlement. Such additional expenses include, but are not limited to

- closing costs, such as those customary and reasonable costs necessary to close the mortgage loan
- prepaid items
- discount points
- non-realty or personal property
- up-front mortgage insurance premium (UFMIP) amounts
- repairs and improvements
- real estate broker fees
- mortgage broker fees
- premium pricing on the Federal Housing Administration (FHA) insured mortgages, and
- yield spread premiums.

**References** For more information on

- closing-related expenses, see [HUD 4155.1 5.A.2](#), and
  - RESPA rules, see <http://www.hud.gov/respa>.
- 

*Continued on next page*

## 1. General Information on Settlement Requirements, Continued

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### 4155.1 5.A.1.b Disclosure Of Origination Charges on the Good Faith Estimate

Lenders must include the sum of *all* fees and charges from origination-related charges in Box 1 on page 2 of the [Good Faith Estimate](#) (GFE). The figure in Box 1

- represents all compensation to the lender and/or broker for originating the loan, and
- will most often *exceed* the specific origination fee caps set for government programs.

Although the GFE requires that lenders provide an aggregated cost for origination services, if a government program or state law requires that lenders provide more detailed information to specific distinct origination fees and charges, lenders may itemize these charges in the empty 800 lines of the [HUD-1](#) Settlement Statement, to the left of the column.

**Reference:** For information on charges, fees, and discounts, see [24 CFR 203.27](#).

---

### 4155.1 5.A.1.c Determining the Amount Needed for Closing

The amount of cash needed by the borrower for closing a loan eligible for FHA mortgage insurance is the *difference* between

- the total cost to acquire the property, including the expenses listed in [HUD 4155.1 5.A.1.a](#), and
  - the amount of the FHA-insured mortgage, excluding any UFMIP.
-

## 2. Settlement Requirements Needed to Close

---

**Introduction** This topic contains information on closing cost settlement requirements used for closing a mortgage transaction, including

- origination fee, unallowable, and other closing costs
  - types of prepaid items, including per diem interest
  - discount points
  - non-realty (chattel) or personal property
  - UFMIP amounts
  - repairs and improvements
  - real estate broker fees
  - mortgage broker fees
  - premium pricing on FHA-insured mortgages
  - yield spread premiums, and
  - seller credits.
- 

**Change Date** February 22, 2010

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*Continued on next page*

## 2. Settlement Requirements Needed to Close, Continued

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**4155.1 5.A.2.a**  
**Origination**  
**Fee,**  
**Unallowable,**  
**and Other**  
**Closing Costs**

Lenders may charge and collect from borrowers those customary and reasonable costs necessary to close the mortgage loan.

Borrowers may not pay a tax service fee.

FHA no longer limits the origination fee to one percent of the mortgage amount for its standard mortgage insurance programs. However, both Home Equity Conversion Mortgage (HECM) and Section 203(k) Rehabilitation Mortgage Insurance programs retain their statutory origination fee caps.

Lenders may charge and collect

- a supplemental origination fee on Section 203(k) rehabilitation mortgages, or
- *two percent* on FHA's Home Equity Conversion Mortgages (HECMs).

**References:** For more information on

- collecting customary and reasonable fees, see [HUD 4155.2 6.A.3.a](#), and
- the supplemental origination fee for 203(k) mortgages, see [HUD 4155.2 1.C.5.f](#)
- the two percent HECM origination fee, see [HUD 4235.1](#), *Home Equity Conversion Mortgages*.

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*Continued on next page*

## 2. Settlement Requirements Needed to Close, Continued

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**4155.1 5.A.2.b**      Prepaid items are collected at closing to cover  
**Types of**  
**Prepaid Items**  
**(Including Per**  
**Diem Interest)**

- accrued and unaccrued hazard insurance
- mortgage insurance premiums
- taxes
- per diem interest, and
- other similar fees and charges.

***Per Diem Interest***

The lender must use a minimum of 15 days of per diem interest when estimating prepaid items. To reduce the burden on borrowers whose loans were scheduled to close at the end of the month, but did not due to unforeseen circumstances, lenders and borrowers may agree to credit the per diem interest to the borrower and have the mortgage payments begin the first of the succeeding month.

---

**4155.1 5.A.2.c**      Discount points that are being paid by the borrower  
**Discount Points**

- become part of the total cash required to close, and
  - are *not* eligible for meeting the minimum down payment requirement.
- 

**4155.1 5.A.2.d**      Non realty (chattel) or personal property items that the borrower agrees to pay  
**Non Realty or**  
**Personal**  
**Property**              for separately, including the amount subtracted from the sales price when determining the maximum mortgage, are included in the total cash requirements for the loan.

---

**4155.1 5.A.2.e**      Any UFMIP amounts paid in cash are added to the total cash settlement  
**UFMIP**  
**Amounts**              requirements. The UFMIP must be

- entirely financed into the mortgage, except any amount less than \$1.00, or
  - paid entirely in cash and all mortgage amounts rounded down to a multiple of \$1.00.
- 

**4155.1 5.A.2.f**      Repairs and improvements, or any portion, paid by the borrower that cannot  
**Repairs and**  
**Improvements**      be financed into the mortgage are part of the borrower's total cash requirements.

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*Continued on next page*

## 2. Settlement Requirements Needed to Close, Continued

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### 4155.1 5.A.2.g Real Estate Broker Fees

If a borrower is represented by a real estate buyer-broker and must pay any fee directly to the broker, that expense must

- be included in the total of the borrower's settlement requirements, and
- appear on the [HUD-1](#) Settlement Statement.

If the seller pays the buyer-broker fee as part of the sales commission, it is not considered an inducement to purchase, or part of the 6 percent seller contributions limitation, as long as the seller is paying only the normal sales commission for that market. Any additional seller-paid commission to the buyer-broker is considered an inducement to purchase.

To determine if the seller paid a buyer-broker fee in addition to the normal sales commission for the market, the lender must obtain a copy of the original listing agreement, and compare it with the [HUD-1](#) Settlement Statement.

**References:** For more information on

- seller contributions, see [HUD 4155.1 2.A.3](#), and
  - inducements to purchase, see [HUD 4155.1 2.A.4](#).
- 

### 4155.1 5.A.2.h Mortgage Broker Fees

Include mortgage broker fees in the total of the borrower's cash settlement requirements and on the [HUD-1](#) Settlement Statement, if he/she pays a fee directly to a mortgage broker.

This requirement applies only in instances in which the borrower independently engages a mortgage broker exclusively to seek financing, and pays the broker directly. The mortgage broker cannot be the same as the originating lender.

**Note:** The payment may *not* come from the lending institution.

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*Continued on next page*

## 2. Settlement Requirements Needed to Close, Continued

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### 4155.1 5.A.2.i Premium Pricing on FHA-Insured Mortgages

Lenders may pay the borrower's closing costs, and/or prepaid items by "premium pricing." Closing costs paid in this manner do not need to be included as part of the 6 percent seller contribution limit. The funds derived from a premium priced mortgage

- may *never* be used to pay any portion of the borrower's down payment
- *must* be disclosed on the Good Faith Estimate (GFE) and the [HUD-1 Settlement Statement](#)
- *must* be used to reduce the principal balance if the premium pricing agreement establishes a specific dollar amount for closing cost and prepaid expenses, with any remaining funds in excess of actual costs reverting to the borrower, and
- may not be used for payment of
  - debts
  - collection accounts
  - escrow shortages or missed mortgage payments, or
  - judgments.

**Note:** The GFE and [HUD-1 Settlement Statement](#) must contain an itemized statement indicating which items are being paid on the borrower's behalf. It is unacceptable to disclose only a lump sum.

**Reference:** For more information on seller contributions, see [HUD 4155.1 2.A.3](#).

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### 4155.1 5.A.2.j Yield Spread Premium

Yield spread premiums (YSP) are not part of the cash required to close, but *must* be disclosed to borrowers on the GFE and [HUD-1 Settlement Statement](#), in accordance with the Real Estate Settlement Procedures Act (RESPA).

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*Continued on next page*

## 2. Settlement Requirements Needed to Close, Continued

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### 4155.1 5.A.2.k Seller Credits on the HUD-1 Settlement Statement

The regulations do not require or permit the presentation or disclosure of seller-paid credits on the [Good Faith Estimate](#) (GFE). On the [HUD-1 Settlement Statement](#), the charge will be displayed in the borrower's column on the HUD-1 and a credit to offset charges will be listed in Section J, Summary of Borrower's Transaction on lines 204-209 with a reduction to the seller's proceeds in Section K, Summary of Seller's Transaction on lines 506-509. When the seller contributes to more than one expense, the seller credit shown on the HUD-1 must reflect the lump sum payment.

*Reference:* For more information on RESPA rules, see <http://www.hud.gov/respa>.

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## Section B. Acceptable Sources of Borrower Funds

### Overview

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**In This Section** This section contains the topics listed in the table below.

<b>Topic</b>	<b>Topic Name</b>	<b>See Page</b>
1	General Information on Acceptable Sources of Borrower Funds	5-B-2
2	Cash and Savings/Checking Accounts as Acceptable Sources of Funds	5-B-4
3	Investments as an Acceptable Source of Funds	5-B-8
4	Gifts as an Acceptable Source of Funds	5-B-10
5	Gift Fund Required Documentation	5-B-15
6	Property Related Acceptable Sources of Funds	5-B-18
7	Loans and Grants as Acceptable Sources of Funds	5-B-24
8	Employer Programs as Acceptable Sources of Funds	5-B-26

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# 1. General Information on Acceptable Sources of Borrower Funds

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**Introduction** This topic contains general information on acceptable sources of borrower funds that can be used for mortgage closing, including

- closing cost and minimum cash investment requirements, and
- types of acceptable sources of borrower funds.

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**Change Date** October 26, 2009

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**4155.1 5.B.1.a Closing Cost and Minimum Cash** Under most FHA programs, the borrower is required to make a minimum down payment into the transaction of at least 3.5 percent of the *lesser* of the appraised value of the property or the sales price.

**Investment Requirements** Additionally, the borrower must have sufficient funds to cover borrower-paid closing costs and fees at the time of settlement. Such funds used to cover the required minimum down payment, as well as closing costs and fees, must come from acceptable sources and must be verified and properly documented.

**References:** For more information on

- the required minimum down payment, see [HUD 4155.1 2.A.2.c](#)
- settlement requirements, see [HUD 4155.1 5.A](#), and
- acceptable sources of borrower funds, see [HUD 4155.1 5.B.1.b](#).

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*Continued on next page*

# 1. General Information on Acceptable Sources of Borrower Funds, Continued

**4155.1 5.B.1.b**  
**Acceptable**  
**Sources of**  
**Borrower**  
**Funds**

The table below lists the acceptable sources of borrower funds and a reference for locating additional information on the various types of funds.

Acceptable Source of Funds	Reference
<ul style="list-style-type: none"> <li>• Earnest money deposit</li> <li>• Savings and checking accounts</li> <li>• Cash saved at home</li> <li>• Cash Accumulated with private savings club</li> </ul>	See <a href="#">HUD 4155.1 5.B.2</a>
<ul style="list-style-type: none"> <li>• Savings bonds</li> <li>• IRAs</li> <li>• 401(k) and Keogh accounts</li> <li>• Stocks and Bonds</li> <li>• Thrift Savings Plans</li> </ul>	See <a href="#">HUD 4155.1 5.B.3</a>
Gift Funds	See <a href="#">HUD 4155.1 5.B.4</a>
<ul style="list-style-type: none"> <li>• Sales proceeds</li> <li>• Sale of personal property</li> <li>• Commissions from sale</li> <li>• Trade Equity</li> <li>• Rent Credit</li> <li>• Sweat Equity</li> </ul>	See <a href="#">HUD 4155.1 5.B.6</a>
<ul style="list-style-type: none"> <li>• Collateralized loans</li> <li>• Disaster relief grants and loans</li> </ul>	See <a href="#">HUD 4155.1 5.B.7</a>
<ul style="list-style-type: none"> <li>• Employer’s Guarantee Plans</li> <li>• Employer Assistance Plans</li> </ul>	See <a href="#">HUD 4155.1 5.B.8</a>
<ul style="list-style-type: none"> <li>• First-Time Homebuyers’ Tax Credits (<i>temporary program expiring with closings no later than 12/01/2009</i>)</li> </ul>	See <a href="#">ML 09-15</a>

## 2. Cash and Savings/Checking Accounts as Acceptable Sources of Funds

---

**Introduction** This topic contains information on cash and savings/checking account funds as acceptable sources of borrower funds, including

- earnest money deposits
  - savings and checking accounts
  - cash saved at home
  - verifying cash saved at home
  - cash accumulated with private savings clubs, and
  - requirements for private savings clubs.
- 

**Change Date** May 10, 2009

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**4155.1 5.B.2.a Earnest Money Deposit** The lender must verify with documentation, the deposit amount and source of funds, if the amount of the earnest money deposit

- exceeds 2 percent of the sales price, or
- appears excessive based on the borrower's history of accumulating savings.

Satisfactory documentation includes

- a copy of the borrower's cancelled check
- certification from the deposit-holder acknowledging receipt of funds, or
- separate evidence of the source of funds.

Separate evidence includes a verification of deposit (VOD) or bank statement showing that the average balance was sufficient to cover the amount of the earnest money deposit, at the time of the deposit.

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*Continued on next page*

## 2. Cash and Savings/Checking Accounts as Acceptable Sources of Funds, Continued

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### 4155.1 5.B.2.b Savings and Checking Accounts

A VOD, along with the most recent bank statement, may be used to verify savings and checking accounts.

If there is a large increase in an account, or the account was recently opened, the lender must obtain from the borrower a credible explanation of the source of the funds.

TOTAL Scorecard Accept and Refer recommendations require that the lender

- obtain an explanation and documentation for recent large deposits in excess of 2 percent of the property sales price, and
- verify that any recent debts were not incurred to obtain part, or all, of the required cash investment on the property being purchased.

**Reference:** For additional information on TOTAL Scorecard, see [HUD 4155.1 6.A.1](#).

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### 4155.1 5.B.2.c Cash Saved at Home

Borrowers who have saved cash at home, and are able to adequately demonstrate the ability to do so, are permitted to have this money included as an acceptable source of funds to close the mortgage.

To include cash saved at home when assessing the borrower's cash assets, the

- money must be verified, whether deposited in a financial institution, or held by the escrow/title company, and
- borrower must provide satisfactory evidence of the ability to accumulate such savings.

**Reference:** For information on verifying cash saved at home, see [HUD 4155.1 5.B.2.d](#).

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*Continued on next page*

## 2. Cash and Savings/Checking Accounts as Acceptable Sources of Funds, Continued

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### 4155.1 5.B.2.d Verifying Cash Saved at Home

Verifying the cash saved at home assets requires the borrower to explain in writing

- how the funds were accumulated, and
- the amount of time it took to accumulate the funds.

The lender must determine the reasonableness of the accumulation, based on the

- borrower's income stream
- time period during which the funds were saved
- borrower's spending habits, and
- documented expenses and the borrower's history of using financial institutions.

**Note:** Borrowers with checking and/or savings accounts are less likely to save money at home, than individuals with no history of such accounts.

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### 4155.1 5.B.2.e Cash Accumulated With Private Savings Clubs

Some borrowers may choose to use non-traditional methods to save money by making deposits into private savings clubs. Often, these private savings clubs pool resources for use among the membership.

If a borrower claims that the cash to close an FHA-insured mortgage is from savings held with a private savings club, he/she *must* be able to adequately document the accumulation of the funds with the club.

**Reference:** For information on the requirements for private savings clubs, see [HUD 4155.1 5.B.2.f](#).

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## 2. Cash and Savings/Checking Accounts as Acceptable Sources of Funds, Continued

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### 4155.1 5.B.2.f Requirements for Private Savings Clubs

While private savings clubs are not supervised banking institutions, the clubs must, at a minimum, have

- account ledgers
- receipts from the club
- verification from the club treasurer, and
- identification of the club.

The lender must reverify the information, and the underwriter must be able to determine that

- it was reasonable for the borrower to have saved the money claimed, and
  - there is no evidence that the funds were borrowed with an expectation of repayment.
-

### 3. Investments as an Acceptable Source of Funds

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**Introduction** This topic includes information on investments as an acceptable source of funds, including

- IRAs, thrift savings plans, 401(k)s and Keogh accounts
  - stocks and bonds, and
  - savings bonds.
- 

**Change Date** May 10, 2009

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**4155.1 5.B.3.a IRAs, Thrift Savings Plans, and 401(k)s and Keogh Accounts** Up to 60 percent of the value of assets such as IRAs, thrift savings plans, 401(k) and Keogh accounts may be included in the underwriting analysis, unless the borrower provides conclusive evidence that a higher percentage may be withdrawn, after subtracting any

- Federal income tax, and
- withdrawal penalties.

**Notes:**

- Redemption evidence is required.
- The portion of the assets not used to meet closing requirements, after adjusting for taxes and penalties, may be counted as reserves.

***TOTAL Scorecard Accept/Reject Recommendation***

TOTAL Scorecard Accept or Reject recommendations require the lender to document the terms and conditions for withdrawal and/or borrowing, and that the borrower is eligible for these withdrawals.

Use only 60 percent of the amount in the account, unless the borrower presents documentation supporting a greater amount, after subtracting any taxes or penalties for early withdrawal.

**Note:** Liquidation evidence is not required.

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### 3. Investments as an Acceptable Source of Funds, Continued

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**4155.1 5.B.3.b  
Stocks and  
Bonds**

The monthly or quarterly statement provided by the stockbroker or financial institution managing the portfolio may be used to verify the value of stocks and bonds.

***Total Scorecard Accept Recommendation***

Evidence of liquidation is not required for the TOTAL Scorecard Accept recommendation.

**Note:** The actual receipt of funds must be verified and documented.

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**4155.1 5.B.3.c  
Savings Bonds**

Government issued bonds are counted at the original purchase price, unless eligibility for redemption and the redemption value are confirmed.

**Note:** The actual receipt of funds at redemption must be verified.

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## 4. Gifts as an Acceptable Source of Funds

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**Introduction** This topic contains information on using gift funds as acceptable sources of borrower funds, including

- a description of gift funds
  - who can provide a gift
  - who cannot provide a gift
  - lender responsibility for verifying the acceptability of gift fund sources
  - requirements regarding donor source of funds
  - equity credit
  - payment of consumer debt must result in a sales price reduction
  - using down payment assistance programs
  - gifts from charitable organizations when the organization loses or gives up its Federal tax-exempt status, and
  - lender responsibility for ensuring that entities are charitable organizations.
- 

**Change Date** May 10, 2009

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**4155.1 5.B.4.a Description of Gift Funds** In order for funds to be considered a gift there must be no expected or implied repayment of the funds to the donor by the borrower.

*Note:* The portion of the gift not used to meet closing requirements may be counted as reserves.

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**4155.1 5.B.4.b Who Can Provide a Gift**

An outright gift of the cash investment is acceptable if the donor is

- the borrower's relative
  - the borrower's employer or labor union
  - a charitable organization
  - a governmental agency or public entity that has a program providing home ownership assistance to
    - low- and moderate-income families
    - first-time homebuyers, or
    - a close friend with a clearly defined and documented interest in the borrower.
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## 4. Gifts as an Acceptable Source of Funds, Continued

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### 4155.1 5.B.4.c Who Cannot Provide a Gift

The gift donor may *not* be a person or entity with an interest in the sale of the property, such as

- the seller
- the real estate agent or broker
- the builder, or
- an associated entity.

Gifts from these sources are considered inducements to purchase, and *must* be subtracted from the sales price.

**Note:** This applies to properties where the seller is a government agency selling foreclosed properties, such as the US Department of Veterans Affairs (VA) or Rural Housing Services.

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### 4155.1 5.B.4.d Lender Responsibility for Verifying the Acceptability of Gift Fund Sources

Regardless of when gift funds are made available to a borrower, the lender *must* be able to determine that the gift funds were *not* provided by an unacceptable source, and were the donor's own funds.

When the transfer occurs at closing, the lender is responsible for verifying that the closing agent received the funds from the donor for the amount of the gift, and that the funds were from an acceptable source.

**Reference:** For the requirements regarding the documentation of this transfer at closing, see [HUD 4155.1 5.B.5.b](#).

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### 4155.1 5.B.4.e Requirements Regarding Donor Source of Funds

As a general rule, FHA is not concerned with how a donor obtains gift funds, provided that the funds are not derived in any manner from a party to the sales transaction.

Donors may borrow gift funds from any other acceptable source, provided the mortgage borrowers are not obligors to any note to secure money borrowed to give the gift.

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## 4. Gifts as an Acceptable Source of Funds, Continued

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### 4155.1 5.B.4.f Equity Credit

Only family members may provide equity credit as a gift on property being sold to other family members.

The restrictions on gifts previously discussed in this topic and the restriction on equity credit may be waived by the jurisdictional Homeownership Center (HOC), provided that the seller is contributing to or operating an acceptable affordable housing program.

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### 4155.1 5.B.4.g Payment of Consumer Debt Must Result in Sales Price Reduction

FHA regards the payment of consumer debt by third parties to be an inducement to purchase.

While FHA permits sellers and other parties to make contributions of up to 6 percent of the sales price of a property toward a buyer's actual closing costs and financing concessions, this requirement applies *exclusively* to the mortgage financing provision.

When someone other than a family member has paid off debts or other expenses on behalf of the borrower

- the funds must be treated as an inducement to purchase, and
- there *must* be a dollar for dollar reduction to the sales price when calculating the maximum insurable mortgage.

**Note:** The dollar for dollar reduction to the sales price also applies to gift funds not meeting the requirement

- that the gift be for down payment assistance, and
  - that it be provided by an acceptable source.
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## 4. Gifts as an Acceptable Source of Funds, Continued

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### 4155.1 5.B.4.h Using Down Payment Assistance Programs

FHA does not “approve” down payment assistance programs providing gifts administered by charitable organizations, such as nonprofits. FHA also does *not* allow nonprofit entities to provide gifts to pay off

- installment loans
- credit cards
- collections
- judgments, and
- similar debts.

Lenders *must* ensure that a gift provided by a charitable organization meets the appropriate FHA requirements, and that the transfer of funds is properly documented.

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### 4155.1 5.B.4.i Gifts from Charitable Organizations That Lose or Give Up Their Federal Tax- Exempt Status

If a charitable organization makes a gift that is to be used for all, or part, of a borrower’s down payment, and the organization providing the gift loses or gives up its Federal tax exempt status, FHA will recognize the gift as an acceptable source of the down payment provided that

- the gift is made to the borrower
  - the gift is properly documented, and
  - the borrower has entered into a contract of sale (including any amendments to purchase price) *on, or before*, the date the IRS officially announces that the charitable organization’s tax exempt status is terminated.
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## 4. Gifts as an Acceptable Source of Funds, Continued

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### 4155.1 5.B.4.j Lender Responsibility for Ensuring That an Entity Is a Charitable Organization

The lender is responsible for ensuring that an entity is a charitable organization as defined by Section 501(a) of the Internal Revenue Code (IRC) of 1986 pursuant to Section 501(c) (3) of the IRC.

One resource available to lenders for obtaining this information is the Internal Revenue Service (IRS) Publication 78, *Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986*, which contains a list of organizations eligible to receive tax-deductible charitable contributions.

The IRS has an online version of this list that can help lenders and others conduct a search of these organizations. The online version can be found at <http://apps.irs.gov/app/pub78> using the following instructions to obtain the latest update:

- enter search data and click “Search”
- click “Search for Charities” under the “Charities & Non-Profits Topics” heading on the left-hand side of the page
- click “Recent Revocations and Deletions from Cumulative List” under the “Additional Information” heading in the middle of the page, and
- click the name of the organization if the name appears on the list displayed.

In addition, FHA has developed a web page that provides a listing of down payment assistance providers whose nonprofit status has been revoked. This page can be found at <http://www.hud.gov/offices/hsg/sfh/np/irstatus.cfm>.

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## 5. Gift Fund Required Documentation

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**Introduction** This topic contains information on the required documentation for gift funds, including

- the requirement for a gift letter, and
- documenting the transfer of gift funds.

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**Change Date** May 10, 2009

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**4155.1 5.B.5.a  
Gift Letter  
Requirement** A lender must document any borrower gift funds through a gift letter, signed by the donor and borrower. The gift letter must

- show the donor's name, address, telephone number
- specify the dollar amount of the gift, and
- state
  - the nature of the donor's relationship to the borrower, and
  - that no repayment is required.

***TOTAL Scorecard Accept/Refer Recommendation***

For the TOTAL Scorecard Accept and Refer recommendation, the borrower must list the following:

- name, address, telephone number
- relationship to the home buyer, and
- the dollar amount of the gift on the loan application or in a gift letter for each cash gift received.

If sufficient funds required for closing are not already verified in the borrower's accounts, document the transfer of the gift funds to the borrower's accounts, in accordance with the instructions described in [HUD 4155.1 5.B.5.b](#).

**Reference:** For additional information on the TOTAL Scorecard, see [HUD 4155.1 6.A.1](#).

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## 5. Gift Fund Required Documentation, Continued

**4155.1 5.B.5.b Documenting the Transfer of Gift Funds** The lender must document the transfer of the gift funds from the donor to the borrower.

The table below describes the requirements for the transfer of gift funds.

<b>If the gift funds ...</b>	<b>Then ...</b>
are in the borrower's account	obtain <ul style="list-style-type: none"> <li>• a copy of the withdrawal document showing that the withdrawal is from the donor's account, and</li> <li>• the borrower's deposit slip and bank statement showing the deposit.</li> </ul>
<ul style="list-style-type: none"> <li>• are to be provided at closing, and</li> <li>• are in the form of a certified check from the donor's account</li> </ul>	obtain a <ul style="list-style-type: none"> <li>• bank statement showing the withdrawal from the donor's account, and</li> <li>• copy of the certified check.</li> </ul>
<ul style="list-style-type: none"> <li>• are to be provided at closing, and</li> <li>• are in the form of a cashier's check, money order, official check, or other type of bank check</li> </ul>	have the donor provide a withdrawal document or cancelled check for the amount of the gift, showing that the funds came from the donor's personal account.
<ul style="list-style-type: none"> <li>• are to be provided at closing, and</li> <li>• are in the form of an electronic wire transfer to the closing agent</li> </ul>	have the donor provide documentation of the wire transfer. <p><b>Note:</b> The lender must obtain and keep the documentation of the wire transfer in its mortgage loan application binder. While the document does not need to be provided in the insurance binder, it must be available for inspection by FHA's Quality Assurance Division (QAD) when that office conducts its onsite review of lenders.</p>

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## 5. Gift Fund Required Documentation, Continued

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### Documenting the Transfer of Gift Funds (continued)

If the gift funds ...	Then ...
<ul style="list-style-type: none"> <li>• are being borrowed by the donor, and</li> <li>• documentation from the bank or other savings account is <i>not</i> available</li> </ul>	<p>have the donor provide written evidence that the funds were borrowed from an acceptable source, not from a party to the transaction, including the lender.</p> <p><b><i>IMPORTANT:</i></b> <i>Cash on hand</i> is not an acceptable source of donor gift funds.</p>

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## 6. Property Related Acceptable Sources of Funds

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**Introduction** This topic contains information on savings, investment, and agency program funds as acceptable sources of borrower funds, including

- types of personal property
  - sale of personal property documentation requirement
  - sales proceeds
  - commission from sale
  - trade equity
  - rent credit
  - sweat equity considered a cash equivalent
  - additional sweat equity requirements, and
  - trade-ins of manufactured homes.
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**Change Date** October 26, 2009

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**4155.1 5.B.6.a  
Types of  
Personal  
Property** In order to obtain cash for closing, a borrower may sell various personal property items. The types of personal property items that a borrower can sell include

- cars
  - recreational vehicles
  - stamps
  - coins, and
  - baseball card collections.
- 

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## 6. Property Related Acceptable Sources of Funds, Continued

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**4155.1 5.B.6.b Sale of Personal Property Documentation Requirement** If a borrower plans to sell personal property items to obtain funds for closing, he/she must provide

- satisfactory estimate of the worth of the personal property items, and
- evidence that the items were sold.

The estimated worth of the items being sold may be in the form of

- published value estimates issued by organizations, such as
  - automobile dealers, or
  - philatelic or numismatic associations, or
- a separate written appraisal by a qualified appraiser with no financial interest in the loan transaction.

Only the *lesser* of the estimated value or actual sales prices are considered as assets to close.

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**4155.1 5.B.6.c Net Sales Proceeds From a Property** The net proceeds from an arms-length sale of a currently owned property may be used for the cash investment on a new house. The borrower must provide a fully executed [HUD-1](#) Settlement Statement as satisfactory evidence of the accrued cash sales proceeds.

If the property has not sold by the time of underwriting, condition loan approval by verifying the actual proceeds received by the borrower. The lender must document the

- actual sale, and
- sufficiency of the net proceeds required for settlement.

**Note:** If the property has not sold by the time of the subject settlement, the existing mortgage must be included as a liability for qualifying purposes.

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## 6. Property Related Acceptable Sources of Funds, Continued

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### 4155.1 5.B.6.d Commission From the Sale of the Property

If the borrower is a licensed real estate agent entitled to a real estate commission from the sale of the property being purchased, then he/she may use that amount for the cash investment, with no adjustment to the maximum mortgage required.

A family member entitled to the commission may also provide gift funds to the borrower.

**Reference:** For information on gift fund requirements, see [HUD 4155.1 5.B.4](#).

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### 4155.1 5.B.6.e Trade Equity

The borrower may agree to trade his/her real property to the seller as part of the cash investment. The amount of the borrower's equity contribution is determined by

- using the *lesser* of the property's appraised value or sales price, and
- subtracting all liens against the property being traded, along with any real estate commission.

In order to establish the property value, the borrower must provide

- a residential appraisal no more than six months old to determine the property's value, and
- evidence of ownership.

**Note:** If the property being traded has an FHA-insured mortgage, assumption processing requirements and restrictions apply.

**Reference:** For more information on assumptions, see [HUD 4155.1 7](#).

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## 6. Property Related Acceptable Sources of Funds, Continued

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### 4155.1 5.B.6.f Rent Credit

The cumulative amount of rental payments that exceed the appraiser's estimate of fair market rent may be considered accumulation of the borrower's cash investment.

The following *must* be included in the endorsement package:

- rent with option to purchase agreement, and
- appraiser's estimate of market rent.

Conversely, treat the rent as an inducement to purchase with an appropriate reduction to the mortgage, *if* the sales agreement reveals that the borrower

- has been living in the property rent-free, or
- has an agreement to occupy the property as a rental considerably below fair market value in anticipation of eventual purchase.

**Exception:** An exception may be granted when a builder

- fails to deliver a property at an agreed to time, and
  - permits the borrower to occupy an existing or other unit for less than market rent until construction is complete.
- 

### 4155.1 5.B.6.g Sweat Equity Considered a Cash Equivalent

Labor performed, or materials furnished by the borrower before closing on the property being purchased (known as "sweat equity"), may be considered the equivalent of a cash investment, to the amount of the estimated cost of the work or materials.

**Note:** Sweat equity may also be "gifted," subject to

- the additional requirements in [HUD 4155.1 5.B.6.h](#), and
  - the gift fund requirements described in [HUD 4155.1 5.B.4](#).
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## 6. Property Related Acceptable Sources of Funds, Continued

### 4155.1 5.B.6.h Additional Sweat Equity Requirements

The table below describes additional requirements for applying sweat equity as a cash equivalent and as an acceptable source of borrower funds.

<b>Sweat Equity Category</b>	<b>Requirement</b>
Existing Construction	<p>Only repairs or improvements listed on the appraisal are eligible for sweat equity.</p> <p>Any work completed or materials provided before the appraisal are <i>not</i> eligible.</p>
Proposed Construction	The sales contract must indicate the tasks to be performed by the borrower during construction.
Borrower's Labor	<p>The borrower must demonstrate his/her ability to complete the work in a satisfactory manner.</p> <p>The lender must document the contributory value of the labor either through</p> <ul style="list-style-type: none"> <li>• the appraiser's estimate, or</li> <li>• a cost-estimating service.</li> </ul>
Delayed Work	<p>The following <i>cannot</i> be included as sweat equity:</p> <ul style="list-style-type: none"> <li>• delayed work (on-site escrow)</li> <li>• clean up</li> <li>• debris removal, and</li> <li>• other general maintenance.</li> </ul>

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## 6. Property Related Acceptable Sources of Funds, Continued

### Additional Sweat Equity Requirements (continued)

Sweat Equity Category	Requirement
Cash Back	Cash back to the borrower in sweat equity transactions is <i>not</i> permitted.
Sweat Equity on Property Not Being Purchased	<p>Sweat equity is <i>not</i> acceptable on property other than the property being purchased.</p> <p>Compensation for work performed on other properties must be</p> <ul style="list-style-type: none"> <li>• in cash, and</li> <li>• properly documented.</li> </ul>
Source of Funds Evidence	<p>Evidence of the following must be provided if the borrower furnishes funds and materials:</p> <ul style="list-style-type: none"> <li>• source of the funds, and</li> <li>• market value of the materials.</li> </ul>

**4155.1 5.B.6.i  
Trade-In of  
Manufactured  
Home**

An acceptable source of borrower cash investment commonly associated with manufactured homes is the sale or trade-in of another manufactured home that is not considered real estate. Trade-ins for cash funds are considered a seller inducement and are not permitted.

## 7. Loans and Grants as Acceptable Sources of Funds

---

**Introduction** This topic contains information on loans and grants as acceptable sources of funds, including

- collateralized loans
  - who can provide collateralized loans, and
  - disaster relief grants and loans.
- 

**Change Date** May 10, 2009

---

**4155.1 5.B.7.a  
Collateralized  
Loans**

Funds may be borrowed for the total required investment, as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property. These assets may include stocks, bonds, and real estate other than the property being purchased.

Certain types of loans secured against deposited funds, where repayment may be obtained through extinguishing the asset, do not require consideration of a repayment for qualifying purposes. The asset securing the loan may *not* be included as assets to close, or otherwise considered as available to the borrower. The types of deposited funds that can secure the loan include

- signature loans
  - the cash value of life insurance policies, or
  - loans secured by 401(k) accounts.
- 

*Continued on next page*

## 7. Loans and Grants as Acceptable Sources of Funds, Continued

---

**4155.1 5.B.7.b  
Who Can  
Provide  
Collateralized  
Loans**

An independent third party must provide the borrowed funds for collateralized loans.

The seller, real estate agent or broker, lender, or other interested party *may not* provide such funds.

Unacceptable borrowed funds include

- unsecured signature loans
- cash advances on credit cards
- borrowing against household goods and furniture, and
- other similar unsecured financing.

---

**4155.1 5.B.7.c  
Disaster Relief  
Grants and  
Loans**

Grants or loans from state and Federal agencies, such as the Federal Emergency Management Agency (FEMA), that provide immediate housing assistance to individuals displaced due to a natural disaster, may be used for the borrower's cash investment.

Secured or unsecured disaster relief loans administered by the Small Business Association (SBA) may also be used. If the SBA loan will be secured against the property being purchased, it must be clearly subordinate to the FHA-insured mortgage.

**Note:** Any monthly payment arising from this type of loan *must* be included in the qualifying ratios.

---

## 8. Employer Programs as Acceptable Sources of Funds

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**Introduction** This topic contains information on employer programs that are acceptable sources of borrower funds, including

- employer's guarantee plans, and
  - employer assistance plans.
- 

**Change Date** May 10, 2009

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**4155.1 5.B.8.a  
Employer's  
Guarantee  
Plans** If the borrower's employer guarantees to purchase the borrower's previous residence as a result of relocation, he/she must submit evidence of the agreement.

The net proceeds must also be guaranteed.

---

**4155.1 5.B.8.b  
Employer  
Assistance  
Plans** If the employer pays the following to attract or retain valuable employees, the payment is considered employee compensation:

- employee's closing costs
- mortgage insurance premiums, or
- any portion of the cash investment.

An adjustment to the maximum mortgage amount is *not* required.

If the employer provides this benefit after loan settlement, the borrower must provide evidence of sufficient cash for closing.

**Note:** A salary advance *cannot* be considered as assets to close, since it represents an unsecured loan.

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## Section C. Borrower Secondary Financing

### Overview

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**In This Section** This section contains the topics listed in the table below.

Topic	Topic Name	See Page
1	General Information on Secondary Financing	5-C-2
2	Permissible Borrower Secondary Financing	5-C-3
3	Government Agency Secondary Financing	5-C-5
4	Nonprofit Agency Secondary Financing	5-C-7
5	Organizations and Private Individuals Providing Secondary Financing	5-C-9
6	Family Member Secondary Financing	5-C-11
7	Secondary Financing for Borrowers 60 Years of Age and Older	5-C-15

---

## 1. General Information on Secondary Financing

---

**Introduction** This topic contains general information on secondary financing, including

- what is secondary financing
  - secondary financing documentation requirements, and
  - permissible secondary financing arrangements.
- 

**Change Date** May 10, 2009

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**4155.1 5.C.1.a**  
**What Is**  
**Secondary**  
**Financing?**

Any financing, other than an FHA-insured first mortgage, that creates a lien against the property is considered secondary financing. Such financing is *not* considered a gift, even if it is a “soft” or “silent” second or has other features forgiving the debt.

*Note:* A “soft” or “silent” second is secondary financing that has no monthly repayment provisions.

---

**4155.1 5.C.1.b**  
**Secondary**  
**Financing**  
**Documentation**  
**Requirements**

The lender must obtain from the provider of any secondary financing

- documentation showing the amount of funds provided to the borrower for each transaction, and
- copies of the loan instruments for the endorsement binder.

*Notes:*

- FHA reserves the right to reject any secondary financing
    - that does not serve the needs of the intended borrower, or
    - where the costs to participants outweighs the benefits derived by the borrower.
  - Costs incurred for participating in a down payment assistance secondary financing program may only be included in the amount of the second lien.
-

## 2. Permissible Borrower Secondary Financing

---

**Introduction** This topic contains information on permissible borrower secondary financing, including

- secondary financing from
    - government agencies
    - nonprofit organizations
    - private individuals or other organizations, and
    - family members, and
  - the FHA policy on borrowing when the borrower is 60 years of age and older.
- 

**Change Date** May 10, 2009

---

**4155.1 5.C.2.a  
Financing  
From  
Government  
Agencies**

FHA will insure a first mortgage loan on a property that has a second mortgage or lien by a Federal, State, or local government agency.

The monthly payments under the insured mortgage and second lien, plus housing expense and other recurring charges, cannot exceed the borrowers' ability to pay.

**Reference:** For more information on secondary financing by government agencies, see [HUD 4155.1 5.C.3](#).

---

**4155.1 5.C.2.b  
Financing  
From Nonprofit  
Organizations**

With advance approval, FHA will insure a first mortgage loan on a property that has a second mortgage held by an approved nonprofit agency.

The monthly payments under the insured mortgage and second lien, plus housing expense and other recurring charges, cannot exceed the borrowers' ability to pay.

**Reference:** For more information on secondary financing by nonprofit organizations, see [HUD 4155.1 5.C.4](#).

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*Continued on next page*

## 2. Permissible Borrower Secondary Financing, Continued

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### 4155.1 5.C.2.c Financing From Private Individuals or Other Organizations

With advance approval, FHA will insure a first mortgage loan on a property that has a second mortgage or lien held by an individual or company, provided that

- the secondary financing is disclosed at the time of application
- the required minimum cash investment is *not* financed
- the first and second mortgage together do *not* exceed FHA mortgage limits
- the borrower can afford the total amount of the payments
- any periodic payments are level and monthly
- there is no balloon payment during the first ten years, and
- there is no prepayment penalty.

**Reference:** For more information on secondary financing by private individuals or other organizations, see [HUD 4155.1 5.C.5.](#)

---

### 4155.1 5.C.2.d Financing From Family Members

FHA permits family member lending on a secured or unsecured basis, up to 100 percent of the borrower's required funds to close. This lending may include the down payment, closing costs, prepaid expenses, and discount points.

If the money lent by the family member is secured against the subject property, whether borrowed from an acceptable source or from the family member's own savings, only the family member provider(s) may be the note holder. FHA will *not* approve any form of securitization of the note that results in any entity *other* than the family member being the note holder, whether at loan settlement or at any time during the mortgage life cycle.

**Reference:** For more information on secondary financing by family members, see [HUD 4155.1 5.C.6.](#)

---

### 4155.1 5.C.2.e Borrowing Policy for Borrowers 60 Years of Age and Older

With advance approval, borrowers 60 years of age and older may borrow the required funds to close for purchasing a principal residence under certain circumstances.

**Reference:** For more information on secondary financing for borrowers 60 years of age and older, see [HUD 4155.1 5.C.7.](#)

---

### 3. Government Agency Secondary Financing

---

**Introduction** This topic contains information on using government agencies for secondary financing, including

- government agencies that can provide secondary financing
  - who can hold a secondary lien, and
  - policies for loans secured by secondary liens.
- 

**Change Date** May 10, 2009

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**4155.1 5.C.3.a  
Government  
Agencies That  
Can Provide  
Secondary  
Financing**

Federal, state, local government, and nonprofit agencies considered instrumentalities of government may provide secondary financing for the borrower's entire amount of required funds to close.

**Reference:** For information on acceptable government instrumentalities, see [HUD 4155.1 4.A.6.](#)

---

**4155.1 5.C.3.b  
Who Can Hold  
a Secondary  
Lien**

When secondary financing is provided by a government agency, the secondary lien must be made or held by the eligible government body or instrumentality. Government units *cannot* use agents including nonprofit or for-profit enterprises to make the second lien, regardless of the source of funds. They can, however, be used to service the subordinate lien if regularly scheduled payments are made by the borrower.

**Example:** Even if funds used for secondary financing funds are from an acceptable source, such as HUD HOME, a government unit, or an eligible nonprofit instrumentality, the subordinate lien *must* be in the name of the eligible entity, such as the

- state
  - county
  - city, or
  - eligible nonprofit instrumentality.
- 

*Continued on next page*

### 3. Government Agency Secondary Financing, Continued

---

**4155.1 5.C.3.c**  
**Policies for**  
**Loans Secured**  
**by Secondary**  
**Liens**

Listed below are the policies for loans secured by secondary liens.

***Financing Terms and Conditions***

- The FHA-insured first mortgage, when combined with any second mortgage or other junior lien from government agencies and nonprofit agencies considered instrumentalities of government, may *not* result in cash back to the borrower.
- The FHA-insured first mortgage *cannot* exceed the FHA statutory limit for the area where the property is located. However, the combined indebtedness of the mortgages *may* exceed the FHA statutory limit.
- The sum of all liens cannot exceed 100 percent of the cost to acquire the property. (*Note:* The cost to acquire the property is the sales price plus borrower-paid closing costs, discount points, repairs and rehabilitation expenses and prepaid expenses.)
- The cost to acquire may exceed the appraised value of the property under these types of government assistance programs.

***Required Monthly Payments***

The required monthly payments, under both the FHA-insured first mortgage and the second mortgage or lien, plus other housing expenses and all recurring charges, *cannot* exceed the borrower's reasonable ability to pay.

***Mortgage Application Disclosures***

The source, amount, and repayment terms must be disclosed in the mortgage application, and the borrower must acknowledge that he/she understands and agrees to the terms.

---

## 4. Nonprofit Agency Secondary Financing

---

**Introduction** This topic contains information on using nonprofit agencies for secondary financing, including

- secondary financing by a nonprofit agency considered an instrumentality of the government
- FHA requirement for government unit that established the non-profit agency
- HOC responsibilities for nonprofit agency approval, and
- secondary financing by an agency not considered an instrumentality of the government.

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**Change Date** May 10, 2009

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**4155.1 5.C.4.a  
Secondary  
Financing by a  
Nonprofit  
Agency  
Considered an  
Instrumentality  
of the  
Government** Nonprofit agencies may provide secondary financing under the terms outlined in [HUD 4155.1 5.C.2.b](#) provided that they

- meet the criteria described in [HUD 4155.1 4.A.6](#), and
- are considered instrumentalities of the government.

*Note:* To be considered an instrumentality of the government, the nonprofit entity must be “established by a governmental body or with governmental approval or under special law to serve a particular public purpose or designated by law (statute or court opinion).”

---

**4155.1 5.C.4.b  
FHA  
Requirement  
for  
Government  
Unit That  
Established the  
Nonprofit  
Entity** FHA requires that the unit of government that established the nonprofit must exercise either organizational control, operational control, or financial control of

- the nonprofit agency in its entirety, or
- at a minimum, the specific borrower assistance program that is using FHA’s credit enhancement.

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*Continued on next page*

## 4. Nonprofit Agency Secondary Financing, Continued

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### 4155.1 5.C.4.c HOC Responsibilities for Nonprofit Agency Approval

The appropriate HOC is responsible, based on information submitted by the nonprofit, for

- approving the nonprofit agency
- determining if the agency can be considered an instrumentality of government, and
- reviewing applications from nonprofits that purport to be instrumentalities of government.

*Note:* The HOC is also responsible for approving nonprofit agencies that are *not* considered instrumentalities of government.

*References:* For information on

- approval of nonprofit agencies that are *not* instrumentalities of government, see [HUD 4155.1 5.C.4.d](#), and
  - acceptable nonprofit government instrumentalities, see [HUD 4155.1 4.A.6](#).
- 

### 4155.1 5.C.4.d Secondary Financing by a Nonprofit Agency Not Considered an Instrumentality of the Government

Nonprofit agencies that are *not* considered instrumentalities of government may provide secondary financing under the same conditions described in [HUD 4155.1 5.C.2.b](#) provided that

- the agency meets the conditions described in [HUD 4155.1 4.A.6](#)
- the borrower makes a down payment of at least 3.5 percent of the lesser of the appraised value or the sales price of the property
- the combined amount of the first and second mortgages does not exceed the statutory loan limit for the area where the property is located, and
- the FHA-insured first mortgage, when combined with any second mortgage or junior lien from the nonprofit agency, may not result in cash back to the borrower.

*Note:* The jurisdictional HOC is responsible for approving these agencies.

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## 5. Organizations and Private Individuals Providing Secondary Financing

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**Introduction** This topic contains information on the conditions for secondary financing from organizations and private individuals, including the

- applicable LTV ratio and mortgage limit
  - repayment terms for secondary mortgages, and
  - required monthly payment for secondary loans.
- 

**Change Date** May 10, 2009

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**4155.1 5.C.5.a  
Applicable  
LTV Ratio and  
Mortgage  
Limits** Other organizations or individuals may provide secondary financing when the combined amount of the first and second mortgages *do not* exceed the

- applicable LTV ratio, and
  - maximum mortgage limit for the area.
- 

**4155.1 5.C.5.b  
Repayment  
Terms for  
Secondary  
Mortgages** Repayment terms for the second mortgage when borrowing from other organizations or private individuals must

- *not* include a balloon payment before ten years (or other such term acceptable to FHA), unless the property is sold or refinanced, and
  - permit repayment by the borrower, without penalty, after giving the lender 30 days advance notice.
- 

*Continued on next page*

## 5. Organizations and Private Individuals Providing Secondary Financing, Continued

---

**4155.1 5.C.5.c**  
**Required**  
**Monthly**  
**Payment for**  
**Secondary**  
**Loans**

The required monthly payment, under both the FHA-insured first mortgage and the second mortgage or lien, plus other housing expenses and all recurring charges, *cannot* exceed the borrower's reasonable ability to pay.

Any periodic payments due on the second mortgage must be calculated as an equal monthly payment.

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## 6. Family Member Secondary Financing

---

**Introduction** This topic contains information on secondary financing provided by a family member, including

- the definition of the term ‘family member’
  - how a family member can help with a property purchase
  - the amount permitted on a family member loan
  - restriction on a borrower being a co-obligor on the Note securing a borrowed down payment, and
  - additional policies regarding financing terms and conditions.
- 

**Change Date** May 10, 2009

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**4155.1 5.C.6.a** For a definition of the term *family member*, see [HUD 4155.1 9](#).  
**Definition:**  
**Family**  
**Member**

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*Continued on next page*

## 6. Family Member Secondary Financing, Continued

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### 4155.1 5.C.6.b How a Family Member Can Help With Property Purchase

Family members may assist with the costs of acquiring a new home in the form of a loan.

Only the family member provider(s) may be the Note holder if the money lent is secured against the subject property.

FHA will *not* approve any form of securitization of the Note that results in any entity other than the family member being the noteholder, whether at loan settlement, or any time during the mortgage life cycle.

---

### 4155.1 5.C.6.c Amount Permitted on a Family Member Loan

FHA permits a family member to lend, on a secured or unsecured basis, a maximum of 100 percent of the borrower's required funds to close, including

- down payment
  - closing costs
  - prepaid expenses, and
  - discount points.
- 

### 4155.1 5.C.6.d Restriction on a Borrower Being a Co-Obligor on the Note Securing a Borrowed Down Payment

When the funds loaned by the family member are borrowed from an acceptable source, the borrower may *not* be a co-obligor on the Note.

**Example:** A son or daughter in law may not be co-obligors on the Note used to secure the money borrowed by the parents that, in turn, was loaned to the borrower for the down payment on the property.

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*Continued on next page*

## 6. Family Member Secondary Financing, Continued

**4155.1 5.C.6.e**      The table below describes additional policies regarding the various financing terms and conditions for loans secured with family member secondary financing.

**Additional Policies Regarding Financing Terms and Conditions**

Financing Category	Policy Description
Maximum insurable mortgage	The maximum insurable mortgage amount is <i>not</i> affected by loans from family members.
Combined financing amount	The combined amount of financing may not exceed 100 percent of <ul style="list-style-type: none"> <li>• the <i>lesser</i> of the property’s                             <ul style="list-style-type: none"> <li>– appraised value, or</li> <li>– sales price, plus</li> </ul> </li> <li>• the normal closing costs, prepaid expenses, and discount points.</li> </ul>
Borrower cash back	While a family member may lend 100 percent of the borrower funds to close requirement, cash back to the borrower at closing (beyond the refund of any earnest money deposit) is <i>not</i> permitted.
Secondary financing payments	If periodic payments of the secondary financing are required, the combined payments may not exceed the borrower’s reasonable ability to pay. <p><i>Note:</i> The secondary financing payments must be included in the total debt to income ratio (that is, the “back end” ratio) for qualifying purposes.</p>
Second lien balloon payments	The second lien may <i>not</i> provide for a balloon payment within five years from the date of execution.

*Continued on next page*

## 6. Family Member Secondary Financing, Continued

### 4155.1 5.C.6.e Additional Polices Regarding Financing Terms and Conditions (continued)

Financing Category	Policy Description
Family member supplying borrowed funds	<p>If the family member providing the secondary financing borrows the funds, the lending source may <i>not</i> be an entity with an identity-of-interest in the sale of the property, such as</p> <ul style="list-style-type: none"> <li>• the seller</li> <li>• a builder</li> <li>• the loan officer, or</li> <li>• the real estate agent.</li> </ul> <p>Mortgage companies that have retail banking affiliates may have that entity loan the funds to the family member. However, the terms and conditions for the loan that will be used for the secondary mortgage cannot be more favorable than it would be for other borrowers.</p> <p><b>Example:</b> There may <i>not</i> be any special consideration given between</p> <ul style="list-style-type: none"> <li>• the making of the mortgage, and</li> <li>• the lending of funds to family members to be used for secondary financing for the purchase of the home.</li> </ul>
Secondary financing document retention	<p>An executed copy of the document describing the terms of the secondary financing must be maintained in the lender's file. An executed copy must also be provided in the endorsement binder.</p>

## 7. Secondary Financing for Borrowers 60 Years of Age and Older

---

<b>Introduction</b>	<p>This topic contains information on secondary financing for borrowers 60 years of age and older, including</p> <ul style="list-style-type: none"><li>• the circumstances in which an older borrower may borrow the cash investment, and</li><li>• the Note interest rate for older borrowers.</li></ul>
<b>Change Date</b>	<p>May 10, 2009</p>
<b>4155.1 5.C.7.a Circumstances in Which an Older Borrower May Borrow the Cash Investment</b>	<p>Borrowers 60 years of age or older may borrow the required funds to close to purchase a principal residence when</p> <ul style="list-style-type: none"><li>• the provider of secondary financing is<ul style="list-style-type: none"><li>– a relative</li><li>– a close friend with a clearly defined interest in the borrower</li><li>– the borrower’s employer, or</li><li>– an institution established for humanitarian or welfare purposes</li></ul></li><li>• the provider of the secondary financing may not have an identity-of-interest in the sale of the property, such as with<ul style="list-style-type: none"><li>– a builder or seller, or</li><li>– any person/organization associated with the builder or seller, and</li></ul></li><li>• the principal amount of the insured mortgage loan, plus the Note or other evidence of indebtedness in connection with the property, does <i>not</i> exceed 100 percent of the value, plus prepaid expenses.</li></ul>
<b>4155.1 5.C.7.b Note Interest Rate for Older Borrowers</b>	<p>The Note or other evidence of indebtedness may not bear an interest rate exceeding the interest rate of the insured mortgage.</p>

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## Chapter 6. Special Underwriting

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## Section A. Special Underwriting Instructions

### Overview

**In This Section** This section contains the topics listed in the table below.

<b>Topic</b>	<b>Topic Name</b>	<b>See Page</b>
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## 1. FHA's TOTAL Mortgage Scorecard

---

**Introduction** This topic contains information on how underwriting uses the TOTAL Mortgage Scorecard, including

- a description of TOTAL and the TOTAL Scorecard
- a comparison of TOTAL to an Automated Underwriting System (AUS)
- TOTAL scoring recommendations
- rescoring and tolerance levels, and
- information on the TOTAL User Guide.

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**Change Date** May 10, 2009

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**4155.1 6.A.1.a Description of TOTAL** The acronym "TOTAL" stands for "Technology Open To Approved Lenders."

TOTAL Scorecard evaluates the overall creditworthiness of the applicants based on a number of credit variables and, when combined with the functionalities of the AUS, indicates a recommended level of underwriting and documentation to determine a loan's eligibility for insurance by the Federal Housing Administration (FHA).

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*Continued on next page*

## 1. FHA's TOTAL Mortgage Scorecard, Continued

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### 4155.1 6.A.1.b Comparison of TOTAL to AUS

TOTAL is not an AUS. It is a scorecard that is used *within* an AUS.

To underwrite a loan electronically, a lender must process the request through an AUS that can communicate with TOTAL. TOTAL operates as a system-to-system connection to an AUS.

Together, TOTAL and the AUS either conclude that the borrowers' credit and capacity for repayment of the mortgage are acceptable or will refer the loan application to a Direct Endorsement (DE) underwriter for further consideration and review.

Regardless of the risk assessment provided by TOTAL, the lender remains accountable for compliance with FHA's eligibility requirements, as well as for any credit, capacity, and documentation requirements not covered in the FHA TOTAL Mortgage Scorecard User Guide.

**Example:** FHA will not be responsible for checking, through TOTAL, lender compliance with maximum mortgage amounts, computing debt-to-income ratios or other functions typically performed by an AUS. TOTAL provides only an assessment of the borrower's credit and capacity to repay.

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*Continued on next page*

## 1. FHA's TOTAL Mortgage Scorecard, Continued

**4155.1 6.A.1.c**  
**TOTAL**  
**Scoring**  
**Recommendations**

TOTAL will return recommendations of either

- “Accept” or “Approve” (different AUSs use different wording), or
- “Refer.”

The table below describes the TOTAL scoring recommendations.

<b>TOTAL Recommendation</b>	<b>Description</b>
Accept/Approve	This recommendation means that, based on the analysis of the credit and capacity to repay, the loan is eligible for FHA insurance provided that data entered into the AUS is true, complete, properly documented and accurate; and the documentation and other eligibility requirements are met.
Refer	<p>This recommendation means that the lender must conduct a manual underwriting review, according to FHA requirements.</p> <p>The lender's DE underwriter <i>must</i> determine if the borrower is creditworthy in accordance with FHA standard credit policies and requirements.</p>

**Note:** Per FHA policy, a borrower *will not be* denied an FHA mortgage solely on the basis of a risk assessment generated by TOTAL.

*Continued on next page*

# 1. FHA’s TOTAL Mortgage Scorecard, Continued

**4155.1 6.A.1.d  
Rescoring and  
Tolerance  
Levels**

TOTAL provides a risk assessment based on the specific data entered by lenders, such as terms and conditions of the loan, income and assets. Changes in those variables can result in a different risk assessment, and FHA requires that the loan be rescored using the new information.

However, where the differences are minor, rescoring is unlikely to trigger a different risk assessment. FHA therefore, provides a degree of tolerance before triggering a requirement for rescoring.

The table below describes the tolerance level for rescoring requirements when assessing income and assets.

<b>When assessing ...</b>	<b>There is no need to rescore if ...</b>
cash reserves	the cash reserves verified are not more than 10 percent less than what the borrower reported on the loan application.
income	the verified income is not more than 5 percent less than what the borrower reported on the loan application.
tax and insurance escrows	the tax and insurance escrows used at scoring do not result in more than a 2 percentage point increase in the payment and debt-to-income ratios.

**4155.1 6.A.1.e  
TOTAL User  
Guide**

FHA has developed the TOTAL User Guide, which is a compilation of the specific credit policies and documentation requirements lenders must follow when using TOTAL.

The instructions in the Guide pertain *only* to those mortgage applications that had a TOTAL risk assessment, including those scored mortgages referred to an underwriter for manual underwriting.

**Reference:** For a copy of the TOTAL User Guide, see [http://www.hud.gov/offices/hsg/sfh/lender/total\\_scorecard.cfm](http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm)

## 2. Temporary Interest Rate Buydowns

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**Introduction** This topic contains information on temporary interest buydowns, including

- purpose of a temporary interest rate buydown
  - eligible transactions/mortgages
  - source of buydown funds
  - underwriting requirements at buydown interest rate
  - additional interest rate buydown instructions
  - underwriter instructions for additional interest rate buydowns
  - lender escrow agreement responsibilities, and
  - escrow agreement requirements.
- 

**Change Date** May 10, 2009

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**4155.1 6.A.2.a Purpose of a Temporary Interest Rate Buydown** Interest rate buydowns are designed to reduce the borrower's monthly payment during the early years of the mortgage.

At settlement, an escrow account is established. Each month, the servicing lender draws down an amount equal to the difference in the principal and interest payment (P&I) at the Note rate, and the P&I at the buydown rate.

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**4155.1 6.A.2.b Eligible Transactions/Mortgages** Temporary interest rate buydowns are permitted *only* on

- purchase transactions, and
- fixed-rate mortgages.

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**4155.1 6.A.2.c Source of Buydown Funds** Buydown funds may come from

- the seller
- the lender
- the borrower, or
- any other interested party.

Funds from the seller or any other interested third party are considered seller contributions, and *must* be included in the 6 percent limit on seller contributions as described in [HUD 4155.1 2.A.3](#).

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*Continued on next page*

## 2. Temporary Interest Rate Buydowns, Continued

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**4155.1 6.A.2.d  
Underwriting  
Requirements  
for Qualifying  
the Borrower**

While interest rate buydowns are permitted, the loan must be underwritten at the Note rate. Lenders may *not* underwrite at the buydown rate.

Buydowns may be treated *only* as a compensating factor.

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**4155.1 6.A.2.e  
Additional  
Interest Rate  
Buydown  
Instructions**

Lender-funded buydowns on fixed-rate money mortgages through premium pricing are acceptable, provided that the funds do not result in a reduction greater than 2 percentage points below the Note rate.

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**4155.1 6.A.2.f  
Lender  
Responsibilities**

Lenders are responsible for ensuring that

- the buydown must not result in a reduction of more than two percentage points below the interest rate on the Note
- the buydown must not result in more than a one percentage point increase in the buydown rate.
- the borrower's payment may change only once a year
- the funds described in the escrow agreement are placed in escrow before or at closing
- a copy of the fully executed escrow agreement, signed by the borrower and provider of funds is provided in the mortgage case binder, and
- the escrow agreement meets the requirements described in [HUD 4155.1 6.A.1.d](#).

**Note:** The underwriter may condition the loan approval for an executed buydown agreement at closing.

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## 2. Temporary Interest Rate Buydowns, Continued

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### 4155.1 6.A.2.g Escrow Agreement Requirements

The escrow agreement requirements with which all buydowns must comply are listed below.

- Any remaining escrow funds not distributed at the time the mortgage loan is prepaid must be applied to the outstanding balance due on the mortgage.
- In the event of foreclosure, the claim for mortgage insurance benefits must be reduced by the amount remaining in the buydown escrow account.
- The escrow agreement
  - *may* provide that assistance payments continue to buyers who assume the mortgage
  - must *not* permit reversion of undistributed escrow funds to the provider if the property is sold or the mortgage is prepaid in full, and
  - must *not* allow unexpended escrow funds to be provided to the borrower in cash, unless the borrower established the escrow account.
- Escrow funds must be held in an escrow account by a financial institution supervised by a Federal or state agency.
- Payments must be made by the escrow agent to the lender or servicing agent. If escrow payments are *not* received for any reason, the borrower is responsible for making the total payment as described in the mortgage note.
- FHA does *not* object to having the lender hold and administer the escrow funds, for up to 60 days, when there is an outstanding forward commitment to sell the mortgage.

**Note:** The escrow agreement text can also apply to repair escrows.

**Reference:** For additional information on repair escrows, see [HUD 4155.2 4.6.d.](#)

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### 3. Construction Permanent Mortgage Program Eligibility

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**Introduction** This topic contains information on the eligibility criteria for a loan to be considered a construction-permanent (CP) mortgage loan, including

- construction-permanent mortgage features
- timing of loan closing and insurance, and
- criteria for consideration as a construction-permanent mortgage loan.

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**Change Date** October 26, 2009

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**4155.1 6.A.3.a  
Construction  
Permanent  
Mortgage  
Features** A construction permanent mortgage loan

- combines the features of
  - a construction loan, which is a short-term interim loan for financing the cost of construction, and
  - the traditional long-term permanent residential mortgage
- involves only one closing
- is considered a purchase transaction, for mortgage insurance and LTV purposes, and
- is made directly to an approved borrower by a lender.

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**4155.1 6.A.3.b  
Timing of Loan  
Closing and  
Insurance** On a construction permanent mortgage loan, there is only one closing, which is prior to the start of construction. At the closing, funds are disbursed to cover the purchase of the land and/or the manufactured housing unit. The balance of the mortgage proceeds are placed in an escrow account to be disbursed through draw requests until construction is completed.

**Note:** For CP on a manufactured home, there is a mandatory holdback of not less than ten percent for all cost components, excluding land.

**Important:** The loan is *not* insured until *after* construction is completed.

**Reference:** For more information on CP loans for manufactured homes, see [4155.1 2.B.8](#).

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### 3. Construction Permanent Mortgage Program Eligibility,

Continued

**4155.1 6.A.3.c** The table below describes the criteria for a loan to be considered a construction-permanent loan and eligible for FHA mortgage insurance.

**Criteria for Consideration as a Construction Permanent Mortgage**

Criteria	Description
Contract with the Builder	<p>The borrower has contracted with a builder to construct the improvements.</p> <p><i>Note:</i> This program is <i>not</i> available to a borrower acting as his/her own general contractor, <i>unless</i> the borrower is a licensed builder by profession. In this case, the acquisition cost must be determined by the actual documented cost to construct the improvements.</p>
Lot Ownership	<p>The borrower must own or be purchasing the lot at the closing of the CP loan.</p> <p><i>Note:</i> If the contractor owns the lot, the lot must be included in the total contract price.</p>
Lot Acquisition	<p>If the borrower purchased the lot within the past six months, he/she <i>must</i> provide a copy of the <a href="#">HUD-1</a> Settlement Statement, or other settlement statement showing the acquisition cost.</p> <p>If the borrower owns the lot free-and-clear, the lender must document the date of ownership and omission or any liens from title work and settlement statements.</p>

Continued on next page

### 3. Construction Permanent Mortgage Program Eligibility, Continued

**4155.1 6.A.3.c Criteria for Consideration as a Construction Permanent Mortgage** (continued)

<b>Criteria</b>	<b>Description</b>
Verification of Loan Balance/Escrow Account	<p>The balance on the CP loan, when it is fully drawn, must be verified.</p> <p>The construction escrow account, if established, must be fully extinguished. Any remaining funds must be applied to the outstanding balance of the permanent loan.</p>
Draw on Loan to Pay Off Lot	If the initial draw on the loan is for the purpose of paying off the lot, the borrower must provide a statement verifying the amount.
Sales Agreement	The borrower must provide a copy of the fully executed contract agreement, which includes the contractor’s price to build.
Extras/Out-of-Pocket Costs	<p>If the borrower is including extras over and above the contract specification and/or is paying out-of-pocket expense over and above the interim loan, then for all out-of-pocket construction costs the borrower must provide</p> <ul style="list-style-type: none"> <li>• a breakdown of the extras</li> <li>• the cost of each</li> <li>• canceled checks, and/or</li> <li>• paid receipts.</li> </ul>

*Continued on next page*

### 3. Construction Permanent Mortgage Program Eligibility,

Continued

#### 4155.1 6.A.3.c Criteria for Consideration as a Construction Permanent Mortgage (continued)

Criteria	Description
Cash Back to Borrower	<p>Replenishment of a borrower's own cash invested during construction is not considered cash back, provided the borrower can substantiate all out-of-pocket expenses used for construction with cancelled checks and/or paid receipts.</p> <p>Lenders must apply any excess funds from the construction proceeds to reduce the principal of the permanent loan. In general, the borrower is not to receive funds after closing. The borrower may receive up to \$500 from any funds remaining after closing from unused prepaid expenses, which may include (but not limited to)</p> <ul style="list-style-type: none"> <li>• per diem interest to the end of the month on the new loan</li> <li>• hazard insurance premium deposits</li> <li>• monthly mortgage insurance premiums, and</li> <li>• any real estate tax deposits needed to establish the escrow accounts.</li> </ul> <p><b>Note:</b> For manufactured homes that have been permanently erected on a site for less than one year prior to the date of the application for mortgage insurance, the borrower may <i>not</i> receive cash back at closing, even if the loan-to-value (LTV) is less than 85 percent.</p>

## 4. Construction Permanent Mortgage Program Requirements

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<b>Introduction</b>	<p>This topic contains closing and post-closing information on the construction-permanent mortgage program, including</p> <ul style="list-style-type: none"><li>• maximum mortgage amount</li><li>• equity in land as a borrower's cash investment</li><li>• permanent loan interest rate</li><li>• timeframe for start of amortization</li><li>• disclosure to the borrower on eligibility for insurance</li><li>• draw on loan to pay off lot</li><li>• remitting UFMIP</li><li>• construction period fees</li><li>• disbursing funds</li><li>• request for endorsement, and</li><li>• warehouse lines-of-credit for construction-permanent loans on manufactured homes.</li></ul>
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<b>Change Date</b>	October 26, 2009
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## 4. Construction Permanent Mortgage Program Requirements, Continued

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### 4155.1 6.A.4.a Maximum Mortgage Amount

The maximum mortgage amount is determined by applying the LTV limits to the *lesser* of the appraised value or the acquisition cost.

The acquisition cost includes

- the builder's price to build
- borrower-paid extras over and above the contract specification and/or out-of-pocket expenses over and above the interim loan
- cost of the land, and
- closing costs.

For extras over the contract specifications and out-of-pocket expenses, the borrower must provide

- a breakdown of the extras
- the cost of each
- canceled checks, and/or
- paid receipts.

If the land has been owned more than six months, or was received as an acceptable gift, the *value* of the land may be used instead of its cost.

**Note:** If the value of the land is lower than acquisition cost, the value must be used in calculating the maximum mortgage amount.

**Important:** If the contractor for the improvements is also the seller of the land, the total acquisition cost for maximum mortgage purposes is the borrower's purchase price.

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## 4. Construction Permanent Mortgage Program Requirements, Continued

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### 4155.1 6.A.4.b Equity in the Land as a Borrower's Down Payment

Equity in the land may be used for the borrower's down payment. However, if the advancement of the permanent loan results in the borrower receiving cash out in excess of \$500, the maximum LTV is limited to 85 percent.

If the land has been owned more than six months, or was received as an acceptable gift, the *value* of the land may be used instead of its cost.

**Note:** If the value of the land is lower than acquisition cost, the value must be used in calculating the maximum mortgage amount.

**Important:** If the contractor for the improvements is also the seller of the land, the total acquisition cost for maximum mortgage purposes is the borrower's purchase price.

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### 4155.1 6.A.4.c Permanent Loan Interest Rate

The permanent mortgage loan interest rate is established at closing. However, a lender may offer a "ceiling/floor" where the borrower may "float" the interest rate during construction.

At the point of interest rate lock-in, the agreement between the lender and the borrower must provide that the permanent mortgage will *not* exceed a specific maximum interest rate, and that, depending on market fluctuations, the borrower will be allowed to lock-in a lower rate.

The borrower must qualify for the mortgage at the maximum rate at which the permanent mortgage may be set.

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### 4155.1 6.A.4.d Timeframe for Start of Amortization

Amortization must begin no later than the first of the month, following 60 days from the date of

- final inspection, or
  - issuance of certificate of occupancy, whichever is later.
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## 4. Construction Permanent Mortgage Program Requirements, Continued

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<b>4155.1 6.A.4.e Disclosure to the Borrower on Eligibility for Insurance</b>	The lender must provide a disclosure to the borrower explaining <ul style="list-style-type: none"><li>• that the loan is <i>not</i> eligible for FHA mortgage insurance until after<ul style="list-style-type: none"><li>– a final inspection, or</li><li>– issuance of a certificate of occupancy by the local governmental jurisdiction, whichever is later, and</li></ul></li><li>• that FHA has no obligation until the mortgage is endorsed for issuance.</li></ul>
<b>4155.1 6.A.4.f Draw on Loan to Payoff Lot</b>	If the initial draw on the loan was for the purpose of paying off the lot or land, the borrower must provide a statement verifying the payoff amount.
<b>4155.1 6.A.4.g Remitting UFMIP</b>	FHA must receive the UFMIP within 10 calendar days of closing, or other time period as may be prescribed by FHA.
<b>4155.1 6.A.4.h Construction Period Fees</b>	Unless a separate agreement is made specifying responsibility, the following costs are paid by the builder during construction: <ul style="list-style-type: none"><li>• construction loan interest</li><li>• commitment fees</li><li>• inspection fees</li><li>• title update charges</li><li>• real estate taxes</li><li>• hazard insurance, and</li><li>• other financing charges incurred during the construction period.</li></ul>
<b>4155.1 6.A.4.i Disbursing Funds</b>	It is the lender's responsibility on a construction permanent mortgage loan to obtain written approval from the borrower before each draw payment is provided to the builder.

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## 4. Construction Permanent Mortgage Program Requirements, Continued

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**4155.1 6.A.4.j  
Request for  
Endorsement**

The lender must submit a request for endorsement within 60 days of the final inspection or issuance of certificate of occupancy, whichever is later.

*Note:* During construction, the loan is not FHA-insured.

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**4155.1 6.A.4.k  
Use of  
Warehouse  
Lines-of-Credit  
for  
Construction  
Permanent  
Loans on  
Manufactured  
Homes**

Lenders may use warehouse lines-of-credit for manufactured homes when the construction, installation and/or alternative construction, from start to completion, can be accomplished in 30 to 60 calendar days. Lenders may also utilize alternative arrangements to fund both closing and construction period disbursements, such as

- non-traditional warehouse lines
- business lines-of-credit, or
- other available sources of interim capital.

Borrowers are not to be charged or otherwise held responsible for the costs associated with interim financing, unless they have executed a separate agreement acknowledging their responsibility for such costs. These costs may not result in an increase in the amount of the permanent loan and/or the monthly principal and interest payment at the time any modification to the note is made.

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## 5. Construction Permanent Mortgage Documentation Requirements for Closing and Endorsement

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**Introduction** This topic contains information on the documentation requirements for closing and endorsing a construction permanent mortgage loan, including

- documentation requirements for closing
  - documentation required prior to endorsement
  - making changes to the Note for the permanent loan, and
  - application of gift funds when closing a construction permanent loan.
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**Change Date** October 26, 2009

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**4155.1 6.A.5.a Documentation Requirements for Closing** Standard FHA documents are used when closing a construction-permanent mortgage loan, with the addition of a

- Construction Rider or Allonge to the Note, and
- Construction Loan Agreement.

These construction documents may be in any form acceptable to the lender, but they must provide that all special construction terms end when the construction loan converts to a permanent loan.

The Construction Loan Agreement must outline

- the terms and conditions of the construction loan, and
- its conversion to a permanent loan.

After conversion, only the permanent loan terms continue to be effective, making the permanent loan eligible for FHA mortgage insurance.

Lenders must also provide an executed Loan Modification Agreement to confirm the existence of a permanent loan and that the corresponding amortizing interest rate on the mortgage loan shall commence or commenced within 60 days of the property being 100% complete.

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## 5. Construction Permanent Mortgage Documentation Requirements for Closing and Endorsement, Continued

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### 4155.1 6.A.5.b Documentation Required for Endorsement

Prior to endorsement, the lender must obtain

- a certification, signed by the borrower after conversion to the permanent loan, that the mortgaged property is free and clear of all liens other than the mortgage
  - verification that the construction loan has been fully drawn down
  - copies of canceled checks and paid receipts for all the borrower's out-of-pocket construction costs, and
  - all property-related requirements for new construction.
- 

### 4155.1 6.A.5.c Making Changes to the Note for the Permanent Loan

The lender must provide acceptable modification instruments that modify the note and security instrument (as applicable), if there are changes made to the Note, such as a

- reduction in the
    - monthly payment amount,
    - interest rate, or
    - principal balance resulting from the application of excess funds, or
  - change in first payment date.
- 

### 4155.1 6.A.5.d Application of Gift Funds when Closing a Construction Permanent Loan

Gifts from eligible sources for down payment shall be applied to the permanent financing on the [HUD-1 Settlement Statement](#) at the time of closing, and not to interim financing for the borrower, in order to receive full benefit of the credit for the CP transaction. For a refinance transaction, the gift funds can only be applied once, to either the construction loan or the permanent loan.

**Reference:** For additional information on gift funds, see [4155.1 5.B.4](#).

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## 6. Mortgage Insurance for Disaster Victims

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**Introduction** This topic contains information on mortgage insurance for disaster victims, including

- description of the Section 203(h) program
  - required borrower evidence of residence and destruction
  - eligible properties
  - amount of financing for eligible borrowers
  - Section 203(h) maximum mortgage amounts
  - timeframe for submission of loan application
  - using Section 203(k) with 203(h) for rehabilitation mortgages
  - Section 203(k) financing percentages
  - Section 203(h) underwriting guidance, and
  - Section 203(h) example scenarios and general underwriting guidance.
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**Change Date** May 10, 2009

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**4155.1 6.A.6.a Description of the Section 203(h) Program** Under the Section 203(h), *Mortgage Insurance for Disaster Victims* program, FHA provides mortgage insurance to assist victims of Presidentially-declared disasters. This program goes into effect when the President declares the disaster, and remains in effect for one year from the date of declaration.

The Federal Emergency Management Agency (FEMA) provides listings of the

- specific affected counties and cities, and
- corresponding disaster declaration dates.

**Note:** The FEMA information can be found at <http://www.fema.gov/disasters>.

**Reference:** For more information on the Section 203(h) program, see [HUD 4155.2 1.C.3](#).

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## 6. Mortgage Insurance for Disaster Victims, Continued

**4155.1 6.A.6.b  
Required  
Borrower  
Evidence of  
Residence and  
Destruction**

Under Section 203(h), the borrower’s previous residence must have been in the disaster area and must have been destroyed or damaged to such an extent that reconstruction or replacement is necessary. Borrowers must provide conclusive evidence of this fact, as outlined in the table below.

*Note:* The borrower may have been the owner of the property or a renter of the property affected.

Conclusive evidence of ...	Includes ...
a permanent residence in the affected area	<ul style="list-style-type: none"> <li>• a valid driver’s license</li> <li>• a voter registration card, or</li> <li>• utility bills.</li> </ul>
destruction of the residence	<ul style="list-style-type: none"> <li>• an insurance report</li> <li>• an inspection report by an independent fee inspector or government agency, or</li> <li>• conclusive photographic evidence showing the destruction or damage.</li> </ul>

**4155.1 6.A.6.c  
Eligible  
Properties**

The following properties are eligible under the Section 203(h) program:

- one unit detached homes
- units in an approved condominium project, or
- “spot loan” in condominiums.

Two, three, and four unit properties *may not* be purchased under the program.

**Reference:** For more information on eligibility for the Section 203(h) program, see [HUD 4155.2 1.C.3](#).

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## 6. Mortgage Insurance for Disaster Victims, Continued

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### 4155.1 6.A.6.d Amount of Financing for Eligible Borrowers

An eligible borrower may receive 100 percent financing of the sales price and no down payment is required. However, closing costs and prepaid expenses *not* paid by the seller must be

- paid by the borrower in cash, or
- paid through premium pricing.

**Note:** Adjustable Rate Mortgages (ARMs) may be used with the Section 203(h) program.

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### 4155.1 6.A.6.e Section 203(h) Maximum Mortgage Amounts

Maximum mortgage amounts for the Section 203(h) program are the same as for the Section 203(b) program.

The list can be accessed

- from the lender's Web page on HUD's Web site at [www.hud.gov](http://www.hud.gov), or
- on the FHA Connection at <https://entp.hud.gov/clas/>.

**Reference:** For information on the Section 203(b) program and maximum mortgage amounts, see [HUD 4155.2 1.C.2](#).

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### 4155.1 6.A.6.f Timeframe for Submission of Loan Application

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

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## 6. Mortgage Insurance for Disaster Victims, Continued

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**4155.1 6.A.6.g**  
**Using Section**  
**203(k) With**  
**203(h) for**  
**Rehabilitation**  
**Mortgages**

The requirement to complete a dwelling more than one year preceding the date of the mortgage insurance application under the Section 203(k), *Rehabilitation Home Mortgage Insurance* program, does *not* apply to properties in a disaster area.

Damaged residences are eligible for Section 203(k) mortgage insurance, regardless of the age of the property. The residence needs only to have been completed and ready for occupancy for eligibility under Section 203(k).

Homes that have been demolished, or will be razed as part of the rehabilitation work, are eligible, provided the existing foundation system is not affected, and will remain in place and be used. The complete foundation system must remain in place.

**Reference:** For more information on the Section 203(k) program, see [HUD 4155.2 1.C.5](#).

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**4155.1 6.A.6.h**  
**Section 203(k)**  
**Financing**  
**Percentages**

The type of mortgage being made determines the percentage of financing when using Section 203(k) with 203(h) for rehabilitation mortgages. In other words, normal LTV ratios apply to Section 203(k) mortgages made in disaster areas.

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## 6. Mortgage Insurance for Disaster Victims, Continued

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### 4155.1 6.A.6.i Section 203(h) Underwriting Guidance

Since many borrowers affected by a major disaster will experience difficulty in providing traditional documentation regarding employment and funds for closing due to the disaster, lenders should be as flexible as prudent decision making permits, when applying FHA's underwriting criteria and documentation requirements.

To the extent possible, lenders should be accommodating towards borrowers

- eligible for Section 203(h) mortgages, whether or not they opt for another FHA program, such as 203(k), regarding gaps in
  - employment
  - documentation for employment
  - available funds, and
  - qualifying ratios, and
- when evaluating the following that were the direct result of a disaster, as reported into HUD's Credit Alert Interactive Voice Response System (CAIVRS):
  - recent derogatory credit
  - bankruptcy
  - foreclosure
  - deed-in-lieu of foreclosure, and
  - delinquent federal obligations.

The guiding principle is to provide FHA financing to disaster victims who can make mortgage payments, but may not have all the traditional documentation as proof of ability to pay.

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## 6. Mortgage Insurance for Disaster Victims, Continued

**4155.1 6.A.6.j**  
**Section 203(h)**  
**Example**  
**Scenarios and**  
**General**  
**Underwriting**  
**Guidance**

The table below contains

- example scenarios involving disaster victims, and
- guidelines for using alternative documentation when traditional documentation is unavailable.

*Note:* The guidelines below are meant to provide general guidance *only* and do not address *all* of the circumstances in which alternative documentation can be used. Each case is different, and ultimately needs to be evaluated on its own merits.

Underwriting Category	Guideline
Credit	<p>Lenders should be able to determine if derogatory credit occurred subsequent to a disaster.</p> <p>If the credit report indicates satisfactory credit prior to a disaster, and any derogatory credit subsequent to the date of the disaster can be related to the effects of the disaster, FHA will consider that the borrower is a satisfactory credit risk, for the underwriting standards.</p>
CAIVRS	<p>FHA determines that a borrower is not eligible for FHA insurance if CAIVRS indicates the borrower is presently delinquent, or has had a claim paid within the previous three years on a loan made or insured by HUD on his/her behalf. FHA is adding, to the list of <i>exceptions</i> to this rule, situations involving Presidentially-declared disasters.</p> <p>If the borrower is reported in CAIVRS, but the credit report indicates the loan was current prior to the disaster, and any delinquency or claim paid can be related to the effects of the disaster, the borrower may be considered eligible.</p> <p>As with any CAIVRS authorization, lenders may contact the appropriate HOC for additional Section 203(h) underwriting information and guidance.</p> <p><b>References:</b> For more information on</p> <ul style="list-style-type: none"> <li>• eligibility for Federally related credit, see <a href="#">HUD 4155.1 4.A.6</a>, and</li> <li>• the requirement to screen borrowers using CAIVRS, see <a href="#">HUD 4155.1 4.A.8</a>.</li> </ul>

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## 6. Mortgage Insurance for Disaster Victims, Continued

### 4155.1 6.A.6 Section 203(h) Example Scenarios and General Underwriting Guidance (continued)

Underwriting Category	Guideline
Income	<p>Borrower's affected by a disaster may not be able to document past or present employment. If prior employment cannot be verified because records are destroyed, and he/she has a current position in the same or similar field, it may still be possible to consider the income.</p> <p>W-2s and tax returns may be obtained from the IRS to confirm prior employment and income. If this information cannot be obtained on a timely basis, the credit report may indicate the borrower's prior employment.</p> <p>Lenders can consider short-term employment, due to the disaster. It is anticipated that lenders will make every effort to obtain documentation about prior employment, and FHA will be flexible on the documentation requirements.</p> <p><b>Note:</b> Lenders should document the efforts taken to obtain traditional documentation.</p>
Qualifying Ratios	<p>When a borrower is purchasing a new home, yet still has an outstanding mortgage on a property located in a FEMA Disaster Area, the lender may exclude the mortgage payment on the previous residence from the qualifying ratio calculation, <i>if</i> the borrower provides the lender with information indicating that</p> <ul style="list-style-type: none"> <li>• he/she is working with the servicing lender to appropriately address his/her mortgage obligation, and</li> <li>• any property insurance proceeds will be applied to the mortgage on the damaged home.</li> </ul>
Assets	<p>Lenders should encourage a borrower to access his/her financial institution's Web sites to attempt to download statements confirming assets needed to close the loan, if hard copy bank records are unavailable.</p> <p>Lenders should document the efforts to verify assets, and make every effort to ensure that the borrower will have funds to complete the transaction.</p>

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## 6. Mortgage Insurance for Disaster Victims, Continued

4155.1 6.A.6 Section 203(h) Example Scenarios and General Underwriting Guidance (continued)

Underwriting Category	Guideline
Liabilities	<p>When a borrower has a continued mortgage obligation on a prior loan securing a property that has been destroyed or damaged, FHA understands that the record may show late payments as a result of a disaster.</p> <p>Lenders should not consider the outstanding mortgage obligation on destroyed, or seriously damaged properties when determining a borrower’s ability to make payments on a new loan, provided the requirements under Qualifying Ratios in this table have been met.</p> <p>FHA takes the position that insurance settlements are likely to pay-off remaining obligations.</p> <p>However, if a borrower was three or more months delinquent on his/her loan <i>prior</i> to the disaster, and the property is destroyed, it would not be prudent for a lender to make a new loan unless he/she can show and document extenuating circumstances.</p>

## 7. Energy Efficient Homes

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**Introduction** This topic contains information on energy efficient homes (EEH), including

- EEH qualifying ratios
  - EEH eligible properties
  - EEH general underwriting policy
  - EEH general underwriting procedures
  - EEH underwriting procedures for new construction mortgages, and
  - EEH policy guidance for streamline refinances.
- 

**Change Date** May 10, 2009

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**4155.1 6.A.7.a  
EEH  
Qualifying  
Ratios**

For a mortgage loan involving an energy efficient home (EEH), the two benchmark qualifying ratios may be exceeded by up to 2 percentage points when the borrower is purchasing or refinancing an EEH.

These higher housing expense- and obligations-to-income ratios are justified due to the anticipated energy costs savings, and become 33 percent and 45 percent, respectively.

**Reference:** For more information on borrower qualifying ratios, see [HUD 4155.1 4.F.](#)

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**4155.1 6.A.7.b  
Eligible EEH  
Properties**

All properties meeting the 2000 International Energy Conservation Code (IECC), formerly known as the Model Energy code (MEC) are considered

- energy efficient, and
- eligible for the 2 percentage points increase in the EEH qualifying ratios.

**Note:** Both new and existing one- to four-unit properties are eligible, including one-unit condominiums and manufactured housing.

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*Continued on next page*

## 7. Energy Efficient Homes, Continued

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### 4155.1 6.A.7.c EEH General Underwriting Policy

An EEH mortgage is initially underwritten as if the energy package did not exist, that is, by using standard FHA underwriting standards, qualifying income ratios, and maximum mortgage/minimum down payment requirements without regard to the energy package.

For an EEH mortgage on new construction, as well as those homes that were built to the 2000 IECC, or are being retrofitted to that standard, the borrower can obtain “stretch ratios” of 33 percent and 45 percent, in addition to the cost of the improvements.

---

### 4155.1 6.A.7.d EEH General Underwriting Procedures

Once it is determined that both the borrower and the property qualify for an FHA-insured mortgage, the lender must determine the dollar amount of the cost-effective energy package that may be added to the loan amount, using the energy rating report and EEM worksheet.

This dollar amount cannot exceed 5 percent (not to exceed \$8,000) of the property’s value, or \$4,000, whichever is *greater*. Regardless of the property’s value, every borrower who otherwise qualifies can finance at least \$4,000 of the costs of the Energy Package, if the cost exceeds \$4,000.

The calculated amount must be added to the approved base loan amount to total the final FHA-insured loan amount, before adding any upfront mortgage insurance premium (UFMIP).

The FHA maximum loan limit for the area may be exceeded by the cost of the energy efficient improvements.

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### 4155.1 6.A.7.e EEH Underwriting Procedures for New Construction Mortgages

When qualifying the borrower, the cost of the energy package must be subtracted from the sales price, since the builder has included the improvements in the sales price.

Calculate the qualifying ratios on the lower amount.

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*Continued on next page*

## 7. Energy Efficient Homes, Continued

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**4155.1 6.A.7.f**  
**EEH Policy**  
**Guidance for**  
**Streamline**  
**Refinances**

The borrower's principal and interest (P&I) payment on the new loan including the energy package, may be greater than the P&I payment on the current loan, provided that the estimated monthly energy savings as shown on the Home Energy Rating Systems (HERS) report exceeds the increase in the P&I.

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## 8. Restriction on Advanced Mortgage Payments

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**Change Date** May 10, 2009

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**4155.1 6.A.8.a  
Advanced  
Mortgage  
Payment  
Requirements**

FHA does not permit a lender to collect from the borrower advance payment(s) of the mortgage, as a condition for making a FHA-insured mortgage.

Lenders are *not* permitted to require a borrower to make mortgage payments to the lender in advance of the borrower's mortgage payment requirements under the security instruments, either through the use of

- post-dated checks
  - cash, or
  - any other form of payment.
-

## 9. Condominium Units Utility Expenses

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**Change Date**      May 10, 2009

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**4155.1 6.A.9.a  
Condominium  
Utility  
Expenses**      The portion of a condominium fee that is clearly attributable to utilities may be subtracted from the Homeowners Association (HOA) dues, before computing ratios, provided the borrower provides proper documentation, such as documentation from the utility company.

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## 10. HUD Real Estate Owned (REO) Acquisitions

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**Change Date**      July 6, 2009

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**4155.1 6.A.10.a**      On a HUD Real Estate Owned (REO) property that requires no more than  
**Calculating**      \$5,000 for repairs to meet FHA's property requirements, 110 percent of the  
**Loans on HUD**      estimated cost of the repairs may be included in the mortgage amount.  
**REO Sales**

**With Repair**  
**Escrow**

*Reference:* For more information on adding required repair costs on HUD REO properties, see [ML 2000-27](#).

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## Section B. ARMS

### Overview

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**In This Section** This section contains the topics listed in the table below.

<b>Topic</b>	<b>Topic Name</b>	<b>See Page</b>
1	Terms and Definitions	6-B-2
2	General Information on ARMs	6-B-3
3	ARM Underwriting Requirements	6-B-5
4	Interest Rate Index	6-B-9
5	Calculating Interest Rate Adjustments	6-B-13
6	Computing Monthly Installment Payments	6-B-18
7	Annual Adjustment Notice Requirement	6-B-20
8	Failure to Provide a Timely/Accurate Annual Adjustment Notice	6-B-23
9	ARM Assumptions and Transfers of Servicing	6-B-25
10	Tracking ARMs	6-B-27

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## 1. Terms and Definitions

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**Change Date**      May 10, 2009

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**4155.1 6.B.1.a**      See [HUD 4155.1 9](#) for definitions of the following ARM-related terms:

**Locating Terms  
and Definitions  
Related to  
ARMs**

- adjusted interest rate
  - calculated interest rate
  - change date
  - current index
  - existing interest rate
  - initial interest rate
  - index, and
  - margin.
-

## 2. General Information on ARMs

**Introduction** This topic contains general information on ARMs, including

- ARM interest rate adjustments and caps
- hybrid ARM eligibility, and
- the maximum number of ARM units insured by FHA.

**Change Date** May 10, 2009

**4155.1 6.B.2.a ARM Interest Rate Adjustments and Caps** The table below describes the annual interest rate adjustment and interest rate cap over the life of the five types of ARM loans.

**Reference:** For information on the frequency of interest rate changes, see [HUD 4155.1 6.B.4.e.](#)

When the ARM is for ...	Then the annual interest rate adjustment, after the initial fixed interest rate period, is ...	And the interest rate cap over the life of the loan is ...
<ul style="list-style-type: none"> <li>• one-year</li> <li>• three years, or</li> <li>• five years</li> </ul>	one percentage point	five percentage points.
<ul style="list-style-type: none"> <li>• five years</li> <li>• seven years, or</li> <li>• ten years</li> </ul>	two percentage point	six percentage points.

**Note:** FHA added the two options for the five year ARM in order to meet the needs of homebuyers, lenders and the secondary mortgage market.

*Continued on next page*

## 2. General Information on ARMs, Continued

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### 4155.1 6.B.2.b Hybrid ARM Eligibility

Owner-occupied principal residences being insured under the following programs are eligible for hybrid ARMs:

- Section 203(b), *Home Mortgage Insurance Program*
- Section 203(h), *Home Mortgage Insurance for Disaster Victims Program*
- 203(k), *Rehabilitation Home Mortgage Insurance Program*, and
- 234(c), *Mortgage Insurance for Condominium Units*.

Nonprofits, including organizations normally eligible as borrowers, and government agencies are not permitted to apply for the hybrid ARM products.

**References:** For information on Section 203 mortgage insurance programs, see

- [HUD 4155.1 6.A.6](#) , and
  - [HUD 4155.2 1.C](#).
- 

### 4155.1 6.B.2.c Maximum Number of ARM Units

The aggregate number of all ARMs insured by FHA in any fiscal year may not exceed 30 percent of the aggregate number of mortgages insured during the preceding fiscal year.

FHA will notify lenders when the maximum percentage is close to being reached during any fiscal year.

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### 3. ARM Underwriting Requirements

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**Introduction** This topic contains information on underwriting ARMs, including

- ARM processing and underwriting requirements
  - ARM pre-loan disclosure
  - basis for annual MIP
  - interest rate information
  - borrower qualifying on the 1-year ARM
  - borrower qualifying on the 3, 5, 7, or 10 year ARM
  - temporary interest rate buydown
  - ARM maturity
  - ARMs not applicable to HECMs
  - model ARM and note, and
  - amortization provisions.
- 

**Change Date** May 10, 2009

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**4155.1 6.B.3.a  
ARM  
Processing and  
Underwriting  
Requirement** ARM loans must be processed and underwritten using the initial interest rate negotiated between the lender and borrower as stated on Form [HUD 92900-A](#), *Addendum to Uniform Residential Loan Application*.

Mortgage credit processing must be in accordance with existing FHA instructions, except as modified subsequently in this topic.

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*Continued on next page*

### 3. ARM Underwriting Requirements, Continued

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**4155.1 6.B.3.b  
ARM Pre Loan  
Disclosure**

At the time of the loan application, the lender *must* provide the borrower with a written explanation of the

- nature of the proposed obligation, and
- features of an ARM, consistent with the disclosure requirements applicable to variable-rate mortgages secured by a principal dwelling under the Truth-in-Lending Act (TILA), “Regulation Z” at
  - [15 United States Code \(USC\) 1601](#), and
  - [12 Code of Federal Regulations \(CFR\) 226.18](#).

Additionally, the lender *must* provide the borrower with a hypothetical monthly payment schedule that displays the maximum potential increases in monthly payments for the term of the ARM. The hypothetical payment schedule should illustrate the maximum increases over the shortest possible time frame.

**Example:** A seven year ARM payment schedule would show the maximum potential increases over the three years following the initial fixed interest rate period of seven years.

**Notes:**

- FHA relies on lenders to comply with TILA, and does not provide disclosures for the ARM products.
  - The ARM disclosure statement, signed by all borrowers, must accompany the loan application, and applicable FHA addenda.
- 

**4155.1 6.B.3.c  
Basis for  
Annual MIP**

The mortgage insurance premium (MIP) amount and any termination provisions must be based on the initial interest rate throughout the term of the loan, regardless of the annual interest rate adjustments to the loan.

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*Continued on next page*

### 3. ARM Underwriting Requirements, Continued

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**4155.1 6.B.3.d Interest Rate Information** The following rate information must be specified on the mortgage documents:

- initial interest rate
- margin
- date of the first adjustment to the interest rate, and
- frequency of adjustments.

---

**4155.1 6.B.3.e Borrower Qualifying on the 1 Year ARM** Borrowers choosing the 1 year ARM must qualify for payments based on the contract or initial rate plus one percentage point. This only applies to the 1 year ARM where the loan-to-value (LTV) is 95 percent or greater.

For this purpose, the LTV is defined as the *lesser* of

- the base loan amount divided by the appraiser’s estimate of value, or
  - the percentage shown on the “LTV” line under the *Qualifying Ratios* section on the [HUD-92900-LT](#).
- 

**4155.1 6.B.3.f Borrower Qualifying on the 3, 5, 7, or 10 Year ARM** Borrower’s choosing the three, five, seven, or ten year ARMs should be qualified at the entry level or Note rate. These ARMs do not require underwriting at the one percentage point above the Note.

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**4155.1 6.B.3.g Temporary Interest Rate Buydowns** Any form of temporary interest rate buydown is prohibited for all ARMs, regardless of LTV.

If there is a permanent buydown, underwriting must be based on the rate in the application.

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*Continued on next page*

### 3. ARM Underwriting Requirements, Continued

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**4155.1 6.B.3.h** ARM loan maturities shall not exceed 30 years.  
**ARM Loan Maturity**

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**4155.1 6.B.3.i** Mortgage lenders must modify the model ARM Note form found in [HUD 4155.2 12.A.3](#) to accommodate the type of ARM being offered, including the  
**Model ARM and Note**

- Change Date
- limits on the interest rate changes associated with the initial fixed rate period of the ARM, and
- lifetime caps.

**Reference:** For information on the model ARM and note, see [HUD 4155.2 6.B.](#)

---

**4155.1 6.B.3.j** The ARM *must*  
**Amortization Provisions**

- be fully-amortizing, and
- contain amortization provisions that allow for periodic adjustments in the rate of interest charged.

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## 4. Interest Rate Index

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**Introduction** This topic contains information on the ARM interest rate index, including

- the two acceptable index types
  - interest rate changes
  - establishing the adjusted interest rate
  - regulation on setting interest rates, and
  - frequency of interest rate changes.
- 

**Change Date** May 10, 2009

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**4155.1 6.B.4.a Two Acceptable Index Types** FHA will insure forward adjustable rate mortgage loan products using either

- the 1 Year London Interbank Offered Rate (LIBOR), or
- the 1 Year Constant Maturity Treasury (CMT) index.

*Note:* The two index types *cannot* be commingled.

<b>Eligible Index Types</b>		
<b>Forward ARMs</b>	<b>LIBOR</b>	<b>CMT</b>
1, 3, 5, 7, 10 Year	1 Year LIBOR	1 Year CMT

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*Continued on next page*

## 4. Interest Rate Index, Continued

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### 4155.1 6.B.4.b Interest Rate Changes

Changes in the interest rate charged on an ARM must correspond to changes in either the

- weekly average yield on United States (U.S.) Treasury securities adjusted to a constant maturity of one year, or equivalent, as
  - provided by the Department of the Treasury, and
  - found on the Federal Reserve Statistical Release H.15, Selected Interest Rates Web site at [www.federalreserve.gov/releases](http://www.federalreserve.gov/releases), or
- LIBOR index as published in the *Wall Street Journal*.

Each change in the mortgage interest rate, except as otherwise provided in this handbook, must correspond to the upward/downward changes in one of these indices.

#### *Notes:*

- The Federal Reserve Statistical Release is published weekly on Monday or on Tuesday if Monday is a Federal holiday.
- The Wall Street Journal is published on the first business day of each week, which is typically a Monday, (or Tuesday if Monday is a non-publishing day). Should the Federal Reserve begin publishing the LIBOR indices in H.15, then lenders must use the H.15 as the source for these LIBOR rates. The LIBOR indices are effective the day they are published, until the day they are published the following week. The published LIBOR index must be rounded to three digits to the right of the decimal point.

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*Continued on next page*

## 4. Interest Rate Index, Continued

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### 4155.1 6.B.4.b Establishing the Adjusted Interest Rate

When establishing the adjusted interest rate, the lender must compare the initial contract interest rate to the sum of the current index figure and the mortgage margin (calculated interest rate).

The adjusted interest rate will be the interest rate charged to the borrower, subject to the limitations of the annual and lifetime caps for the respective ARM type.

The current index figure must be the most recent index figure available 30 calendar days before the Change Date (effective date of an adjustment to the interest rate as shown in Paragraph 5(a) of the model adjusted rate note form.)

**Note:** Existing model notes and security instruments currently reflect only the 1 Year CMT Index. Therefore, when LIBOR rates are chosen, the adjustable rate notes and other related documents must reflect the applicable LIBOR index.

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### 4155.1 6.B.4.c Section 203.49 (c) Regulation on Setting Interest Rates

Section 203.49 (c) of the regulations provides a method for setting the new interest rate as an alternative to using the margin to set the new rate.

Section 203.49 (c) states that “to set the new interest rate, the lender will

- determine the change between the initial or base index figure, and the current index figure, or
- add a specified margin to the current index figure.”

Ginnie Mae will *only* purchase ARMs that use the margin method for establishing the new interest rate. HUD requests that the lender contact the FHA Single Family Program Development Office for guidance, if he/she wishes to use the other method for establishing the new interest rate.

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## 4. Interest Rate Index, Continued

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### 4155.1 6.B.4.d Frequency of Interest Rate Changes

Interest rate adjustments must occur on an annual basis.

The table below describes exceptions for the first adjustment rate changes.

<b>If the ARM is for ...</b>	<b>Then the first adjustment rate change may occur no sooner than ...</b>	<b>And no later than ...</b>
one year	12 months	18 months.
three years	36 months	42 months.
five years	60 months	66 months.
seven years	84 months	90 months.
10 years	120 months	126 months.

---

## 5. Calculating Interest Rate Adjustments

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**Introduction** This topic contains information on how to calculate interest rate adjustments, including

- calculating annual adjustments
  - current basis for the index
  - determining the current index figures
  - determining the calculated interest rate
  - determining the new adjusted interest rate
  - interest rate adjustments over the term of the mortgage, and
  - effective date for the adjusted interest rate.
- 

**Change Date** May 10, 2009

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**4155.1 6.B.5.a  
Calculating  
Annual  
Adjustments**

The lender and borrower negotiate the initial interest rate and margin. The margin *must* be constant for the entire term of the mortgage. The interest rate remains constant for the initial period (either a 1, 3, 5, 7, or 10 year period, depending on the ARM) and then may change annually for the remainder of the loan term.

To calculate the annual adjustments to the initial interest rate

- determine the current index (CMT or LIBOR)
- determine the calculated interest rate, and
- compare the calculated interest rate to the existing interest rate to determine the new adjusted interest rate subject to the annual and lifetime caps.

**Note:** Once the new adjusted interest rate is calculated, notice of the change must be provided to the borrower.

**References:** For information on

- determining the current index, see [HUD 4155.1 6.B.5.c](#)
  - determining the calculated interest rate, see [HUD 4155.1 6.B.5.d](#)
  - comparing the calculated interest rate to the existing interest rate to determine the new adjusted interest rate, see [HUD 4155.1 6.B.5.e](#), and
  - providing notice to the borrower of the interest rate change, see [HUD 4155.1 6.B.7](#).
- 

*Continued on next page*

## 5. Calculating Interest Rate Adjustments, Continued

### 4155.1 6.B.5.b Basis for the Index

The index used is based on either the

- weekly LIBOR rate, or
- weekly average yield on U.S. Treasury securities, adjusted to a constant maturity of one year.

The index used must be

- the one effective on the date 30 calendar days before the Change Date, and
- either the
  - CMT, shown on the Federal Reserve Board Statistical Release H.15 (effective the day it is issued, until a new H.15 index is published), or
  - LIBOR, shown in the *Wall Street Journal* (effective the day it is issued, until a new weekly *Wall Street Journal* is published).

### 4155.1 6.B.5.c Determining the Current Index Figures

The table below describes the current index figure to use based upon the particular day of the week on which the 30<sup>th</sup> calendar day falls.

When the 30 <sup>th</sup> calendar day falls on a ...	Then use the index figure in the H.15 release (or <i>Wall Street Journal</i> if using the LIBOR) issued ...	If ...
Monday that is a business day	that Monday	the 30 <sup>th</sup> calendar day prior to a Change Date and the issue date of an H.15 release both occur on the same day (that is, they both occur on a Monday).
Monday that is a Federal holiday	the prior week	The 30 <sup>th</sup> calendar day before the Change Date falls on a Monday that is a Federal holiday.

*Continued on next page*

## 5. Calculating Interest Rate Adjustments, Continued

### 4155.1 6.B.5.c Determining the Current Index Figures (continued)

When the 30 <sup>th</sup> calendar day falls on a ...	Then use the index figure in the H.15 release (or <i>Wall Street Journal</i> if using the LIBOR) issued ...	If ...
day of the week other than Monday	on the Monday of that week (or issued on Tuesday if that Monday is a Federal holiday.)  <i>Example:</i> Assuming a December 1, 2005 Change Date, the 30 calendar days before December 1 is Tuesday November 1. Use the correct index figure issued on Monday October 31.	---

### 4155.1 6.B.5.d Determining the Calculated Interest Rate

The calculated interest rate is the current index, plus the margin (the number of basis points identified as “margin” in Paragraph 5(C) of the model adjustable rate note), rounded to the nearest 1/8<sup>th</sup> of one percentage point (0.125 percent).

This complies with Ginnie Mae’s requirement that mortgages placed into Ginnie Mae pools must be rounded to the nearest 1/8<sup>th</sup> of one percentage point at each Change Date.

*Continued on next page*

## 5. Calculating Interest Rate Adjustments, Continued

- 4155.1 6.B.5.e Determining the New Adjusted Interest Rate** Compare the calculated interest rate to the existing interest rate in effect for the preceding 12 months, to determine the new adjusted interest rate.
- The table below provides instructions on determining the new adjusted interest rate, based upon the results of the comparison between
- the calculated interest rate, and
  - the existing interest rate.

If the calculated interest rate is ...	Then the new adjusted rate will be ...
<i>equal</i> to the existing interest rate	the same as the existing interest rate.
<i>less</i> than the existing interest rate	<ul style="list-style-type: none"> <li>• the calculated interest rate, for one-three- and five-year ARMs if the calculated interest rate is <i>less</i> than <i>one</i> percentage point higher or lower than the existing interest rate, and</li> <li>• the calculated interest rate for five, seven- and ten-year ARMs if the calculated interest rate is <i>less</i> than <i>two</i> percentage points higher or lower than the existing interest rate.</li> </ul>
<i>more</i> than the existing interest rate	<ul style="list-style-type: none"> <li>• limited to one percentage point higher or lower than the existing interest rate for one, three, and five year ARMs, <i>if</i> the new calculated interest rate is more than one percentage point (100 basis points) higher or lower than the existing interest rate. (<i>Note:</i> Index changes in excess of one percentage point may not be carried over for inclusion in an adjustment in a subsequent year.), and</li> <li>• the calculated interest rate for five, seven and ten year ARMs, <i>if</i> the calculated interest rate is more than two percentage points (200 basis points) higher or lower than the existing interest rate. (<i>Note:</i> Index changes in excess of two percentage points may not be carried over for inclusion in an adjustment in a subsequent year.)</li> </ul>

*Continued on next page*

## 5. Calculating Interest Rate Adjustments, Continued

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**4155.1 6.B.5.f  
Interest Rate  
Adjustments  
Over the Term  
of the Mortgage**

Adjustments to the interest rate over the entire term of the mortgage may not result in a change in either direction of more than

- five percentage points (500 basis points) from the initial contract interest rate for one, three, and five year ARMS, or
  - six percentage points (600 basis points) for five, seven and ten year ARMs.
- 

**4155.1 6.B.5.g  
Effective Date  
for the  
Adjusted  
Interest Rate**

An adjusted interest rate is effective on the Change Date, and thereafter is deemed to be the existing interest rate. The new rate remains in effect until the next Change Date.

During the term of the mortgage, each adjustment is effective on the same date of each succeeding year.

---

## 6. Computing the Monthly Installment Payment

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**Introduction** This topic contains information on how to compute the monthly installment payment, including

- determining the new monthly payments, and
  - the timing of the new monthly payment.
- 

**Change Date** May 10, 2009

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**4155.1 6.B.6.a Determining New Monthly Payments** Interest rate changes may only be implemented through adjustments to the borrower's monthly payments. Lenders must determine a new monthly payment each time there is a new interest rate on the mortgage due to the interest rate adjustment calculation described in [HUD 4155.1 6.B.5](#).

The portion of the monthly payment, attributable to principal and interest, is calculated by

- determining the amount necessary to fully amortize the unpaid principal balance for the remaining term of the mortgage
- crediting all eligible prepayments, but not debiting any delinquency, and
- adding escrow requirements to the principal and interest.

**Notes:**

- Unpaid principal balance for computing the monthly installment is the balance that would be due on the Change Date if there had been no default in any payment, but reduced by the amount of any prepayments to the principal.
  - All ARM adjustments affect interest percentages only. Negative amortization is not permitted.
- 

*Continued on next page*

## 6. Computing the Monthly Installment Payment, Continued

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### **4155.1 6.B.6.b Timing of the New Monthly Payment**

Since interest is payable on the first day of the month following the month in which the interest accrued, the borrower will begin to pay the new monthly payment 30 days after the Change Date, provided the lender gives the borrower proper notice.

*Reference:* For information on the requirement for an Annual Adjustment Notice to the borrower, see [HUD 4155.1 6.B.7.](#)

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## 7. Annual Adjustment Notice Requirement

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**Introduction** This topic contains information on the Annual Adjustment Notice, including

- Annual Adjustment Notice policy
  - required Notice content
  - sending the Adjustment Notice
  - effect of foreclosures and delinquencies on lender notification obligation
  - Annual Adjustment Notice record retention, and
  - lender responsibility for follow-up after sending the Notice
- 

**Change Date** May 10, 2009

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**4155.1 6.B.7.a  
Annual  
Adjustment  
Notice Policy**

At least 25 days before any adjustment to a borrower's monthly payment may occur, the lender must provide written notification to the borrower regarding

- the new mortgage interest rate
- the amount of the new monthly payment
- the current index, and
- how the payment adjustment was calculated.

Prior to issuance of the notice, the lender must calculate the new adjusted interest rate, as instructed in [HUD 4155.1 6.B.5](#).

The first adjustment to the interest rate becomes effective on the date specified in Paragraph 5A (Change Date) of the ARM Note and thereafter, each adjustment becomes effective on the same date of each succeeding year during the term of the mortgage.

**Note:** Lenders must notify borrowers

- 30 days before any adjustments, *if this provision is stated* in the mortgage agreement, and
  - annually, even if the existing interest rate does not change.
- 

*Continued on next page*

## 7. Annual Adjustment Notice Requirement, Continued

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**4155.1 6.B.7.b  
Required  
Notice Content**

The content of the Adjustment Notice must meet the criteria of [24 CFR 203.49\(h\)](#), *Eligibility of Adjustable Rate Mortgages*, and include

- date the Adjustment Notice is mailed
  - change date
  - existing interest rate
  - adjusted interest rate
  - current Index and publishing date
  - method of calculating the adjustment to monthly payments
  - amount of the adjusted monthly payments, and
  - any other information that may be required by law, such as an explanation of why the adjusted interest rate is less than the calculated interest rate when the cap is reached.
- 

**4155.1 6.B.7.c  
Sending the  
Adjustment  
Notice**

Send the Adjustment Notice to the borrower by Certified Mail, Return Receipt Requested.

The lender can also send the Notice by first class mail to all property owners identified on his/her records, unless the borrower's whereabouts are known to be elsewhere.

---

**4155.1 6.B.7.d  
Effect of  
Foreclosures  
and  
Delinquencies  
on Lender  
Notification  
Obligation**

The lender's obligation to compute and adjust the interest rate, and provide notice to the borrower, is *not* affected by delinquencies or foreclosures, so long as the mortgage debt exists.

It is the lender's responsibility to see that its collection actions continually update the mortgage debt.

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*Continued on next page*

## 7. Annual Adjustment Notice Requirement, Continued

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**4155.1 6.B.7.e**  
**Annual**  
**Adjustment**  
**Notice Record**  
**Retention**

The HUD review purposes, lenders must

- keep evidence that timely notice was sent to the borrower, and
- retain annual adjustment computations for the mortgage term.

A file copy of the suggested HUD Annual Adjustment Notice is sufficient to satisfy this requirement.

Should disputes arise, the HUD suggested method for evidence may not be sufficient. Lenders should instead be guided by the advice of counsel about the type and duration of record retention.

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**4155.1 6.B.7.f**  
**Lender**  
**Responsibility**  
**for Follow Up**  
**After Sending**  
**the Notice**

The Lender should notify his/her collections personnel of the possibility that the Annual Adjustment Notice was not received by a borrower, and of the need to take remedial action, when necessary. Collection personnel should

- make a follow up call to determine if the notice was received, if the borrower's payments do not reflect the increase/decrease described in the Notice, and
  - immediately mail a duplicate Notice if not received.
-

## 8. Failure to Provide a Timely/Accurate Annual Adjustment Notice

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**Introduction** This topic contains information on failure to provide a timely or accurate Annual Adjustment Notice, including

- Notice failure for more than one year
- restriction on collecting payment increases
- decline of new interest rate, and
- inaccurate Annual Adjustment Notice.

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**Change Date** May 10, 2009

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**4155.1 6.B.8.a Notice Failure for More Than One Year** If the lender fails to provide notice to the borrower for more than one year, then he/she must determine an adjusted interest rate for each omitted year, because the calculations for each year affect the rate for subsequent years.

The one and two percentage point limitations and five and six percentage point caps apply to each year, and must be considered when determining the new interest rate.

Penalties will be imposed on the lender if he/she fails to provide borrower notification in advance of each Change Date.

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**4155.1 6.B.8.b Restriction on Collecting Payment Increases** Although the new interest rate may increase, the lender is prevented from collecting any increase in payments until the Notice has met the required 25-day advance notice requirement.

If timely notice is not provided, the

- lender forfeits his/her right to collect the increased amount, and
- borrower is relieved from the obligation to pay the increased payment amount.

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*Continued on next page*

## 8. Failure to Provide a Timely/Accurate Annual Adjustment Notice, Continued

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### 4155.1 6.B.8.c Decline of New Interest Rate

If the new interest rate declines, the failure of the lender to provide proper Notice would result in overpayments, until the mortgage rate is properly adjusted.

In this case, the lender must refund the excess, with interest, at a rate equal to the sum of the Margin and Index in effect on the Change Date, from the date of the excess payment to the date of repayment.

After the lender applies the refund to any existing delinquency, the borrower has the option of

- a cash refund, or
- applying the excess to the unpaid principal balance or the mortgage.

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### 4155.1 6.B.8.d Inaccurate Annual Adjustment Notice

HUD requires that errors be corrected if the

- lender miscalculates the interest rate and/or the monthly payment, and
- the errors are reflected in the Notice.

HUD does not take a position on whether an erroneous Notice constitutes a failure to provide notice under the terms of the mortgage contract. This is a legal matter that is subject to local law and court interpretation.

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## 9. ARM Assumptions and Transfers of Servicing

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**Introduction** This topic contains information on ARM assumptions and transfers of servicing, including

- transfers of servicing among lenders
- disclosing sales transaction terms, and
- creditworthiness review.

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**Change Date** May 10, 2009

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**4155.1 6.B.9.a  
Transfers of  
Servicing  
Among Lenders** The seller is responsible for providing the transferee with complete servicing records reflecting total compliance with ARM disclosure and reporting requirements.

HUD regulations require that the transferee/assignee assume all servicing obligations. However, negligent ARM lenders/transferees are not permitted to avoid his/her disclosure obligations.

If a failure of Notice or other error is discovered, the lender/transferee holding the loan when the failure occurred, is responsible for reimbursing the lender currently holding the loan, if any burden or refund to the borrower is required.

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*Continued on next page*

## 9. ARM Assumptions and Transfers of Servicing, Continued

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### 4155.1 6.B.9.b Disclosing Sales Transaction Terms

Lenders should encourage sellers to disclose the terms of an existing ARM in any sales transaction. However, when an assumption takes place, both the seller and lender should assume responsibility for notifying the assumptor about the terms and conditions of the ARM.

When the lender becomes aware of an assumption, and has the name of the assumptor, he/she should provide the assumptor with

- a copy of the original Disclosure Statement, and
- an explanatory letter addressing the ARM obligations.

The lender should document an acknowledgement of the assumptor's receipt of the disclosure information.

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### 4155.1 6.B.9.c Creditworthy Review

The lender must prepare a new Disclosure Statement to ensure that the assumptor is aware of the ARM obligation, when the assumption transaction

- requires a creditworthiness review, or
- release from personal liability is requested and approved.

Processing of the following HUD forms must be based on the interest rate in effect at the time that the complete credit review package is submitted to the DE Underwriter:

- Form [HUD 92210](#), *Request for Credit Approval of Substitute Mortgagor*, and/or
  - Form [HUD 92210.1](#), *Approval of Purchaser and Release of Seller*.
-

## 10. Tracking ARMs

**Introduction** This topic contains information on tracking ARMs, including

- ARM suffix codes
- DE suffix codes, and
- ARM-type indicators.

**Change Date** May 10, 2009

**4155.1 6.B.10.a  
ARM Suffix  
Codes** In order to track ARM activity, case number suffix codes (Section of the Act Automatic Data Processing (ADP) Codes) are

- indicated on all Form [HUD-92900](#) application addendums, and
- printed on Form [HUD- 59100](#), *Mortgage Insurance Certificate*.

**4155.1 6.B.10.b  
DE Suffix  
Codes** The table below lists the suffix codes for DE cases.

Eligible Program	Section of the Act Suffix Code
203(b)	729
223(e)	829
203(k) first lien	730
234(c)	731
247 Hawaiian Homelands	780
248 Indian Lands	788
203(k) Condominium	815

*Continued on next page*

## 10. Tracking ARMs, Continued

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**4155.1 6.B.10.c** In addition to the ADP suffix codes assigned to ARMs, a hybrid ARM-type  
**ARM Type** indicator has been added to the FHA's Computerized Home Underwriting  
**Indicators** Management System (CHUMS).

When submitting loan data to FHA via the FHA Connection, or its functional equivalent, the lender must identify the type of ARM, if the ARM is indicated by an ADP code, by selecting the one, three, five, seven, or ten year ARM-type indicator.

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## Section C. Streamline Refinances

### Overview

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**In This Section** This section contains the topics listed in the table below.

<b>Topic</b>	<b>Topic Name</b>	<b>See Page</b>
1	Requirements for Streamline Refinances	6-C-2
2	Credit Qualifying Streamline Refinances	6-C-6
3	Streamline Refinance Borrower and Property Related Requirements	6-C-8
4	Types of Permissible Streamline Refinances	6-C-11
5	Establishing Net Tangible Benefit of Streamline Refinance	6-C-16

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# 1. Requirements for Streamline Refinances

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<b>Introduction</b>	<p>This topic contains information on requirements for streamline refinances, including</p> <ul style="list-style-type: none"> <li>• a description of a streamline refinance</li> <li>• permissible geographic areas</li> <li>• use of appraisals</li> <li>• ignoring or setting aside an appraisal</li> <li>• reviewing HUD LDP and GSA exclusion lists</li> <li>• credit report requirements and availability of credit score</li> <li>• underwriting requirements, use of TOTAL Scorecard and loan application documentation, and</li> <li>• certification requirement for streamline refinance and required case binder documentation.</li> </ul>
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<b>Change Date</b>	December 8, 2009
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<b>4155.1 6.C.1.a Description of a Streamline Refinance</b>	<p>Streamline refinances</p> <ul style="list-style-type: none"> <li>• are designed to lower the monthly principal and interest payments on a current FHA-insured mortgage, and</li> <li>• must involve no cash back to the borrower, except for minor adjustments at closing that are not to exceed \$500.</li> </ul>
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<b>4155.1 6.C.1.b Permissible Geographic Areas for Streamline Refinances</b>	<p>Lenders may solicit and process streamline refinance applications from any area of the country, provided the lender is approved for Direct Endorsement (DE) by at least one Homeownership Center (HOC).</p> <p><b>References:</b> For information on</p> <ul style="list-style-type: none"> <li>• DE Lender Program application and approval, see             <ul style="list-style-type: none"> <li>– <a href="#">HUD 4155.2 2.A</a>, and</li> <li>– <a href="#">HUD 4155.2 2.B</a>, and</li> </ul> </li> <li>• HOC jurisdictions, see <a href="#">HUD 4155.1 8.1</a>.</li> </ul>
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## 1. Requirements for Streamline Refinances, Continued

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### 4155.1 6.C.1.c Use of Appraisals on Streamline Refinances

FHA does not *require* an appraisal on a streamline refinance. These transactions can be made with or without an appraisal.

FHA does *not* require repairs to be completed on streamline refinances with appraisals, with the exception of lead-based paint repairs. However, the lender may require completion of repairs as a condition of the loan.

**References:** For information on streamline refinances

- with an appraisal (no credit qualifying), see [HUD 4155.1 3.C.3](#) , and
  - without an appraisal, see [HUD 4155.1 3.C.2](#) .
- 

### 4155.1 6.C.1.d Ignoring or Setting Aside an Appraisal on Streamline Refinances

If an appraisal has been performed on a property, and the appraised value is such that the borrower would be better advised to proceed as if no appraisal had been made, then

- the appraisal may be ignored and not used, and
  - a notation of this decision must be made on the [HUD-92900-LT, FHA Loan Underwriting and Transmittal Summary](#).
- 

### 4155.1 6.C.1.e Reviewing HUD LDP and GSA Exclusion Lists

HUD's CAIVRS does not need to be checked for streamline refinances, but the following must still be reviewed for all borrowers:

- [HUD Limited Denial of Participation](#) (LDP) List, and
- General Services Administration (GSA) [List of Parties Excluded from Federal Procurement or Non-procurement Programs](#).

**References:** For more information on HUD's LDP List, GSA exclusion lists, and using CAIVRS to check borrower eligibility for Federally-related credit, see

- [HUD 4155.1 4.A.6](#), and
  - [HUD 4155.1 4.A.7](#).
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*Continued on next page*

## 1. Requirements for Streamline Refinances, Continued

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### 4155.1 6.C.1.f Credit Report Requirements and Availability of Credit Score for Streamline Refinances

FHA does *not* require a credit report, except for credit qualifying streamline refinances. However, the lender may require this as part of their credit policy.

If a credit score is available, the lender must enter the credit score into FHA Connection (FHAC). If more than one credit score is available, the lender must enter *all* available credit scores into FHAC.

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### 4155.1 6.C.1.g Underwriting Requirements, Use of TOTAL Scorecard and Loan Application Documentation

Lenders may not use the TOTAL Scorecard on streamline refinance transactions. If a lender uses TOTAL to underwrite a loan, that loan must be underwritten and closed as a rate and term (no cash-out) refinance transaction.

Lenders may *no longer* use an abbreviated version of the Uniform Residential Loan Application (URLA).

Due to various disclosure requirements, the application for mortgage insurance must be signed and dated by the borrower(s) before the loan is underwritten. Lenders are permitted to process and underwrite the loan after the borrower(s) and interviewer complete the initial URLA and initial form [HUD 92900A, HUD/VA Addendum to Uniform Residential Loan Application](#).

The lender must continue to ensure compliance with the Equal Credit Opportunity Act (ECOA) and all other regulatory requirements.

**Reference:** For information on ECOA and other regulations, see [HUD 4155.2 1.B.5](#).

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*Continued on next page*

## 1. Requirements for Streamline Refinances, Continued

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**4155.1 6.C.1.h  
Certification of  
Borrower's  
Employment  
and Income for  
a Streamline  
Refinance and  
Required Case  
Binder  
Documentation**

The lender must certify that the borrower was employed and had income at the time of loan application.

The lender certification must be

- in writing
- on company letterhead, and
- signed and dated.

When submitting the loan for insurance endorsement, the lender must include the signed certification and a copy of the payoff statement in the case binder.

*Note:* Certification requirements are set forth in [Title 18 U.S.C 1014](#), which provides in part that whoever knowingly and willfully makes or uses a document containing any false, fictitious, or fraudulent statement or entry, in any matter in the jurisdiction of any department or agency of the United States, shall be fined not more than \$1,000,000 or imprisoned for not more than 30 years or both, and violation of this or others may result in debarment and civil liability for damages suffered by HUD.

*References:* For information on payoff calculations see [4155.1 3.C.2.c](#).

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## 2. Credit Qualifying Streamline Refinances

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**Introduction** This topic contains information on credit qualifying streamline refinancing, including

- features of a credit qualifying streamline refinance
  - the maximum mortgage amount
  - lender responsibility for credit documentation and borrower qualifying, and
  - required usage of a credit qualifying streamline refinance.
- 

**Change Date** May 10, 2009

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**4155.1 6.C.2.a Features of a Credit Qualifying Streamline Refinance** Credit qualifying streamline refinances contain all the normal features of a streamline refinance, but provide a level of assurance for continued performance on the mortgage.

The lender must provide evidence that the remaining borrowers have an acceptable credit history and ability to make payments.

---

**4155.1 6.C.2.b Maximum Mortgage Amount** Guidelines for calculating the maximum mortgage amount on credit qualifying streamline refinances may be found as follows:

<b>If the credit qualifying streamline refinance is made ...</b>	<b>Then the maximum mortgage amount is calculated as described in ...</b>
<i>with</i> an appraisal	<a href="#">HUD 4155.1 3.C.3.</a>
<i>without</i> an appraisal	<a href="#">HUD 4155.1 3.C.2.</a>

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*Continued on next page*

## 2. Credit Qualifying Streamline Refinances, Continued

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### 4155.1 6.C.2.c Lender Responsibility for Credit Documentation and Borrower Qualifying

For credit qualifying streamline refinancing, the lender must

- verify the borrower's income and credit report
  - compute the debt-to-income ratios, and
  - determine that the borrower will continue to make mortgage payments.
- 

### 4155.1 6.C.2.d Required Usage of a Credit Qualifying Streamline Refinance

Credit qualifying streamline refinances must be considered

- when a change in the mortgage term will result in an increase in the mortgage payment more than 20 percent
- when deletion of a borrower or borrowers will trigger the due-on-sale clause
- following the assumption of a mortgage that
  - occurred less than six months previously, and
  - does *not* contain restrictions (that is, the due-on-sale clause) limiting assumptions only to creditworthy borrowers, and
- following an assumption of a mortgage that
  - occurred less than six months previously, and
  - did *not* trigger the transferability restriction (that is, the due-on-sale clause), such as in a property transfer resulting from a divorce decree or by devise or descent.

**Note:** The use of a credit qualifying streamline refinance in situations in which the change in mortgage term will result in an increase in the mortgage payment is *only* permissible for

- owner-occupied principal residences
  - secondary residences meeting the requirements of [HUD 4155.1 4.B.3](#), and
  - those investment properties purchased by governmental agencies and eligible nonprofit organizations as described in [HUD 4155.1 4.A.6](#).
-

### 3. Streamline Refinance Borrower and Property Related Requirements

---

**Introduction** This topic contains information on borrower and property related requirements for streamline refinances, including

- borrower cash to close
  - holding period prior to borrower eligibility
  - borrower additions or deletions to title
  - withdrawn condominium approvals
  - seven unit exemptions, and
  - seasoning and payment requirement for borrower eligibility.
- 

**Change Date** December 8, 2009

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**4155.1 6.C.3.a Borrower Cash to Close on a Streamline Refinance** If assets are needed to close, the lender must verify, document, and determine the acceptability of the assets to be utilized.

**Reference:** For more information on acceptable source of funds for closing, see [4155.1 5.B.](#)

---

**4155.1 6.C.3.b Holding Period Prior to Borrower Eligibility on a Streamline Refinance** A borrower is eligible for a streamline refinance without credit qualifying if

- he/she has owned the property for at least six months, and
- the previous borrowers received a release of liability at the time of the assumption.

This rule applies to mortgages that do not contain restrictions limiting the assumption only to credit worthy assumptors.

**Note:** Typically these types of mortgages were made prior to December 1989.

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*Continued on next page*

### 3. Streamline Refinance Borrower and Property Related Requirements, Continued

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**4155.1 6.C.3.c  
Borrower  
Additions or  
Deletions to the  
Title**

Individuals may be *added* to the title on a streamline refinance without

- a credit worthiness review, and
- triggering the due-on-sale clause.

Individuals may be *deleted* from the title on a streamline refinance, *only*

- under the circumstances described in [HUD 4155.1 6.C.2.d](#)
  - when
    - an assumption of a mortgage *not* containing a due-on-sale clause occurred more than six months previously, and
    - the assumptor can document that he/she has made the mortgage payments during this interim period, or
  - following an assumption of a mortgage in which
    - the transferability restriction (due-on-sale clause) was *not* triggered, such as in a property transfer resulting from a divorce decree or by devise or descent
    - the assumption or quit-claim of interest occurred more than six months previously, and
    - the remaining owner-occupant can demonstrate that he/she has made the mortgage payments during this time.
- 

**4155.1 6.C.3.d  
Withdrawn  
Condominium  
Approvals**

If approval of a condominium project has been withdrawn, FHA will insure only streamline refinances *without* appraisals for that condominium project.

**Reference:** For more information on FHA requirements on condominiums, see [HUD 4155.1 4.B.1.](#)

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**4155.1 6.C.3.e  
Seven Unit  
Exemptions**

An eligible investor that has a financial interest in more than seven rental units, as described in [24 CFR 203.42](#), may only refinance *without* appraisals.

**Reference:** For more information on the seven-unit limitation, see [HUD 4155.1 4.B.4.d.](#)

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*Continued on next page*

### 3. Streamline Refinance Borrower and Property Related Requirements, Continued

**4155.1 6.C.3.f**  
**Seasoning and**  
**Mortgage**  
**Payment**  
**History**  
**Requirement**  
**for Borrower**  
**Eligibility on a**  
**Streamline**  
**Refinance**

At the time of loan application, the borrower must

- have made at least six payments on the FHA-insured mortgage being refinanced, and
- exhibit an acceptable payment history as described in the table below.

<b>If the mortgage has ...</b>	<b>Then the borrower...</b>
less than 12 months payment history	must have made all mortgage payments within the month due
12 months payment history or greater	must have <ul style="list-style-type: none"> <li>• experienced no more than <i>one</i> 30 day late payment in the preceding 12 months, and</li> <li>• made all mortgage payments within the month due for the three months prior to the date of the loan application.</li> </ul>

## 4. Types of Permissible Streamline Refinances

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**Introduction** This topic contains information on the types of permissible streamline refinances, including

- no cost refinances
  - transactions ineligible for streamline refinance term reduction
  - ineligibility of delinquent mortgages
  - ARM to ARM refinancing
  - ARM to fixed rate refinancing
  - fixed rate to ARM refinancing
  - GPM to fixed rate refinancing
  - GPM to ARM refinancing
  - Section 203(k) to Section 203(b) refinancing
  - Section 235 to Section 203(b) refinancing, and
  - ineligibility of investment properties or secondary residences.
- 

**Change Date** December 8, 2009

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**4155.1 6.C.4.a  
No Cost  
Refinances** No cost refinances, in which the lender charges a premium interest rate to defray the borrower's closing costs and/or prepaid items, are permitted.

The lender may also offer an interest free advance of amounts equal to the present escrow balances on the existing mortgage to establish a new escrow account.

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## 4. Types of Permissible Streamline Refinances, Continued

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### 4155.1 6.C.4.b Transactions Ineligible for Streamline Refinance Term Reduction

A transaction for the purpose of reducing the mortgage term, must be underwritten and closed as a rate and term (no cash-out) refinance transaction.

**Reference:** For more information on the types of refinances, see [4155.1 3.A.1.c.](#)

---

### 4155.1 6.C.4.c Ineligibility of Delinquent Mortgages

Delinquent mortgages are *not* eligible for streamline refinancing until the loan is brought current.

**Reference:** For more information on streamline refinancing mortgages, see [4155.1 6.C.3.f.](#)

---

### 4155.1 6.C.4.d ARM to ARM Refinancing

An ARM may be refinanced to another ARM, provided that there is a net tangible benefit to the borrower.

ARM to ARM refinances may be transacted with or without an appraisal.

**Important:** An ARM may be used only for refinancing principal residences.

**References:** For more information on the net tangible benefit of refinance, see

- [4155.1 6.C.5.a.](#), and
  - [4155.1 6.C.5.b.](#)
- 

### 4155.1 6.C.4.e ARM to Fixed Rate Refinancing

The interest rate on the new fixed rate mortgage will be no greater than 2 percentage points above the current rate of the one-year ARM. For hybrid ARMs, the total mortgage payment on the new fixed rate mortgage may not increase by more than 20 percent.

**Example:** Total mortgage payment on the hybrid ARM is \$895; the total mortgage payment for the new fixed rate mortgage must be \$1,074 or less.

**Reference:** For more information on acceptable payment history, see [4155.1 6.C.3.f.](#)

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*Continued on next page*

## 4. Types of Permissible Streamline Refinances, Continued

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### 4155.1 6.C.4.f Fixed Rate to ARM Refinancing

A fixed rate mortgage may be refinanced to a one year ARM, with or without an appraisal, provided that the interest rate of the new mortgage is at least two percentage points below the interest rate of the current mortgage.

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### 4155.1 6.C.4.g GPM to Fixed Rate Refinancing

A section 245 Graduated Payment Mortgage (GPM) may be refinanced to a fixed rate mortgage, with or without an appraisal, provided that there is a net tangible benefit to the borrower.

If the streamline refinance is completed without an appraisal, the new mortgage amount may exceed the statutory limit by the accrued negative amortization, and the new UFMIP.

**References:** For more information on

- net tangible benefit requirements, see
    - [4155.1 6.C.5.a](#), and
    - [4155.1 6.C.5.b](#), or
  - seasoning requirements for streamline refinances, see [4155.1 6.C.3.f](#).
- 

### 4155.1 6.C.4.h GPM to ARM Refinancing

A GPM may be refinanced to an ARM, *provided* that the note rate results in a reduction to the current principal and interest payments.

If the streamline refinance is completed without an appraisal, the new mortgage amount may exceed the statutory limit by the accrued negative amortization, and the new UFMIP.

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*Continued on next page*

## 4. Types of Permissible Streamline Refinances, Continued

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### 4155.1 6.C.4.i Section 203(k) to Section 203(b) Refinancing

A section 203(k) rehabilitation mortgage may be refinanced into a Section 203(b) mortgage after all work is complete.

The rehabilitation work is considered complete by

- a fully executed certificate of completion
- closing the rehabilitation escrow account with a final release, and
- the lender entering the required close out information into the FHA Connection, or its functional equivalent.

**Note:** Before lenders can order a case number for a refinance of a Section 203(k) mortgage, the previous lender must have completed the Section 203(k) closeout process in FHA Connection. See

<https://entp.hud.gov/clas/html/f17npcase-1.cfm> for further information.

**Reference:** For more information on the Section 203(b) Home Mortgage Insurance Program, see [HUD 4155.2 1.C.2](#).

---

### 4155.1 6.C.4.j Section 235 to Section 203(b) Refinancing

Lenders may refinance Section 235 mortgages to Section 203(b) mortgages using the streamline underwriting procedures described in [HUD 4155.1 6.C](#) and [HUD 4155.1 3.C](#).

Any overpaid subsidy that has been paid by the lender to HUD, and is part of the borrower's mortgage account, can be included in the Section 203(b) mortgage amount, provided that the mortgage amount does not exceed the maximum mortgage permitted under the streamline refinancing requirements described in either [HUD 4155.1 3.C.2](#) or [HUD 4155.1 3.C.3](#), as appropriate.

If HUD has a junior lien that was part of the original Section 235 financing, HUD will subordinate the junior lien to the Section 203(b) mortgage that refinances the Section 235 mortgage.

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## 4. Types of Permissible Streamline Refinances, Continued

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**4155.1 6.C.4.k  
Investment  
Properties or  
Secondary  
Residences  
Ineligible for  
Streamline  
Refinance**

In addition to meeting the requirement for a reduction in the total mortgage payment, investment properties or secondary residences are not eligible for streamline refinancing to ARMs.

*References:* For more information on

- investment properties, see [4155.1 4.B.4](#), and
  - secondary residences, see [4155.1 4.B.3](#).
-

## 5. Establishing Net Tangible Benefit of Streamline Refinance

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**Introduction** This topic contains information on establishing the net tangible benefit of a streamline refinance, including

- definition of net tangible benefit
  - net tangible benefit of reduction in total mortgage payment
  - net tangible benefit of refinance from adjustable rate mortgage (ARM) to fixed rate mortgage, and
  - net tangible of fixed rate to ARM refinance.
- 

**Change Date** December 8, 2009

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**4155.1 6.C.5.a  
Definition of  
Net Tangible  
Benefit of  
Streamline  
Refinance** The lender must determine that there is a net tangible benefit as a result of the streamline refinance transaction, with or without an appraisal.

Net tangible benefit is defined as a

- reduction in the total mortgage payment, which includes
  - principal
  - interest
  - taxes and insurances
  - homeowners' association fees
  - ground rents
  - special assessments, and
  - all subordinate liens, or
- refinance from an ARM to a fixed rate mortgage.

**References:** For more information on the net tangible benefit of

- reduction in total mortgage payment, see [4155.1 6.C.5.b](#)
  - ARM to fixed rate refinances, see [4155.1 6.C.5.c](#), and
  - fixed rate to ARM refinances, see [4155.1 6.C.4.e](#).
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## 5. Establishing Net Tangible Benefit of Streamline Refinance, Continued

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### 4155.1 6.C.5.b Net Tangible Benefit of Reduction in Total Mortgage Payment from Streamline Refinance

To qualify as a net tangible benefit, the new total mortgage payment must be *at least* five percent lower than the total mortgage payment for the mortgage being refinanced.

**Example:** Total mortgage payment on the existing FHA-insured mortgage is \$895; the total mortgage payment for the new FHA-insured mortgage must be \$850 or less.

**Note:** This requirement applies when refinancing from

- fixed rate to fixed rate
- ARM to ARM
- Graduated Payment Mortgage (GPM) to ARM
- GPM to fixed rate
- GPM to ARM
- 203(k) to 203(b), and
- 235 to 203(b).

**References:** For additional information on

- ARM to ARM refinancing, see [4155.1 6.C.4.d](#)
- fixed rate to ARM refinancing, see [4155.1 6.C.5.d](#)
- GPM to ARM refinancing, see [4155.1 6.C.4.h](#)
- GPM to fixed rate refinancing, see [4155.1 6.C.4.g](#)
- 203(k) to 203(b) refinancing, see [4155.1 6.C.4.i](#), and
- 235 to 203(b) refinancing, see [4155.1 6.C.4.j](#).

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*Continued on next page*

## 5. Establishing Net Tangible Benefit of Streamline Refinance, Continued

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### 4155.1 6.C.5.c Net Tangible Benefit of ARM to Fixed Rate Refinance

The interest rate on the new fixed rate mortgage will be no greater than two percentage points above the current rate of a one-year ARM.

**Important:** For hybrid ARMs, the total mortgage payment on the new fixed rate mortgage may not increase by more than 20 percent.

**Example:** Total mortgage payment on the hybrid ARM is \$895; the total mortgage payment for the new fixed rate mortgage must be \$1,074 or less.

**Reference:** For additional information on ARM to fixed rate refinancing see [4155.1 6.C.4.e](#).

---

### 4155.1 6.C.5.d Net Tangible Benefit of Fixed Rate to ARM Refinance

Fixed rate mortgages may be refinanced to one-year ARMs provided that the interest rate in the new mortgage is *at least* two percentage points below the interest rate of the current mortgage.

**Reference:** For additional information on fixed rate to ARM refinancing see [4155.1 6.C.4.f](#).

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## Section D. Energy Efficient Mortgage Program

### Overview

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**In This Section** This section contains the topics listed in the table below.

<b>Topic</b>	<b>Topic Name</b>	<b>See Page</b>
1	General Information on the EEM Program	6-D-2
2	Basic EEM Program Requirements and Criteria	6-D-6
3	Home Energy Rating System (HERS) Report Requirements	6-D-12
4	Processing and Underwriting Requirements	6-D-15

---

## 1. General Information on the EEM Program

---

**Introduction** This topic contains general information on the Energy Efficient Mortgage (EEM) Program, including

- the purpose of the EEM
  - EEM maximum allowable financing
  - FHA endorsement prior to EEM improvement installation, and
  - escrow account responsibilities and requirements.
- 

**Change Date** May 10, 2009

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**4155.1 6.D.1.a Purpose of the EEM Program** The FHA EEM Program allows a borrower to finance 100 percent of the expense of a cost effective “energy package,” that is, the property improvements to make the house more energy efficient. The EEM Program recognizes that the improved energy efficiency of a house can increase its affordability by reducing the operating costs.

Because the home is energy efficient, the occupant(s) will save on utility costs, and therefore, be able to devote more income to the monthly mortgage payment.

A cost effective energy package is one where the cost of improvements, including maintenance, is less than the present value of the energy saved over the useful life of those improvements.

Energy efficiency improvements can include energy saving equipment, and active and passive solar technologies.

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*Continued on next page*

## 1. General Information on the EEM Program, Continued

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### 4155.1 6.D.1.b EEM Maximum Allowable Financing

Under the FHA EEM Program, a borrower can finance into the mortgage 100 percent of the cost of eligible energy efficient improvements, subject to certain dollar limitations, without an appraisal of the energy efficient improvements. For the EEM Program

- the mortgage amount includes the cost of the energy efficient improvement, in addition to the usual mortgage amount normally permitted
- the FHA maximum loan limit for the area *may* be exceeded by the cost of the energy efficient improvements
- for existing properties, energy related weatherization items may be combined with the EEM, where the maximum dollar amount allowed under the EEM does not cover the cost of the entire energy package, and
- the energy efficient improvements *must* be cost effective in order to be included into the mortgage.

The amount of the cost effective energy package is added to the approved base loan amount before adding any upfront mortgage insurance premium.

The FHA maximum loan limit for the area may be exceeded by the cost of the energy efficient improvements.

For existing properties, energy-related weatherization items may be combined with the EEM, where the maximum dollar amount allowed under an EEM does not cover the cost of the entire energy package. The weatherization amount would be the cost of the improvements not covered by the EEM amount. With a 203(k), the excess improvements would be included in the rehabilitation work.

**Note:** While the energy package may be financed into the loan, the borrower does not need to qualify with the additional financing or provide additional down payment.

**References:** For more information on

- cost-effectiveness of the improvements, see [HUD 4155.1 6.D.2.d](#)
- the calculation worksheet, see [HUD 4155.1 6.D.4.b](#), and
- maximum mortgage additions, see [HUD 4155.1 2.A.5.g](#).

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*Continued on next page*

## 1. General Information on the EEM Program, Continued

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**4155.1 6.D.1.c  
Escrow  
Account  
Required for  
FHA  
Endorsement  
Prior to  
Improvement  
Installation**

FHA *will* endorse a mortgage for an existing property, before the energy-efficient improvements are installed, provided that the lender establishes an escrow account and deposits funds into the account to pay for the energy-efficient improvements.

The escrow account must be established for no more than 90 days (or 180 days for Section 203(k) rehabilitation mortgages), and, if the improvements are not completed within 90 days (or 180 days for Section 203(k) rehabilitation mortgages), the lender must apply the funds held in escrow to a prepayment of the principal balance of the mortgage.

**Note:** For new construction, there is no escrow account since the energy package is installed as part of the total construction, which must be completed prior to closing. The energy package must be completed before the mortgage is eligible for insurance, if using FHA's Construction-Permanent mortgage.

**Reference:** For more information on lender responsibilities for the escrow account, see [HUD 4155.1 6.D.1.d](#).

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*Continued on next page*

## 1. General Information on the EEM Program, Continued

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**4155.1 6.D.1.d**  
**Lender**  
**Responsibilities**  
**for the EEM**  
**Escrow**  
**Account**

In order for FHA to insure a mortgage prior to installation of energy-efficient improvements, the lender must

- ensure that an escrow account is established and insured at a financial institution supervised by a Federal agency, and that the appropriate funds are deposited into the account
- administer the account, or arrange for administration by a
  - utility company
  - nonprofit organization, or
  - government agency
- execute Form [HUD-92300](#), *Mortgage Assurance of Completion*, to indicate that the escrow for the improvements has been established, and
- upon completion of the improvements
  - inspect the improvements, or arrange for inspection by the rater or an FHA fee inspector, and
  - notify FHA, through the FHA Connection, that the improvements have been made and that the escrow has been cleared.

**Notes:**

- The borrower *cannot*
    - be paid for labor (sweat equity) on work he/she performed, or
    - receive cash back from the mortgage transaction.
  - If the improvements are not completed within 90 days, or 180 days for a 203(k) rehabilitation mortgage, the lender must apply the funds held in escrow to a prepayment of the mortgage principal.
-

## 2. Basic EEM Program Requirements and Criteria

---

**Introduction** This topic contains information on basic EEM program requirements and criteria, including

- eligible EEM properties and programs
  - underwriting the EEM
  - appraisal requirements
  - the cost of energy efficient improvements
  - determining the energy package
  - when work differs from the approved energy package
  - the required inspection by a HERS representative
  - requirements for the HERS representative, and
  - the requirement for streamline refinance transactions.
- 

**Change Date** October 26, 2009

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**4155.1 6.D.2.a Eligible EEM Properties and Programs** New and existing one to four unit properties, including one unit condominiums and manufactured housing properties, are eligible for the EEM Program.

EEMs may be used for both purchases and refinances, including streamline refinances, with

- Section 203(b)
- Section 203(k) rehabilitating loans
- Section 234(c) units in condominium projects, and
- 203(h) mortgages for disaster victims

**Note:** The allowable EEM dollar amount is for the entire property, and not based on a per unit base for multiple unit properties.

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## 2. Basic EEM Program Requirements and Criteria, Continued

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### 4155.1 6.D.2.b Underwriting the EEM

The mortgage is initially underwritten as if the energy package did not exist, by using standard FHA underwriting standards, qualifying income ratios, and maximum mortgage/minimum down payment requirements without regard to the energy package.

For an EEM on new construction, as well as those homes that were built to the 2000 International Energy Conservation Code, formerly known as the Model Energy Code, or are being retrofitted to that standard, the borrower in addition to the cost of improvements, can get “stretch ratios” of 33% and 45%.

Also for new construction, when qualifying the borrower, the cost of the energy package should be subtracted from the sales price (since the builder has included those improvements in the sales price) and the qualifying ratios calculated on this lower amount.

FHA does not set the fees for the Home Energy Rating, including the physical inspection, the HERS Report, and any post-installation test. The fees charged to the borrower for the Home Energy Rating must be customary and reasonable for the area. These fees may be included and financed as part of the energy package if the entire package, including those fees, is cost-effective. If not, such fees are considered closing costs. With a Section 203(k), the rating fee and inspections would be in addition to the consultant’s fee.

**Note:** FHA’s TOTAL mortgage scorecard may also be used for underwriting EEMs. If the lender obtains an “accept” or “approve” on a mortgage loan application, FHA will recognize the risk rating from TOTAL and permit the increase to the mortgage payment without re-underwriting or rescoring provided that the lender’s DE underwriter attests that he or she has reviewed the calculations associated with the energy efficient improvements, and found the mortgage and the property to be in compliance with FHA’s underwriting instructions.

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## 2. Basic EEM Program Requirements and Criteria, Continued

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### 4155.1 6.D.2.c Appraisal Requirements

There is no need for a second appraisal that reflects the expense of the energy package and the improvements. The appraisal does not need to reflect the value of the energy package that will be added to the property for either new or existing construction.

On a Section 203(k), the after-improved value is to be used for the EEM process.

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### 4155.1 6.D.2.d Cost of Energy Efficient Improvements

Once the borrower and the property are determined eligible for FHA-insured financing, the lender determines the dollar amount of the cost-effective energy package that may be added to the mortgage amount, using the energy rating report and an EEM worksheet.

The cost of any improvement to the property is eligible for financing into the mortgage, providing it will increase the property's energy efficiency and is determined to be cost effective.

In addition to the base FHA maximum mortgage amount, which is calculated on the value of the home, the loan amount for an EEM can be increased by the cost of effective energy improvements. The maximum amount of the cost of the energy efficient improvements that may be added to the base mortgage amount is up to the *least* of 5% of

- the value of the property
  - 115% of the median area price of a single family dwelling, or
  - 150% of the conforming Freddie Mac limit.
- 

*Continued on next page*

## 2. Basic EEM Program Requirements and Criteria, Continued

### 4155.1 6.D.2.e Determining the Energy Package

The energy package is the set of improvements agreed to by the borrower, based on recommendations and analysis performed by a qualified home energy rater using the HERS tool.

The HERS must

- meet the minimum requirements of the Department of Energy (DOE) approved ratings guidelines, and
- achieve passing results for DOE's Building Energy Simulation Test (BESTTEST), or subsequent testing requirements.

For new construction, the energy package includes those cost-effective energy improvements over and above the requirements of the 2000 IECC.

### 4155.1 6.D.2.f When Work Differs From the Approved Energy Package

The table below describes the actions required if the improvement work differs from that of the approved energy package.

When the ...	Then ...
work that is done differs from the approved energy package	submit a change order, along with a revised HERS report to the DE underwriter for approval.
changes still meet the cost-effectiveness test	further analysis is <i>not</i> required.
changes <i>do not</i> meet the cost-effectiveness test	the funds for the work not included in the approved energy package must be used to pay down the loan principal.

*Continued on next page*

## 2. Basic EEM Program Requirements and Criteria, Continued

### 4155.1 6.D.2.g Required Inspection by HERS Representative

The cost of the energy improvements, including maintenance costs, and the estimate of the energy savings must be determined based upon a physical inspection of the property by a home energy rater using HERS.

The rater must be trained to perform the physical inspection and/or diagnostic tests that provide the data on the property. The home energy rater, using the HERS, prepares a written home energy rating report, and provides copies to both the homebuyer/homeowner, and the lender.

The HERS report provides estimates of the costs of improvements and the expected energy savings. The report is developed either from

- a physical inspection of the existing property, or
- the plans and specifications of the house being built.

The lender must include a copy of the HERS report and Energy Efficient Mortgage Worksheet in the closing package, placed behind Form [HUD-92900-LT, FHA Loan Underwriting and Transmittal Summary](#), when requesting insurance endorsement.

**References:** For more information on

- requirements for the HERS representative, see [HUD 4155.1 6.D.2.h](#), and
- information for the home energy rating report, see [HUD 4155.1 6.D.3](#).

### 4155.1 6.D.2.h Requirements for the HERS Representative

The HERS representative or energy consultant, must be an independent entity. He/she cannot be related directly or indirectly to the seller of the property, the prospective borrower, or the contractor selected by the borrower to install the energy efficient improvements.

The HERS representative or energy consultant may be

- a utility company
- a local, state, or Federal government agent
- an entity approved by a local, state, or Federal government agency specifically for the purpose of providing home energy ratings on residential properties, or
- a nonprofit organization experienced in conducting home energy ratings of residential properties.

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## 2. Basic EEM Program Requirements and Criteria, Continued

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**4155.1 6.D.2.i  
Requirement  
for Streamline  
Refinance  
Transactions**

For a streamline refinance, the borrower's P&I payment on the new loan, including the energy package, may be greater than the P&I payment on the current loan, provided the estimated monthly energy savings as shown on the HERS report exceeds the increase in the P&I.

On a streamline refinance without an appraisal, the original principal balance substitutes for an appraised value.

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### 3. Home Energy Rating System (HERS) Report Requirements

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**Introduction** This topic contains information on the requirements for the home energy rating report, including

- HERS report requirements
  - required information for the HERS report, and
  - the HERS representative certification statement.
- 

**Change Date** May 10, 2009

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**4155.1 6.D.3.a  
HERS Report  
Requirements** The HERS representative or energy consultant is responsible for preparing the home energy rating report. He/she must

- prepare the report in writing, and
- provide a copy to the
  - prospective borrower, and
  - lender.

**Note:** The lender must include a copy of the home energy rating report in the closing package, when requesting insurance endorsement.

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### 3. Home Energy Rating System (HERS) Report Requirements, Continued

**4155.1 6.D.3.b Required Information for the HERS Report** The energy package report prepared by the HERS representative must include the information described in the table below.

Type of Information	What to Include
General Information	Include <ul style="list-style-type: none"> <li>• the address of the property</li> <li>• the name of the homebuyer(s)/homeowner(s)</li> <li>• the FHA case number (if applicable)</li> <li>• the name of lender (if applicable)</li> <li>• the type of property</li> <li>• identify new or existing property, and</li> <li>• the date of the               <ul style="list-style-type: none"> <li>– physical inspection of the existing property, or</li> <li>– plan review for new construction.</li> </ul> </li> </ul>
Energy Features Description	Include a description of the energy features currently at the property (or proposed features if new construction), including, at a minimum <ul style="list-style-type: none"> <li>• a description of the insulation R values in ceilings, walls, and floors</li> <li>• infiltration levels and barriers (caulking, weatherstripping, and sealing)</li> <li>• a description of the windows (storm, double pane, triple pane) and doors, and</li> <li>• a description of the heating (including water heating) and cooling systems.</li> </ul>
Energy Package Description	Include a description of the energy package, which for <ul style="list-style-type: none"> <li>• <i>existing properties</i>, includes those cost-effective improvements recommended to improve the energy efficiency of the property, or</li> <li>• <i>new construction</i>, includes those cost-effective improvements to be included in the home that exceeded the requirements of 2000 IECC.</li> </ul>

Continued on next page

### 3. Home Energy Rating System (HERS) Report Requirements, Continued

#### 4155.1 6.D.3.b Required Information for the HERS Report (continued)

Type of Information	What to Include
Energy Package Estimate	Include estimated costs of the energy package, the useful life, and the costs of any maintenance over the useful life of the improvements.
Annual Estimates	<p>The estimated present annual utility costs, before installation of the energy package, for existing property and for new construction (i.e., a referenced house built to 2000 IECC standards)</p> <p>Include the estimated annual</p> <ul style="list-style-type: none"> <li>• costs <i>after</i> installation of the energy package, and</li> <li>• savings in utility costs <i>after</i> installation of the energy package, including the present value of the savings.</li> </ul> <p><i>Note:</i> The present value test is a statutory requirement. Actual energy savings cannot be used to determine cost effectiveness in lieu of the present value calculation of the energy savings.</p>
Inspection Report Names	Include printed name(s) and signature(s) of the person(s) performing the inspection and preparing the report, as well as the date of the report.

**4155.1 6.D.3.c HERS Representative Certification Statement** The following certification statement must be signed by the person(s) who

- inspected the property, and
- prepared the HERS report.

*“I certify, that to the best of my knowledge and belief, the information contained in this report is true and accurate and I understand that the information in this report may be used in connection with an application for an energy efficient mortgage to be insured by the Federal Housing Administration of the United States Department of Housing and Urban Development.”*

## 4. Processing and Underwriting Requirements

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<b>Introduction</b>	<p>This topic contains information on the processing and underwriting requirements, including</p> <ul style="list-style-type: none"> <li>• processing an EEM, and</li> <li>• the Energy Efficient Mortgage Worksheet.</li> </ul>
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<b>Change Date</b>	May 10, 2009
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<b>4155.1 6.D.4.a Processing an EEM</b>	<p>When a borrower submits a loan application, the lender processes the loan application and qualifies the borrower using the standard underwriting requirements and qualifying ratios.</p>
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If the borrower elects to have an EEM and add the cost of the energy efficient improvements to the mortgage, the lender must complete the additional processing steps found in the table below.

Step	Action
1	<p>Obtain the home energy rating report prepared by a HERS representative or energy consultant showing</p> <ul style="list-style-type: none"> <li>• the estimated costs of installing the energy efficient improvements, including any maintenance costs, and</li> <li>• the estimated annual savings in utility costs that will result from the installation of the energy efficient improvements.</li> </ul>
2	<p>Using the HERS report, determine whether the energy efficient improvements are “cost effective” by calculating the</p> <ul style="list-style-type: none"> <li>• <i>present cost</i> of the energy improvements, including maintenance costs (if any) over the useful life of the improvements, and</li> <li>• <i>present value of the energy savings</i> over the useful life of the energy improvements.</li> </ul>

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## 4. Processing and Underwriting Requirements, Continued

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### Processing an EEM (continued)

Step	Action
3	<p>Are the energy-efficient improvements cost effective (meaning that the present <i>cost</i> of improvements is <i>less</i> than the present value of the energy savings)?</p> <ul style="list-style-type: none"> <li>• If <i>yes</i> <ul style="list-style-type: none"> <li>– add 100 percent of the cost of the energy-efficient improvements, subject to the dollar limits described in <a href="#">HUD 4155.1 6.D.2.d</a>, to the otherwise allowable maximum mortgage amount, and</li> <li>– go to Step 4.</li> </ul> </li> <li>• If <i>no</i>, do <i>not</i> include the additional expense of the energy package in the maximum mortgage amount.</li> </ul> <p><b>Note:</b> If the improvements <i>are</i> determined to be cost effective, no appraisal is necessary and the borrower is not required to meet any further credit standards.</p>
4	Calculate the UFMIP on the full mortgage amount, which includes the cost of the energy improvements.

*Continued on next page*

## 4. Processing and Underwriting Requirements, Continued

**4155.1 6.D.4.b** The following is a copy of the *Energy Efficient Mortgage Worksheet*.  
**Energy  
 Efficient  
 Mortgage  
 Worksheet**

<b>Energy Efficient Worksheet</b>		
Borrower's Name:		FHA Case No.:
Property Address:		
A. Qualifying Mortgage Amount	1. Mortgage (w/o MIP)	A. \$ _____
B. EEM Amount	The Home Energy Rating Report will provide the <ul style="list-style-type: none"> <li>• information on the Recommended Energy Package</li> <li>• cost, and</li> <li>• present value of the energy saved.</li> </ul>	
	Compare Cost and PV of energy savings: <ul style="list-style-type: none"> <li>• Cost of the Energy Package \$ _____</li> <li>• PV of Energy Saved \$ _____</li> <li>• Is PV more than Cost? Y / N</li> <li>• If Yes, Continue:</li> </ul>	
	1. If the Cost is less than \$4,000, enter the Cost in B.	B. \$ _____
	2. If the Cost is more than \$4,000, but 5% of the value is less than \$4,000, enter \$4,000 in B.	
	3. If the Cost is less than 5% of the value, but 5% of the value is more than \$4,000, enter the lesser of the cost, or \$8,000 in B.	
	4. If the Cost is greater than 5% of the value, enter the lesser of 5% of the value, or \$8,000 in B.	
C. Final EEM Mortgage Amount (without MIP)	Add A and B.	C. \$ _____
REMARKS:		

## Section E. Hope for Homeowners (H4H) Program

### Overview

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**In This Section** This section contains the topic “*General Information on the Hope for Homeowners (H4H) program.*”

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## 1. General Information on the HOPE for Homeowners (H4H) Program

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**Introduction** This topic contains general information on the HOPE for Homeowners (H4H) program, including

- a description of the H4H program
  - the effective dates for the program, and
  - a reference for comprehensive guidance on the H4H program.
- 

**Change Date** December 30, 2009

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**4155.1 6.E.1.a Description of the H4H Program** The Helping Families Save Their Homes Act of 2009 amends the National Housing Act, providing for key changes in the HOPE for Homeowners (H4H) Program.

Under the H4H program, certain borrowers who are having difficulty in paying their mortgages are eligible to refinance into affordable FHA-insured mortgages.

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**4155.1 6.E.1.b Effective Dates for the H4H Program** The H4H program is effective for *endorsements* on or after January 1, 2010 through September 30, 2011.

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**4155.1 6.E.1.c Guidance on the H4H Program** For comprehensive guidance on the H4H program, see [ML 09-43](#).

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## Chapter 7. Assumptions

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#### Chapter 7. Assumptions

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## Chapter 7. Assumptions

### 1. General Information on Assumptions

---

**Introduction** This topic contains general information on assumptions, including

- assumability restrictions
  - restrictions of the HUD Reform Act of 1989
  - mortgages subject to the 1989 Act
  - mortgages not subject to the 1989 Act, and
  - release from liability.
- 

**Change Date** May 10, 2009

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**4155.1 7.1.a  
Assumability  
Restrictions**

All Federal Housing Administration (FHA)-insured mortgages are assumable. However, since 1986, FHA has placed certain restrictions on the assumability of FHA-insured mortgages. Mortgages originated before December 1, 1986 generally contain no restrictions on assumability.

Depending on the date of the loan origination, the lender may require a creditworthiness review of the assumptor. To determine what restrictions to assumability have been placed on the mortgage, the lender must review the mortgage's legal documents.

Lenders should note that some mortgages executed from 1986 through 1989 contain language that is not enforced due to later Congressional action. Mortgages from that period are now freely assumable, despite any restrictions stated in the mortgage.

**Reference:** For more information on assumability, see [HUD 4330.1 Rev-5](#), *Administration of Insured Home Mortgages*.

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*Continued on next page*

## 1. General Information on Assumptions, Continued

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### 4155.1 7.1.b Restrictions of the HUD Reform Act of 1989

Under the HUD Reform Act of 1989, mortgages closed on or after December 15, 1989 require credit qualification of those borrowers wishing to assume the mortgage. The creditworthiness review requirement spans the life of the mortgage. This requirement applies to both

- those borrowers who take title to properties subject to the mortgage without assuming personal liability for the debt, and
- those borrowers who assume and agree to pay the mortgage.

Additionally, the Act stipulates that

- assumptions without credit approval are grounds for acceleration of the mortgage, if permitted by applicable state law and subject to HUD approval, unless the
  - seller retains an ownership interest in the property, or
  - transfer is by devise or descent, and
- private investors are prohibited from assuming insured mortgages that are subject to the restrictions of the 1989 act. (This restriction applies whether or not there is a release from liability by the lender of the selling mortgagor.)

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*Continued on next page*

## 1. General Information on Assumptions, Continued

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### 4155.1 7.1.c Mortgages Subject to the 1989 Act

Mortgages subject to the 1989 Act require that the lender automatically prepare the release from liability, thereby releasing the original owner when he/she sells by assumption to a creditworthy assumptor who executes an agreement to assume and to pay the debt, thus becoming the substitute borrower.

The due-on-sales clause generally is triggered when an owner is deleted from the title, except when that party's interest is transferred by devise, descent, or other circumstances in which the transfer cannot legally lead to exercise of the due-on-sale, such as a divorce in which the party remaining on title retains occupancy.

**Reference:** For information on processing a release from liability, see [HUD 4155.1 7.1.e](#).

---

### 4155.1 7.1.d Mortgages Not Subject to the 1989 Act

Mortgages executed before December 15, 1989 require that the lender honor all former owners' written requests to process a formal release from liability.

Lenders must grant a release from liability if the assumptor

- is creditworthy, and
  - agrees to execute a statement agreeing to assume and pay the mortgage debt.
- 

*Continued on next page*

## 1. General Information on Assumptions, Continued

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### 4155.1 7.1.e Processing a Release From Liability

In order to initiate processing of a release of liability, the lender completes [HUD Form 92210](#), *Request for Credit Approval of Substitute Mortgagor*, or other similar form used by the lender. Execution of this form does not formally release the borrower from personal liability on the mortgage note.

Execution of [HUD 92210.1](#), *Approval of Purchaser and Release of Seller*, or other similar form used by the lender constitutes a formal release of liability.

Only the lender can execute the release of liability. The lender is required to release all parties from liability when the assuming borrower is found creditworthy.

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## 2. Creditworthiness Review

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**Introduction** This topic contains information on the creditworthiness review for assumptions, including

- who determines if an assumptor is creditworthy
- contracts between servicing lenders and DE lenders, and
- additional requirements for creditworthiness review.

---

**Change Date** May 10, 2009

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**4155.1 7.2.a  
Who  
Determines if  
an Assumptor  
Is Creditworthy** The lender who is the holder or servicer of the mortgage determines the creditworthiness of the assumptor in accordance with standard mortgage credit analysis requirements.

The Direct Endorsement (DE) lender may also use an approved authorized agent to process assumptions.

Assumption creditworthiness review processing must be completed within 45 days from the date the lender receives all necessary documents.

**Reference:** For information on the allowable fees for assumption processing, see [HUD 4330.1 Rev-5](#), *Administration of Insured Home Mortgages*.

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*Continued on next page*

## 2. Creditworthiness Review, Continued

### 4155.1 7.2.b Contracts Between Servicing Lenders and DE Lenders

There are a number of servicing lenders that

- *do not* originate mortgages, or
- *are not* approved under the DE program.

In these situations, if the servicer is a supervised or non supervised financial institution, the servicer may contract with a DE approved lender to underwrite its credit qualifying assumptions. The DE underwriter must indicate his/her Computerized Homes Underwriting Management System (CHUMS) identification number of the mortgage credit analysis worksheet. The fee is negotiated between the servicer and DE lender.

Supervised lenders with a HUD approved authorized agent relationship may have the agent underwrite its credit qualifying assumptions.

### 4155.1 7.2.c Additional Credit Review Requirements

The table below lists additional creditworthiness review requirements for assumptors.

Requirement	Description
Credit Review	The lender reviews the assumptor's credit, if the mortgage being assumed is held or serviced by a DE approved lender.
Secondary Financing	Secondary financing or other borrowed funds may be used by the assuming borrowers, provided the repayment terms are <ul style="list-style-type: none"> <li>• clearly defined, and</li> <li>• included in the underwriting analysis.</li> </ul>
Seller Contributions	Cash contributions from the seller in order to facilitate an assumption are <i>not</i> acceptable. The existing mortgage balance must be reduced by the amount of the contribution.  However, the seller may pay the assumptor's normal closing costs, including processing fees and credit report fees, with no reduction to the mortgage.

*Continued on next page*

## 2. Creditworthiness Review, Continued

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### 4155.1 7.2.c Additional Credit Review Requirements (continued)

Requirement	Description
Documentation Requirements	For information on the documentation requirements for the creditworthiness review of assumptions, see <a href="#">HUD 4155.2 3.C.</a>
Assumptions by Other Legal Entities	If a creditworthiness review is required, an assumption solely in the name of a corporation, partnership, sole proprietorship, and trust, is <i>not</i> acceptable.

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### 3. LTV Reduction Requirements

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**Introduction**

This topic contains information on Loan to Value (LTV) reduction requirements for assumptions, including

- general LTV reduction requirement information
  - investors assuming mortgages, and
  - owner-occupants assuming property as a secondary residence.
- 

**Change Date**

May 10, 2009

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**4155.1 7.3.a  
General LTV  
Reduction  
Requirement  
Information**

Certain mortgages, depending on when originated, may require a reduction to the outstanding principal balance, when assumed

- by investors, or
  - as secondary residences.
- 

**4155.1 7.3.b  
Investors  
Assuming  
Mortgages**

When assuming mortgages *not* subject to the HUD Reform Act of 1989, investors must pay down the outstanding mortgage balance to a 75 percent LTV ratio *if* the owner-occupant requests a release of liability and

- the mortgage was originated by an owner-occupant pursuant to a VA Certifications of Reasonable Value (CRV) issued, or
- the mortgage is one for which a DE underwriter signed an appraisal report on or after February 5, 1988.

Either the original or the current appraised value of the property may be used to determine compliance with the 75 percent LTV limitation.

This requirement continues throughout the life of the mortgage.

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### 3. LTV Reduction Requirements, Continued

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**4155.1 7.3.c  
Owner  
Occupants  
Assuming  
Property as a  
Secondary  
Residence**

Owner occupants must pay down the outstanding mortgage balance to an 85 percent LTV ratio when assuming a property as a secondary residence for which a

- VA CRV was issued, or
- DE underwriter signed an appraisal report on or after February 5, 1988, but before January 27, 1991

Either the original appraised value or the current appraised value of the property may be used to determine compliance with the 85 percent LTV limit.

Mortgages pursuant to a VA CRV or DE Lender appraisal report or master appraisal report issued or signed on or after January 27, 1991, *may not* be assumed as secondary residences, except under hardship provisions as outlined in [HUD 4155.1 4.B.3](#).

**Note:** This policy does not apply to mortgages exempt from the investor prohibitions.

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## Chapter 8. Exhibits

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## Chapter 8. Exhibits

### 1. Exhibit 1: Single Family HOC Jurisdictions

**Change Date**      May 10, 2009

**4155.1 8.1.a HOC Information**      The table below lists the location information for the Homeownership Center (HOC) jurisdictions. The telephone number is for the FHA Resource Center, which is available from 8 a.m. EST to 8 p.m. EST.

HOC	Telephone Number	Representative States		
Atlanta	1-800-CALL-FHA (225-5342)	Alabama	Indiana	Puerto Rico
		Florida	Kentucky	South Carolina
		Georgia	Mississippi	Tennessee
		Illinois	North Carolina	Virgin Islands
Denver	1-800-CALL-FHA	Arkansas	Missouri	South Dakota
		Colorado	Montana	Texas
		Iowa	Nebraska	Utah
		Kansas	New Mexico	Wisconsin
		Louisiana	North Dakota	Wyoming
		Minnesota	Oklahoma	
Philadelphia	1-800-CALL-FHA	Connecticut	Michigan	Pennsylvania
		Delaware	New Hampshire	Rhode Island
		District of Columbia	New Jersey	Vermont
		Maine	New York	Virginia
		Maryland	Ohio	West Virginia
		Massachusetts		
Santa Ana	1-800-CALL-FHA	Alaska	Guam	Nevada
		Arizona	Hawaii	Oregon
		California	Idaho	Washington

**Note:** Electronic mail requests and on-line service inquiries can be sent to [hud@custhelp.com](mailto:hud@custhelp.com) 24 hours a day, seven days a week.

## Chapter 9. Glossary

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## Chapter 9. Glossary

### 1. Glossary of Handbook Terms

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**Change Date**      May 10, 2009

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**4155.1 9.1.a**      The table below contains definitions of terms used in this handbook.  
**Definitions of**  
**Handbook**  
**Terms**

Term	Definition
Adjusted interest rate	The <i>adjusted interest rate</i> is the new interest rate effective for the 12-month period following each Change Date.  The Adjusted Interest Rate becomes the Existing Interest Rate on the next Change Date.
Calculated interest rate	The <i>calculated interest rate</i> is the Current Index, plus the Margin, rounded to the nearest one-eighth of one percentage point (0.125%).  The Calculated Interest Rate is used to determine the Adjusted Interest Rate.
Change date	The <i>change date</i> is the effective date of an adjustment to the interest rate, referred to as the Interest Rate Adjustment Date by Ginnie Mae.  The date is specified in Paragraph 5(A) of the ARM Note, and is not the date for which the monthly payments change.
Current index	The <i>current index</i> is the most recently available Index published 30 calendar days before the Change Date.
Existing interest rate	The <i>existing interest rate</i> is the interest rate effective immediately prior to any adjustment on the pending Change Date.

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## 1. Glossary of Handbook Terms, Continued

### 4155.1 9.1.a Definitions of Handbook Terms (continued)

Term	Definition
Family member	<p>A <i>family member</i> is defined as a borrower's</p> <ul style="list-style-type: none"> <li>• child, parent, or grandparent</li> <li>• spouse</li> <li>• legally adopted sons or daughters</li> <li>• child who is placed with the borrower by an authorized agency for legal adoption, and</li> <li>• foster children.</li> </ul> <p><i>Note:</i> A child is defined as a son, stepson, daughter, or stepdaughter.</p>
Federal debt	<p><i>Federal debt</i> is defined as</p> <ul style="list-style-type: none"> <li>• a VA-guaranteed mortgage</li> <li>• a Title I loan</li> <li>• a Federal student loan</li> <li>• a Small Business Administration Loan</li> <li>• a delinquent Federal taxes, or</li> <li>• having a lien, including taxes, placed against the borrower's property for a debt owed to the U.S.</li> </ul>
Identity-of-interest transaction	<p>An <i>identity-of-interest transaction</i> is a sales transaction between parties with a family, business relationship, or other business affiliates, for the purchase of a principal residence.</p> <p><i>Note:</i> An identify-of-interest transaction does <i>not</i> include an employer/employee transaction when purchasing the seller's principal residence.</p>
Index	<p><i>Index</i> is the weekly average yield on United States Treasury securities adjusted to a constant maturity of one year, published in the Federal Reserve Bulletin H.15.</p>

Continued on next page

# 1. Glossary of Handbook Terms, Continued

## 4155.1 9.1.a Definitions of Handbook Terms (continued)

Term	Definition
Initial interest rate	<p>The <b><i>Initial Interest Rate</i></b> is the rate stated in the ARM Note that will be in effect from the date of the first monthly payment for the ARM.</p> <p><b><i>Reference:</i></b> For information on the frequency of interest rate changes, see <a href="#">HUD 4155.1 6.B.4.e</a>.</p>
Margin	<p><b><i>Margin</i></b> is the agreed upon number of percentage points added to the Current Index for determining the Calculated Interest Rate.</p> <p>The number</p> <ul style="list-style-type: none"> <li>• is specified in Paragraph 5(C) of the ARM Note, and</li> <li>• remains constant for the life of the mortgage.</li> </ul>
Non-occupying borrower transaction	<p>A <b><i>non-occupying borrower transaction</i></b> is a transaction involving two or more borrowers where one or more borrower will <i>not</i> occupy the property as the principal residence.</p>
Self-employed borrower	<p>For FHA mortgage loan underwriting purposes, a <b><i>self-employed borrower</i></b> is a borrower with a 25 percent or greater ownership interest, in a business.</p>
Third party contribution	<p>A <b><i>third party contribution</i></b> is a payment by an interested third party, or a combination of parties, toward the buyer's</p> <ul style="list-style-type: none"> <li>• closing costs, per <a href="#">ML 06-04</a></li> <li>• prepaid expenses</li> <li>• discount points, and</li> <li>• other financing concessions.</li> </ul> <p><b><i>Note:</i></b> Interested parties include</p> <ul style="list-style-type: none"> <li>• real estate agents</li> <li>• builders, and</li> <li>• developers.</li> </ul>