

# FHA Mortgage

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# Chapter 1: Product Overview

## **Product Definition**

FHA Mortgages assist borrowers in becoming homeowners by offering a mortgage with lower down payment requirements and less restrictive qualifying criteria.

## **Documentation Options**

The following are the available documentation options:

- Full Documentation
- Alternative Documentation

## **Third Party Originations**

Third party originations are permitted on this product.

## **State Restrictions**

At this time, only properties in Texas are eligible for financing with NexBank.

- Cash-Out refinances are not permitted on Primary Residences

## **Servicing**

This product is service released

## Chapter 2: Product Codes

### Terms

The following terms are available:

- Fixed rate mortgages on 15 and 30 year terms.
- ARM Mortgages on 30 year terms only

### Section of the Act Codes

The table below identifies the Section of the Act Codes used to identify which HUD program the loan will be insured under.

Prefix	Corresponding Suffix
203b	703 – Standard (non-condo loans)
234c	734 – Condos
203h – Disaster	703 – Standard (non-condo)
203h – Disaster	734 - Condos
203b/251	720 – ARMs (non condo)
234c/251	731 – Condo ARMs
203h – Disaster	729 – ARMs (non-condo)
203h – Disaster	731 – Condo ARMs

### Fixed Rate Product Code Tables

These tables identify the fixed rate product codes

Fixed Rate Description	Product Code
15 Year Fixed	F15
30 Year Fixed	F30
30 Year Fixed	F100

### ARM Product Code Tables

This table identifies the ARM investor code

Fully Amortizing Description	Product Code
3 Year ARM, 30 Year Amortization	F31
5 Year ARM, 30 Year Amortization	F51

## Chapter 3: Full/Alternative Documentation

### Documentation Requirements

Full Documentation requirements are:

- Verification of Deposit (VOD) forms is permitted
- Employment and income must be evidenced using Alternative documentation

Alternative Documentation requirements are:

- A full month's most recent computer generated pay stubs with year to date (YTD) figures, and
- Copies of previous two years W-2 forms, and
- A telephone verification of the applicant's current employment documenting the date of verification and the name, title, and telephone number of the person with whom employment was verified
- Copies of the most recent two month's bank statements covering the most recent two month period in lieu of a VOD
- Self-employed borrowers require the following documentation:
  - Copies of the past two years signed and dated individual federal income tax returns
  - A balance sheet and year-to-date Profit and Loss statement
  - If the business is a corporation, "S" corporation, or partnership:
    - Copies of the signed federal business income tax returns for the previous two years plus all applicable schedules
    - A business credit report is required for corporations and "S" corporations
  - No business tax returns are required if ALL of the following 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

Note: Certified true copies may be used in lieu of the original if using Alternative Documentation

### Maximum Loan Amounts and LTVs

The maximum loan amount is limited to the local statutory mortgage loan limits as published by the HUD field offices.

Reference: The most current loan limits can be found at <https://entp.hud.gov/idapp/html/hicostlook.cfm>

Loan Purpose	Occupancy	Maximum LTV	Minimum FICO
Purchase	Primary (1 – 4 Units)	96.5%	620
Purchase (F100)	Primary (1 Unit) HUD Repo Only	100%	680
No cash-out	Primary (1 – 4 Units)	97.75%	620
Cash-out Refinance	N/A in Texas	N/A	N/A

### Minimum Cash Investment

The borrower must make a minimum cash investment into the transaction equal to 3.5% of the lesser of the sales price or appraised value.

### Minimum Cash Investment (F100)--HUD \$100 Down Program

HUD offers various incentives in conjunction with properties acquired through foreclosure. The incentives may include but are not limited to the following:

- \$100 down payment when using FHA financing.
- Sales allowances that can be used for closing costs, down payment or to make repairs to the property.\*
- Broker bonuses for owner-occupied sales.\*

\*Subject to NexBank approval on a case-by-case scenario

\*\*Title Policy is required for all HUD Repo's regardless of verbiage in the Purchase Agreement/Sales Contract

### Premium Pricing

Lenders may pay the borrower's allowable closing costs and/or prepaids through premium pricing.

- Premium pricing must be disclosed on the Good Faith Estimate and the HUD-1 Settlement Statement
  - Must include an itemized statement indicating which items are being paid on the borrower's behalf
  - Disclosing only a lump sum is not acceptable
  - Amount paid on the borrower's behalf for each item may not exceed the allowable fee permitted by the jurisdictional HOC.
  - Need not be considered as part of the 6% seller contribution limit
  -

**Caution:** Funds derived from premium priced mortgages may never be used to pay:

- Any portion of the borrower's 3.5% required contribution
- Debts, collection accounts, escrow shortages, missed mortgage payments or judgments

### Maximum Cash-Out Restrictions

FHA has no maximum cash-out restrictions, where cash out is allowed.

**Qualifying Ratios**

31%/43%, unless there are significant compensating factors or an AU approval is received.

Reference: See Chapter 20: Underwriting-General Guidelines for additional information on compensating factors and/or guidelines.

**Reserve Requirements**

- Three month's PITI is required on all purchase transactions of 3 to 4 unit properties
- No reserves are required for all other transactions.

Caution: Reserves cannot come from a gift.

## Chapter 4: Qualifying Payment and Additional ARM Information

### Qualifying Payment

The borrower will be qualified using a full PITI payment.

### Cap Structure Table

This table identifies the various Cap structures.

ARM Type	Interest Rate Caps			Margin
	Initial	Subsequent	Lifetime	
3 Year	1%	1%	5%	2.25%
5 Year	1%	1%	5%	2.25%

### Qualifying Rates

3/1 and 5/1 ARM loans are qualified at the initial Note Rate.

### Conversion Option

Not permitted.

### Loan Assumptions

FHA loans are assumable at any time. FHA has placed certain restriction on the assumption of FHA-insured mortgages since 1986. Depending on the date of loan, a creditworthiness review of the assumer may be required by the lender.

### Index Table

All FHA loans are based on the Treasury Index which is the weekly average yield on United States Treasury securities adjusted to a constant maturity of one year as published by the Federal Reserve Board.

## Chapter 5: Prepayment Penalty

**Restrictions**  
Not permitted

## **Chapter 6: Borrower Eligibility**

### **U.S. Citizens**

Permitted with no restrictions

### **Permanent Resident Aliens**

FHA will insure mortgages made to lawful permanent resident aliens under the same terms and conditions as U.S. citizens.

### **Non-Permanent Resident Aliens**

FHA will insure mortgages to non-permanent resident aliens under the same terms and conditions as U.S. citizens under the following conditions:

- Primary residence only
- The borrower must have a valid Social Security Number
- The borrower must be eligible to work in the U.S. as evidenced by an Employment Authorization Document (EAD) issued by the Bureau of Citizenship and Immigration Services (BCIS)
- If the authorization for temporary residency status will expire within one year and a prior history of residency status renewals exists, the lender may assume continuation will be granted. If there are no prior renewals, the likelihood of renewal must be determined based upon information from the BCIS.

Note: The Social Security card is not to be used as evidence of work status for non-permanent resident aliens.

### **Not-For-Profit Organizations**

Not Permitted

### **Military Personnel**

Eligible for maximum financing if a member of the immediate family will occupy the property as a Primary Residence, even if the service person is stationed elsewhere

### **Ineligible Borrowers**

- Foreign Nationals
- Irrevocable Trusts
- Life/Estate Trusts
- All other Trusts
- LLC (Limited Liability Corporation)

### **Borrowers Closing in the Name of a Trust** (Not available at this time)

An individual borrower must remain as the beneficiary and occupy the property as a Primary Residence

- Lender must be satisfied that the trust provides it with reasonable means to assure that it is notified of any subsequent change of occupancy or transfer of beneficial interest
- The trust must appear on the Security Instrument
- The individual borrower must appear on the Security Instrument when required to create a valid lien under state law, but is otherwise not required to appear
- The owner-occupant and other borrowers, if any, must appear on the Note along with the trust
- The individual borrower is not required to appear on the property deed or title

### **Non-Occupant Co-Borrower**

Permitted with the following limitations:

- If the LTV exceeds 75%, property is limited to one-unit residence only
- LTV is limited to 75% in the following circumstances:
  - The non-occupant co-borrower is also the seller, or
  - The non-occupant co-borrower is not related by blood, marriage, by law or evidence of a family-type, long-standing relationship cannot be documented
- Maximum financing is permitted for:
  - Borrowers related by blood, marriage or by law (spouse, parent-child, siblings, step-children, aunts/uncles, nieces/nephews), or
  - Unrelated individuals that can document evidence of a family-type long-standing and substantial relationship not arising out of the transaction
- Transactions in which parents help their children buy their first home are permitted as long as the non-occupant co-borrower is not developing a portfolio of rental properties
  - The amount of financial contribution by the non-occupant co-borrower and the number of properties similarly owned must be looked at closely
- All borrowers, regardless of occupancy status, must sign the Security Instrument and the Note

# Chapter 7: Occupancy Eligibility

## Primary Residences

A Primary Residence is defined as a one to four unit property that will be occupied by the owner for the majority of the calendar year.

- At least one borrower must occupy the property and sign the Security Instrument and the Mortgage Note.
- The Security Instrument requires a borrower to establish genuine occupancy in the home as the borrower’s Primary Residence within 60 days after signing the Security Instrument with continued occupancy for at least one year
- Net rental income is the appraiser’s estimate of fair market rent for all units, including the unit chosen by the borrower for occupancy, less the appraiser’s estimate for vacancies, or the vacancy factor used by the Regional Homeownership Center (HOC). This calculation is only used to determine the maximum loan amount. The borrower still must credit qualify per guidelines.

Note: Three to four unit properties must be self-sufficient, (i.e., the maximum mortgage amount may be limited so that the PITI does not exceed rental income)

## Second Homes

Not permitted

## Investment Properties

- Not Allowed

## Property Ownership Requirements/Anti-Flipping Rule

Only owners of record can sell properties that will be financed using FHA mortgages. The transaction may not involve any sale or assignment of the sales contract. Underwriters must verify seller is owner of record. Examples of acceptable documentation include: a property sales history report, a copy of the recorded deed from the seller, property tax bill, or title commitment/binder.

Note: The seller’s date of acquisition is the date of settlement on the seller’s purchase of the property. The re-sale date is the date of execution of the sales contract by the FHA buyer.

The table to follow details the eligibility and requirements involving the re-sale of properties where the current owner of record has held title for less than 12 months.

Title held by current owner of record for...	Eligibility (*)	Considerations
Less than 90 days	Not eligible	N/A
91 – 180 days	Eligible	<ul style="list-style-type: none"> <li>• A HUD-1 or other documentation must be</li> </ul>

		<p>obtained from the seller to document sales price</p> <ul style="list-style-type: none"> <li>• A second appraisal must be obtained if the re-sale price is 100% or more over the price paid by the seller when the property was acquired <ul style="list-style-type: none"> <li>○ The mortgage amount must be calculated using the lowest appraised value and the conditions from the appraisal with the lowest value must be followed</li> <li>○ The second appraisal must be completed by an FHA Roster appraiser and must comply with all FHA appraisal requirements</li> </ul> </li> <li>• The lender must resolve the repairs and conditions from both appraisals</li> </ul>
181 – 365 days	Eligible	A HUD-1 or other documentation must be obtained from the seller to document sales price
1 year and more	Eligible	None
<p>*The time sales restrictions do not apply to the following sales:</p> <ul style="list-style-type: none"> <li>• Sales of properties by HUD of its Real Estate Owned, or other US Government agencies (VA/Rural Housing)</li> <li>• Sales of properties by nonprofits approved to purchase HUD-owned single-family properties at a discount with resale restrictions</li> <li>• Sales of properties by state and federally chartered financial institutions and Government Sponsored Enterprises (e.g., FNMA and FHLMC)</li> <li>• Sales of properties by local and state government agencies</li> <li>• A seller that inherited a property will not be required to hold title to that property for 90 days before he/she can sell it with FHA Insured financing <ul style="list-style-type: none"> <li>○ The seller must still be the owner of record, but the 90-day ownership period will not be required</li> <li>○ Since there was no previous sale of the property because it was inherited, there is no previous sales price that might trigger the second appraisal requirement set forth in the flipping rules</li> <li>○ Documentation evidencing the inheritance must be included in the case</li> </ul> </li> </ul>		



	<p>the family's needs</p> <ul style="list-style-type: none"> <li>○ The borrower must provide satisfactory evidence of the increase in legal dependents and how the property no longer meets the family's needs.</li> <li>○ Borrower must also pay down the outstanding mortgage balance on the present property to 75% LTV. A current appraisal must be used to determine loan-to-value compliance</li> </ul> <p><u>Note:</u> Properties previously acquired as Investment Properties are not subject to these restrictions</p>
<p>FHA Seven Unit Limitation</p>	<p>Prohibits any borrower from obtaining FHA-insured financing for a property that may be rented if the borrower has or will have a financial interest in more than seven rental units (regardless of financing type) in a neighboring area, generally defined as within a two-block radius</p>
<p>Converting Existing Homes to Rentals</p>	<ul style="list-style-type: none"> <li>○ <u>Relocations:</u> The homebuyer is relocating with a new employer, or being transferred by the current employer to an area not within reasonable and locally recognized commuting distance. A properly executed lease agreement (i.e., a lease signed by the homebuyer and the lessee) of at least one year's duration after the loan is closed is required. FHA recommends that underwriters also obtain evidence of the security deposit and/or evidence the first month's rent was paid to the homeowner.</li> <li>○ <u>Sufficient Equity in Vacated Property:</u> The homebuyer has a loan-to-value ratio of 75 percent or less, as determined by either a current (no more than six months old) residential appraisal or by comparing the unpaid principal balance to the original sales price of the property. 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.</li> </ul>

# Chapter 8: Property Eligibility

## Ineligible Properties

- Manufactured Homes
- Modular Homes
- Leaseholds
- Condos with leaseholds
- Non-warrantable Condos
- Condotels
- Native American Leasehold estates
- Cooperatives
- Working farms
- Orchards
- Hotel Condominiums
- Bed and Breakfasts
- Unique Properties

## Condominiums (Condos)

All projects must be FHA approved and meet FHA's condo guidelines.

### References:

- The website for FHA approved Condos is <https://entp.hud.gov/idapp/html/condolook.cfm>

## PUDs

PUD approval not required

## Modular Housing

Not permitted at this time

## Panelized Home

- Building in which panels, such as whole wall with windows, doors, wiring and outside siding, are factory-built, and then are transported to the site and assembled
- Built to local building codes of the jurisdiction in which it is permanently located
- Must assume the characteristics of a site-built home

## Prefabricated Home (Pre-cut)

- Building materials are factory-cut to design specifications, transported to the site and assembled
- Built to local building codes of the jurisdiction in which it is permanently located
- Must assume the characteristics of a site-built home

### **Townhouses/Row Houses**

Single-family dwelling units attached to one another by common walls, generally with a common facade; Title to the unit and its lot is vested in the individual buyer with a fractional interest in common areas, if any.

### **Unique Properties**

Not permitted

### **Acreage**

Addressed on a case-by-case basis

### **Legal Non-Conforming Zoning**

If the appraisal indicates a property's zoning is of a legal non-conforming (grandfathered use) nature, one of the following must be obtained:

- The appraiser must address the issue within the body of the appraisal, specifically state the property may be rebuilt "as is" in the event of a loss and indicate the source of the information, OR
- A letter or addendum from the appraiser must be obtained addressing the issue, specifically stating the property may be rebuilt "as is" in the event of a loss and indicate the source of the information, OR
- A letter from the county or governing municipality must be obtained stating the property may be rebuilt "as is" in the event of a loss

### **Declining Markets**

- A second FHA appraisal report will be required for properties located in a declining market with a loan amount >\$417,000 and LTV >95%
- In a declining market an appraiser must:
- Include a minimum of two active listings or pending sales on the appraisal form (in addition to the three settled sales)
- Appraisals of properties located in declining markets must include at least two comparable sales that closed within 90 days prior to the effective date of the appraisal otherwise a detailed explanation is required why the sales could not be provided
- Ensure that active listings and pending sales are market tested and have reasonable market exposure to avoid the use of over priced properties as comparables. Reasonable market exposure reflected by typical marketing times for the neighborhood
- Adjust active listings to reflect the contract purchase price whenever possible or adjust pending sales to reflect list to sale price ratios
- Adjust pending sales to reflect the contract purchase price possible or adjust pending sales to reflect list to sale price ratios
- Include the original list price, any revised list price, and total days on the market
- Reconcile the adjusted values of active listings or pending sales with the adjusted values of the settled sales provided
- Include an absorption rate analysis

## **New Construction**

Is defined as a subject property that is less than one year old whether or not it has been previously occupied. One year is measured from the date of the final certificate of occupancy to the date of application.

FHA's three categories of new construction include the following (the category is based upon the status of construction at the time the appraisal is completed):

- Proposed
  - No concrete or permanent material has been placed on site
  - Digging of footings is not considered permanent
- Under construction
  - From the first placement of concrete until 100% complete
- Existing less than one year
  - Includes all appraisals performed less than one year since receipt of final occupancy permit issued

Generally, new construction properties are limited to 90% LTV of lesser of the sales price or appraised value. For a "new construction" property to be eligible for financing greater than 90%, whether or not it has been previously occupied, one of the following must occur:

- The dwelling's site plans and materials were approved by the Departments of Veteran's Affairs (VA), an eligible DE Underwriter, or a builder under FHA's builder certification procedures before construction began, OR
- The dwelling is covered by a builder's ten year warranty plan acceptable to HUD, OR
- The local jurisdiction has issued, prior to construction, a building permit AND a certificate of occupancy or an equivalent (this option does not apply to condos or manufactured houses)

Caution: Condos must have a 2 - 10 Warranty

Documentation needed to satisfy requirements for obtaining a high ratio loan (LTV > 90%) on properties categorized as "New Construction", vary depending upon whether or not the local jurisdiction issues building permits, performs local inspections and issues Occupancy Certificates. The documentation requirements for both options are detailed below:

### **Option A:**

Local jurisdiction issues building permits, performs local inspections and issues Occupancy Certificates. All of the following is required:

- An issuance of a building permit (or equivalent – a letter from the local jurisdiction, explaining what their "equivalent" is to a building permit or occupancy certificate, must be retained in the file along with a copy of the "equivalent) by a local jurisdiction prior to construction – this permit is

acceptable evidence of “pre-approval”. A copy of the permit must be retained in the file

- An issuance of a Certificate of Occupancy (or equivalent – see above) – this certificate is evidence of the local inspections
- If the property is 100% complete at the time of appraisal, the appraisal may serve as the final inspection
- If the property is not 100% complete at the time of appraisal, a final inspection by the Appraiser – this is needed in order for the underwriter to certify the property is 100% complete and the property meets HUD’s minimum property standards which is a requirement of the HUD -92900-A
- One year Builder’s Warranty of Completion (Form HUD-92544)
- Builder’s Certification of Plans, Specifications and Site (Form HUD-92541)

**Option B:**

Local jurisdiction does NOT issue a building permit and a Certificate of Occupancy. All of the following is required:

- An Early Start Letter or proof of enrollment in a warranty plan acceptable to HUD
- One year Builder’s Warranty of Completion (Form HUD-92544)
- Builder’s Certification of Plans, Specifications and Site (Form HUD-92541)
- If the property is 100% complete at the time of appraisal, the appraisal may serve as the final inspection
- If the property is not 100% complete at the time of appraisal, a final inspection from an FHA fee inspector is required
- For proposed construction, the initial and framing inspections by the appraiser or fee inspector unless a 10 year warranty is obtained
- Design and local authority approval of individual water supply and/or sewage disposal system

Construction documentation requirements for loans with  $\leq 90\%$  LTV:

- Builder’s Certification of Plans, Specifications, and Site (Form HUD-92541)
- Final inspection by the Appraiser

Notes: The appraisal report for properties under construction that are more than 90% complete with only minor finish work remaining (buyer preference items, i.e. floor coverings, appliances, fixtures, landscaping, etc.) will be made “Subject to the following Repairs or Alterations”. This eliminates the need for construction exhibits (plans and specs, description of materials and plans for any individual water and/or septic system).

## **Chapter 9: Construction-Perm Option**

**Construction-Perm Option**

Not available at this time

## Chapter 10: Special Product Options

### Section 203h Program (Disaster Victims)

HUD has a special mortgage insurance program under Section 203h of the National Housing Act to assist victims of Presidentially –declared disaster areas. Individuals or families whose residences were destroyed or damaged to such an extent that reconstruction or replacement is necessary are eligible for 100% financing on purchase transactions. The Federal Emergency Management Agency (FEMA) provides a listing of the specific affected counties and cities and corresponding declaration dates. These lists can be accessed at the following website: <http://fema.gov>. Unless addressed below, all other requirements must meet standard guides.

- The borrower is eligible for 100% financing of the lesser of the value of the sales price or the appraised value for purchasing a one family dwelling
- The home being purchased need not be located in the area where the previous home was located
- Eligible property types are limited to one unit detached homes or units in an approved condominium project
  - Spot Approvals are also eligible
- 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. The borrower may have been the owner of the property or a renter of the property affected
  - The borrower must provide conclusive evidence of this fact
    - Documentation showing a permanent residence in the affected disaster area includes a valid driver's license, a voter registration card, utility bills, etc.
    - Documentation regarding the destruction of the residence includes an insurance report, an inspection report by an independent fee inspector or a government agency, or conclusive photographic evidence showing the destruction of damage
- Use of either Fixed or ARM loans is permitted
- Temporary buydowns are permitted per standard guides
- No down payment is required
  - Closing costs and prepaid expenses not paid by the seller must be paid by the borrower in cash or paid through premium pricing
- Same statutory mortgage loan limits as 203b apply
- HUD recognizes that victims of disasters may have to incur debts to replace personal property and will allow a total fixed payment to gross income ratio of 45% without compensating factors. The 45% ratio can also be exceeded with appropriate compensating factors.
- Borrower's application must be submitted within one year of the President's declaration of the disaster
- Only Loan Prospector (LP) can be used to evaluate the 203h Program.

- LP Findings will return the following message: “FB – Review FHA Statutory Investment Requirement for eligibility.”
- The underwriter must validate that the loan is exempt from the statutory investment requirement based upon the loan meeting the requirements of the 203h program

**Good Neighbor Next Door (GNND)**

Not available at this time.

**Energy Efficient Mortgages**

Not available at this time.

# Chapter 11: Refinance Requirements

## Introduction

A refinance involves repaying an existing real estate debt from the proceeds of a new mortgage that has the same borrowers and the same property. As long as the borrower has legal title (even though not originally on the loan), the borrower is eligible to refinance the loan.

Lenders are not permitted to allow borrowers to “skip” payments. The borrower is either to 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 homeowner in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

## Restrictions

- Special consideration must be made if the property being refinanced has been listed for sale in the last six months

## Refinance of Loans with Less Than One Year of Seasoning

If the property was acquired less than one year before the loan application and is not already FHA insured, the original sales price of the property also must be considered in determining the maximum mortgage. With 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.

Reference: See “Renovated/Remodeled Property Policy” in Chapter 16: Appraisal Requirements for additional requirements applicable to homes that have been improved in the last 12 months.

## Paying off Land Contract

- If borrower will use the loan to complete payment on a land contract, contract for deed, or similar type financing in which the borrower does not have title to the property, the mortgage may be processed as either a purchase or refinance transaction with maximum FHA insured financing, provided the borrower receives no more than \$250 cash at closing.
- If all loan proceeds are used to pay the outstanding balance on the land contract and eligible repairs, renovation, etc., the appropriate LTV ratio is applied to the lesser of:
  - The appraised value; OR
  - The total cost to acquire the property (the original purchase price plus any documented cost the purchaser incurs for rehabilitation,

repairs, renovation, or weatherization) plus allowable closing costs and, if treated as refinanced, reasonable discount points

- 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 \$250 at closing, the LTV is limited to 85% of the sum of the appraised value and allowable closing costs.

Note: Replenishment of the borrower's own cash expended for repairs, improvements, or renovation, is not considered as "cash back" provided the borrower can document with cancelled checks and paid receipts, all out of pocket funds spent for those purposes.

### **No Cash-Out Refinance Guidelines**

The maximum base mortgage cannot exceed the lesser of the following calculations, subject to the statutory limits for the area:

- Maximum Loan-To-Value Calculation, OR
- Existing Debt Calculation which includes the following:
  - Payoff of the first mortgage
    - May include interest charged by the servicing lender when payment will not be received by the first of the month
    - May include prepayment penalties assessed on a conventional mortgage or FHA Title I loan
    - May include accrued late charges and escrow shortages
    - May NOT include delinquent interest
  - Payoff of subordinate liens which are more than one year old.
    - If the subordinate lien is an equity line, and there have been advances in excess of \$1,000 within the past 12 months for purposes other than repairs and rehabilitation of the property, the line of credit is not eligible for inclusion in the new mortgage
    - Subordinate liens may remain subordinate as long as they meet FHA guidelines on subordinate financing
  - Payoff of an ex-spouse's or other co-mortgagor's equity is permitted and not considered cash-out as long as the divorce decree, settlement agreement, or other genuine equity agreement documents the equity awarded
  - Paying related closing costs, discount points, prepaids, borrower paid repairs required by the appraisal and other fees as determined acceptable by the appropriate HOC
  - Subtract any refund or UFMIP; OR
- The lesser of sales price, maximum loan-to-value calculation, and existing debt calculation must also be considered in determining the maximum mortgage amount for any property owned less than 12 months from date of application and not already FHA-insured

Notes:

- Cash back to the borrower at any closing may not exceed \$500
- Any appraisal requirements, including repairs, must be complied with before the mortgage is eligible for insurance endorsement

Reference: See Maximum LTV table in Chapter 3: Full/Alternative Documentation to determine maximum LTV calculation.

**Cash-Out Refinance Guidelines**

Not permitted in Texas

# Chapter 12: Subordinate Financing

**Definition**

Any financing that creates an additional lien against the property is considered subordinate financing. This includes soft or silent seconds which may contain no monthly payment provisions or other features forgiving the debt.

Note: Costs incurred for participating in a down payment assistance subordinate financing program may not be included in the first lien loan amount.

Caution: FHA reserves the right to reject any subordinate financing that does not serve the needs of the intended borrower or where it believes the costs to the participants outweigh the benefits derived by the homebuyer.

**Requirements**

The following requirements must be met when down payment assistance, in the form of subordinate financing, is received in conjunction with an FHA first mortgage:

- If there are any occupancy requirements or resale restrictions they must automatically and permanently terminate upon foreclosure or assignment of the insured mortgage to HUD
  - The relevant legal documents must have language that accomplishes this result
- Subordinate financing combined with the FHA first mortgage may exceed the value of the property provided that:
  - The governmental unit or nonprofit instrumentality of the government providing the financing is supporting or engaging in a neighborhood revitalization effort as approved by the local HOC for that area
  - Repayment of the subordinate lien is due only when the property is sold or the mortgage is paid in full
- The following items form the subordinate financing provider must be included in the endorsement binder:
  - Documentation showing the amount of funds provided to the borrower in each transaction
  - Copies of the loan instruments

**Allowable Sources/Loan Amount Calculations**

The following table identifies the various allowable sources of secondary financing and respective loan amount calculations.

Source	Requirements
Government Agencies	Federal, state and local government agencies, as well as nonprofit agencies considered instrumentalities of government may provide subordinate financing for the borrower's entire cash investment. <ul style="list-style-type: none"> <li>• The second lien itself must be made or held by the eligible governmental body or instrumentality</li> <li>• The FHA-insured first mortgage, when combined</li> </ul>

<p>Government Agencies (cont'd)</p>	<p>with any second mortgage or other junior liens from government agencies may not result in cash back to the borrower</p> <ul style="list-style-type: none"> <li>• The sum of all liens cannot exceed 100% of the cost to acquire the property <ul style="list-style-type: none"> <li>○ The cost to acquire may exceed the appraised value of the property</li> <li>○ The FHA insured <b>first</b> mortgage <b>cannot</b> exceed the FHA statutory limit for the area where the property is located <ul style="list-style-type: none"> <li>▪ The <b>combined</b> indebtedness, however, <b>may exceed</b> the FHA statutory limit</li> </ul> </li> </ul> </li> </ul> <p>Note: The cost to acquire includes the following: sales price, allowable borrower-paid closing costs, discount points, prepaids and repair/rehabilitation expenses</p>
<p>Non-Profit Agencies</p>	<p>Nonprofit agencies that meet the criteria described above in the Government Agency section and are considered instrumentalities of government may provide subordinate financing under the same terms as a Government Agency</p> <ul style="list-style-type: none"> <li>• The appropriate HOC is responsible for approving the nonprofit, as well as determining if it can be considered an instrumentality of the government <ul style="list-style-type: none"> <li>○ To obtain this status the nonprofit must be an entity “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)”.</li> <li>○ FHA also requires that the unit of government that established the nonprofit also must either exercise organizational control, operational control, or financial control of the nonprofit in its entirety or, at minimum, the specific homebuyer assistance program that is using FHA’s credit enhancement</li> <li>○ The HOCs review applications from nonprofits that purport to be instrumentalities of government and make approval decisions based on information submitted by the nonprofit</li> </ul> </li> <li>• Nonprofit agencies, not considered instrumentalities of government, may provide subordinate financing as above, provided: <ul style="list-style-type: none"> <li>○ The borrower must make a cash investment of at least 3.5% of the acquisition cost</li> <li>○ The combined amount of the first and second mortgages cannot exceed the statutory loan limit</li> </ul> </li> </ul>

Non-Profit Agencies (cont'd)	<p>for the area where the property is located</p> <ul style="list-style-type: none"> <li>○ The jurisdictional HOC is responsible for approving the nonprofit agency</li> </ul>
Other Organizations and Private Individuals	<ul style="list-style-type: none"> <li>• The combined amounts of the first and second mortgages do not exceed the applicable loan-to-value factor and the maximum mortgage limit for the area</li> <li>• Borrower must make cash investment of at least 3.5% of the cost to acquire the property</li> <li>• The repayment terms of the second mortgage must not provide for a balloon payment before ten years (or other such term acceptable to FHA), unless the property is sold or refinanced, and must permit prepayment by the borrower, without penalty, after giving the lender 30 days advance notice</li> <li>• The required monthly payment under both, the insured 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 are due monthly and are substantially the same in amount</li> </ul>
Borrowers 60 Years of Age and Older	<p>Borrowers 60 years of age or older may borrow the required cash investment for purchasing a principal residence, provided:</p> <ul style="list-style-type: none"> <li>• The principal amount of the insured mortgage loan, plus the note or other evidence of indebtedness in connection with the property, may not exceed 100%</li> <li>• The lender is relative of the borrower, a close friend with a clearly defined interest in the borrower, the borrower's employer, or an institution established for humanitarian or welfare purposes</li> <li>• The lender's interest is not solely in the sale of the property, such as a builder or seller, or any person or organization associated with builders or sellers</li> <li>• The note or evidence may not bear an interest rate exceeding the interest rate of the insured mortgage</li> </ul>
Family Member Lending	<p>Family members are permitted to lend, on a secured or unsecured basis, up to 100% of the borrower's required cash investment which may include:</p> <ul style="list-style-type: none"> <li>• Down payment</li> <li>• Closing costs</li> <li>• Prepays</li> <li>• Discount points</li> </ul> <p><u>Note:</u> A "Family Member" is defined as the following relatives of the borrower or the borrower's spouse:</p>

Family Member Lending (cont'd)	<ul style="list-style-type: none"><li>• Child (daughter, stepdaughter, son or stepson)<ul style="list-style-type: none"><li>○ Includes legally adopted children or foster children</li></ul></li><li>• Parent</li><li>• Grandparent</li></ul> <p><u>Reference:</u> See HUD Handbook 4155.10 for additional details</p>
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**Calculating CLTV Ratio**

Divide the sum of the first lien mortgage and the total credit line limit/loan balance and any other subordinate financing by the lesser of the sales price or appraised value.

## Chapter 13: Temporary Buydowns

### **Restrictions**

Temporary buydowns are not permitted at this time.

# Chapter 14: Appraisal Requirements

## Appraisal

The information in the report must be accurate, internally consistent, written in clearly understandable language, fully supported and sufficiently documented to FHA standards

- All transactions require Form 1004MC
- For existing properties > one year old, the appraisal report must be dated within 180 days of the note date
- For new construction, the appraisal report must be within 12 months of the note date. (See Date of Conditional Commitment)
- For refinance transactions requiring an appraisal, a new appraisal is always required
- Properties that have been listed for sale within the last six months are ineligible for refinance transactions
- An Operating Income Statement will be required on all 2 to 4 unit properties
- Properties appraised in “Fair Condition” are unacceptable. The property must be brought up to at least “Average Condition”, prior to closing
  - A final inspection showing the work has been completed must be included in the file
  - Escrow holdbacks may be permitted
  - A re-certification of value is not acceptable even if the existing appraisal is less than six months old
  - Refinance appraisals are valid for 180 days

## References:

- See Property Ownership Requirements/Anti-Flipping Rule section in Chapter 9: Occupancy Eligibility for appraisal requirements associated with the FHA Anti-Flipping Rule

## Acceptable Appraisal Forms

The table below reflects the correct appraisal forms that should be used

Appraisal Report Name	Freddie Mac/Fannie Mae Form Number	Specific Use
Uniform Residential Appraisal Report	Form 70/1004	Required on 1 unit properties
Small Residential Income Property Appraisal Report (2-4 units)	Form 72/1025	Required on 2-4 unit properties
Individual Condominium Unit Appraisal Report	Form 465/1073	Required on Condominiums

### **Cost Approach**

The cost approach to valuation will be mandatory for:

- Unique properties
- Properties with specialized improvements

If required, the appraiser is to complete the Cost Approach section of the appraisal report as detailed in HUD Handbook 4150.2

Note: The Remaining Economic Life must be completed for every FHA loan whether or not the cost approach is required.

Note: Effective with case numbers assigned 10/1/09 or later the appraisal must be completed by a certified residential or certified general appraiser.

# Chapter 15: Survey and Inspection Requirements

## Survey Requirements

If the title company insuring the mortgage requires a survey to remove exception to survey matters, the survey must conform to the requirements of the title insurance company's standards, or any applicable legal standards relating to surveys.

Note: A copy of the required survey, whether new or existing, must be in the closed loan package.

## Inspection Requirements

The table below identifies a few examples of inspections that could be required.

Note: Additional inspections may be required at the discretion of the appraiser or underwriter.

Type of Inspection/Test	When Required
Wood Destroying (Termite)	<ul style="list-style-type: none"> <li>• Evidence of active infestation, or</li> <li>• Mandated by state or local jurisdiction, or</li> <li>• Customary to the area</li> </ul>
Well (Individual Water System)	<ul style="list-style-type: none"> <li>• Mandated by state or local jurisdiction, or</li> <li>• Knowledge that well water may be contaminated, or</li> <li>• Evidence of:               <ul style="list-style-type: none"> <li>○ Corrosion of pipes (plumbing), or</li> <li>○ Areas of intensive agriculture within ¼ mile, or</li> <li>○ Dump, junkyard, landfill, factory, gas station, or dry cleaning operation within ¼ mile, or</li> <li>○ Unusually objectionable taste, smell or appearance of well water</li> </ul> </li> </ul>
Septic	<ul style="list-style-type: none"> <li>• Evidence of system failure, or</li> <li>• Mandated by state or local jurisdiction, or</li> <li>• Customary to the area</li> </ul>
Distances between Well and Septic	<p>The appraiser should request a copy of a survey form the homeowner, if available, that would show the distances.</p> <ul style="list-style-type: none"> <li>• The appraiser is not required to sketch the distances between the well and septic but should note in the appraisal if the distances appear to be met as well as note any adverse inspections or due diligence               <ul style="list-style-type: none"> <li>○ It is the lender's decision as to whether a qualified third party should map out these instances</li> </ul> </li> </ul>

<p>Distances between Well and Septic (cont'd)</p>	<ul style="list-style-type: none"><li>○ In cases where the lot is small and depending on the location of the well, the lender may want to get a survey</li><li>● Therefore, when the appraiser states in the appraisal report that the distances do not appear to meet FHA requirements, then the lender must obtain a survey to verify the distances</li></ul> <p><u>Note:</u> If the appraiser makes no statement in the appraisal, then it is the lender's discretion/decision whether to obtain a survey</p>
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# Chapter 16: Escrow

## **Introduction**

An escrow account must be established for real estate taxes, hazard insurance, monthly MIP and if applicable, flood insurance

# Chapter 17: Mortgage Insurance Requirements

## Mortgage Insurance Premium Requirements

The table below identifies mortgage insurance premium (MIP) requirements

Type of MI Premium	Term	LTV	Factor
Upfront MIP - Purchase Money Mortgage and Full Credit Qualifying Refinances	Any	Any	1.75%
Annual MIP for all loans	> 15 years	≤95%	0.50%
	> 15 years	>95%	0.55%
	≤ 15 years	≤ 90%	None
	≤ 15 years	> 90%	0.25%

### Notes:

- Upfront MIP (UFMIP) is determined by multiplying the base loan amount by the UFMIP factor
- The Annual MIP is determined by multiplying the base loan amount by the appropriate Annual Premium factor. Since the Annual MIP is collected in monthly installments, divide the resulting number by 12 to obtain the monthly premium. This figure is included in the proposed monthly housing expenses and qualifying ratios

### Cancellation of Annual MIP

- For mortgages with terms greater than 15 years, the annual MIP will be cancelled when the LTV reaches 78%, provided the borrower has paid the annual MIP for at least five years. The LTV is calculated using the lesser of the original appraised value or original sales price. When the LTV reaches 78% based on either of these amounts, the MIP is cancelled. The borrower does not need to refinance the mortgage to have their MIP cancelled.
- For mortgages with terms of 15 years or less, the annual MIP will be cancelled when the LTV reaches 78%

Note: An annual MIP of 0.50% will be collected the entire duration of the loan for Condos and 203k loans closed prior to January 1, 2006, regardless of term or LTV.

# Chapter 18: Underwriting – General Guidelines

## Introduction

The following requirements are for manually underwritten mortgages. Follow AUS feedback for LP/DU processed loans. Generally, all loans will be underwritten to FHA guidelines along with the underwriting parameters outlined in these guidelines.

- The “Four C’s of Credit” are evaluated during the underwriting process:
  - Credit History
  - Capacity to Repay
  - Cash to Close
  - Collateral
- FHA’s “base line” credit policies are made up of the following:
  - The types of income that may be considered in qualifying the borrower
  - The liabilities that must be included in determining creditworthiness
  - Debt-to-income ratios
  - Compensating factors

Note: Social Security Number (SSN) verification is required on all loans. Each borrower must provide evidence of his or her SSN to the lender. The lender must validate the SSN by obtaining pay stubs, valid tax return transcripts from the IRS, passport or by using an SSN validation service. The lender must resolve any inconsistencies in the SSN or multiple SSNs revealed during processing and underwriting.

## Package Submission

NexBank has delegated underwriting authority; therefore e-submit your loans to your local underwriting/fulfillment center

## Automated Underwriting Eligibility

The use of Loan Prospector (LP) or DO/Desktop Underwriter (DU) is permitted on this product.

Reference: See the ARM product code table in Chapter 6: ARM Product Codes and Additional Information, for ARM plan codes that are required when submitting an ARM loan through DU.

## Automated Underwriting Guidelines

- NexBank has delegated underwriting authority
- Loans must receive an Accept or Approve/Eligible
- AU usage is mandatory
- Any documentation relief can be utilized on this product
- Any appraisal relief cannot be utilized on this product
- The minimum FICO score is 620, no exceptions

Reference: See subtopic “Examples of Compensating Factors” in this Chapter

- Manual downgrade is required if the credit report reflects any disputed accounts

### Credit Guidelines

Use the following guidelines for loans not submitted through an AU system. The table below identifies various credit topics and the respective considerations for each.

Topic	Consideration
Credit Alert Interactive Voice Response System (CAIVRS)	<p>Is a Federal government-wide repository of information on those individuals with delinquent or defaulted Federal debt and on those for whom a payment of an insurance claim has occurred</p> <ul style="list-style-type: none"> <li>• Must be checked for all borrowers through: <ul style="list-style-type: none"> <li>○ FHA Connection</li> </ul> </li> <li>• CAIVRS authorization code for each borrower must be written on the MCAW (92900LT)</li> </ul> <p><u>Reference:</u> See HUD Handbook 4155.1 for details</p>
Traditional Credit Report	<p>Reports that fail to show bankruptcies, judgments, lawsuits, foreclosures and tax liens:</p> <ul style="list-style-type: none"> <li>• Must be supplemented with a corrected report</li> <li>• File must contain credit report and documentation in writing, an analysis of the reasons for any discrepancies between the credit reports</li> <li>• The lender must reconcile any inconsistency on the credit report</li> <li>• Borrower must explain in writing all inquiries shown on the credit report in the last 90 days</li> </ul>
Previous Rental or Mortgage Payment History	<p>The lender must determine the borrower's payment history of housing obligations through one of the following:</p> <ul style="list-style-type: none"> <li>• Credit report</li> <li>• Verification of Rent (VOR) directly from the landlord <ul style="list-style-type: none"> <li>○ No identity-of-interest with the borrower may exist</li> </ul> </li> <li>• Verification directly from mortgage servicer</li> <li>• Cancelled checks covering the most recent 12 month period</li> <li>• No late payments covering the most recent 12 month period</li> </ul>
Recent and/or Undisclosed Debts	<p>The lender must determine the purpose of any recent debts, as the indebtedness may have been incurred to obtain part of the required cash investment on the property being purchased</p> <ul style="list-style-type: none"> <li>• The borrower must provide a satisfactory</li> </ul>



Judgments (LP and DU Refer or Manually Underwritten Loans) (cont'd)	<ul style="list-style-type: none"> <li>○ Even though the accounts may be paid in full, the delinquent obligation must be considered as an indication for the borrower's regard for credit</li> </ul>
Collections and Judgments (LP and DU approvals)	<p>The FHA Total Scorecard manual states that FHA does not require the payoff of collection accounts as the Accept/Approve risk classification triggers neither an explanation requirement , nor a hypothetical monthly payment to be used in qualifying the borrower</p> <ul style="list-style-type: none"> <li>• If there is an established payment arrangement made for a collection account, this amount should be used in the debt ratio</li> <li>• The presence of collection accounts in the borrower's credit history already results in lowering the credit bureau scores used in TOTAL scorecard and thus, no further information need be provided by the borrower</li> </ul> <p>All judgments, tax liens and mechanics' or material men's liens whether or not the loan received an Accept or Approve/Eligible decision must be paid in full at or before the loan closing</p> <ul style="list-style-type: none"> <li>• An exception may be made if the borrower has agreed with the creditor to make regular and timely payments on the judgment, and documentation is provided that the payments have been made in accordance with the agreement provided in our mortgage lien will be in first lien position</li> </ul>
Previous Mortgage Foreclosure	<p>The existence of previously foreclosed properties within three years is generally not eligible for a new FHA-insured mortgage</p> <ul style="list-style-type: none"> <li>• If the foreclosure was the result of documented extenuating circumstances that were beyond the control of the borrower and the borrower has re-established good credit since the foreclosure, the lender may grant an exception to the three year policy.</li> </ul> <p>Note: Extenuating circumstances include serious illness or death of a wage earner, but do not include the inability to sell the house because of a job transfer or relocation to another area</p>
Bankruptcy	History/existence permitted provided:

	<ul style="list-style-type: none"> <li>• Chapter 7 (liquidation): Borrower’s discharge date of the bankruptcy must be at least two years from date of application to be eligible for FHA-insured mortgage <ul style="list-style-type: none"> <li>○ An elapsed period of less than two years, but not less than 12 months, may be acceptable if: <ul style="list-style-type: none"> <li>▪ The borrower can show that the bankruptcy was caused by extenuating circumstances beyond his or her control, and</li> <li>▪ Has since exhibited a documented ability to manage his or her financial affairs in a responsible manner</li> </ul> </li> <li>○ Additionally, the lender must document that the borrower’s current situation indicates that the events that led to the bankruptcy are not likely to recur</li> </ul> </li> <li>• Chapter 13 (repayment): <ul style="list-style-type: none"> <li>○ Document that at least one year of the payout period has elapsed and all required payments have been paid on time, and</li> <li>○ Borrower must have permission from the court to enter into the mortgage transaction</li> </ul> </li> </ul>
<p>Consumer Credit Counseling Plans</p>	<p>For Manually Underwritten Mortgages, participation in a consumer credit counseling payment program does not disqualify a borrower from obtaining an FHA-insured mortgage provided:</p> <ul style="list-style-type: none"> <li>• Document that one year of the pay-out period has elapsed under the plan, and</li> <li>• The borrower’s payment performance has been satisfactory (i.e., all required payments made on time), and</li> <li>• Receive written permission from the counseling agency to enter into the mortgage transaction</li> </ul> <p>For LP and DU approvals, the FHA Total Scorecard manual also states that the borrower’s decision to participate in Consumer Credit Counseling (CCCS) does not trigger a requirement for additional documentation since the credit bureau scores already reflect any degradation in credit history</p> <ul style="list-style-type: none"> <li>• The borrower’s credit history, not voluntary participation in CCCS is the important variable in scoring the mortgage and thus, no explanation or</li> </ul>

	other documentation is needed
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**Nontraditional Credit Verification and Evaluation**

Not available at this time.

**Selecting the Credit Score**

We require the “Middle/Lower then Lowest” method to be used when selecting the credit score. To use the “Middle/Lower then Lowest” method, the Underwriting Score for each borrower must be determined.

This procedure to establish Underwriting Scores should be used for each borrower on the loan. Once the Underwriting Score for each borrower is determined, the lowest of these scores should be used (if more than one borrower is on a loan) to determine if minimum FICO requirements are met as listed in the Minimum Credit Score section below.

If...	Then...
Three usable FICO scores are received from the borrower	The middle score will be used as the Underwriting Score  <u>Note:</u> When two scores are the same, that score will be used
Two usable FICO scores are received from the borrower	The lower score will be used as the Underwriting Score

Note: Merged In-File credit reports are acceptable as long as three national repositories are accessed and public records are searched.

**Minimum Credit Score**

NexBank has established 620 as a minimum FICO threshold for FHA mortgages.

Reference: See the previous subtopic Selecting the Credit Score for determining the FICO for each borrower.

**Examples of Compensating Factors**

This table identifies examples of acceptable compensating factors

Compensating Factor	Consideration
Ability to pay housing	The borrower has successfully demonstrated the ability to pay housing expenses equal to or greater than the proposed monthly housing expense for the new mortgage over the past 12-24 months
Down Payment	The borrower makes a large down payment (10% or more) toward the purchase of the property
Savings	The borrower has demonstrated an ability to accumulate savings and a conservative attitude toward the use of credit
Previous housing expense	Previous credit history shows that the borrower has the ability to devote a greater portion of income to

	housing expenses
Other Income	The borrower receives documented compensation of income not reflected in effective income, but directly affecting the ability to pay the mortgage including food stamps and similar public assistance benefits
Increased housing expense	There is only a minimal increase in the borrower's housing expense
Cash Reserves	The borrower has substantial documented cash reserves $\geq$ three months after closing <ul style="list-style-type: none"> <li>The lender must judge whether or not the asset is liquid or readily convertible to cash and can be done so absent retirement or job termination</li> </ul>
Non-Taxable Income	The borrower has substantial non-taxable income (if no adjustment was made previously in the ratio computations)
Increased earnings	The borrower has a potential for increased earnings, as indicated by the job training or education in the borrower's profession
Trailing Spouse	The home is being purchased as a result of relocation of the primary wage-earner, and all of the following is met in regards to the secondary wage-earner: <ul style="list-style-type: none"> <li>Has an established history or employment</li> <li>Is expected to return to work</li> <li>Reasonable prospects exist for securing employment in a similar occupation in the new area <ul style="list-style-type: none"> <li>The underwriter must document the availability of such possible employment</li> </ul> </li> </ul>

### Liabilities

This table identifies liability considerations used in determining qualifying ratios

Liability/Expense	Consideration
Installment Debt	<ul style="list-style-type: none"> <li>Obligations which extend ten or more months must be included in the borrower's debt-to-income ratios</li> <li>Debts lasting less than ten months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after the loan closing</li> </ul>
Child Support Payments	Must be counted in the total debt-to-income ratios if they will continue for ten or more months
Debts not counted in Ratios	<ul style="list-style-type: none"> <li>Child care expenses</li> </ul>

	<ul style="list-style-type: none"> <li>• Student loan payments that are deferred for a minimum of 12 months from the Note date</li> <li>• Funds to cover the required investment may be obtained from certain types of loans secured against deposited funds (such as signature loans, cash value of life insurance policies, loans secured by 401ks, etc.), in which the repayment may be obtained through extinguishing the asset <ul style="list-style-type: none"> <li>○ These assets securing the loan may not be included as assets available to the borrower</li> </ul> </li> </ul>
Non-purchasing Spouses	<p>Except for the obligations specifically excluded by state law, the debts of the non-purchasing spouse must be included in the borrower's qualifying ratios if:</p> <ul style="list-style-type: none"> <li>• The borrower resides in a community property state, or</li> <li>• The property to be insured is located in a community property state</li> </ul> <p>Notes:</p> <ul style="list-style-type: none"> <li>• A credit report must be obtained for the non-purchasing spouse in order to determine the debt-to-income ratio</li> <li>• The non-purchasing spouse's credit history will be reviewed case-by-case. Major derogatory trades, records or history will be considered.</li> <li>• The non-purchasing spouse must have a valid social security number or tax payer identification number</li> </ul>

### Contingent Liabilities

This table identifies contingent liabilities used in determining qualifying ratios

Contingent Liabilities	Consideration
Mortgage Assumptions	When a borrower remains obligated on an outstanding FHA-insured, VA-guaranteed, or conventional mortgage secured by a 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 the debt is still counted against the

	<p>borrower unless:</p> <ul style="list-style-type: none"> <li>• The originating lender of the mortgage being underwritten obtains from the servicer of the assumed loan a payment history showing that mortgage has been current during the previous 12 months, or</li> <li>• An appraisal or closing statement from the sale of the property supports a value that results in a 75% or less LTV ratio (i.e., the outstanding balance on the mortgage loan minus any UFMIP, if applicable, cannot exceed 75% of the appraised value or sales price)</li> </ul>
Co-Signed Obligations	<p>If the borrower is a co-signer or is otherwise co-obligated on a car loan, student loan, mortgage, or any other obligation, the liability will still be counted as debt unless documented proof is obtained evidencing the primary obligor:</p> <ul style="list-style-type: none"> <li>• Has been making payments during the previous 12 months on a regular basis, and</li> <li>• Does not have a history of delinquent payments on the loan</li> </ul>
Prior Home PITI and/or Bridge Loan Payment	Must always be considered in the DTI ratio

### **Non-Arms Length Transactions**

Non-Arms Length Transactions, (or as FHA refers to them: Identity-of-Interest Transactions) are restricted to a maximum LTV of 85%. Identity-of-Interest is defined as a transaction between family members, business partners or other business affiliates. However, maximum financing above 85% LTV is permissible under the following circumstances:

- A family member purchasing a home as a Primary Residence from another family member. If the property being sold is the seller's Investment Property, the maximum mortgage is the lesser of:
  - 85% LTV
    - The 85% may be waived if the borrower 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; or
  - The appropriate LTV ratio applied to the sales price (plus or minus required adjustments)
- An employee of a builder purchasing one of the builder's new homes or models as a principal residence
- A current tenant purchasing the property that he or she has rented for at least six months predating the sales contract

- A lease or other written evidence must be submitted verifying occupancy
- Sales by corporations that transfer employees out of an area purchase the transferred employee's home and then resell to another employee

# Chapter 19: Underwriting – Income/Asset Documentation Guidelines

## Introduction

Stable monthly income is the borrower's verified gross monthly income from all verifiable sources which can reasonably be expected to continue through the next three years

## References:

- For further clarification of Income Categories/Requirements, see FHA Handbook 4155.10
- See "Automated Underwriting Guidelines" within Chapter 20: Underwriting – General Underwriting for allowable documentation relief options

## Salaried Borrowers

- Evidence of a two-year history of employment is required
- Verbal verification of employment (VOE); and
- Pay stubs for the most recent thirty day period showing year-to-date (YTD) income; and
- W-2 forms for the past two years
- If a borrower indicated he or she was in school or in the military during any of this time, the borrower must provide evidence supporting this claim, such as a college transcript or discharge papers
- Employment gaps spanning one month or more must be explained
- Documented seasonal employment allowances can be made

Note: Frequent job changes in the same line of work with advance income or benefits are acceptable.

## Self-Employed Borrowers

A borrower who has an ownership interest of 25% or more in a business is considered to be self-employed.

- The business must have been established for a minimum of two years
- Must have a signed 4506T
- Copies of the past two years signed individual federal income tax returns
- Copies of the past two years signed business income tax returns if the business is a corporation or an "S" corporation, or partnership
- No business tax returns are required if ALL of the following 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
- A balance sheet and year-to-date Profit and Loss statement are required

Note: A 12 to 24 month history will be considered provided the borrower has at least two years previous successful employment (or a combination of one year

employment and one year formal education or training) in that occupation, or a related occupation.

#### When Multiple Businesses Exist:

Typically, complete business tax returns for all businesses present are required. However, there are special circumstances where tax returns for only the primary business are required:

- The primary business is defined as:
  - Contributing 75% or more of the total income, and
  - 100% of the income utilized for the ratio calculations
- The business should be in existence for at least two years
- The business must show consistent or increasing net income
- Attention must be paid to the layers of risk present: low FICOs for the program/product selected, property issues, high LTV, inconsistent earnings
- There should be no other exception or risk layer other than those allowed by the program/product selected
- In some cases, a letter from the accountant stating that the non-primary business(s) are not operating at a loss may be prudent

#### **Bonus and Overtime**

May be used to qualify the borrower, provided

- It has been received for the past two years, and
- There are reasonable prospects of its continuance
- 24-month average is required

If less than two years, may be considered on a case-by-case basis

- If the earnings trend over that period of time of receipt must be established and analyzed
- Adequate documentation must be provided
- The employer must state the bonus or overtime is likely to continue, and

The reasoning for using this income must be justified

#### **Commission Income**

May be used to qualify the borrower provided:

- 24 month average is required
- Schedule A of the borrower's tax returns must be obtained to document unreimbursed business expenses
  - A 24-month average of the expenses must be deducted from income

Notes:

- Borrowers with commission income received for more than one year but less than two years may be considered favorably provided that sound rationalization for acceptance can be documented for income continuance
- Commission earned for less than one year is not considered effective income. An exception 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

**Part-time Income**

Defined as jobs taken in addition to the normal regular employment to supplement the borrower's income. If a borrower's regular employment is simply less than a typical 40-hour work week, the stability of that income should be evaluated as any other regular on-going primary employment (e.g., a registered nurse that has been working 24 hours per week for the last year. This is the borrower's primary job, even though less than 40 hours, and it should be included as effective income.)

- Seasonal employment (e.g. umpiring baseball games in summer, working at a department store during holiday shopping season) is considered an may be used in qualifying if the lender documents that the borrower has worked the same type of job for the past two years and expects to be rehired during the next season
- Income from a part-time position that has been received for less than two years may be included as effective income, provided the lender justifies and documents that the income's continuance is likely
- Income from part-time positions not meeting these requirements may be considered as a compensating factor only

**Other Income**

The table below defines the requirements for "Other Income"

Note: For all tax-exempt income, the income may be grossed up once its continuance for three years has been established.

<b>Source</b>	<b>Documentation</b>
Employer Differential Payments	If the employer subsidizes the mortgage payments through direct payment, the amount of the payment is considered gross income; it may not be used to offset the mortgage payment directly, even if the employer pays the servicing lender directly
Notes Receivable	A copy of the Note must be presented to establish the amount and length of payment
Interest and Dividends	May be used, provided that documentation (tax returns or account statements) supports a two-year history of receipt
Military Income	Income from variable housing allowances, clothing allowances, flight or hazard pay, rations and proficiency pay is acceptable, provided its probability

	of continuance is verified in writing
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
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
Mortgage Credit Certificates	If a government entity subsidizes the mortgage payments, either through direct payments or through tax rebates, these payments can be considered as acceptable income if verified in writing

### Non-Employed Income

Includes many sources of passive income such as: social security, pension or retirement income and VA benefits. The table below defines the requirements for "Non-Employed Income".

Note: For all tax-exempt income, the income may be grossed up once its continuance for three years has been established.

Source	Documentation
Retirement and Social Security Income	Verification from the source (former employer, Social Security Administration): <ul style="list-style-type: none"> <li>• Federal tax returns</li> <li>• Award letter</li> <li>• IRS 1099</li> <li>• Pension statement</li> </ul> Note: If any benefits expire within the first full three years of the mortgage term, the income may be considered as a compensating factor.
VA Benefits	Direct compensation, such as for a service-related disability, is acceptable, subject to documentation from the VA <ul style="list-style-type: none"> <li>• Education benefits, used to offset education expenses, are not acceptable</li> </ul>
Unemployment Income	Unemployment income must be documented for two years. Reasonable assurance of its continuance is also required. (This requirement may apply to individuals employed on a seasonal basis, such as farm workers, resort employees, etc.) <ul style="list-style-type: none"> <li>• IRS 1099</li> <li>• Most recent two years pages one and two individual federal income tax returns</li> <li>• Other documentation</li> </ul>
Government Assistance Programs	Income received from government assistance programs is acceptable, subject to documentation from the paying agency, provided the income is expected to

	<p>be received for at least three years</p> <ul style="list-style-type: none"> <li>• If the income is not expected to be received for at least three years, such income may be considered as a compensating factor</li> </ul>
Section 8 Income	<p>If borrower is to receive subsidies under the housing choice voucher homeownership option program from a Public Housing Agency:</p> <ul style="list-style-type: none"> <li>• Obtain documentation from Agency to prove receipt</li> <li>• Assume that the subsidy will continue for at least three years making the subsidy eligible to be considered an effective income for qualifying purposes <ul style="list-style-type: none"> <li>○ Monthly subsidy amount may be treated as income and may be grossed up by 25% in determining the homebuyer's qualifying ratios</li> <li>○ If monthly subsidy is issued via two-party check made payable to both the borrower and servicing lender, the subsidy may be used to directly offset the mortgage amount</li> </ul> </li> <li>• Identify as a Section 8 subsidized mortgage loan by entering "88" as the program identification code in CHUMS</li> </ul>
Alimony/Child Support & Separate Maintenance Income	<p>If an applicant chooses to disclose this source of income, proof evidencing the continuance of such payments for the next three years is required</p> <ul style="list-style-type: none"> <li>• The borrower must provide a copy of the divorce decree, legal separation agreement or voluntary payment agreement, and</li> <li>• Evidence that payments have been received during the last 12 months. Acceptable evidence includes cancelled checks, deposit slips, tax returns, court records, etc.</li> <li>• Periods of less than 12 months may be acceptable provided the payer's ability and willingness to make timely payments is adequately documented</li> </ul>

## Rental Income

The table below identifies requirements for rental income

Property Type	Documentation
Subject 2 to 4 unit Primary Residence	The rent received from the additional units not occupied by the borrower may be used for qualifying purposes. The rent (after subtracting the local FHA offices estimate for vacancies and maintenance, or 25% if the local FHA has not established a separate allowance) may be added to the borrower's gross income in calculating the qualifying ratios; it may not be used to offset the monthly mortgage payment
Non-Subject Investment Properties and 2-4 unit Primary Residences other than the subject property	<ul style="list-style-type: none"><li>• Signed leases may be used to calculate gross rents only if the property was acquired since the last income tax filling and is not shown on the Schedule E. however, no more than 75% of the gross rental income can be used before subtracting PITI</li><li>• For properties listed on the Schedule E from the borrower's 1040s, depreciation may be added back to the net income or less shown. Lender must make certain the borrower still owns each property listed on the Schedule E</li><li>• If six or more units are owned by the borrower in the same general area, a map disclosing the locations must be submitted evidencing compliance with HUD's seven unit limitation</li></ul>

## Reserve Requirements

The following are the reserve requirements:

- Three months PITI is required on all purchase transactions of 3 to 4 unit properties

Caution: Reserves cannot be from a gift

Note: Although reserves are not required except as stated above, additional reserves can help strengthen the overall quality of a loan.

## Asset Documentation

The following are asset documentation requirements:

- Written verification of deposit (VOD) with the most current bank statement, OR
- Two months bank statements covering the most recent months available

Note: The borrower may pay for their credit report and appraisal fee on a credit card. The new credit card payment must be counted into the ratios for qualifying the borrower. The source of the fees must be documented by one of the following:

- Copy of personal or credit card convenience check
- Credit card slip

- Bank or credit card statement
- Written on the Good Faith Estimate

### **Business Accounts for Down Payments**

In general, Business accounts should not be used as source of funds for down payment unless the business structure is as a “Sole Proprietor”, because of the potential negative impact on the health of the business. However, it is permissible to use business accounts for reserves and as a source of down payment; subject to the following:

- Any business funds used should not represent the entire source of down payment
- Attention must be paid to the layers of risk present: low FICOs for the program/product selected, property issues, high LTV, inconsistent earnings
- There should be no other exception or risk layer other than those allowed by the program/product selected
- The business should be in existence for at least two years
- The business must show consistent or increasing net income
- Borrower must demonstrate 100% ownership of the business
- Letter from borrower’s CPA stating borrower has full access to the funds and that withdrawal and use of the business funds will not negatively affect the ongoing operation of the business
- Most recent three months account statements, including all pages for all transactions

Note: Every attempt must be made to verify additional personal assets including retirement accounts.

### **Unacceptable Sources of Assets**

The following are unacceptable sources of assets:

- Proceeds of a personal or unsecured loan unless from family member
- A gift that must be repaid in full or in part
- A cash advance on a revolving charge account or unsecured line of credit

Reference: See Chapter 14: Subordinate Financing for requirements regarding unsecured loans from family members

### **Gift Fund Requirements**

An outright gift of the cash investment is acceptable if the donor is one of the following:

- Relative of the borrower
- Borrower’s employer or labor union
- Charitable organization
- Governmental agency or public entity that has a program to provide homeownership assistance to low- and moderate-income families or first-time homebuyers
- Close friend with a clearly documented interest in the borrower

The table below outlines the documentation requirements related to when the borrower received or will receive their gift funds.

**Warning:** Cash on hand is not an acceptable source of donor's gift funds

Borrower's receipt of gift funds	Documentation Requirements
For gift funds already on deposit in the borrower's account	<ul style="list-style-type: none"> <li>• Copy of the donor's withdrawal slip or cancelled check, and</li> <li>• Copy of the borrower's deposit slip and bank statement showing the deposit, and</li> <li>• Gift letter</li> </ul>
For gift funds being provided at closing	<ul style="list-style-type: none"> <li>• Verify and document the closing agent received funds from the donor, including proof of withdrawal for the amount of the gift.</li> <li>• The use of a cashier's check, money order, official check or any other type of bank check will be acceptable provided the donor provides a withdrawal document for the amount of the gift showing the funds came from the donor's own personal account</li> <li>• If the donor borrowed the gift funds, documentation must be provided that the funds were borrowed from an acceptable source, i.e. not from a party to the transaction including the mortgage lender</li> <li>• Gift letter</li> </ul>

### Gift Fund Requirements

#### Notes:

- Donor and borrower must execute a gift letter listing the following:
  - Borrower name
  - Donor's name, address and phone number
  - Donor's relationship to the borrower
  - Dollar amount of gift
  - Must state that no repayment is required
  - Must contain language asserting that the funds were not made available to the donor from any person or entity with an interest in the sale of the property

### 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 use this money as an acceptable source of funds to close

- Funds must be verified either on deposit in a financial institution or held by the escrow/title company. Additional documentation must include:
  - Evidence provided from the borrower showing ability to accumulate such a savings, and

- Written explanation from the borrower on how such funds were accumulated and the amount of time taken to do so
- Special consideration will focus on determining the reasonableness of the accumulation of the funds based on the borrower's income stream, the time period during which the funds were saved, the borrower's spending habits, documented expenses and the borrower's history of using financial institutions.

Note: Individuals with checking and/or savings accounts are less likely to save money at home than an individual with no history of such accounts.

### **Homeownership Bridal Registry**

Provides couples planning to get married, and other individuals who are in a situation where gifts are typically received, the opportunity to establish a savings account in order to help them accumulate gift funds to be used towards the down payment on the purchase of a home. The following table describes the process requirements.

<b>Stage</b>	<b>Description</b>
1	In the situation of a couple planning to get married, the originating office is to give the borrowers some form letters completed on the originating office's letterhead, which the borrowers can distribute to their family and friends <u>Note:</u> When gift funds are being received for a situation other than a couple planning to get married, it will be up to the individual(s) to notify their family and friends of the program
2	The borrowers are to open a new interest bearing savings account at the bank of their choice
3	Funds may be deposited by family and friends directly into the Bridal Registry Account, or given by cash or check to the couples or individuals for deposit
4	A copy of the bank statement and/or account ledger verifying the deposits and a fully executed Lender and Borrower Certification must be included in the HUD case binder

### **Interested Party Contributions**

Interested party contributions can be used to pay closing costs and prepaids. Interested parties include, but are not limited to:

- Builder
- Developer
- Seller of the property
- Real estate agent

Contributions from interested parties are acceptable with the following limitations:

- Maximum contribution is 6% of the property's sales price towards the buyers actual closing costs, prepaid expenses, discount points and other financing concessions

- FHA deems 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 six percent of the sales price of a property toward a buyer's actual closing costs and financing concessions, this policy applies exclusively to the provision of mortgage financing. Other expenses paid in behalf of the borrower must result in a dollar-for-dollar reduction to sales price.
- Included in the 6% limitation are buydown funds and payment of the UFMIP

Caution: Contributions exceeding 6% of the sales price must be treated as an inducement to purchase thereby reducing the amount of the mortgage.

## Chapter 20: Closing Requirements

### Closing Requirements Legal Forms Table

This table identifies the legal forms required during closing.

Product Type	Form(s) Required
All	<ul style="list-style-type: none"> <li>• FHA Mortgage/Deed of Trust for the state where the property is located</li> <li>• Initial Escrow Account Statement</li> </ul>
FHA Fixed	<ul style="list-style-type: none"> <li>• FHA Multi-state Note, or</li> <li>• FHA Note for the state where the property is located</li> </ul>
FHA ARM	<ul style="list-style-type: none"> <li>• FHA ARM Multi-state Adjustable Rate Note, or</li> <li>• FHA Adjustable Rate Note for the state where the property is located</li> </ul>

### Miscellaneous Required HUD Forms

Be sure to use the most current version of each of these forms as required or applicable.

- Buying Your Home – Settlement Costs and Helpful Information – A HUD Guide
- Homeowner’s Fact Sheet (FHA)
- “For Your Protection Get a Home Inspection” Form
- Existing loans Form NPCA-1 ([or Texas Wood Destroying Insect Report](#)) Wood Destroying Insect Infestation Inspection report
- New Construction loans – revised NPCA-99a and current NPCA-99b
- For HUD REPO Purchases only: Radon Gas and Mold Notice and Release Agreement

### Additional Closing Requirements Table

This table identifies the additional forms required as applicable

Reason	Form/Endorsement
1-4 Family Rider	Multi-state – Form 3170
Condo Rider	FHA Condo Rider
Condo Endorsement	ALTA 4 <a href="#">or T-28</a>
PUD Rider	FHA PUD Rider
PUD Endorsement	ALTA 5 <a href="#">or T-17</a>
FHA Annual Disclosure ARM Notice	<u>Reference:</u> See Chapter 6: ARM Product Codes and Additional Information for specific ARM Disclosure forms as they relate to each ARM option
Location Endorsement	ALTA 9  <u>Note:</u> Required in areas where surveys are not customary
Revocable Trust	Revocable Trust Rider (Not available at this time)
Income source documented by tax returns	Signed 4506T

### Interim Interest Credits

Borrower may receive an interest credit if the loan closes within the first five days of the month.