

FEDERAL GOVERNMENT UNDERWRITING PROGRAMS

KEY TERMS AND PHRASES

203(k) Rehabilitation Home Mortgage Insurance	Federal Housing Administration (FHA)
Acquisition cost	FHA Upfront Mortgage Insurance Premium (UFMIP)
American Recovery and Reinvestment Act of 2009 (ARRA)	FHA new minimum credit scores
Annual premium	Formal assumption
Certificate of Reasonable Value (CRV)	Prepaid items
Closing costs	Release of liability
Department of Housing and Urban Development (HUD)	Section 203(b) home mortgage insurance
Department of Veterans Affairs (VA)	Section 245 Graduated Payment Mortgage
Economic Stimulus Act of 2008 (ESA)	Simple assumption
Eligibility	Title 1 Home Improvement
Entitlement	

LEARNING OBJECTIVES

At the conclusion of this chapter, students will be able to:

- Understand the difference between a Veterans Administration mortgage loan and the primary FHA mortgage loan programs
- Describe the components of an FHA loan, including its unique requirement of mortgage insurance as a part of the closing costs and continuing mortgagor obligations
- Outline basic mortgage assumption rights of borrowers who have FHA or VA mortgage loans
- Understand the purposes and features of—as well as the mortgagor and property qualification approval process for—the popular FHA single-family mortgage products
- Describe how a veteran can qualify for a residential home loan under the guidelines of the Veterans Administration

INTRODUCTION

There are many federal agencies with programs that provide assistance to people buying homes, rehabilitating homes, renting apartments, applying for farm loans, or needing housing following a natural disaster. All involve government help in the form of a loan, a grant, or an underwriting guarantee that insures private lenders against loss. Several of the government agencies that make direct loans to borrowers were discussed in Chapter 3 as part of the discussion of primary-market lenders. This chapter is limited to two major agencies with home loan underwriting programs that have helped many people to buy and/or rehabilitate their homes. Neither is in the business of making direct loans, although they do offer financial assistance when disposing of repossessed properties. One is the Federal Housing Administration (FHA), which is under the **Department of Housing and Urban Development (HUD)**, and the other is the Department of Veterans Affairs (called the “VA”).

The oldest and probably the best-known of all government housing agencies is the FHA, and its most popular mortgage insurance programs will be outlined in this chapter. The VA was granted authority during World War II to offer housing assistance to qualified veterans in the form of a partial guaranty of a home loan.

Both agencies have one feature in common: the fact that their underwriting activities are not expected to be funded by tax revenues, but rather by fees charged to those who use the programs. The FHA has always charged an insurance premium for its underwriting commitment. The VA loan program was initially a veteran's benefit at no charge, but today a funding fee is required. The increased closing costs of both agencies' programs, plus the higher loan-to-value programs offered by conventional lenders, has made them less competitive with conventional loans, causing the FHA's market share to slowly erode to 15% between 1985 and 1993. Between 1998 and 2005, the FHA's market share declined even further, with the ascendance of alternative mortgage types such as Alternate A and subprime. Conventional mortgage lending declined to less than six percent nationwide and to nearly zero in some states, such as California.

With the subprime market collapse in 2008, however, the FHA program has seen a huge increase in origination volume. It is expected that the FHA's market share topped out at 40% of all mortgage insurance premiums written in 2010. This was caused by three factors: (1) the FHA offered the only remaining alternative for moderate-income, first-time

home buyers with less than perfect credit or little credit history; (2) HUD expanded the maximum loan limits to reach deeper into the housing market in states with higher average housing costs; and (3) Congress passed the Housing and Economic Recovery Act of 2008, which revised the National Housing Act to do the following:

1. Require that the mortgagor shall have paid, in cash or its equivalent, an amount equal to not less than 3.5% of the appraised value of the property
2. Eliminate the variable loan-to-value limits that were based on the combination of the property value and the average closing costs of the state where the property is located (also known as “down payment simplification”)
3. Limit the total FHA-insured first mortgage to 100% of the appraised value, and require the inclusion of the upfront mortgage insurance premium (UFMIP) within that limit

In 2011, the FHA tightened credit standards, incorporating minimum credit scores into the underwriting process and increasing mortgage insurance premiums. The effect is that borrowers with credit scores below 500 are not eligible. Moreover, the level of required upfront mortgage insurance premiums are now as high as 1.75%—up from 1%—and annual MIP is up to 1.35% from only .55% in 2009. Thus, the market share of FHA has declined in total mortgages made from a high of 32% of all mortgages made in 2009 to 22.3% at the end of 2013.¹

Since June 4, 2013, all new FHA-insured mortgages that require MIP payments no longer allow the cancellation of MIP payments when the loan drops below 78% of the property value or initial LTV, whichever is higher.

Congress occasionally approves housing subsidy programs that may be handled through HUD/FHA, but these fall into a separate category from the underwriting programs discussed in this chapter.

FEDERAL HOUSING ADMINISTRATION

The **Federal Housing Administration (FHA)** was one of the many agencies created by the federal government during the Great Depression to

¹“FHA Single Family Market Share 4th Quarter 2014.” Office of Risk Management and Regulatory Affairs, Office of Evaluation, Reporting & Analysis Division, Department of Housing and Urban Affairs, Sept. 30, 2014. Accessed Jan. 3, 2015 at http://portal.hud.gov/hudportal/documents/huddoc?id=FHA_SF_MarketShare_2014Q2.pdf

help resolve the economic problems that plagued the nation. It is one of the very few that survived, and it has proven its value over nearly seven decades of operation.

The reasons for which the FHA was formed in 1934 are still valid today, although its area of operations has expanded substantially from its origin as an initial assistance program for home buyers.

The purposes of the FHA are to: (1) encourage wider home ownership, (2) improve housing standards, and (3) create a better method of financing mortgage loans. All these aims have been successfully realized, even beyond original hopes. This was accomplished without making a single loan, simply by the sound use of government credit to insure mortgage loans. After its initial widespread rejection by many private lenders, a government-insured commitment is now readily salable to a large number of investors. Even in the tightest money markets, there has always been funding available for a government-insured loan.

Early History

When the FHA stepped into the housing picture in 1934, houses had been financed for 50% to 60% of their sales price on a first mortgage of three to five years, with a small second and even a third mortgage at increasingly higher interest rates. The average loan was a three- to five-year balloon note with interest only due every six months, and it was callable at the option of the bank even if payments were current should the bank need the cash to meet deposit withdrawals. The FHA introduced a better way. By offering to insure a single large loan up to 80% of value (an extremely high ratio in those days), the FHA was able to insist that the down payment be made in cash, permit no secondary financing, and command a moderate interest rate. The loans were for long terms—up to 20 years at first—and fully amortized over the life of the loan. Equal monthly payments covered principal and interest. Escrow accounts were established for hazard insurance and property taxes, requiring payment of one-twelfth of the yearly cost each month. Each monthly payment also included a premium to cover the cost of the FHA's mortgage default insurance. Most of these features were later incorporated into the loan guarantee program of the Veterans Administration and have now become normal procedure for conventional loans as well. While none of these ideas actually originated with the FHA, this agency gave them wide usage for the first time and brought about a sweeping reform in the field of residential financing.

As the FHA gained strength in its housing assistance, more titles and sections were added to its operations. While the FHA has over 50 different programs in its portfolio of assistance to borrowers for home loans, improvement loans, nursing home loans, mobile home park loans, multifamily project loans, and land development loans, our concern in this chapter is primarily with the 11 loan programs for single-family residences. Under the assistance programs for home loans, the FHA provides special help for members of the armed services, civilian employees of the armed services, and disaster victims, as well as programs in experimental housing, urban renewal, and condominium housing.

In 1993, HUD Secretary Henry Cisneros undertook a major overhaul of all multifamily housing programs, which had suffered accumulated losses in excess of \$6 billion. By then, single-family programs had recovered from a period of substantial foreclosures, and the Mutual Mortgage Insurance Fund that sustains the programs was again operating in the black. Few people really understand that the FHA mortgage program is one of the most successful, self-sustaining government programs in U.S. history—unlike so many others that have drained taxpayer resources.

HUD/FHA Terminology and Basic Procedures

All underwriting programs are implemented by the issuance of a Certificate of Insurance that protects the lender against default. The differences between the programs are based on the kind of property involved and the qualifications of the individual who needs the help. There may be lower cash requirements for some and, in certain programs, an actual subsidy of interest costs. Also, the property must meet certain standards to qualify as collateral for an insured commitment.

To handle qualification of borrowers and the property offered as collateral, HUD/FHA follows certain procedures as detailed in its *Underwriter's Guide*. There are some words and phrases with special meaning in the world of HUD/FHA loan qualification. For example, a conventional lender measures the loan amount against the property value almost regardless of its sales contract value or certain types of deferred maintenance. In the past, with an FHA loan, a distinction was made between loans of \$50,000 or less and those exceeding \$125,000. That changed with the passage of the **Economic Stimulus Act of 2008 (ESA)**, which we will discuss later. The conventional lender focuses its cash requirement on a down payment; the FHA requires 3.5% in cash at closing, which

may come from the down payment plus closing costs. Regardless of the details, the basic qualification procedures are the same—whether FHA, VA, or conventional—and their purpose is to distinguish a creditworthy borrower and evaluate the property to make sure it serves as adequate collateral for a loan. Nevertheless, to understand FHA procedures, it is necessary to understand their basic requirements. These are detailed in the following sections.

Acquisition Cost

The amount of mortgage insurance available under any HUD/FHA program is limited to a percentage of the acquisition cost. **Acquisition cost** is the *lesser* of the purchase price or the appraised value.

Calculation of Down Payment

For the purposes of this calculation, there are only two categories of loans: (1) those in the amount of \$50,000 or less, and (2) those for more than \$50,000. For loans of \$50,000 and less, the FHA insures 98.75%. For loans over \$50,000, the FHA insured commitment is 97.75%.

The amount of cash required to close is now at 3.5%, a combination of down payment plus closing costs. Previous rules allowed closing costs to be included in the insured commitment; new rules do not allow this, but the buyer can add closing costs to the down payment to achieve the 3.5% cash requirement to close.

On March 1, 2011, requirements for down payments under standard FHA Section 203(b) purchase money mortgages became tied to the borrower's credit score. The HUD Handbook 4155.1 4.A.1.c was changed to state that, if the borrower's minimum decision credit score is equal to or above 580, the loan is eligible for maximum financing and an LTV of 96.5%. If the credit score is between 500 and 579, the loan is limited to a maximum LTV of 90%, and if the credit score is less than 500, the loan is not eligible for standard Section 203(b) FHA-insured financing. Exceptions to this new tightening of underwriting standards are:

- Section 223(e)
- Section 238
- Section 247
- Section 248

- Section 255, Home Equity Conversion Mortgages (HECM)
- Title I
- HOPE for Homeowners

There are still provisions for borrowers with non-traditional or insufficient credit histories to be eligible for maximum financing, but they must meet the underwriting guidelines in HUD Handbook 4155.1 4.C.3.

Closing Costs

Permissible **closing costs** are defined by regional FHA insuring offices in accordance with local practices, and therefore are not always uniform. These costs include the HUD/FHA application fee, a lender's origination fee, costs of the title search, legal fees to prepare necessary closing instruments, and miscellaneous costs such as notary fees, recording costs, and a credit report charge. New rules were released in November 2010 that gave more flexibility in determining acceptable closing costs. Lenders may charge and collect from borrowers those customary and reasonable costs necessary to close the mortgage loan. For example, borrowers may not be forced to pay a tax service fee that lenders collect when they use a third-party vendor to determine current real estate tax payment status and annual costs rather than calling or checking with the county clerk's office themselves. 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 of 2% for HECM mortgage loans, and as of May 2009, when the Section 203(k) mortgage involves insurance of advances and partial disbursements of the Rehabilitation Escrow Account, the lender may collect from the borrower a supplemental origination fee that compensates the lender for the additional cost of disbursements and inspections of the work, limited to 1.5% of the portion of the mortgage allocated to rehabilitation or \$350, whichever is greater.

Prepaid Items

HUD/FHA distinguishes between closing costs and **prepaid items**. Closing costs are described more fully in the above paragraph. Prepaid items are property taxes, insurance premiums (including the FHA mortgage

insurance premium), and possibly subdivision maintenance fees, most of which must be placed in an escrow account with the lender. It also covers *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 on the first day of the succeeding month.

Property Taxes

The borrower must pay whatever pro rata share of property taxes may fall due for the first year plus one month in escrow at closing. HUD/FHA requires one month of all annual prepaids to be held by the lender, but allows two months to be held at lender's option as a cushion.

Subdivision Maintenance Fees

In some areas, maintenance fees are considered to be in about the same category as taxes. That is, nonpayment can result in foreclosure of the property. To protect the lender, such charges may be required to be paid into escrow.

Hazard Insurance Premium

A full year's premium for property insurance must be paid in advance of closing, plus one month of premium placed in escrow. The same requirement applies to flood insurance, if applicable.

Flood Insurance and FHA Requirements

Effective March 1, 2011, FHA required that all mortgagees obtain a flood zone determination on all properties instead of simply strongly encouraging such action. Such a determination is obtained from a review of the Federal Emergency Management Agency (FEMA) flood maps. In addition, FHA is now consistent with the Coastal Barrier Resources Act (CBRA), prohibiting FHA mortgage insurance for properties located within designated coastal barriers. Mortgagees will be required to obtain life-of-loan flood zone determination services for all properties that will be collateral for FHA-insured mortgages, as determined by FEMA flood maps. Authorized FHA lenders and servicers must comply with provisions that any property located within a designated Coastal Barrier Resource System (CBRS) unit is not eligible for an FHA-insured mortgage.

Where Are We Now?

Avoiding Foreclosure

Whether you are in foreclosure now or worried about it in the future, HUD.gov has information that can help. The HUD.gov website provides links that allow home owners to do the following:

- (EHLP)
- Learn about the U.S. Treasury's Hardest-Hit Fund Initiative
- Talk to a foreclosure avoidance counselor
- Talk to their lenders
- Find state and local foreclosure resources
- Contact HOPE NOW
- Contact the Homeownership Preservation Foundation
- Learn whether they are at risk of foreclosure
- Obtain a *Save Your Home* brochure
- Discover tips for avoiding foreclosure
- Learn about foreclosure scams

FHA MORTGAGE INSURANCE PREMIUMS

There have traditionally been two types of FHA mortgage insurance premiums: (1) an **Upfront Mortgage Insurance Premium (UFMIP)**, and (2) a continuing **annual premium** paid monthly and typically called the Mortgage Insurance Premium (MIP). These two premiums have changed considerably over the years, including three times in 2010, so it is important that the reader always check the current UFMIP and MIP for each of the 11 individual FHA residential mortgage loan programs.

On August 12, 2010, Public Law 111-229 was passed, providing the Secretary of Housing and Urban Development (HUD) with additional flexibility regarding the amount of the premiums charged for Federal Housing Administration (FHA) single-family housing mortgage insurance programs. Specifically, the new law permits HUD to increase the amount of the annual mortgage insurance premium that HUD is authorized to charge. This allowed HUD/FHA to change the UFMIP and MIP for loans with different loan-to-value ratios, based on the loan terms and the amount of the loan being insured. For most FHA loans, the UFMIP

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is 1.75% of the insured amount of the original principal balance of the mortgage. The act authorizes HUD to adjust the amount of the annual mortgage insurance premiums through Federal Register Notice or Mortgagee Letter.

Now FHA is in a better position to address the increased demands of the marketplace and return the Mutual Mortgage Insurance (MMI) fund to congressionally mandated levels without disruption to the housing market. Based on the new authority, effective for FHA loans for which the case number is assigned on or after April 1, 2013 or June 3, 2013 based on Mortgagee Letter 2013-04 issued on January 31, 2013 which will require all the following new enhancements to raise funding for the MMI:

- revision to the period for assessing the annual MIP;
- removal of the exemption from the annual MIP for loans with terms of 15 years or less and LTVs of less than or equal to 78 percent at origination;
- increase in the annual MIP for mortgages with terms less than or equal to 15 years and LTV ratios less than or equal to 78 percent at origination.
- rescinds the automatic cancellation of the annual MIP collection announced in MLs 2000-38 and 2000-46;
- rescinds ML 2011-35, under which mortgages with terms of 15 years or less and LTVs of less than or equal to 78 percent at time of origination were exempt from the annual MIP; and
- rescinds and updates Sections 7.3.a, 7.3.c, 7.3.d, 7.3.e, 7.3.f, and 7.3.g of HUD Handbook 4155.2 as appropriate.

Programs Not Affected by the Premium Changes

The following upfront and annual premium programs were not affected by Mortgagee Letter 2013-04 they are:

- Streamline refinance transactions of existing FHA loans that were endorsed on or before May 31, 2009 (see ML 2012-04)
- Title I
- Home Equity Conversion Mortgages (HECM)
- Section 247 (Hawaiian Homelands)
- Section 248 (Indian Reservations)

Upfront Premiums & Annual Premiums

For all FHA loans that are assigned a case number on or after June 3, 2013, including both FHA traditional purchase products and refinance products, the upfront premium (shown in basis points below) will be charged for all amortization terms. The following schedule shows the most common UFMIP and MIP percentage rates, according to HUD Mortgagee Letter 2013-04:

Loan Term > 15 Years				Loan Term ≤ 15 Years					
>95.00% LTV		≤95.00% LTV		>90.00% LTV		78.01%–90.00% LTV		≤78.00% LTV	
UFMIP	ANNUAL	UFMIP	ANNUAL	UFMIP	ANNUAL	UFMIP	ANNUAL	UFMIP	ANNUAL
1.75%	1.35%	1.75%	1.30%	1.75%	0.70%	1.75%	0.45%	1.75%	0.45%

FHA Mortgagee Letter 2015-01, effective for case numbers assigned on or after January 26, 2015, reduces annual MIP rates for FHA Title II forward mortgages and provides FHA lenders the opportunity for cancellation of existing case numbers in order to utilize the MIP rates contained in ML 2015-01. See reduced rates below:

Loan Term > 15 Years				Loan Term ≤ 15 Years					
>95.00% LTV		≤95.00% LTV		>90.00% LTV		78.01%–90.00% LTV		≤78.00% LTV	
UFMIP	ANNUAL	UFMIP	ANNUAL	UFMIP	ANNUAL	UFMIP	ANNUAL	UFMIP	ANNUAL
1.05%	.85%	1.00%	.80%	.95%	0.70%	.70%	0.45%	.45%	0.45%

Practice Exercise: UFMIP and Annual MIP Calculation

Calculate the minimum FHA down payment amount by multiplying the cost of the house by 3.5%. (The minimum down payment for an FHA loan is 3.5%.) For example, if the home costs \$300,000, the minimum down payment is \$10,500.

- Calculate the initial loan amount by subtracting your planned down payment from the price of the home. Using the minimum down payment in the example, the loan amount is \$289,500.
- Multiply the loan amount by 1.05% to calculate the upfront MIP. In the example loan, \$289,500 multiplied by 1.05% yields an upfront MIP of \$3040.

Next, calculate the annual MIP using the following five steps:

1. Calculate the amortization schedule of the loan. If the upfront MIP will be financed, it should be added to the loan amount. Use an online loan amortization calculator.
2. Calculate the average outstanding balance for the first year of the mortgage. The average balance is calculated by adding together the original loan amount plus the loan balance after the first 11 payments and dividing the total by 12. In the example loan, the initial loan amount is \$294,566; at a 4.5% rate, the average outstanding balance is \$292,392.10.²
3. Multiply the average outstanding balance by the annual MIP rate of .85%. In the example, \$292,392.10 times .85% is \$2,485.33.
4. Reduce the annual MIP amount by dividing by 1 plus the upfront MIP factor, if the upfront MIP was added to the loan amount. The upfront MIP is 1.05%, so the annual MIP result from above is divided by 1 plus 0.0085, or 1.0085. The result is \$2,517.64. This is the annual MIP amount for the first year of the example FHA loan.
5. Divide the annual MIP amount by 12 for the amount that will be added to the monthly mortgage payment. In the example, \$209.80 is added to each monthly loan payment.

First-Time Home Buyer with HUD-Approved Pre-Purchase Counseling

The National Housing Act, as amended by the Housing and Economic Recovery Act of 2008, authorizes upfront premiums of up to 3%, except these premiums cannot exceed 2.75% for first-time home buyers who complete HUD-approved pre-purchase counseling. Since the upfront premium rate of 1%, effective October 4, 2010, remains below the statutory cap, no variable rate is provided for first-time home buyers who receive HUD-approved counseling.

Home Equity Conversion Mortgage (HECM) Loans

Effective for all HECM loans for which the case number is assigned on or after October 4, 2010, FHA will increase the annual premium that is

²Go to www.Bankrate.com and click on the calculator at the top of the page.

collected on a monthly basis. This policy change will not affect the upfront premiums collected. The annual premium, shown in basis points below, is to be remitted on a monthly basis, and will be charged according to the following schedule:

Premium Type	Basis Points or % of Mortgage Balance
Upfront (UFMIP)	50 to 250 BPS or 5 to 2,5%
Annual (MIP)	125 BPS or 1.25%

Premium Refund

The UFMIP is subject to partial refund when a loan is paid off prematurely. The FHA Commissioner determines how much of the upfront premium is refunded when loans are terminated. Refunds are based on the number of months the loan is insured. For any FHA-insured loans with a closing date prior to January 1, 2001, and endorsed before December 8, 2004, no refund is due the home owner after the end of the seventh year of insurance. For any FHA-insured loans closed on or after January 1, 2001, and endorsed before December 8, 2004, no refund is due the home owner after the fifth year of insurance. For FHA-insured loans endorsed on or after December 8, 2004, no refund is due the home owner unless he or she refinanced to a new FHA-insured loan, and no refund is due to home owners in this second category after the third year of insurance. Mortgagee Letter 2005-03 provides additional information on the recent policy changes regarding refunds of upfront mortgage insurance premiums. It behooves an owner or sales agent to contact the local HUD/FHA office for current information on a possible refund when a transaction involves property with an existing FHA loan. A sales agent should also be aware that no refund will be made on an FHA loan assumption, and if an FHA loan is made to refinance an existing FHA loan, any refundable portion of the previously paid UFMIP can be applied to the UFMIP due on the refinanced loan.

ASSUMPTION OF AN FHA LOAN

From its beginning in 1934 and through to 1986, an FHA loan was classed as "freely assumable." This meant that a borrower holding an FHA mortgage loan had the right to sell the property, deliver title, and assign repayment of the loan to a new buyer without either FHA's or the mortgagee's approval. While this right did exist, what was overlooked was the fact that

an assignment by the mortgagor resulted in no release of liability for the mortgagor/seller. Therefore, the seller remained fully liable for repayment for the remaining life of the loan. So long as house prices escalated, as they did in the 1970s and the early 1980s, this was not a big problem. The few foreclosures that occurred generally resulted in repossession of a house of greater value than the mortgage obligation.

However, this situation began to change in the mid-1980s, when repossessions increased as house values declined in some depressed areas of the country. (We would see a similar pattern in the condition of the residential market during the financial crisis.) What the FHA encountered when defaults occurred was houses occupied by persons unknown to them. The effort to notify an original obligor who remained liable was difficult since he or she most likely had moved away. Further trouble resulted when original obligors contended that they had not been notified of any default. They felt no further responsibility since the house had been conveyed along with the mortgage in accordance with what they believed to be an acceptable procedure.

To correct the situation, HUD/FHA changed the assumption rules. In fact, the rules were changed twice between 1986 and 1989, and there are now three separate sets of requirements. The differing requirements are distinguished by date of loan origination (which is the date of the FHA-insured commitment) and are not retroactive. To better understand the changes, we will first examine the two methods that have always applied to FHA loan assumptions. One is called a simple assumption and the other a formal assumption.

Simple Assumption

With a **simple assumption**, property may be sold and the loan assumed without notification to the FHA or its agent (the mortgage lender). However, with this method, the seller remains fully liable to the FHA and the lender for repayment of the loan, regardless of the buyer's assumed obligation.

Formal Assumption

With a **formal assumption**, the property is not conveyed to a new buyer until that person's creditworthiness has been approved by the FHA or its agent. With a creditworthy buyer assuming the loan, the seller may obtain

a full release of liability from the FHA. This is the method that the FHA has always recommended, but the agency did not require it until 1989.

The three separate categories of FHA loans for assumption purposes, distinguished by date of origination, are as follows:

1. **For loans originated prior to December 1, 1986.** The original rules still apply. The borrower has an option to sell the mortgaged property by simple or formal assumption rules. It should be noted that in this category, using a formal assumption, a release of liability from the FHA is available but is not automatic. The release should be obtained as one of the documents delivered when the transaction is closed and should also be filed of record.
2. **For loans originated between December 1, 1986, and December 15, 1989.** For loans in this category, there is a restriction on early assumptions, after which time the loan can be freely assumed by simple assumption. Specifically, an owner/occupant cannot sell the property with an assumption during the first 12 months after execution of the mortgage except to an approved buyer—meaning by formal assumption. If the seller is an investor (in rental property), a simple assumption sale cannot be made during the first 24 months after execution of the mortgage. Failure to comply with this restriction can result in acceleration of the loan balance.

After the one- or two-year period, this category of loans may be assumed without prior approval of the buyer. However, should a simple assumption be undertaken, both the seller and buyer remain fully liable for five years after the new mortgage is executed. If the loan is not in default after five years, the seller is automatically released from further liability.

3. **For loans originated on or after December 15, 1989.** Creditworthiness approval of the new buyer must be obtained prior to conveyance of title for all assumptions. Failure to comply can result in acceleration of the note. If an acceptable borrower assumes the mortgage loan, the lender cannot refuse to release the original borrower from further liability.

In addition to regular mortgage loans, the rules on assumptions apply to subsequent sale transactions consummated with a contract for deed, a lease purchase agreement, or a wraparound note. An exception applies if properties are transferred by operation of law, such as devise or descent.

The additional time necessary to meet qualification standards for a new buyer can be irritating to both buyer and seller, but it is a safer course to follow. This is particularly true now that the FHA policy is to pursue collection of defaulted loans to the original obligors if they remain liable.

Between November 2003 and May 2005, FHA developed a system to allow assumption data to be input into an assumption case tracking system, allowing the case to be tracked online to see the status of the case, as follows:

1. *Success updates allowed.* This indicates that the case assumption request was processed—that is, the case has been successfully re-assigned to the new lender and/or new sponsor/agent.
2. *Unavailable.* This indicates that the system is down.
3. *Error.* This indicates that an error has occurred during the case assumption process and that the case has not been assumed successfully. The data were either missing or in error.

In today's market, some servicing organizations are authorized to service FHA loans but are not "supervised originators." This means that they do not have the rights to underwrite the credit-qualifying assumptions as would an authorized seller/servicer with Direct Endorsement underwriters on staff approved by the FHA.

INVESTOR MORTGAGORS ELIMINATED

Since its origin, a primary purpose of HUD/FHA has been to provide suitable housing to qualified people. To promote this goal, rental housing has been encouraged as a means of increasing available dwelling units in this country. Unfortunately, in the late 1980s, investor loans experienced a much higher rate of default than owner-occupied housing loans, and it became necessary to limit the FHA's risk exposure. As a result, insured loans for investors were eliminated as of December 15, 1989.

While new loans to investors were eliminated, loans made prior to December 15, 1989, may still be assumed by investors, although some restrictions apply. Essentially, additional cash could be required so that the balance due on a loan assumed by an investor does not exceed 75% of the value of the property.

A procedure that is considered an attempt to circumvent the restriction on investor financing is sometimes referred to as a *friendly foreclosure*. In this process, an investor "lends" a portion of an FHA mortgagor's

equity to the owner and places a second lien on the property. This step in itself does not violate HUD requirements. The next step, however, is a preplanned default by the owner on the second mortgage and a foreclosure transferring title to the investor, and this step *does* violate the provision barring investors from acquiring HUD-financed properties. This second provision provides for acceleration of the note if all or part of the property is transferred (other than by devise or descent) to a purchaser who does not occupy the property.

Exceptions to Restrictions on Investor Financing

There are two important exceptions that allow investors to acquire property with an FHA-insured commitment, as follows:

1. **HUD foreclosures.** Investors may still purchase HUD-foreclosed properties with a 25% down payment and the balance financed with an FHA-insured commitment, or within the guidelines of any special program.
2. **Section 203(k) Rehabs.** Section 203(k) Rehabilitation Home Mortgage Insurance is available to investors. This program combines a purchase money mortgage with a construction loan. It targets the restoration of rundown houses as a practical means of adding to the country's housing stock. More details on the 203(k) program are provided in a later section of this chapter.

LOAN DEFAULT AND FORECLOSURE

The insured commitment on a HUD/FHA loan covers 100% of the loan amount since lenders normally loan exactly the insured amount. In the event of a default and foreclosure action, previous practice has been for the FHA to pay off the loan balance, with interest, in exchange for an assignment of the mortgagee's claim to the foreclosed property. The property becomes federally owned and subject to rehabilitation and resale as permitted under FHA rules.

With the substantial escalation of foreclosures beginning in the mid-1980s, HUD/FHA undertook a new policy in an effort to stem depletion of its Mutual Mortgage Insurance Fund (the back-up fund for single-family insurance programs). The new policy calls for a case-by-case review of each foreclosure prior to taking action. When a foreclosure

becomes necessary, HUD/FHA appraises the property to determine its fair market value. If this value proves to be less than the amount due on the loan, the FHA will pay the difference between the fair market value of the property and the balance due on the loan to the lender. The lender is then asked to make its claim for that difference without a conveyance of the property. The practice is known within the industry as a *claim without conveyance*.

Its purpose, of course, is to limit both the cash payout on claims and the number of properties returned for the FHA to manage, rehabilitate, and resell. So long as the determination of fair market value by HUD/FHA is accurate, losses to the lender could be minimized. Nevertheless, lenders have been skeptical of the practice, as it allows the FHA to set its own value on the amount of an insured commitment. Furthermore, lenders feel much better served if they never have to undertake repossession of a foreclosed property. Claim without conveyance is one of the changes that has increased the risk of an FHA loan for a mortgage lender.

Reporting Defaults and Foreclosures

Another change in practices since late 1986 is that the FHA, having been faced with massive foreclosure problems, requires mortgagees to notify credit bureaus of defaults and foreclosures. This report must include the names of original obligors who allowed loans to be assumed without obtaining a release of liability.

In 1987, HUD introduced the Credit Alert Interactive Voice Response System (CAIVRS) to collect and furnish credit data from its own files for lenders' and borrowers' use. These data are primarily detailed reports on borrowers who might owe amounts to the government or its agencies or guarantee programs. By maintaining a file of information on those who default on its loans, HUD is able to minimize the problem of borrowers obtaining a second or third HUD loan after defaulting on an earlier obligation. In 1992, the system was expanded to include default information on guaranteed loans made by the Rural Development Services (formerly, the Farmers Home Administration program), Small Business Administration, Department of Veterans Affairs, and the Department of Education.

HUD reported on their website that, "The use of CAIVRS has allowed participating agencies to better monitor their credit programs and to reduce the credit extended to individuals with outstanding delinquencies

on Federal debts. CAIVRS has allowed participating agencies to avoid potential losses in excess of \$12 billion in 2012.”³

For any federally guaranteed loan, as evidence that screening was performed, the lender must enter a CAIVRS response code on the loan analysis sheet. If a claim was caused by unavoidable circumstances, or if a satisfactory repayment plan has been arranged, the applicant may still be approved.

FHA LOAN LIMITS

Limitations on Loan Amounts

Federal Housing Administration (FHA) single-family loan limits have changed frequently over the past 20 years. The most dramatic is the result of the **American Recovery and Reinvestment Act (ARRA)**, signed into law on February 17, 2009. The dual concept of maximum loan amount limitation based on high- and low-cost geographic areas is still a factor, and one that we will more fully discuss later in this chapter, as these limitations have been affected by the various new federal laws passed in 2008 and 2009 that have now been merged into one common listing shown in

Table 8-1 HUD/FHA Floor and Ceiling Limits*

Property Size	Low Cost Area “Floor”	High Cost Area “Ceiling”
One Unit	\$271,050	\$625,500
Two Units	\$347,000	\$800,775
Three Units	\$419,425	\$967,950
Four Units	\$521,250	\$1,202,925

*Based on HUD/FHA Mortgagee Letter 2014-25

Source: © 2016 OnCourse Learning

The announced methodology used and allowed by HUD was developed using the following criteria:

- The minimum FHA national loan limit “floor” is at 65% of the national conforming loan limit (\$417,000 for a one-unit property for

³The FHA Solvency Act of 2013. Hearing before the Committee on Banking, Housing and Urban Affairs, United States Senate, July 24, 2013. Retrieved from GPO’s Federal Digital System: <http://www.gpo.gov/fdsys/pkg/CHRG-113shrg82782/pdf/CHRG-113shrg82782.pdf>

the period January 1, 2015, through December 31, 2015). The “floor” applies to those areas where 115% of the median home price is less than 65% of the national conforming loan limit.

- The maximum FHA national loan limit “ceiling” is at 150% of the national conforming loan limit. In areas where 115% of the median home price (of the highest cost county) exceeds 150% of the conforming loan limit, FHA loan limits remain at 150% of the conforming loan limit.
- Mortgage Letter 2014-25 sets the FHA loan limits for 2015 that are effective for all Title II FHA forward insurance programs except for Streamline Refinance loans and loans made in Special Exceptions for Alaska, Hawaii, Guam, and Virgin Islands.

Exceptions to loan limits and a county-by-county listing of loan limits can be found at the following HUD/FHA link: <https://entp.hud.gov/idapp/html/hicostlook.cfm>

Value of Property, Down Payment, and Closing Costs

The FHA values the property itself as the lesser of the appraised value or the purchase price. The 2009 change requires the borrower to pay 3.5% of the acquisition cost in cash to close. The cash requirement can be met with the down payment plus closing costs. The older rules allowed closing costs to be added to the property value, thus increasing the amount that could be borrowed. New rules do not allow this. Closing costs are those listed in the Loan Estimate (the same Loan Estimate required by RESPA to be furnished to a loan applicant) but cannot exceed certain FHA limitations, as determined in the local area. Acceptable closing costs include attorney’s fees, credit report, appraisal costs, origination fee, and title insurance.

Example

For houses priced higher than \$150,000:

Acquisition cost	\$ 200,000
Loan amount (96.5%)	<u>– \$193,000</u>
Down payment & closing costs	\$ 7,000

To meet the \$7,000 cash required to close (i.e., 3.5% of acquisition cost in the preceding example), the borrower may add the money paid for closing costs to the down payment.

In addition, to meet the 3.5% requirement, the borrower may also use proper gift money if supported by a gift letter. A seller may pay up to 6% in costs, but anything over that amount is considered a reduction in selling price. The 3.5% cash requirement cannot consist of discount points or prepaid expenses, or any portion of such charges. Borrowers can still finance the Upfront Mortgage Insurance Premium. (Using the example above, multiply the amount that can be borrowed (\$193,000) by the current 1.75% UFMIP, or \$3,378. Therefore, if they choose to do so, the borrower could finance up to \$196,378, or over 98% LTV.)

The 2015 revised mortgage amount calculation applies to the following programs: 203(b) Home Mortgages and condominium mortgages; 203(i) Outlying Areas; 203(n) Cooperative Units; 203(k) Rehabilitation Home Mortgage Insurance; and 223(e) Home Mortgages in older, declining urban areas. The new calculation does not apply to 203(h) Housing for Disaster Victims or 221(d)(2) Low Cost and Moderate Income.

SECONDARY FINANCING WITH HUD/FHA-INSURED COMMITMENTS

If the mortgagor uses any funds that require a lien to be placed on the property, it is considered secondary financing and must be taken into account when determining the maximum insurable amount. This is true whether or not the note may be forgiven at some future date depending on the borrower's continued employment. HUD/FHA will insure first mortgages on property with secondary financing under the following conditions:

1. The sum of the first and second mortgages cannot exceed the applicable loan-to-value ratio or maximum mortgage limit for that area.
2. The payments under the insured first mortgage and the second mortgage do not exceed the mortgagor's reasonable ability to pay.
3. Any periodic payments on the second mortgage are collected monthly and are substantially in the same amount.

4. The repayment terms of the second mortgage: (a) do not provide for a balloon payment before 10 years or such other terms not acceptable to HUD/FHA, and (b) permit prepayment by the mortgagor without penalty.

HUD/FHA PROGRAM DETAILS

There are now over 50 different programs offered by HUD/FHA. They include multifamily housing, manufactured home parks, nursing homes, and planned unit developments (PUDs), as well as the better-known single-family housing programs. Their utilization varies somewhat across the country according to local situations. Some programs have become inactive due to loan limitations or qualification standards that no longer fit the changing housing market.

This section examines the qualifications needed and the restrictions placed on several of the more popular programs, including:

1. Section 203(b)—Home Mortgage Insurance (including the special assistance offered veterans) and condominiums
2. Section 203(k)—Rehabilitation Home Mortgage Insurance
3. Section 245—Graduated Payment Mortgage
4. Title 1—Home Improvement Loan Insurance

Section 203(b)—Home Mortgage Insurance

The basic 203(b) program authorized in the initial act of 1934 is still the most widely used home mortgage insurance program. Experience gained from this program has been used extensively in the development of many succeeding plans. It is used as a standard with some of the other housing assistance programs, which refer to qualification requirements simply as “same as 203(b).”

As with all HUD/FHA programs, the property to be acquired and used as collateral for the loan must meet applicable standards. While there are no special requirements for the individual borrower under 203(b), he or she must have an acceptable **FHA new minimum credit scores** as defined next, and demonstrate an ability to make the required investment as well as to handle the monthly mortgage payments.

Section 203(b) offers the simplified calculation of the down payment (FHA loan commitment of 96.5% of acquisition value with 3.5% cash

required to close. A borrower's credit score can now affect the maximum allowed LTV. As previously discussed, those with credit scores between 500 and 579 are required to make a 10% investment.

As part of the Housing and Economic Recovery Act of 2008 (HERA), the Federal Housing Administration (FHA) implemented an approval process for condominium projects and insurance requirements for mortgages on individual units under Section 203(b) of the National Housing Act. HUD/FHA insures mortgages for the purchase of individual family units in multifamily housing projects now with the change under Section 234(c). It also insures loans for the construction or rehabilitation of housing projects intended for sale as individual condominium units under Section 234(d). The approved units under the old 234(d) have all been phased out, and now condominiums are covered by Section 203(b).

A *condominium* is defined as joint ownership of common areas and facilities by the separate owners of single-family dwelling units in the project. To be acceptable for FHA insurance, the project must include at least four dwelling units. At least one other unit in each project must be acquired under a government-underwritten program.

Before a loan can be insured for a single condominium, the entire project must meet HUD/FHA minimum standards, just as a new subdivision must meet compliance standards. The agreement under which a homeowners' association may function comes under scrutiny, as do the rights of the developer. The question of when the developer vacates the premises becomes more important with a condominium, as it affects control of the common areas. Under FHA requirements, the developer may not claim a right of first refusal to offer condominiums for resale.

Section 203(b)(Veteran)

Under 203(b), HUD/FHA has a special concession for qualified veterans, allowing an insured commitment of 100% of the first \$25,000. Regular 203(b) limits apply to all loans over that amount.

The FHA veterans' program has additional value, as it offers broader **eligibility** measures than those available under the VA program. The basic differences are as follows:

1. The FHA qualification requires 90 days of active duty and a discharge other than dishonorable. The VA has longer time spans of required service at different periods of time; for example, hot war/cold war distinctions. (See VA requirements later in this chapter.)

2. The FHA does not take into consideration any prior commitment of the veteran's entitlement, while the VA must deduct any previous usage of the entitlement if the loan has not been paid off or assumed by another qualified veteran.

Veterans using FHA for their home loans can in some circumstances receive 100% financing and do not pay monthly mortgage insurance premiums.

Section 203(k)—Rehabilitation Home Mortgage Insurance

To help restore and preserve the nation's existing housing stock, the 203(k) program has been revised and expanded. In June 1993, this kind of loan was made eligible for "direct endorsement," which means lenders can underwrite them without prior HUD field office approval. Further stimulus for the program was given by allowing the loans to be sold to secondary-market investors when the loan is originated and before rehabilitation is completed.

Unlike any other HUD-insured program, 203(k) combines a purchase money mortgage with a construction loan. The new revision offers an insured commitment (with the same limits as 203[b]) that allows the purchase of an existing house over one year old, plus sufficient additional money to rehabilitate the property. The program is limited to one- to four-family dwellings and can be utilized as follows:

1. Purchase and rehabilitate an existing one- to-four-family dwelling (completed for more than one year) that will be used for residential purposes.
2. Refinance and rehabilitate an existing one- to-four-family dwelling and refinance the outstanding indebtedness (not applicable for Streamline [k]).
3. Rehabilitate a dwelling after it has been moved from one site to a new foundation (excluding manufactured homes).

Section 203(k) should not be used unless the rehabilitation or improvement costs total a minimum of \$5,000 (not applicable for Streamline 203[k], which has no minimum, but does have a \$35,000 maximum).

A single insurance commitment combines the funds needed to purchase the property or refinance existing indebtedness, the costs incidental to closing, and the money needed to complete the proposed rehabilitation. If the 203(k)-insured commitment involves insurance of advances, which

would be normal when rehabilitation is required, then a Rehabilitation Loan Agreement must be executed by the lender and the borrower. As part of this agreement, there must be an inspection and release schedule that details the amount of escrowed money that can be released at each stage of completion.

Before any release of funds can be made by the lender holding the escrow account, an inspection must be made to determine satisfactory completion of the work to that stage. Inspection is made by HUD-approved fee inspectors from a list provided by the HUD field office. The number of inspections required will vary with the complexity of the rehabilitation but cannot exceed four plus the final one.

The current maximum mortgage calculation for a 203(k) is based on:

1. the estimate of as-is value or the purchase price of the property before rehabilitation, whichever is less, plus the estimated cost of rehabilitation and allowable closing costs; or
2. 110% of the expected market value of the property upon completion of the work, plus allowable closing costs, if the subject property to be rehabilitated is to be the principal residence (owner-occupied).

The maximum mortgage amount is based on 96.5% of (1) or (2) above. Should the rehab loan be for an investment property (non-occupant mortgagor or builder/rehabber), the maximum mortgage amount will be based on 85% of (1) or (2) above. The dollar difference between the maximum mortgage amount (96.5% of the fair market value for an owner/occupant) and the mortgage amount available to an investor (85% of acquisition cost) will remain in escrow with the lender until the property is assumed by an owner/occupant acceptable to the Commissioner of the Federal Housing Administration. The qualifying housing and debt ratios are the same as in the 203(b) program.

Because this program is fairly complex and requires additional supervision by the mortgage lender, higher charges are permitted. Lenders may add one percentage point to the normal 1% origination fee for a purchase money mortgage, and 1.5% more than normal for the rehabilitation loan, with a minimum of \$350 plus some other modest fees for plan review inspection.

Mortgage Limits and the Insured Commitment

Both the maximum amount of mortgage loan permitted and the calculation of the maximum insured commitment are determined on the same basis as that for the 203(b) program described earlier in this section.

Section 245—Graduated Payment Mortgage (GPM)

Several years of experimental testing provided the groundwork for HUD/FHA to offer an insurance program for graduated payment mortgages, which was approved nationally in November 1976. The purpose of the program is to reduce monthly payments in the early years of the mortgage term so that families with lower incomes, but reasonable expectation of future increases, can qualify for suitable housing in a higher-cost market.

The program was well received through the early 1980s, as it enabled many young families to purchase their first home. Initially, the program was targeted at first-home buyers, so the original program guidelines were more lenient. The key benefit for the applicant is that income qualification is based on the monthly payment required for the first year, which is normally much less than necessary to fully amortize the loan. The repayment plan worked well in times when housing prices escalated and inflation was an accepted fact of life. However, the GPM and its borrowers faced difficulties when the economy reversed into a downslide in the late 1980s. To avoid further problems, qualification guidelines were tightened a bit.

Section 245 is limited to owner/occupant applicants; there are no other special qualifications such as income limitations. As in other programs, the applicant must have an acceptable credit record, demonstrate ability to make the required down payment, and be able to handle the monthly mortgage payments. In addition, the applicant must have reasonable expectation of an increased annual income in future years.

The lower monthly payments in the early years under most of the HUD/FHA Section 245 plans are insufficient to pay anything on principal and do not cover all of the interest due each month (see Table 8-1). Consequently, each year the unpaid interest is added to the principal balance due. Since the loan balance is increased, rather than reduced or "amortized," the result is called negative amortization. To prevent an increase in the loan balance from exceeding the value of the property, higher down payments may be required.

Mortgage Limits

The maximum amount of the insured commitment for Section 245 is derived as the lesser of two calculations, a process that we will describe more fully later. Section 245 plans make it possible for the loan amount (that is, the principal balance due on the loan) to increase due to the

TABLE 8-2 HUD/FHA Section 245 GPM Factors

		Monthly Principal and Interest (P & I) Factors (per \$1,000 of original loan balance)					
Principal Balance Factor		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6+
INTEREST RATE: 8.00%							
Plan I	1000.0195	6.6651	6.8317	7.0025	7.1775	7.3570	7.5409
Plan II	1012.8612	6.0579	6.3608	6.6789	7.0128	7.3634	7.7316
Plan III	1030.9550	5.5101	5.9233	6.3676	6.8452	7.3585	7.9104
INTEREST RATE: 9.00%							
Plan I	1002.3085	7.3244	7.5075	7.6952	7.8876	8.0848	8.2869
Plan II	1021.0154	6.6706	7.0042	7.3544	7.7221	8.1082	8.5136
Plan III	1043.5617	6.0788	6.5347	7.0248	7.5517	8.1181	8.7269

Source: © 2016 OnCourse Learning

negative amortization feature (adding unpaid interest to the principal balance each year). Thus the loan balance can increase to an amount greater than the initial authorized loan amount. This possibility is recognized and does not constitute a violation of the National Housing Act so long as the down payment computations are made in accordance with Section 245 instructions.

Section 245—Repayment Plans

HUD/FHA insures graduated-payment mortgages with five different repayment plans. These are differentiated by the rate of payment increases each year and the duration of the escalation period. Three plans offer 2.5%, 5%, and 7.5% annual increases for the first five years; two plans offer 2% and 3% increases for the first ten years. Stated another way, the initial monthly payment amount is calculated so that it can be increased each year at a fixed, or predetermined, rate until it reaches a constant-level payment amount by the sixth year for the five-year plans, and by the eleventh year for the ten-year plans. The amount of monthly payment, the mortgage insurance premium, and the down payment required depend on the interest rate and the term of the loan. To simplify the calculation of these amounts, the FHA has published a series of tables that give factors to be used in the calculation of payment requirements.

Calculating the 245 Insured Commitment

To comply with the requirements, it is necessary to make two separate calculations to establish the correct maximum insured commitment. Since the insured commitment almost always becomes the amount of the loan, the difference between the commitment and the contract price is the required down payment. The first calculation that determines the insured commitment, called Criterion I in the example that follows, is the same as that required for Section 203(b) qualification. The second calculation, Criterion II, is in accordance with the Section 245 formulas. The lesser of the two results is the amount of the insured commitment.

Under Criterion II for the nonveteran applicant, the procedure is to take 97% of the property value (including closing costs) and divide the result by the highest outstanding balance factor for the applicable plan and interest rate. Different procedures apply for veterans and for properties constructed without prior FHA approval that are less than one year old.

Example

To calculate the down payment and monthly mortgage payments for a HUD 245 loan, the applicant refers to a HUD/FHA Graduated Payment Factor Table. This is available at any HUD/FHA office and provides factors with differing interest rates and the HUD payment plan that applies. Table 8-2 illustrates these factors for three plans and two different interest rates. For this example, assume a property value of \$190,000 and closing costs of \$3,800, a total value for mortgage insurance purposes of \$193,800. Assume that the loan requested has a 30-year term and an interest rate of 8% using Plan III. (Plan III offers payment amounts increasing at 7.5% each year for the first five years.) The calculation must be made by two separate criteria to determine which offers the lesser loan amount.

Criterion I [same as 203(b)]

Value of property (acquisition cost)	\$190,000
Insured commitment (96.5%)	183,350

Criterion II (245 Calculation)

Value of property	$\$193,800 \times .97 =$	187,986
	$\$187,986 \div 1030.9550 =$	182.34162
	$182.34162 \times 1,000 =$	182,341.61

Per these calculations, Criterion II offers the lesser loan amount of \$182,341.61 and, therefore, the applicable number is rounded down to \$182,300. The difference between the loan amount and the purchase cost is the down payment; thus, \$193,800 minus \$182,300 equals \$11,500.

The cost of the mortgage insurance premium must be added as a one-time charge at closing. For this example, consider that 100% of current UFMIP (always check for current status of percentage of loan amount), which is 1.75% UFMIP, will be financed (that is, added to the loan amount at closing). Calculate as follows:

$\$182,300 \times 1.75\%$	=	\$ 3,190
Add: Property loan	=	<u>\$182,300</u>
Total insured commitment	=	\$185,490

Next, compute the monthly payment amounts, again referring to abbreviated Table 8-2. At an 8% interest rate for Plan III, the table shows a monthly P&I factor of 5.5101 for the first year's payments. Round the loan amount to \$1,000 units and multiply as follows.

For the first year:

$$(\$185,490 \div 1,000) \times 5.5101 = \$1,022.07 \text{ (first year's P\&I payments)}$$

And for the second year:

$$(\$185,490 \div 1,000) \times 5.9233 = \$1,098.71 \text{ (second year's P\&I payments)}$$

Complete the computation for each successive year, always applying the P&I factor to the initial loan amount. The amount of the sixth-year payment in this example remains constant for the remaining life of the loan.

Title 1—Home Improvement Loan Insurance

One of the more popular programs offered by HUD/FHA is insurance on loans to finance home improvements. The money may be used for major or minor improvements, alterations, or repairs of individual homes and nonresidential structures, whether owned or rented. Lenders determine eligibility for these loans and handle the processing themselves. The smaller loans in this category are usually handled as unsecured personal loans (recording of a mortgage instrument is not required).

Any creditworthy property owner is eligible for a Title I loan. Loans may also be made to tenants for improvement of leased apartment units provided the lease term is at least six months longer than the term of the loan. In addition, Title I covers the insurance of loans on mobile homes (manufactured housing) that do not qualify as real estate. Whether or not a mobile home qualifies as real estate depends on state laws, the nature of its title, and how it is taxed. States generally claim an ad valorem property tax if the unit is permanently attached to the ground.

Where Are We Now?

When visiting the HUD/FHA Website (<http://portal.hud.gov/hudportal/HUD?src=/topics>), you have access to these topics:

- Avoiding Foreclosure
- Buying a Home
- Economic Development
- Energy
- Environment
- Fair Lending
- Freedom of Information Act (FOIA)
- FY2012 Budget
- Grants
- Home Improvements
- Homelessness
- Homes for Sale
- Housing Choice Voucher Program (Section 8)
- Housing Discrimination
- Housing Research and Data Sets
- HUD Homes
- Information for Disabled Persons
- Information for Senior Citizens
- Limited Denials of Participation
- Rental Assistance

- Veteran Information
- Volunteering
- Working with HUD

HUD/FHA QUALIFICATION PROCEDURES

Since its beginning, HUD/FHA has trained its own valuation and mortgage credit staff to handle the qualification of loan applicants so as to assure compliance with the special requirements of the various programs. Guidelines are furnished in a comprehensive *Underwriter's Guide*, supplemented with an almost continuous flow of updated information to keep readers abreast of changing needs and new laws.

While the process has been difficult to fit into a computerized analysis program, in 1996, the FHA approved the use of Freddie Mac's Loan Processor as a system to analyze loan applications. The purpose is to expedite loan processing and reduce costs, and possibly to qualify some applicants who might otherwise be rejected. As pointed out earlier, the computer does not reject an applicant, but rather, asks the lender's underwriting department for further information to help process the loan application.

No two applications are alike, and judgment calls sometimes become necessary to determine proper approval or rejection. The system has always permitted sufficient flexibility to allow a review of the decision if the applicant feels an error has been made.

In 1983, HUD established the Direct Endorsement Program in an effort to both reduce costs and simplify the process for mortgagees (mortgage lenders) to secure insurance endorsements. Under this program, the mortgagee underwrites and closes a mortgage loan without prior HUD review or approval. The authority to participate in this program is a privilege granted to mortgagees on the basis of demonstrated qualifications, experience, and expertise.

In this procedure, the mortgagee is given sufficient certainty of HUD approval to justify undertaking the responsibility. Essentially, HUD requires compliance with its rules and does not "second guess" the underwriters' decisions. HUD does make a post-endorsement review, and if underwriting deficiencies are discovered in the loan documents, an underwriting report is sent to the mortgagee. However, the insurance

contract is incontestable except in cases of fraud or misrepresentation. If the mortgagee continues to submit marginal-type loans under this program, its authority under Direct Endorsement may be withdrawn.

ANALYZING THE LOAN APPLICATION

In the past decade, the various government agencies involved with underwriting home loans have made a concerted effort to simplify procedures, including the use of standard forms by all agencies plus the acceptance of each other's appraisals and general procedures. The present form used by lenders to apply for government underwriting is a uniform version that combines HUD Form 92900, VA Form 26-1802a, and the Rural Development Services (formerly FMHA) Home Loan Guaranty form. This is the form that a mortgage company submits to HUD/FHA to apply for mortgage insurance. It is based on information obtained from the borrower's loan application and subsequent verifications. The borrower's application to the lender for a loan is also a standard form that has been made mandatory for all residential loans, as will be explained more fully in the next chapter.

One of the standardization chores that the industry is working on is to make the various computerized loan analysis systems compatible. As they were originated, each system was designed to operate with different software, making it more difficult for lenders to work with more than one system. It is the intention of major lenders to offer systems that can be used by others with similar software.

When computerized analysis of loan applications was introduced in 1995 by several major lenders, FHA did not approve any one system. Its procedure at first was to approve an FHA lender's use of an automated system, but not the system itself. Then in 1996, FHA gave approval for a joint pilot project for its lenders to use Freddie Mac's Loan Prospector (LP) system for loan analysis. The agency hoped to reduce processing time and to qualify some borrowers who would not have qualified through ordinary lender underwriting. Now, approved seller/servicers can use either Fannie Mae's automated underwriting system, Desktop Underwriter (DU), or Freddie Mac's LP and further speed the underwriting loan approval process.

In 2009, the FHA introduced its "Technology Open To Approved Lenders" (TOTAL) underwriting scorecard that was tied into DU and LP. TOTAL, it was announced, was to be a tool to assist approved FHA seller/servicers in the management of their workflow and in expediting the endorsement process, and was particularly helpful for those lenders

that had Direct Endorsement Underwriters on staff. TOTAL should not be considered a substitute for the lender's responsibilities in the consideration of risk and creditworthiness. Direct Endorsement lenders using TOTAL remain solely responsible for the underwriting decision.

Since TOTAL works through various automated underwriting systems (AUS), it primarily evaluates the overall creditworthiness of the applicants based on a number of credit variables and determines an associated risk level of a loan's eligibility for insurance by FHA. It is FHA's policy that no borrower is to be denied an FHA-insured mortgage based solely on a risk assessment generated by TOTAL. In certain instances and circumstances, TOTAL cannot be used, so manual underwriting must be done instead.

TOTAL does not:

- reject applications;
- review the loan for compliance;
- review maximum mortgage amounts;
- compute debt-to-income ratios;
- review property eligibility;
- determine LTV; or
- complete additional functions typically performed by an AUS.

The agency requires that all transactions be scored through TOTAL except transactions involving borrowers without credit scores and streamline refinance transactions. Lenders should not use TOTAL on streamline refinance transactions, as the results are considered invalid. Direct Endorsement approved seller/servicers must keep up with all Mortgagee Letters that change full eligibility considerations for those using TOTAL. An example is Mortgagee Letter 2013-05, effective April 1, 2013, advising all approved seller/servicers that when underwriting loans where the borrower has a decision credit score below 620 and the debt-to-income ratio exceeds 43.00%, these loans must be manually underwritten. HUD had its TOTAL scorecard system modified to issue a scoring recommendation of "Refer for loans" when such criteria are entered.

Analysis of Property and the Borrower

The property and the borrower are processed separately in determining qualification. Procedures that are followed for approval of the property are

outlined in the sections that follow. Qualifying the borrower is explained in Chapter 9, "Borrower Qualification," which compares FHA methods with both VA and conventional methods to better illustrate their similarities and differences.

Qualifying the Property

The FHA requires an appraisal to be made of property offered as collateral by one of its staff appraisers or by an FHA-approved fee appraiser. Following are the distinctions made for four basic categories of property:

1. **Proposed construction.** To qualify, plans and specifications are submitted to HUD/FHA prior to the start of construction. If found acceptable, the approved plans and specifications are certified and returned to the mortgagee.
2. **Low-ratio properties.** For loans of 90% of the value, not approved by HUD or VA prior to construction and not covered by an acceptable warranty plan, and for properties that are less than one year old at the date of application, HUD requires an appraisal by its own staff or a HUD-assigned fee appraiser to determine the value.
3. **Existing construction.** Property completed at least one year prior to the date of application must be appraised by a staff appraiser or a fee appraiser assigned by HUD/FHA.
4. **Warranty plan.** If a property is covered by a warranty plan approved by HUD, a conditional commitment by HUD/FHA or a VA CRV (Certificate of Reasonable Value) may be used to qualify the property.

Property Value

HUD/FHA defines *proper value*—that is, the value of the house and land—as the lesser of the FHA-appraised value or the purchase price. Since it is possible for an earnest money contract to be signed prior to making an appraisal, the value in an appraisal can be different from the agreed-upon price. Should the appraised value be *less* than the agreed-upon price, FHA rules permit a buyer to withdraw from the earnest money contract (unilaterally rescind it) and recover the earnest money in full. Or, should the buyer prefer, the purchase can be consummated at the contract price, but any amount paid over the appraised value must be in cash. The amount of the loan is calculated as a percentage of the appraised value in such a case.

Another frequently used option is to renegotiate the contract to reflect the appraised value.

Determining Value

HUD/FHA appraisals are made in the same manner as other appraisals, with possibly one slight difference: Because of the volume of FHA activity, the agency retains substantial records of previous transactions that can be used for making good comparisons with other sales. HUD field offices can usually quote a current value per square foot of house in most of its neighborhoods.

However, the FHA has the same problem as the VA and conventional loan underwriters, with the impact of seller loan buydowns on the price of a house that may be used as a comparable. Over a period of time, it is quite possible for a home builder to offer an attractive buydown for a loan, add its costs to the price of the house, and develop an inflated "market value" that could be used as a sales comparable. HUD/FHA addresses this problem in two steps: (1) all appraisals must now include as additional information the amount of loan discount when the house was acquired, and (2) excessive buydowns must be deducted from the value of any house used as a comparable.

Example

Say that a \$200,000 loan was made to the homeowner with an eight-point discount and buydown tied in. Say that in the region involved, the FHA considers anything over five points to be "excessive." This would mean that three points, amounting to \$6,000 of the \$200,000 loan amount, is considered a reduction in the sales price for that property. Thus, if the listed sale price had been \$218,000, its true price for use as a comparable would be \$212,000 (\$218,000 minus \$6,000 equals \$212,000).

Scope of Appraisal

The HUD/FHA appraisal contains other important information. In addition to placing a dollar value on the property, an appraiser also determines what repairs may be needed to restore the property to acceptable FHA

standards. Special inspections may be called for to examine the roofing, plumbing, electrical system, heating/air conditioning system, and water heater.

If deficiencies are found, the property must be brought up to standard before the loan can be funded. The seller may make the repairs or, in some cases, the buyer may do the work as part of the buyer's cash contribution—a "sweat equity" contribution.

In 1995, HUD advised its underwriters to delete "conditions that have little or nothing to do with safety or soundness of the property" from repair requirements stipulated by an appraiser.

DEPARTMENT OF VETERANS AFFAIRS (VA)

The Veterans Administration was elevated to cabinet rank in 1989 as the **Department of Veterans Affairs**. Title and mortgage documents now reflect conveyance to the "Secretary of Veterans Affairs" rather than the "Administrator of Veterans Affairs." While the VA administers a number of programs for the benefit of eligible veterans, our interest is confined to the home loan program that was created in 1944 as part of the "G.I. Bill of Rights." Section 501 of this act provides for a first-mortgage real estate loan that is partially guaranteed by the VA and is subject to strict rules covering all phases of the loan: the borrower, the lender, the property, the loan charges, the term and loan amount, collections, and foreclosures. The primary interest of the VA is to assist the veteran, and it is to this end that the rules are directed.

While HUD/FHA insures 100% of its approved loans, the VA guarantees only a portion of the loan amount. Since the guarantee reduces the risk exposure for a lender, it has been considered an acceptable loan. The VA does not have a cash requirement for a veteran to qualify—meaning no down payment is required. Even the VA funding fee can be added to the loan amount rather than paid in cash. However, the "no cash" rule describes what is acceptable to the VA for its loan approval. It does not apply to a lender who may require a down payment and an origination fee paid by the veteran. Thus, even though a VA loan may be found with no cash required of the veteran, many lenders believe some investment on the part of a borrower makes a more acceptable loan, and this practice is permitted by the VA.

Not all veterans are eligible for a home loan guarantee. They must meet certain minimum requirements of time served on active duty.

Eligibility for a loan is different from “entitlement,” although the terminology is often confused. The differences between what is meant by these two terms are more fully described next.

Eligibility of a Veteran

To be eligible for a home loan guarantee, the veteran must have served on active duty a minimum amount of time that varies during different periods—lesser time during periods of “hot wars,” and longer for other types of conflict. Military service requirements for VA loan eligibility almost always require that a veteran has had an honorable discharge. When dealing with VA loan eligibility, applicants with other than honorable discharges will usually require further investigation by the VA. This is necessary to determine if the service was performed under other than dishonorable conditions. For many years, service eligibility was broken down into “Wartime” and “Peacetime” service based on the criteria presented in Table 8-3.

Active Duty Service Personnel

For military currently on active duty defined as regular duty (not active duty for training), applicants are eligible after having served 181 days (90 days during the Gulf War) unless discharged or separated from a previous qualifying period of active duty service.

Selected Reserves or National Guard and Other Qualifying Military or Service Personnel

If an applicant not otherwise eligible has completed a total of six years in the Selected Reserves or National Guard (member of an active unit, attended required weekend drills and two-week active duty for training) and received an honorable discharge *and* been placed on the retired list, been transferred to the Standby Reserve or an element of the Ready Reserve other than the Selected Reserve after service characterized as honorable service, or continues to serve in the Selected Reserves, he or she may be considered eligible for the program.

Individuals who completed less than six years may be eligible if discharged for a service-connected disability.

Under certain circumstances, current United States citizens who served in the armed forces of a government allied with the United States

Table 8-3 Veteran Home Loan Guarantee Eligibility Requirements

Status	Qualifying Wartime & Peacetime Periods	Qualifying Active Duty Dates	Minimum Active Duty Service Requirements
Veteran	WWII	9/16/1940–7/25/1947	90 total days
	Post-WWII	7/26/1947–6/26/1950	181 continuous days
	Korean War	6/27/1950–1/31/1955	90 total days
	Post-Korean War	2/1/1955–8/4/1964	181 continuous days
	Vietnam War	8/5/1964–5/7/1975 *For Veterans who served in the Republic of Vietnam, the beginning date is February 28th, 1961	90 total days
	Post-Vietnam War	5/8/1975–9/7/1980 *The ending date for officers October 16th, 1981	181 continuous days
Currently on Active Duty	24-month rule	9/8/1980–8/1/1980* The beginning date for officers is October 17th, 1981	24 continuous months, OR The full period (at least 181 days) for which you were called or ordered to active duty
	Gulf War	8/2/1990–Present	24 continuous months, OR The full period (at least 90 days) for which you were called or ordered to active duty
Currently on Active Duty	Any	Any	90 continuous days
National Guard & Reserve Member	Gulf War	8/2/1990–Present	90 days of active service
Other Eligibility based on			
• Six years of service in the Selected Reserve or National Guard, AND • Were discharged honorably, OR • Were placed on the retired list, OR • Were transferred to the Standby Reserve or an element of the Ready Reserve other than the Selected Service after Service characterized as honorable, OR • Continue to serve in the Selected Reserve			

Exceptions for Gulf War Service from 8/2/1990 forward to dates to be determined are:

- Completed at least 90 days of active duty and been discharged under the specific authority of 10 USC 1173 (Hardship), or 10 USC 1171 (Early Out), or have been determined to have a compensable service-connected disability
- Been discharged with less than 90 days of service for a service-connected disability; individuals may also be eligible if they were released from active duty due to an involuntary reduction in force, certain medical conditions or, in some instances, for the convenience of the government

in World War II are also considered eligible. So are some individuals with service as members in certain organizations, including Public Health Service officers; cadets at the United States Military, Air Force, or Coast Guard Academy; midshipmen at the United States Naval Academy; officers of the National Oceanic and Atmospheric Administration; and merchant seamen with World War II service.

Owner-Occupied

The VA guaranty can be used by a veteran only to buy a house to live in as a principal residence. The guaranty cannot be used to purchase rental property, except for an approved one- to-four-family dwelling that is also occupied by the veteran/buyer. The definition of an owner/occupant has been expanded to include a qualified veteran's spouse during the time a veteran is on active duty out of the country.

Eligibility of Spouses of Otherwise Qualifying Veterans

Any non-remarried spouse of a veteran who died while in service or from a service-connected disability, or any spouse of a serviceperson missing in action or a prisoner of war, is eligible. A surviving spouse who remarries on or after attaining age 57, and on or after December 16, 2003, may be eligible for the home loan benefit as well. However, a surviving spouse who remarried before December 16, 2003, and on or after attaining age 57, must have applied no later than December 15, 2004, to establish home loan eligibility. The VA must deny applications submitted after the December 15, 2004 deadline from surviving spouses who remarried before December 6, 2003.

For any veteran considering the purchase of a home and the use of a VA loan, it is a good idea to ask the VA regional office to confirm eligibility. This is done by submitting VA Form 26-1880, "Request for Determination of Eligibility and Available Loan Guaranty Entitlement." The VA response to this request answers two questions: Is the veteran eligible? And if so, how much is available in the entitlement?

The Loan Guaranty Entitlement

The amount of money that the VA will guarantee for a veteran is called an **entitlement**. At its origin in 1944, the maximum entitlement amounted to

\$2,000. As housing prices increased over the years, Congress has periodically adjusted the entitlement limit, as shown in Table 8-4.

Sliding Scale Guaranty

Prior to 1988, the VA applied the same maximum permissible amount as the guaranty portion of a loan regardless of the amount of the loan. As the size of loans continued to increase, the single-figure guaranty became disproportionate for a smaller loan as compared with larger loans. The VA introduced a sliding scale of loan guaranties on February 1, 1988, when the limit was increased to \$36,000. The new guaranty limits are a mix of loan percentages and fixed amounts, as shown in Table 8-5.

Where Are We Now?

Illustrations of Guarantee Calculation

Illustration 1

If a veteran has not previously used an entitlement and now wishes to purchase a home that would qualify for a loan of \$300,000, the loan would fall in the guaranty category of 25% (see Table 8-5). To calculate:

$$300,000 \times 25\% = \$75,000 \text{ (guaranty applied to the loan)}$$

Illustration 2

Assume a veteran with full entitlement is purchasing a home for \$700,000 where the county loan limit is \$625,500. The loan would fall into the guaranty category of 25% (See Table 8-5).

$$\$625,500 \times 25\% = \$156,375 \text{ maximum guaranty and entitlement available for the loan}$$

$$\$156,375 \div \$700,000 = 22.34\% \text{ maximum guaranty}$$

To be able to sell the loan, lenders will require $\$700,000 \times 25\% = \$175,000$ guaranty. The veteran will need a Down Payment Combination Requirement of \$175,000 minus \$156,375, the maximum guaranty. This yields a required down payment of \$18,625.

Illustration 3

Assume a second veteran has used \$54,000 of entitlement on a prior loan (which cannot be restored) and plans to purchase a home for \$405,000 in a county with a loan limit of \$625,500.

$\$625,500 \times 25\% = \$156,375$; maximum guaranty $\$156,375 - \$54,000 = \$102,375$ entitlement available

$\$102,375 \times 4 = \$409,500$ maximum loan amount with 25% guaranty

Since the proposed loan amount will be less than \$409,500, the lender will receive a 25% VA guaranty on the loan of \$405,000, and a down payment will not be required.

Table 8-4 Entitlement Increments

Date of Increase	Maximum Entitlement
	\$ 2,000
Original Act, 1944	4,000
December 28, 1945	7,500
July 12, 1950	12,500
May 7, 1968	17,500
December 31, 1974	25,000
October 1, 1978	7,500
October 7, 1980	36,000
February 1, 1988	46,000
December 18, 1989	50,750
October 13, 1994	60,000
December 27, 2001	89,913*
December 10, 2004	104,250*
January 1, 2006	

*The Veterans Benefits Improvement Act of 2004 began an expansion of VA maximum loan amounts to the levels of those of Fannie Mae and Freddie Mac, and its guarantee amount to 25% of that maximum. This was to be indexed through 2008, but the Veterans Housing Opportunity and Benefits Act of 2006 eliminated the \$80,000 maximum loan amount, in addition to the need for Secretarial determination of higher loan amounts in high-cost areas. Instead, the new limit on Native American Direct Loan (NADL) is the same as the Federal Home Loan Mortgage Corporation (or Freddie Mac) single-family conventional conforming loan limit. That limit is currently \$417,000 for loans located in the 48 contiguous states and \$625,000 for loans in Alaska, Guam, Hawaii, and the U.S. Virgin Islands. Increases in these loan limits will be published annually, based upon the annual adjustment in the Freddie Mac conventional conforming loan limit, which is \$417,000 for 2015. In 2015, high-cost area loan limits have increased for 46 counties due to a high-cost area adjustment or the county being newly assigned to a high-cost area, and are as high as \$938,250 for a single-family residence.

Illustration 3

Assume a second veteran has used \$54,000 of entitlement on a prior loan (which cannot be restored) and plans to purchase a home for \$405,000 in a county with a loan limit of \$625,500.

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TABLE 8-5 Sliding Scale Guaranty

Loan Amount	Guaranty Amount Range
\$45,000 and less	50% of loan
\$45,001 to \$56,250	\$22,500
\$56,251 to \$90,000	40% of loan not to exceed \$36,000
\$90,001 to \$144,000	\$36,000
\$144,001 to \$417,000	25% of loan not to exceed the maximum loan guaranty of \$104,250*

*Always refer to the VA county-specific loan limit. Note that Effective January 1, 2015, VA's 2015 Loan Limits are the same as the Federal Housing Finance Agency's limits. For purposes of determining the VA guaranty, lenders are instructed to reference only the One-Unit Limit column in the FHFA Table entitled "Fannie Mae and Freddie Mac Maximum Loan Limits for Mortgages Acquired in Calendar Year 2015 and Originated after 10/1/2011 or before 7/1/2007." The highest county single-family limit in 2015 is \$938,250; that amount, if multiplied by 25%, would equal a maximum guaranty of \$234,562.50, which is lower than it was in 2014.

Source: © 2016 OnCourse Learning

Tier 1 or Partial Entitlements

If a veteran sells a house with assumption of a VA loan, the Department of Veterans Affairs remains liable to the holder of that note (the lender) until it is paid off. This is true whether or not the selling veteran has obtained a release of liability from the obligation to the VA. So when this occurs, the veteran's entitlement for that existing loan remains committed insofar as the VA is concerned. This means that the amount of entitlement previously committed cannot be used to acquire another property. However, when the entitlement limit itself is increased, the additional amount becomes available for further use. Under such circumstances, a veteran may be eligible for partial entitlement.

Example

A veteran purchased a home in 1977 using a VA guaranty that amounted to \$17,500 at that time (refer to Table 8-4). The home was sold in 1992 with an assumption of the old loan by the new buyer. If the veteran seller did not obtain a restoration of full entitlement at the time, there is still a new entitlement that can amount to the difference between the \$17,500 that remains committed and the current limit of \$104,250. But there is now a limit on partial entitlements.

Limit on Tier 1/Partial Entitlements

Except in the case of eligible loans in excess of \$144,000, the maximum amount of the guarantee remains \$36,000. For example, a veteran who previously used a \$17,500 entitlement that has not been restored has \$18,500 available (\$36,000 minus \$17,500 equals \$18,500) for use in connection with any eligible purpose. However, in the event of a new loan in excess of \$144,000, the remaining entitlement used to guarantee the loan amount will be based on the difference between \$46,000 and the previously used guaranty amount. Thus, the same veteran with a previously used guaranty amount of \$17,500 would have a \$28,500 entitlement for use if the purpose of the new loan is to acquire a home or condominium with a loan in excess of \$144,000. A real estate agent or loan officer dealing with a partial entitlement question should understand whether the veteran is in a high-cost county before attempting to advise about his or her remaining entitlement, and would benefit by contacting the local VA office or by visiting this link on the Veterans' Administration website: http://www.benefits.va.gov/HOMELOANS/purchaseco_loan_limits.asp.

Practical Value of an Entitlement

In the marketplace, the amount of entitlement is a key determinant of the maximum size of a VA loan because almost all VA loans are now sold into Ginnie Mae loan pools. It is a Ginnie Mae, not a VA, requirement that in order for any VA loan to be accepted into a Ginnie Mae-underwritten pool, it must have guaranty and/or cash covering at least 25% of the loan amount. Since VA loans can be approved with no cash down, the market puts emphasis on the amount of a veteran's entitlement, meaning at least 25% of the loan amount must be a VA guaranty. In other words, a VA loan cannot exceed four times its guaranty. The VA's limit-on-loan amount is quite different; in this case, the loan cannot exceed the appraised value of the property. The appraised value in VA terminology is **the Certificate of Reasonable Value (CRV)**.

Restoration of Entitlement

Restoration of entitlement is often confused with a release of liability. They are quite different and require two separate procedures if both are to be accomplished. One way of distinguishing between the two is to think of restoration of entitlement as help in obtaining a new loan. Release of

liability, as will be explained later, has to do with responsibility for an old loan. Restoration is important for a veteran desiring to purchase a new house, and this question should be considered in any contract when a veteran sells a house that has a VA loan.

There are two ways for a veteran to regain the right to full entitlement. These are as follows:

1. **Pay off the loan through sale of the property.** This means not allowing an existing VA loan to be assumed. Once the loan is paid off, the obligation of the VA terminates for that loan and the veteran's entitlement rights can be restored. One further requirement is that the house must be vacated, as a veteran can only own one house, which must be his or her own principal residence.
2. **Substitute another veteran's entitlement.** To qualify under this procedure, the veteran may sell his or her home on an assumption basis, but only to another qualified veteran. The purchasing veteran must: (a) have at least as much entitlement as the selling veteran, (b) meet the normal income and creditworthiness requirements, and (c) agree to permit the entitlement to be substituted.

For many years, the VA also required that there be a compelling personal reason for the sale—for example, a job transfer—to restore a veteran's entitlement. This is no longer necessary.

Other Special Veterans Rights

The American Recovery and Reinvestment Act of 2009 (ARRA) included a temporary expansion of the Homeowner's Assistance Program benefits for private home sale losses of both military and civilian Defense Department personnel. The program may provide benefits for those with military affiliation who lose money on a home purchased before July 1, 2006, and must sell due to a service-forced relocation or certain other service-related circumstances. The circumstances covered by the ARRA allow for compensation for service members with or without VA loans who sell their homes and suffer a loss due to declines in fair market value if the sale was made necessary by relocation after a military base closure; reassignment ordered between July 1, 2006, and September 30, 2012; or a combat wound requiring relocation for further medical assistance.

The ARRA also provides protection for surviving spouses of those killed in the line of duty. The ARRA allows for appropriation to be used by the Secretary of Defense in a number of alternative ways, such as by

acquiring title to a military person's property or reimbursing a military person for losses after a private sale.

Under the ARRA provisions, the federal government is prepared to cover part of a veteran's loss if the veteran was effectively forced to sell as a result of any of the above. The government could buy the home, and the price or payment would be determined by a formula. Generally, the government would cover the difference between 95% of the prior fair market value and the fair market value at the time of the event that resulted in a loss.

Non-Spouse Co-Ownership

A veteran wanting to use their VA home loan benefit to purchase a home along with a non-spouse/non-veteran often is not realistic if the veteran does not intend to use the home as their primary residence. When taking a VA home loan, the occupying borrower has to be an eligible veteran. While the VA does not specifically prohibit non-occupying co-borrowers, it does require that such a loan be sent to them for prior authorization. Although both incomes can be used to qualify for the loan, the borrower's (veteran's) income must be sufficient to repay his/her portion of the loan. Also, the VA guaranty covers only the veteran's portion of the loan. The outcome will be that few or possibly no VA lenders will issue a loan without a full guaranty.

Assumption of a VA Loan

Prior rules allowed the assumption of a VA loan by any purchaser—veteran or nonveteran—without approval by the VA. What became lost in the long upswing in the housing market into the early 1980s, however, was the fact that the seller remained primarily liable for repayment of that assumed loan; the loan could be transferred, but not the responsibility for its repayment. Unless the selling veteran took the available steps to find a creditworthy buyer and then obtain a release of liability, the obligation remained. When the economy in certain areas of the country began to decline in the mid-1980s, defaults and foreclosures became far more prevalent. Many problems resulted when a private mortgage lender was forced to foreclose on properties that had been conveyed to buyers unknown to the VA or the lender.

A claim for repayment of a defaulted VA loan is a debt owed to the federal government (as is an FHA claim) and subject to collection from the debtor(s) through the U.S. government's right of indemnification and/

or subrogation. To reduce any recurrence of this kind of problem, the VA changed the assumption rules for all VA-guaranteed loans underwritten after March 1, 1988.

Assumption by Creditworthy Buyers Only

For loans underwritten after March 1, 1988, assumptions are not permitted without prior underwriting approval by the lender or the VA. This rule is not retroactive and does not apply to loans underwritten before that date, meaning that older loans may still be freely assumed. But without a release of liability from the old loan, the seller remains fully liable.

Veterans holding VA loans underwritten after March 1, 1988, must follow specific procedures if a loan assumption is anticipated. Specifically, a selling veteran must notify the mortgagee before the property is transferred. The mortgagee must then determine if the prospective buyer meets credit standards. If the selling veteran fails to notify the mortgagee before transferring the property, or if the property is transferred to a buyer who has failed the creditworthiness test, the lender has the right to accelerate the note. There exists a right of appeal for the selling veteran: Should the lender determine that the prospective buyer is not creditworthy, the seller has 30 days to appeal the decision. The non-veteran that assumes the loan must meet the same underwriting requirements as if a new VA loan were being made. If the VA overrides the lender's determination, the lender must then approve the assumption.

To protect the veteran and to make sure assumption requirements are fully disclosed, mortgage instruments underwritten after March 1, 1988, must show in capital letters on the first page the following sentence: "THIS LOAN IS NOT ASSUMABLE WITHOUT THE APPROVAL OF THE DEPARTMENT OF VETERANS AFFAIRS OR ITS AGENT."

A transfer fee of one-half of 1% of the balance due on the loan shall be payable at the time of transfer to the loan holder, or its authorized agent, as trustee for the Secretary for Department of Veterans Affairs. In the event the fee is not paid, it shall be added to the debt secured by this instrument.

Release of Liability

The above-stated rules underline the importance of selling a house to someone who is capable of making payments on the loan if it is to be assumed. While it will take many years for the older, more easily assumed loans to work their way out of existence, selling veterans continue to have

the right to obtain a release of liability in a sale with a loan assumption. A selling veteran is entitled to a **release of liability** if the following conditions are met:

1. The loan must be current.
2. The purchaser/assumptor must qualify from the standpoint of income and be an acceptable credit risk.
3. The purchaser must agree to assume the veteran's obligations on the loan.

The veteran need not sell the house to another veteran in order to obtain a release of liability for a loan assumption. The purchaser need only meet the above-listed requirements. Release of liability is a separate form and should be completed at the time the transaction is closed.

Loan Default and Foreclosure

Even though the VA guaranty covers only a portion of the loan amount, historically, in the event of foreclosure, VA followed a policy of paying off the principal balance with interest due and taking title to the property. This practice enhanced the value of a VA guaranty for the lender. However, as foreclosures escalated in the late 1980s, increased losses were sustained by the VA. To better protect the programs and reduce potential cost to taxpayers, the VA changed its procedures when faced with a foreclosure.

Similar to the practice followed by HUD/FHA, the VA now requires notification of a pending foreclosure so that it can have the property appraised. On a case-by-case basis, the VA then decides what action is in the best interest for the agency; that is, the VA must decide whether or not it is best for the VA to pay off the loan and take title to the property, or simply pay only the guaranty amount to the lender. If the latter method is followed, the VA pays the guaranty and declines to bid for the property at foreclosure, or "no-bids" the property. This means the lender takes title in foreclosure and must arrange for whatever disposition it can find.

The "no-bid" procedure has substantially altered the risk level of a VA loan for lenders and is one of the reasons why lenders encourage veteran applicants to consider competitive conventional loans.

Funding Fee

Initially, the VA home loan program was handled as part of the country's ongoing commitment of service to veterans. For many years, there was no

charge for processing the loan application or for issuing the guaranty certificate. However, increasing costs and growing losses caused Congress to add a 0.50% funding fee in 1982 for issuance of a VA guaranty. Since then, the fee has been raised and lowered several times, the latest increase becoming effective in 2012 based on the changes from the Honoring America's Veterans and Caring for Camp Lejeune Families Act of 2012 ("Honoring Veterans Act"). There are still three categories of eligible veterans with differing fees. The fee is reduced as down payment is increased, as shown in Table 8-6.

The fee is payable at closing and may be included in the amount of the loan. There are a few exceptions. For example, the fee is not paid by veterans receiving compensation for service-connected disabilities or surviving spouses of veterans who died in service or as a result of service-connected disabilities. The Honoring Veterans Act grants exemption from paying the funding fee for:

- Veterans receiving VA compensation for service-connected disabilities
- Veterans who are entitled to receive compensation for service-connected disabilities if they do not receive retirement pay
- Veterans who are rated by the VA as eligible to receive compensation as a result of pre-discharge disability examination and rating or on the basis of a pre-discharge review of existing medical evidence (including service medical and treatment records) that results in issuance of a memorandum rating
- Veterans entitled to receive compensation, but who are not presently in receipt because they are on active duty
- Surviving spouses of veterans who died in service or from service-connected disabilities (whether or not such surviving spouses are veterans with their own entitlement and whether or not they are using their own entitlement on the loan)

Fees apply to all types of VA-guaranteed loans, but they vary for different categories. For instance, the fee for interest rate reduction/refinancing loans was reduced to 0.50% as of October 28, 1992, and was extended to December 31, 2017, under the Honoring Veterans Act. The VA accepts the possibility that the addition of a funding fee may make the loan in excess of the property value.

Negotiated Interest Rate and Discount

In a historic change for the VA, Congress passed legislation in 1992 to allow market interest rates and discounts to be applied to VA loans. (The FHA made

this change in 1982.) Before this change, the VA set a maximum permissible rate for issuance of its guaranty and allowed no discount to be paid by a veteran borrower. Even though the VA interest rate was changed periodically to stay abreast of market fluctuations, the cost of a loan to the borrower was adjusted by lenders to meet current market yields through a change in the discount. The burden was placed on the seller, who was required to pay any discount, and this cost was often shifted into the price of the property.

The new law, which became effective October 28, 1992, allows loans to be guaranteed by the VA at an interest rate agreed upon between the veteran and the lender. In addition, discount points as agreed between veteran and lender may be paid by the veteran, but may not be added to the loan amount.

Adjustable Rate Mortgage (ARM)

ARMs have had an on-again, off-again relationship with the Veterans Administration. Just 10 years ago, a three-year test period to underwrite ARM mortgages expired on September 30, 1995. The reason given for the elimination at that time was that the program had cost the VA money. Currently, the VA allows traditional ARMs, hybrid ARMs (3/1, 5/1, 7/1, and 10/1), graduated payment mortgages (GPM), and growing equity mortgages (GEM) for veteran loans.

Interest Rate Reduction Refinancing Loans (IRRRLs)

In times of low interest rates, such as what occurred during the 1990s, both the FHA and the VA take steps to encourage refinancing existing loans. It is not their money that is at stake, but their underwriting guaran-

TABLE 8-6 VA Funding Fees (Funding fee is based on the amount of down payment)

Down Payment	First Time	Multiple User	Nat'l Guard	Nat'l Guard	Stmlne Refi	Cashout Refi	Cashout Refi	Cashout Refi
	Purchase Multiple				Regular Res/Nat'l Multiple Use*			
(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)
None	2.15%	3.30%	2.40%	3.30%	.50%	2.15%	2.4%	3.3%
5-<10%	1.50%	1.50%	1.75%	1.75%	.50%	2.15%	2.4%	3.3%
10% or more	1.25%	1.25%	1.50%	1.50%	.50%	2.15%	2.4%	3.3%

* Multiple Use Cash Out Refinance Funding Fee is the same for Regular Military and Reserve/National Guard.

Source: Veterans Benefits Administration. *Lender's Handbook*, VA Pamphlet 26-7 (Revised), Chapter 8, pp. 8-21.

tees of loan repayment. The easier it is for their borrowers to repay loans, the lower the risk for the underwriting agencies. Refinancing loans to obtain lower interest rates results in lower monthly payments and easier repayment, and reduces default risk.

Inducements to refinance include eliminating an appraisal, extending loan terms, and reducing funding or insuring fees. For VA loans closed after January 21, 1988, the term may be extended for up to 10 years longer than the remaining term of the original loan, but not longer than a maximum of 30 years and 32 days. The veteran need not occupy the house to secure refinancing but must certify that the house was occupied by the veteran when the loan was secured. The funding fee for refinancing has been reduced to 0.50 points.

The rules applicable to refinancing a VA-guaranteed loan at a lower interest rate were modified in May 1999. In a final rule on the issue, the VA will not permit refinancing if a loan is delinquent. Furthermore, the payment must be reduced on the refinanced loan and the veteran seeking refinancing must meet certain credit standards. The purpose of requiring a payment reduction is to prevent unscrupulous lenders from lowering the interest rate while still packing the refinanced loan with excessive fees so that the payment is actually increased.

Other VA Requirements and Procedures

To assure the veteran that the home loan will be properly handled and that the government guaranty will not be abused, the VA has a number of specific requirements relating to the loan and how it is handled. Essential areas of VA concern are discussed next.

The Lender

To protect against any unscrupulous activity, the VA distinguishes between supervised and nonsupervised lenders. A *supervised* lender is one who is subject to periodic examination and regulation by a federal or state agency. Savings associations, commercial banks, savings banks, and insurance companies all qualify as supervised lenders. As such, they can process loans on an automatic basis.

Under this procedure, the supervised lender takes all the necessary steps to qualify a borrower, asks for a VA appraisal, and then makes its own underwriting decision. If favorable, the information is submitted to the VA in a Loan Report that the VA is obliged to honor with the issuance of a guaranty certificate.

A *nonsupervised* lender is anyone who does not qualify as a supervised lender. Mortgage companies, fraternal associations, and individuals are examples of nonsupervised lenders. To obtain a certificate of guaranty from the VA, the nonsupervised lender must first obtain approval from the VA to make a loan to the veteran applicant, and would have to submit all required information to the VA office for underwriting approval.

A third category of lender is a *nonsupervised lender that qualifies for automatic loan processing*. Mortgage companies that are wholly-owned subsidiaries of a supervised lender, subject to the same periodic examination as their parent firm, are listed in this category. If the VA qualifications are met, the nonsupervised lenders may submit their own approved applications for guaranty in the form of a Loan Report, and receive the same automatic issuance of a VA guaranty certificate as a supervised lender.

Term of the Loan

A VA home loan can be obtained for up to 30 years. Shorter terms are approved by the VA if required by the lender and accepted by the veteran. The veteran has the right to repay all or any part of the principal balance due on the loan at any time with no additional interest charges or penalties.

Loan Servicing

The administration of a VA loan is not prescribed by the VA. Approved lenders are expected to follow the normal standards and practices of prudent lenders. The VA expects a veteran/obligor to meet the obligations fully and on time; however, it does encourage reasonable forbearance on the part of the lender with enforcement of its collections. The lender is required to notify the VA of a default within 60 days after nonpayment of an installment. Failure to file the default notice within the prescribed time limits can result in a reduction of the guaranty allowed for the lender.

Default and Foreclosure

Once notification of a default has been filed with the VA, there is no time limit that dictates when a lender must take action to foreclose on the property. If foreclosure does become necessary, the VA must first appraise the property and set a "specified value." This value becomes the minimum amount for which the property can be sold and serves as a protection for all parties involved.

In years past, the VA has followed the practice of paying a lender in full on a foreclosed loan and taking title to repossessed property. It was

not legally obligated to do this but believed assurance to a lender of full recovery of its loan balance with interest provided greater credibility for the VA guaranty. And certainly it did so.

More recently, as foreclosure problems escalated, the VA altered its policies into what is commonly called a "no-bid" action in foreclosure proceedings. This means that the VA now appraises the property's net value to the VA prior to a lender foreclosure action. If it would cost the VA less to pay off the guaranty to the lender (rather than the balance due on the loan), it simply chooses not to bid at the foreclosure auction (no-bid) and forfeits any further claim to the property. This possibility has lessened the value of a VA guaranty for many lenders.

Manufactured Home Loans

The Veterans Housing Act of 1970 (updated in 1974) authorized the VA to guarantee loans made by private lenders to veterans for the purchase of new and used mobile homes. (Mobile homes constructed on or after June 15, 1976, are called *manufactured homes*, as defined by HUD.) The same VA rules apply to a manufactured home as for a site-built house; it must be occupied by the veteran as his or her principal residence. The unit so acquired may be a single-wide or a double-wide, and the authorization to guarantee also covers a lot suitable for a manufactured home.

Because the status of a manufactured home as real versus personal property is not always clear, the VA now offers two categories under which lenders may request guarantees. The older procedure, identified as Section 1819 (of Title 38), offers a guaranty at the lesser of 50% of the loan amount up to a maximum of \$20,000. Effective on March 2, 1984, a new provision was added to Section 1810 increasing the maximum guaranty for a manufactured home permanently affixed to a lot, provided the manufactured home is considered real property under laws of the state where the lot is located. A Section 1810 loan allows longer repayment terms and may be guaranteed on the same sliding scale entitlement as for site-built houses.

Section 1810 permits a veteran to purchase a manufactured home already permanently affixed to a lot, or a home and a lot to which the home will be permanently affixed, or to refinance an existing loan secured by a manufactured home permanently affixed to a lot. The veteran is allowed to pay a reasonable discount on the refinancing portion of the loan. The term of these loans can be for as long as 30 years and 32 days. Interest rate and discount can be negotiated between the veteran and lender.

Manufactured home loans are not an additional entitlement for the veteran, as the privilege is reduced by the amount of entitlement already committed, similar to a regular home loan. The same rules that apply to regular VA house loans regarding a veteran's entitlement, negotiated interest rate, and liability for repayment also apply to a manufactured home loan.

Analyzing the Loan Application

Both the property to be pledged as collateral and the veteran applicant must meet VA qualification standards. Because both HUD/FHA and the VA have similar underwriting goals (that is, a sound building as collateral and a creditworthy borrower), their qualification standards are similar. And each agency now accepts the other's qualifications of applicants with a few exceptions. Property qualification is considered next. The process of qualifying a veteran applicant is examined in the next chapter to allow comparisons with other loan-qualifying procedures.

Qualifying the Property

The VA uses both its own staff and approved independent fee appraisers to inspect and evaluate property that may serve as loan collateral. While the appraisal form has been standardized (see Appendix for an illustration), the VA refers to its appraisal analysis as a Certificate of Reasonable Value (CRV). A CRV represents the maximum amount a lender may loan and still obtain an underwriting guarantee from the VA. A veteran may purchase a house at a price exceeding the CRV, but any amount in excess of the CRV must be paid in cash. Or, if the CRV comes in at less than the agreed price, the veteran has the right to withdraw from the contract and recover the earnest money in full.

The requirements mentioned are for VA qualification and are not necessarily the same as a lender might require. Lenders are not required to make a loan at the VA-permissible limits. Simply put, a lender cannot exceed those limits and still obtain a VA guaranty. But if the lender's policy is more limited than that allowed by the VA, the lender is free to apply its own limitations and still obtain a VA guaranty commitment. For instance, many lenders will not accept 100% loan-to-value loans regardless of VA permission. Nevertheless, so long as the loan does not exceed VA limits, the guaranty can be issued. The same concept applies to all other underwriting programs—FHA, GNMA, and all conforming loans—and the

lender is free to offer a loan at lower than the designated limits and may still qualify the loan for whatever underwriting program is sought. The point is that loan applicants should not expect government agency maximum limitations to be uniformly accepted by all private lenders.

Scope of the VA Appraisal

Like the HUD/FHA appraisal procedure discussed earlier in this chapter, there are other pieces of information needed beyond the property evaluation. The VA is the only agency that still requires information on the maintenance and utility costs of the house to be acquired. Both of these costs are considered in an applicant's income qualification under the residual guideline method, as more fully described in the next chapter. And like the FHA, VA appraisers are expected to make the necessary adjustments in valuation that will more closely reflect the property's real value rather than an inflated value caused by excessive financial inducements.

The appraiser's responsibility extends to inspecting the property to make sure that it meets VA minimum property standards. If not, repairs may be required to upgrade the property before the loan can be funded.

Questions for Discussion

1. How has the FHA achieved the goals for which it was established?
2. Explain the two different dollar limits that apply to HUD/FHA-insured commitments.
3. In HUD/FHA settlement requirements, what rules apply to the handling of the down payment? To the handling of the closing costs?
4. Explain the difference between loan underwriting commitments made by the VA and those made by HUD/FHA.
5. What charges must a borrower pay for a HUD/FHA-insured commitment?
6. How are interest rates determined on HUD/FHA loans? On VA loans?
7. What are the assumption requirements now in effect for HUD/FHA loans? For VA loans?
8. Distinguish between the release of liability for a veteran and the restoration of entitlement.
9. What is the purpose of the HUD/FHA 203(k) Rehabilitation Home Mortgage Insurance program?
10. What charges, if any, must a veteran pay for a loan guaranty?