Date: XXXX, 2023

Mortgagee Letter 2023-XX

To: All FHA-Approved Mortgagees
All Direct Endorsement Underwriters
All Eligible Submission Sources for Condominium Project Approvals
All FHA Roster Appraisers
All FHA-Approved 203(k) Consultants
All HUD-Approved Housing Counselors
All HUD-Approved Nonprofit Organizations
All Governmental Entity Participants
All Real Estate Brokers
All Closing Agents

Subject	Consideration of Accessory Dwelling Unit Rental Income
Purpose	This Mortgagee Letter (ML) establishes protocols for the Appraiser's analysis and reporting of Accessory Dwelling Unit (ADU) market rent on appraisals and for consideration of this rental income in underwriting forward mortgages and performing the financial assessment for Home Equity Conversion Mortgages (HECM).
Effective Date	The provisions of this ML are effective immediately. All updates will be incorporated into a forthcoming update of the HUD Handbook 4000.1, *FHA Single Family Housing Policy Handbook* (Handbook 4000.1).
Public Feedback	HUD welcomes feedback from interested parties for a period of 30 calendar days from the date of issuance. To provide feedback on this policy document, please send feedback to the FHA Resource Center at answers@hud.gov or call 1-800-CALLFHA (1-800-225-5342). HUD will consider the feedback in determining the need for future updates.
Affected Programs	The provisions of this ML apply to FHA Single Family Title II Forward and Home Equity Conversion Mortgage (HECM) programs.

Background

FHA programs currently allow for the purchase, rehabilitation, or refinance of properties that include a single ADU. FHA does not, however, presently allow for the inclusion of income from the ADU in the Borrower's qualifying income.

FHA recognizes that ADUs have emerged as a significant source of affordable housing with income potential for property owners and buyers, and that ADUs can also serve as a basis for generational wealth-building. Additionally, ADU rental income can contribute to mortgage payments and help Borrowers sustain homeownership. To support the goals of increasing the stock of affordable housing and expanding opportunities for wealth building and homeowner stability, FHA is updating its appraisal protocols, underwriting requirements, and the HECM financial assessment to permit the inclusion of income from an ADU in the assessment of a Borrower's qualifying income for purposes of obtaining FHA-insured Mortgage financing. FHA is also updating its guidance to appraisers regarding how to determine and report market rent for Properties with ADUs.

Summary of Changes

This ML:

- updates the definition and standard in Property Types – Accessory Dwelling Unit (II.A.1.b.iv(B)(4));
- provides guidance on underwriting income in:
  - Underwriting the Borrower Using the TOTAL Mortgage Scorecard (TOTAL) – Rental Income (TOTAL) (II.A.4.c.xii(I)); and
  - Manual Underwriting of the Borrower – Rental Income (Manual) (II.A.5.b.xii(I));
- updates reserve requirements for Properties:
  - with ADUs in General Asset Requirements (TOTAL) – Reserves (TOTAL) (II.A.4.d.i(C)); and
  - with two-unit Properties in General Asset Requirements (Manual) – Reserves (Manual) (II.A.5.c.i(C));
- updates types of improvements eligible for a Standard 203(k) transaction Standard 203(k) Eligible Improvements – Types of Improvements (II.A.8.a.vi(A)(1));
- adds a single family property with an ADU as an eligible property type for new construction financing in New Construction – Eligible Property Types (II.A.8.i.ii);
- updates the table in Appraiser and Property Requirements for Title II Forward and Reverse Mortgages – Acceptable Appraisal Reporting Forms and Protocols (II.D.3);
- updates Characteristics of Property Improvements – Identifying an Accessory Dwelling Unit (II.D.3.b.vii(E)); and

- adds guidance on rental income related to ADUs in 3.50, 3.51, 3.52, 3.53, and 3.54 of the HECM Financial Assessment and Property Charge Guide.

FHA Single Family Housing Policy Handbook 4000.1

Origination Through Post-closing/ Endorsement

The policy changes will be incorporated into Handbook 4000.1 as follows:

Accessory Dwelling Unit (II.A.1.b.iv(B)(4))

(a) Definition

An Accessory Dwelling Unit (ADU) refers to a single habitable living unit with means of separate ingress and egress that meets the minimum requirements for a living unit (II.A.3.a.ii(F)). ADUs are subordinate in size and can be added to, created within, or detached from a primary one-unit Single Family dwelling, which together constitute a single interest in real estate.

(b) Standard

A Single Family residential one-unit Property with a single ADU remains a one-unit Property. For any Single Family residential Property with two or more units, a separate additional Dwelling Unit must be considered as an additional unit.

Rental Income (TOTAL) (II.A.4.c.xii(I))

(1) Definition

Rental Income refers to income received or to be received from the subject Property or other real estate holdings.

(2) Rental Income Received from the Subject Property (TOTAL)

(a) Standard

The Mortgagee may consider Rental Income from existing and prospective tenants if documented in accordance with the following requirements.

Rental Income from the subject Property may be considered Effective Income when the Property is or will be a single-unit dwelling with an ADU, a two- to four-unit dwelling, or an acceptable one- to four-unit Investment Property.

No income from commercial space may be included in Rental Income calculations.

(b) Required Documentation

Documentation varies depending upon the length of time the Borrower has owned the Property.

(*i*) Limited or No History of Rental Income

Where the Borrower does not have a history of Rental Income from the subject since the previous tax filing:

Two- to Four-Units

The Mortgagee must verify and document the proposed Rental Income by obtaining an appraisal showing fair market rent (use Fannie Mae Form 1025/Freddie Mac Form 72, *Small Residential Income Property Appraisal Report*) and, if available, the prospective leases.

One Unit or One Unit with an Accessory Dwelling Unit

The Mortgagee must verify and document the proposed Rental Income by obtaining a Fannie Mae Form 1004/Freddie Mac Form 70, *Uniform Residential Appraisal Report (URAR)*, and a Fannie Mae Form 1007/Freddie Mac Form 1000, *Single Family Comparable Rent Schedule*, showing fair market rent and, if available, the prospective lease.

(*ii*) Calculation of Rental Income

Where the Borrower has a history of Rental Income from the subject Property since the previous tax filing, the Mortgagee must verify and document the existing Rental Income by obtaining the Borrower's most recent tax returns, including Schedule E, from the previous two years.

The Rental Income from a Property owned less than two years is the annualized rental income divided by the number of months the Property has been owned. The Mortgagee must document the date of acquisition by providing the deed, Closing Disclosure, or other legal document.

(c) Calculation of Effective Income

The Mortgagee must add the net subject property Rental Income to the Borrower's gross income to calculate Effective Income. The Mortgagee may not reduce the Borrower's total Mortgage Payment by the net subject property Rental Income.

(*i*) Limited or No History of Rental Income

Two- to Four-Units

To calculate the Effective Income from the subject Property where the Borrower does not have a history of Rental Income from the subject Property since the previous tax filing, the Mortgagee must use 75 percent of the lesser of:

- fair market rent reported by the Appraiser; or
- the rent reflected in the lease or other rental agreement.

One Unit or One Unit with an Accessory Dwelling Unit

To calculate the Effective Income from the subject Property where the Borrower does not have a history of Rental Income from the subject Property since the previous tax filing, the Mortgagee must use 50 percent of the lesser of:

- fair market rent reported by the Appraiser; or
- the rent reflected in the lease or other rental agreement.

The amount of the Rental Income from the ADU used as Effective Income may not exceed 30% of the total Effective Income used to qualify the Borrower.

(*ii*) Calculation of Rental Income

The Mortgagee must calculate the Rental Income by averaging the amount shown on Schedule E.

Depreciation, mortgage interest, taxes, insurance, and any HOA dues shown on Schedule E may be added back to the net income or loss.

If the Property has been owned for less than two years, the Mortgagee must annualize the Rental Income for the length of time the Property has been owned.

(3) Rental Income from Other Real Estate Holdings (TOTAL)

(a) Standard

Rental Income from other real estate holdings may be considered Effective Income if the documentation requirements listed below are met. If Rental Income is being derived from a Property being vacated by the Borrower, the Borrower must be relocating to an area more than

100 miles from the Borrower's current Principal Residence. The Mortgagee must obtain a lease agreement of at least one year's duration

after the Mortgage is closed and evidence of the payment of the security deposit or first month's rent.

(b) Required Documentation

(*i*) Limited or No History of Rental Income

Where the Borrower does not have a history of Rental Income for the Property since the previous tax filing, including Property being vacated by the Borrower, the Mortgagee must obtain an appraisal evidencing market rent and that the Borrower has at least 25 percent equity in the Property. The appraisal is not required to be completed by an FHA Roster Appraiser.

Two- to Four-Units

The Mortgagee must verify and document the proposed Rental Income by obtaining an appraisal showing fair market rent (use Fannie Mae Form 1025/Freddie Mac Form 72, *Small Residential Income Property Appraisal Report*) and, if available, the prospective leases.

One Unit or One Unit with an Accessory Dwelling Unit

The Mortgagee must verify and document the proposed Rental Income by obtaining a Fannie Mae Form 1004/Freddie Mac Form 70, *Uniform Residential Appraisal Report (URAR)*, and a Fannie Mae Form 1007/Freddie Mac Form 1000, *Single Family Comparable Rent Schedule*, showing fair market rent and, if available, the prospective lease.

(*ii*) History of Rental Income

The Mortgagee must obtain the Borrower's last two years' tax returns with Schedule E.

(c) Calculation of Effective Net Rental Income

(*i*) Limited or No History of Rental Income

To calculate the effective net Rental Income from other real estate holdings where the Borrower does not have a history of Rental Income since the previous tax filing, the Mortgagee must deduct the Principal, Interest, Taxes, and Insurance (PITI) from 75 percent of the lesser of:

- fair market rent reported by the Appraiser; or
- the rent reflected in the lease or other rental agreement.

(*ii*) Calculation of Net Rental Income

The Mortgagee must calculate the net Rental Income by averaging the amount shown on the Schedule E provided the Borrower continues to own all Properties included on the Schedule E.

Depreciation shown on Schedule E may be added back to the net income or loss.

If the Property has been owned for less than two years, the Mortgagee must annualize the Rental Income for the length of time the Property has been owned.

The Rental Income from a Property owned less than two years is the annualized rental income divided by the number of months the Property has been owned. The Mortgagee must document the date of acquisition by providing the deed, Closing Disclosure, or other legal document.

Positive net Rental Income must be added to the Borrower's Effective Income. Negative net Rental Income must be included as a debt/liability.

(4) Boarders of the Subject Property (TOTAL)

(a) Definition

Boarder refers to an individual renting space inside the Borrower's Dwelling Unit. A tenant of an ADU is not a Boarder.

(b) Standard

Rental Income from Boarders is only acceptable if the Borrower has a two-year history of receiving income from Boarders that is shown on the tax return and the Borrower is currently receiving Boarder income.

(c) Required Documentation

The Mortgagee must obtain two years of the Borrower's tax returns evidencing income from Boarders and the current lease.

For purchase transactions, the Mortgagee must obtain a copy of the executed written agreement documenting their intent to continue boarding with the Borrower.

(d) Calculation of Effective Income

The Mortgagee must calculate the Effective Income by using the lesser of the two-year average or the current lease.

General Asset Requirements (TOTAL) (II.A.4.d.i)

(C) Reserves (TOTAL)

The Mortgagee must verify and document all assets submitted to the AUS.

Reserves refer to the sum of the Borrower's verified and documented liquid assets minus the total funds the Borrower is required to pay at closing.

Reserves do not include:

- the amount of cash taken at settlement in cash-out transactions;
- incidental cash received at settlement in other loan transactions;
- equity in another Property; or
- borrowed funds from any source.

(1) Required Reserves for One Unit with an Accessory Dwelling Unit and Two-Unit Properties

If Rental Income is being used to qualify, the Mortgagee must verify and document Reserves equivalent to two months' PITI after closing for one unit with an ADU and two-unit Properties.

(2) Required Reserves for Three- to Four-Unit Properties

The Mortgagee must verify and document Reserves equivalent to three months' PITI after closing for three- to four-unit Properties.

Rental Income (Manual) (II.A.5.b.xii(I))

(1) Definition

Rental Income refers to income received or to be received from the subject Property or other real estate holdings.

(2) Rental Income Received from the Subject Property (Manual)

(a) Standard

The Mortgagee may consider Rental Income from existing and prospective tenants if documented in accordance with the following requirements.

Rental Income from the subject Property may be considered Effective Income when the Property is or will be a single-unit dwelling with an ADU, a two- to four-unit dwelling, or an acceptable one- to four-unit Investment Property.

No income from commercial space may be included in Rental Income calculations.

(b) Required Documentation

Required documentation varies depending upon the length of time the Borrower has owned the Property.

(*i*) Limited or No History of Rental Income

Where the Borrower does not have a history of Rental Income from the subject since the previous tax filing:

Two-to Four-Units

The Mortgagee must verify and document the proposed Rental Income by obtaining an appraisal showing fair market rent (use Fannie Mae Form 1025/Freddie Mac Form 72, *Small Residential Income Property Appraisal Report*) and, if available, the prospective leases.

One Unit or One Unit with an Accessory Dwelling Unit

The Mortgagee must verify and document the proposed Rental Income by obtaining a Fannie Mae Form 1004/Freddie Mac Form 70, *Uniform Residential Appraisal Report (URAR)*, and a Fannie Mae Form 1007/Freddie Mac Form 1000, *Single Family Comparable Rent Schedule*, showing fair market rent and, if available, the prospective lease.

(*ii*) Calculation of Rental Income

Where the Borrower has a history of Rental Income from the subject since the previous tax filing, the Mortgagee must verify and document the existing Rental Income by obtaining the existing lease, rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal or military renters, or property rehabilitation), and the Borrower's most recent tax returns, including Schedule E, from the previous two years.

The Rental Income from a Property owned less than two years is the annualized rental income divided by the number of months the Property has been owned. The Mortgagee must document the date of acquisition by providing the deed, Closing Disclosure, or other legal document.

(c) Calculation of Effective Income

The Mortgagee must add the net subject property Rental Income to the Borrower's gross income to calculate Effective Income. The Mortgagee may not reduce the Borrower's total Mortgage Payment by the net subject property Rental Income.

(i) Limited or No History of Rental Income

Two- to Four-Units

To calculate the Effective Income from the subject Property where the Borrower does not have a history of Rental Income from the subject Property since the previous tax filing, the Mortgagee must use 75 percent of the lesser of:

- fair market rent reported by the Appraiser; or
- the rent reflected in the lease or other rental agreement.

One Unit or One Unit with an Accessory Dwelling Unit

To calculate the Effective Income from the subject Property where the Borrower does not have a history of Rental Income from the subject Property since the previous tax filing, the Mortgagee must use 50 percent of the lesser of:

- fair market rent reported by the Appraiser; or
- the rent reflected in the lease or other rental agreement.

The amount of the Rental Income from the ADU used as Effective Income may not exceed 30% of the total Effective Income used to qualify the Borrower.

(*ii*) History of Rental Income

The Mortgagee must calculate the Rental Income by averaging the amount shown on the Schedule E.

Depreciation, mortgage interest, taxes, insurance, and any HOA dues shown on Schedule E may be added back to the net income or loss.

If the Property has been owned for less than two years, the Mortgagee must annualize the Rental Income for the length of time the Property has been owned.

(3) Rental Income from Other Real Estate Holdings (Manual)

(a) Standard

Rental Income from other real estate holdings may be considered Effective Income if the documentation requirements listed below are met. If Rental Income is being derived from the Property being vacated by the Borrower, the Borrower must be relocating to an area more than 100 miles from the Borrower's current Principal Residence. The Mortgagee must obtain a lease agreement of at least one year's duration after the Mortgage is closed and evidence of the payment of the security deposit or first month's rent.

(b) Required Documentation

(*i*) Limited or No History of Rental Income

Where the Borrower does not have a history of Rental Income for the Property since the previous tax filing, including Property being vacated by the Borrower, the Mortgagee must obtain an appraisal evidencing market rent and that the Borrower has at least 25 percent equity in the Property. The appraisal is not required to be completed by an FHA Roster Appraiser.

Two- to Four-Units

The Mortgagee must verify and document the proposed Rental Income by obtaining an appraisal showing fair market rent (use Fannie Mae Form 1025/Freddie Mac Form 72, *Small Residential Income Property Appraisal Report*) and, if available, the prospective leases.

One Unit or One Unit with an Accessory Dwelling Unit

The Mortgagee must verify and document the proposed Rental Income by obtaining a Fannie Mae Form 1004/Freddie Mac Form 70, *Uniform Residential Appraisal Report (URAR)*, and a Fannie Mae Form 1007/Freddie Mac Form 1000, *Single Family*

Comparable Rent Schedule, showing fair market rent and, if available, the prospective lease.

(*ii*) History of Rental Income

The Mortgagee must obtain the Borrower's last two years' tax returns with Schedule E.

(c)Calculation of Effective Net Rental Income

(*i*) Limited or No History of Rental Income

To calculate the effective net Rental Income from other real estate holdings where the Borrower does not have a history of Rental Income since the previous tax filing, the Mortgagee must deduct the PITI from 75 percent of the lesser of:

- fair market rent reported by the Appraiser; or
- the rent reflected in the lease or other rental agreement.

(*ii*) Calculation of Net Rental Income

The Mortgagee must calculate the net Rental Income by averaging the amount shown on the Schedule E provided the Borrower continues to own all Properties included on the Schedule E.

Depreciation shown on Schedule E may be added back to the net income or loss.

If the Property has been owned for less than two years, the Mortgagee must annualize the Rental Income for the length of time the Property has been owned.

The Rental Income from a Property owned less than two years is the annualized rental income divided by the number of months the Property has been owned. The Mortgagee must document the date of acquisition by providing the deed, Closing Disclosure, or other legal document.

Positive net Rental Income must be added to the Borrower's Effective Income. Negative net Rental Income must be included as a debt/liability.

(4) Boarders of the Subject Property (Manual)

(a) Definition

Boarder refers to an individual renting space inside the Borrower's Dwelling Unit. A tenant of an ADU is not a Boarder.

(b) Standard

Rental Income from Boarders is only acceptable if the Borrower has a two-year history of receiving income from Boarders that is shown on the tax return and the Borrower is currently receiving Boarder income.

(c) Required Documentation

The Mortgagee must obtain two years of the Borrower's tax returns evidencing income from Boarders and the current lease.

For purchase transactions, the Mortgagee must obtain a copy of the executed written agreement documenting their intent to continue boarding with the Borrower.

(d) Calculation of Effective Income

The Mortgagee must calculate the Effective Income by using the lesser of the two-year average or the current lease.

General Asset Requirements (Manual) (II.A.5.c.i)

(C) Reserves (Manual)

Reserves refer to the sum of the Borrower's verified and documented liquid assets minus the total funds the Borrower is required to pay at closing.

Reserves do not include:

- the amount of cash taken at settlement in cash-out transactions;
- incidental cash received at settlement in other loan transactions;
- gift funds;
- equity in another Property; or
- borrowed funds from any source.

(1) Required Reserves for One Unit with an Accessory Dwelling Unit and Two-Unit Properties

If Rental Income is being used to qualify, the Mortgagee must verify and document Reserves equivalent to two months' PITI after closing for one unit with an ADU and two-unit Properties.

(2) Required Reserves for Three- to Four-Unit Properties

The Mortgagee must verify and document Reserves equivalent to three months' PITI after closing for three- to four-unit Properties.

Standard 203(k) Eligible Improvements (II.A.8.a.vi(A))

(1) Types of Improvements

Types of eligible improvements include, but are not limited to:

- converting a one-family Structure to a two-, three-, or four-family Structure;
- adding an Accessory Dwelling Unit (ADU) that will be attached to an existing Structure;
- renovating an existing ADU that is attached or unattached to an existing Structure;
- decreasing an existing multi-unit Structure to a one- to four-family Structure;
- reconstructing a Structure that has been or will be demolished, provided the complete existing foundation system is not affected and will still be used;
- repairing, reconstructing, or elevating an existing foundation where the Structure will not be demolished;
- purchasing an existing Structure on another site, moving it onto a new foundation, and repairing/renovating it;
- making structural alterations such as the repair or replacement of structural damage, additions to the Structure, and finished attics and/or basements;
- rehabilitating, improving, or constructing a garage;
- eliminating health and safety hazards that would violate HUD's Minimum Property Requirements (MPR) (II.A.3.a.ii);
- installing or repairing wells and/or septic systems;
- connecting to public water and sewage systems;
- repairing/replacing plumbing, heating, AC, and electrical systems;
- making changes for improved functions and modernization;
- making changes for aesthetic appeal;
- repairing or adding roofing, gutters, and downspouts;
- making energy conservation improvements;

- creating accessibility for persons with disabilities;
- installing or repairing fences, walkways, and driveways;
- installing a new refrigerator, cooktop, oven, dishwasher, built-in microwave oven, and washer/dryer;
- repairing or removing an in-ground swimming pool;
- installing smoke detectors;
- making site improvements;
- landscaping;
- installing or repairing exterior decks, patios, and porches;
- constructing a windstorm shelter; and
- covering lead-based paint stabilization costs, if the Structure was built before 1978, in accordance with the Single Family mortgage insurance lead-based paint rule (24 CFR 200.805 and 200.810(c)) and the U.S. Environmental Protection Agency's (EPA) Renovation, Repair and Painting Rule (40 CFR 745, especially subparts E and Q).

New Construction (09/26/2022) (II.A.8.i)

ii. Eligible Property Types [Updates to this section must be implemented for case numbers assigned on or after January 4, 2021]

The following property types are eligible for New Construction financing:

- Site Built Housing (one unit, one unit with an ADU, or two- to four-units)
- Condominium units in Approved Projects or Legal Phases
- Manufactured Housing (one unit or one unit with an ADU)

Acceptable Appraisal Reporting Forms and Protocols (II.D.3)

Property/Assignment Type	Acceptable Reporting Form
Single Family, Detached, Attached or Semi-Detached Residential Property, One-Unit Property or a One-Unit Property with a Single Accessory Dwelling Unit	Fannie Mae Form 1004/Freddie Mac Form 70, *Uniform Residential Appraisal Report (URAR)*; Mortgage Industry Standards Maintenance Organization (MISMO) 2.6 Government-Sponsored Enterprise (GSE) format
Single Family Comparable Market Rent Analysis	Fannie Mae Form 1007/Freddie Mac Form 1000, *Single Family Comparable Rent Schedule*

Single Unit Condominium	Fannie Mae Form 1073/Freddie Mac Form 465, *Individual Condominium Unit Appraisal Report;* MISMO 2.6 GSE format
Manufactured (HUD Code) Housing	Fannie Mae Form 1004C/Freddie Mac Form 70B, *Manufactured Home Appraisal Report;* MISMO 2.6 Errata 1 format
Small Residential Income Properties (Two to Four Units)	Fannie Mae Form 1025/Freddie Mac Form 72, *Small Residential Income Property Appraisal Report;* MISMO 2.6 Errata 1 format
Update of Appraisal (All Property Types)	Summary Appraisal Update Report Section of Fannie Mae Form 1004D/Freddie Mac Form 442, *Appraisal Update and/or Completion Report;* MISMO 2.6 Errata 1 format
Compliance or Final Inspection for New Construction or Manufactured Housing	Form HUD-92051, *Compliance Inspection Report*, in Portable Document Format (PDF)
Compliance or Final Inspection for Existing Property	Certification of Completion Section of Fannie Mae Form 1004D/Freddie Mac Form 442, *Appraisal Update and/or Completion Report;* MISMO 2.6 Errata 1 format

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Characteristics of Property Improvements (II.D.3.b.vii)

(E) Accessory Dwelling Unit

(1) Identification of an Accessory Dwelling Unit

An Accessory Dwelling Unit (ADU) is subordinate in size, location, and appearance to the primary Dwelling Unit and may or may not have separately metered utilities. The ADU must be legally permissible under the zoning, which may include a legal nonconforming use.

(2) Required Analysis and Reporting Protocols

As part of the highest and best use analysis, the Appraiser must make the determination to classify the Property as a Single Family dwelling with an ADU, or a two-family dwelling. The conclusion of the highest and best use analysis will then determine the classification of the Property and the required analysis reporting.

(a) Single Family One-Unit Dwelling with an Accessory Dwelling Unit

When the highest and best use analysis determines the Property to be a Single Family dwelling with an ADU, the Appraiser must:

- provide a description of the ADU characteristics;
- summarize the ADU's market acceptance;
- report the Gross Living Area (II.D.3.c) of the ADU separate from the primary dwelling;
- state whether the ADU can be legally rented without restrictions; and
- report the current ADU occupancy and the relevant details of any known lease agreements.

(b) Optional Accessory Dwelling Unit Market Rent Analysis

The Mortgagee may request an opinion of the ADU market rent in the scope of work. The Appraiser may provide the ADU market rent only if:

- the highest and best use is determined to be a one-unit Single Family dwelling with an ADU;
- the ADU is legally rentable without restrictions; and
- the Appraiser determines that a non-transient (see Restriction on Investment Properties for Hotel and Transient Use (II.A.1.b.iv(A)(4))) monthly market rent can be credibly developed.

The analysis of the rental data must include support for the ADU comparable rental selections, the adjustments applied, and the opinion of the ADU market rent. The Appraiser must include the ADU opinion of market rent on the Fannie Mae Form 1007/Freddie Mac Form 1000, *Single Family Comparable Rent Schedule*, as an attachment to the appraisal and include the following supplemental statement:

> *"This form is completed to provide FHA an opinion of the market rent of the subject's legally rentable Accessory Dwelling Unit (ADU). Sufficient competitive market data exists to develop credible results."*

Appraisers completing the optional ADU market rent analysis must comply with FHA's Appraiser Competency Requirement (I.B.1.e.ii).

The Appraiser must contact the Mortgagee if unable to fulfill a request for ADU market rent analysis.

(c) Comparable Selection for Optional Accessory Dwelling Unit Market Rent Analysis

The Appraiser must include a sufficient number of comparable rents to produce a credible ADU market rent estimate. The Appraiser must include at least one comparable rental that is a Single Family dwelling with a rented ADU. If a Single Family dwelling with a rented ADU is not available, the Appraiser must supplement with the most appropriate rental available and summarize the reason for the selection and how the marketability of the ADU was determined.

HECM Financial Assessment and Property Charge Guide

The policy changes amend the HECM Financial Assessment and Property Charge Guide, as follows:

Section 3.50, Rental Income from the Subject Property

Rental income refers to income received or to be received from the subject property or other real estate holdings.

The mortgagee may consider rental income from existing and prospective tenants if documented in accordance with the following requirements.

Rental income from the subject property may be considered effective income when the property is or will be a single-unit dwelling with an Accessory Dwelling Unit (ADU) or a two- to four-unit dwelling.

No income from commercial space may be included in rental income calculations.

Required documentation varies depending upon the length of time the borrower has owned the property.

Limited or No History of Rental Income

Where the borrower does not have a history of rental income from the subject property since the previous tax filing:

Two-to Four-Units

The mortgagee must verify and document the proposed rental income by obtaining an appraisal showing fair market rent (use Fannie Mae Form 1025/Freddie Mac Form 72, *Small Residential Income Property Appraisal Report*) and, if available, the prospective leases.

One Unit or One Unit with an Accessory Dwelling Unit

The mortgagee must verify and document the proposed rental income by obtaining a Fannie Mae Form 1004/Freddie Mac Form 70, *Uniform Residential Appraisal Report (URAR)*, and a Fannie Mae Form 1007/Freddie Mac Form 1000, *Single Family Comparable Rent Schedule*, showing fair market rent and, if available, the prospective lease.

Calculation of Rental Income

Where the borrower has a history of rental income from the subject property since the previous tax filing, the mortgagee must verify and document the existing rental income by obtaining the existing lease, rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal or military renters, or property rehabilitation), and the borrower's most recent tax returns, including Schedule E, from the previous two years.

The rental income from a property owned less than two years is the annualized rental income divided by the number of months the property has been owned. The mortgagee must document the date of acquisition by providing the deed, closing disclosure, or other legal document.

Section 3.51, Calculating Rental Income from the Subject Property

The mortgagee must add the net subject property rental income to the borrower's gross income to calculate effective income.

Limited or No History of Rental Income

Two- to Four-Units

To calculate the effective income from the subject property where the borrower does not have a history of rental income from the subject property since the previous tax filing, the mortgagee must use 75 percent of the lesser of:

- fair market rent reported by the appraiser; or
- the rent reflected in the lease or other rental agreement.

One Unit with an Accessory Dwelling Unit

To calculate the effective income from the subject property where the borrower does not have a history of rental income from the subject property since the previous tax filing, the mortgagee must use 50 percent of the lesser of:

- ADU market rent reported by the appraiser; or
- the rent reflected in the lease or other rental agreement if there is a tenant in place at the time of closing.

History of Rental Income

The mortgagee must calculate the rental income by averaging the amount shown on the Schedule E.

Depreciation, mortgage interest, taxes, insurance, and any HOA dues shown on Schedule E may be added back to the net income or loss.

If the property has been owned for less than two years, the mortgagee must annualize the rental income for the length of time the property has been owned.

Section 3.52, Rental Income – Other Real Estate Holdings

Rental income from other real estate holdings may be considered effective income if the documentation requirements listed below are met. If rental income is being derived from the property being vacated by the borrower, the borrower must be relocating to an area more than 100 miles from the borrower's current principal residence. The mortgagee must obtain a lease agreement of at least one year's duration after the mortgage is closed and evidence of the payment of the security deposit or first month's rent.

Limited or No History of Rental Income

Where the borrower does not have a history of rental income for the property since the previous tax filing, including property being vacated by the borrower, the mortgagee must obtain an appraisal evidencing market rent and that the borrower has at least 25 percent equity in the property. The appraisal is not required to be completed by an FHA Roster appraiser.

- **Two to Four Units**
  The mortgagee must verify and document the proposed rental income by obtaining an appraisal showing fair market rent (use Fannie Mae Form 1025/Freddie Mac Form 72, *Small Residential Income Property Appraisal Report*) and, if available, the prospective leases.

- **One Unit or One Unit with an Accessory Dwelling Unit**
  The mortgagee must verify and document the proposed rental income by obtaining a Fannie Mae Form 1004/Freddie Mac Form 70, *Uniform Residential Appraisal Report*, and a Fannie Mae Form 1007/Freddie Mac Form 1000, *Single Family Comparable Rent Schedule*, showing fair market rent and, if available, the prospective lease.

History of Rental Income

The mortgagee must obtain the borrower's last two years' tax returns with Schedule E.

Section 3.53, Calculating Rental Income from Other Real Estate Holdings

Limited or No History of Rental Income

To calculate the effective net rental income from other real estate holdings where the borrower does not have a history of rental income since the previous tax filing, the mortgagee must deduct the principal, interest, taxes, and insurance payment (PITI) from 75 percent of the lesser of:

- fair market rent reported by the appraiser; or
- the rent reflected in the lease or other rental agreement.

Calculation of Rental Income

The mortgagee must calculate the net rental income by averaging the amount shown on the Schedule E provided the borrower continues to own all properties included on the Schedule E.

Depreciation shown on Schedule E may be added back to the net income or loss.

If the property has been owned for less than two years, the mortgagee must annualize the rental income for the length of time the property has been owned.

The rental income from a property owned less than two years is the annualized rental income divided by the number of months the property has been owned. The mortgagee must document the date of acquisition by providing the deed, closing disclosure, or other legal document.

Positive net rental income must be added to the borrower's effective income. Negative net rental income must be included as a debt/liability.

Section 3.54, Income from Boarders of the Subject Property

Boarder refers to an individual renting space inside the borrower's dwelling unit. A tenant of an ADU is not a boarder.

Rental income from boarders is only acceptable if the borrower has a two-year history of receiving income from boarders that is shown on the tax return and the borrower is currently receiving boarder income.

The mortgagee must obtain two years of the borrower's tax returns evidencing income from boarders and the current lease.

For HECM for Purchase transactions, the mortgagee must obtain a copy of the executed written agreement documenting their intent to continue boarding with the borrower.

Paperwork Reduction Act

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501-3520) and assigned OMB control numbers 2502-0005; 2502-0059; 2502-0117; 2502-0189; 2502-0302; 2502-0306; 2502-0322; 2502-0358; 2502-0404; 2502-0414; 2502-0429; 2502-0494; 2502-0496; 2502-0524; 2502-0525; 2502-0527; 2502-0538; 2502-0540; 2502-0556; 2502-0561; 2502-0566; 2502-0570; 2502-0583; 2502-0584; 2502-0589; 2502-0595; 2502-0600; 2502-0610; and 2502-0611. In accordance with the PRA, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

Questions

Any questions regarding this ML may be directed to the FHA Resource Center at 1-800-CALLFHA (1-800-255-5342), answers@hud.gov, or www.hud.gov/answers. The FHA Resource Center is prepared to accept calls from persons who are deaf or hard of hearing, as well as individuals with speech or communication disabilities. Information on how to make an accessible phone call is available at https://www.fcc.gov/consumers/guides/telecommunications-relay-service-trs.

Signature

Julia R. Gordon
Assistant Secretary for Housing –
FHA Commissioner