

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

MORTGAGEE LETTER 00-27

**TO: ALL APPROVED MORTGAGEES
ALL FHA ROSTER APPRAISERS**

**SUBJECT: Appraising and Financing HUD Real Estate Owned (REO) Properties With FHA-Insured
Financing - Single Family Loan Production**

The purpose of this Mortgagee Letter is to provide approved FHA mortgagees with processing instructions for FHA-insured financing that involve a HUD Real Estate Owned (REO) property and to clarify FHA requirements regarding REO appraisals completed for both HUD's Management and Marketing contractors (the M&M contractor) and mortgage lenders. This letter emphasizes that all FHA approved Mortgagees and all FHA roster appraisers must comply with the appraisal requirements outlined in Mortgagee Letter 99-18 and the updated appraisal handbook 4150.2. This letter creates a new categorization "insurable with condition(s)" under which an appraiser may complete an appraisal on a HUD REO property when utilities cannot be activated at the time the appraisal is completed. FHA insurance will not be offered on any HUD REO property unless the mortgage lender or purchaser obtains a complete systems check or any other certifications needed to satisfy the insurability of the mortgage on the property.

The policies and instructions in this Mortgagee Letter are designed to provide clarification regarding the processing of HUD REO sales contracts. These requirements are **effective immediately** for all HUD REO sales transactions. The intent of these policies is to bring the processing of applications for FHA mortgage insurance on HUD REO properties more closely in line with those for other purchase mortgage transactions.

Appraisal Requirements for Marketing REO Properties

Appraisals for HUD REO properties may be performed only by an appraiser listed on the FHA Appraiser Roster. The appraisal must fully conform with the requirements and processing procedures prescribed in Mortgagee Letter 99-18 and the Appraisal Handbook 4150.2. There are, however, unique challenges in preparing a HUD REO appraisal. Issues that need additional instructions are discussed below.

Appraisal Type

Upon conveyance of properties to HUD's REO inventory, HUD's M&M contractor shall obtain an **as-is appraisal** (not as-repaired) for each HUD REO property to determine the listing price. In accordance with 4150.2, the appraiser is required to complete both the Valuation Condition Sheet (Form HUD-92564-VC) and Homebuyer Summary Form (HUD-92564-HS). The Valuation Condition Sheet must list needed repairs as identified in Mortgagee Letter 99-18.

Utility Issues

Utilities should be on at the time the appraisal is conducted, unless there are documented extenuating circumstances. In the event of extenuating circumstances, the appraiser should note the following:

- o On the Uniform Residential Appraisal Report (URAR), the appraiser will annotate "The following utilities were not on at the time the appraisal was conducted (e.g., electric, gas, and/or water) - Unable to verify their functionality."
- o On the VC sheet, it also should be clearly noted that "The following utilities were not on at the time the appraisal was conducted (e.g., electric, gas, and/or water). - Unable to verify their functionality." However, the appraiser should note any readily observable condition that is evident. Completion of the Valuation Condition Sheet requires observation of 13 areas that include, but is not limited to, the well and individual water supply, the septic system, structural conditions and mechanical systems, to ascertain any obvious defects (i.e., exposed wiring, frayed wiring, presence of leaks, structural damage of plumbing fixtures). Extra attention should be given to the readily observable condition of the utility systems that are not activated at the time of the appraisal.
- o HUD's M&M contractor shall permit entry to the purchaser(s) during the contract period to activate the utilities for the purposes of conducting a home inspection. If the HUD REO appraisal was completed without the utilities being activated, the mortgage lender or purchaser(s) must complete the systems check while the utilities are activated.

Release of the Appraisal to Lender/Purchaser

- o HUD's REO appraisal is made available to the mortgage lender or purchaser(s) at no charge when a current appraisal is available. This is done to reduce out of pocket expenses by the purchaser(s). The mortgage lender should contact the M&M contractor to obtain a copy of the current appraisal.

Ordering Updated Appraisals

Mortgage lenders may not order an updated appraisal from a roster appraiser because the sales price exceeds the as-is value specified on the M&M contractor's appraisal. Mortgage lenders may order and the borrower may be charged for an updated appraisal only under the following circumstances:

A. Section 203(k). Mortgage lenders must order, and the purchaser(s) may be charged for, an as-repaired appraisal on all Section 203(k) transactions. If the M&M contractor's as-is appraisal is more than six months old, mortgagees also have the option of ordering an updated as-is appraisal. However, an as-is appraisal is not mandatory if the underwriter believes the sales price is equal to the as-is value. In this case, the age of the appraisal is not an issue.

B. Appraisals Over Six Months Old. Appraisals have a life of six months for existing construction. The original appraisal obtained by the M&M contractor must be used, provided the mortgage lender has approved the purchaser(s) or a valid HUD sales contract was executed prior to the expiration date of the appraisal. For reference, see HUD Handbook 4000.2 REV-2, dated 7/91, paragraph 4-2 and HUD Handbook 4000.4 REV-1 CHG-2, dated 7/94, paragraph 3-4. Mortgage lenders must exercise sound judgment in determining if documentation updates are required on the purchaser(s).

In those instances where the M&M contractor's appraisal is more than six months old and a valid HUD sales contract was not executed prior to the expiration date of the appraisal, the mortgage lender must order, and the purchaser(s) may be charged for, an updated appraisal. Mortgage lenders should instruct appraisers to perform an as-is appraisal, not an as-repaired appraisal, in accordance with the procedures outlined in Appendix A-1 of HUD Handbook 4150.2. If mortgage lenders request a copy of the M&M contractor's appraisal and such copy is not available, mortgage lenders should order a new appraisal.

If the updated appraisal results in a lower as-is value of the property, the purchaser(s) will be given the opportunity to proceed with the transaction with no adjustment made to the sales price, requiring an additional cash investment by the purchaser(s) or the purchaser(s) may withdraw their offer to purchase the property and receive a full refund of the earnest money deposit.

Should the updated appraisal result in a higher as-is value, the sales price will not be adjusted. In these situations, the mortgage amount will be based upon the value established by the updated appraisal. The mortgage amount, however, cannot exceed the sales price indicated on the sales contract.

Note: If an updated appraisal is ordered, the updated appraisal **must** be used when processing the application. Mortgage lenders **do not** have the option of ordering an updated appraisal and then deciding whether to use that appraisal or the M&M contractor's appraisal.

Inspection Requirements

Termite/Pest Inspections

The M&M contractor is required by HUD to obtain a termite and pest control inspection on all properties which the appraiser has recommended be offered with FHA mortgage insurance unless the property lies within a pre-designated geographic area not prone to termite and pest infestation. Mortgage lenders should contact the M&M contractor to obtain a free copy of this inspection report.

Well and Septic System Inspections

If the HUD REO property has a well and/or septic tank, mortgage lenders should contact the M&M contractor to determine if an inspection has been performed, and, if it has, to obtain a free copy of this inspection report. Where the M&M contractor has not ordered tests, mortgage lenders are responsible for ensuring that any tests and certifications required are obtained in accordance with HUD Handbook 4150.2, paragraph 3-6 A. 5 and Mortgagee Letter 95-34. Mortgage lenders should contact the M&M contractor to arrange for testing.

HUD REO Marketing Approaches

This mortgagee letter introduces a new marketing approach for HUD's REO properties. That category is "Insurable with Condition(s)" and it is described in greater detail below. Each HUD REO property will be offered for sale using one of the following four approaches:

1. **Insurable**. Properties marketed as "insurable" are those which meet FHA's Minimum Property Requirements (MPR) at the time of the appraisal in their as-is condition without repairs necessary.
2. **Insurable With Condition(s)**. Insurable properties may have conditions which must be satisfied to fully meet FHA's MPR. The M&M contractor's Internet listings will disclose what conditions must be satisfied. For a property that is listed as "insurable with condition(s)" (property appraised without the benefit of the utilities being activated during the time of the appraisal, properties with flat roofs, and/or a property which appears to be insurable but a certification for a specific item(s) is required), the mortgage lender/purchaser(s) must have a complete systems check, the flat roof inspection to assure a two year life, and any other certification needed to satisfy the appraiser's concerns listed on the VC form performed by a reputable individual or firm at the purchaser(s) expense to ensure complete system functionality prior to loan closing. If repairs are required that do not exceed \$5,000, the loan may be financed as a 203(b) repair escrow and the lender may process the loan using the instructions for cases with repair escrow. If repairs are required that exceed \$5,000, the loan may be processed with Section 203(k) financing provided the cost of repairs are in compliance with REO program policies.
3. **Insurable With Repair Escrow**. A property that requires no more than \$5,000 for repairs to meet FHA's MPR as determined by the appraiser, is eligible to be marketed for sale in its as-is condition with FHA mortgage insurance available, provided the purchaser(s) establishes a cash escrow to ensure the completion of the required repairs. Purchaser(s) are permitted to include in their mortgage an amount equal to 110% of the estimated cost of the repairs.
4. **Uninsurable**. Properties offered for sale "Uninsured" do not meet, in their as-is condition, FHA's MPR and the cost of repairs identified by the appraiser to meet MPR are estimated to exceed \$5,000. Uninsurable properties qualify **only for Section 203(k) financing**.

The approach under which each property is being listed for sale is specified on the M&M contractor's Internet property listings and on the form HUD-9548, Sales Contract. Properties are marketed based on the condition of the property existing at the time of listing.

Sales Contract Requirements

Mortgage lenders may only accept a fully executed copy of form HUD-9548, Sales Contract from purchaser(s) applying for FHA-insured financing to purchase a HUD REO property. The sales contract will specify the sales price, the financing terms, the amount of closing costs HUD will pay at settlement, the real estate commission HUD will pay, the closing date, and any discount on the sales price that will be provided at settlement.

As required in Mortgagee Letter 99-18, where FHA-insured financing is specified on the sales contract, a Form HUD-92564-CN, ***For Your Protection: Get A Home Inspection***, must also be

submitted to the lender through the broker or purchaser. If this form is signed after the date the sales contract was signed, the sales contract must be re-executed.

If the contract is not complete, if there are questions about the terms or conditions, or if the contract must be amended as a condition of loan approval, mortgagees should contact the M&M Contractor. Mortgagees should also be aware of the following:

- o The sales contract must be signed by the M&M contractor. If the sales contract has not been signed by the M&M contractor, mortgage lenders should not process a mortgage application.
- o In order to qualify for FHA-insured financing, the first block on Line 4 of the sales contract, as well as the applicable block for the FHA program - 203(b), 203(b) repair escrow, or 203(k) - must be checked. REO properties that are condominiums which are offered for sale with FHA mortgage insurance, should be processed under Section 234, even though Section 203(b) is specified on the sales contract.
- o In the event the home inspection or the systems check reveals that repairs are needed which no longer makes the property eligible for an FHA-insured 203(b) mortgage, the mortgage lender should contact the M&M contractor to discuss alternatives to allow the sale to continue. The M&M contractor may allow the modification of the sales contract, as needed, to reflect either an Insured with Repair Escrow sale or to an FHA 203(k) sale in those instances where the mortgage lender provides them with sufficient documentation to support the change in financing. The sales contract must be revised to include this revision and initialed by both the purchaser and the M&M contractor.
- o In the event the purchaser(s) wishes to finance eligible rehabilitation in the purchase mortgage through a 203(k) mortgage but the property was listed as "insurable", the mortgage lender should provide the M&M contractor with sufficient documentation to support the change in financing terms and obtain a modification to the sales contract.
- o A specific down payment and mortgage amount is no longer required to be established on Line 4 of the form HUD-9548 Sales Contract. Under new direction to the M&M contractors, the mortgage amount and down payment amounts will be left blank. The purchaser(s) must, however, continue to indicate the type of financing being sought.
- o The amount on Line 5 of the Sales Contract represents actual borrower financing and closing costs to be paid on their behalf by HUD (the seller) out of the sales proceeds. It does not represent an amount which the borrower may finance in the mortgage.
- o Only the actual amount of closing and financing costs will be paid by HUD at settlement. The borrower will not be credited at settlement for any unused portion. Pre-paid items may not be paid out of the amount on Line 5 (See HUD Notice 99-04). The only exception to this policy is the Officer/Teacher Next Door Program.
- o Specified on Line 8 of the Sales Contract will be the percentage discount, if any, that will be applied to the sales price at settlement. Where the price will be discounted, the mortgage amount will be based on that discounted sales price, not the contract sales price. See below for further information.

- o Specified on Line 9 of the sales contract will be the number of days, normally 45 or 60, in which the sale must be closed. Mortgage lenders should be prepared to complete their processing in sufficient time to allow the borrower to meet this time frame.

Case Number Processing

In regard to case numbers, please note the following:

- o Mortgagees must obtain a new FHA Case Number for applications for FHA-insured financing involving REO properties. When entering the case information in FHA Connection, mortgagees should select "Real Estate Owned" for Processing Type.
- o During the case number processing procedure, CHUMS will require a response to the following question, "Was this case previously sold as a Property Disposition?". Mortgage lenders should always check **YES** when processing an application for FHA-insured financing on an REO property. The mortgagee should complete the 'Previous Case Number' field. This field is designed to track REO properties sold with FHA-insured financing and if they are subsequently sold by the individuals who purchased them from HUD. If entry of the previous case number triggers an error message, the mortgage lender should request that the Processing and Underwriting Division of their Homeownership Center post the number in the CHUMS Property Disposition file.
- o Mortgage lenders should not order an appraisal on REO property transactions unless they are processing a 203(k) sales transaction or the M&M contractor's appraisal is more than six months old. When not ordering an appraisal, the appraiser fields should be left blank.
- o If the REO property is a condominium, FHA Connection will require the entry of the Condo ID. If FHA financing was approved on the sales contract, but the condominium development is not approved and the condominium project is in compliance with the Spot Loan procedure (ML 96-41), mortgagees should enter "Yes" in the Spot Lot field. For the property to be FHA insured, the condominium project must be approved and in compliance with FHA policies on condominiums (i.e., 51 percent owner occupancy).

Mortgagee Appraisal and Property Review Requirements

In order to calculate the maximum mortgage amount and underwrite the loan, mortgage lenders must obtain from the M&M contractor a complete copy of the as-is appraisal to include Form HUD-92564-VC, Valuation Conditions-Notice to Lenders, and Form HUD-92564-HS, Homebuyer Summary. Mortgage lenders should place two copies of the M&M contractor's appraisal in the case binder submitted for insurance endorsement.

Mortgage lenders are responsible for reviewing the property description, comparables and adjustments specified on the appraisal, and for otherwise ensuring that the stated value is accurate. Mortgage lenders should also ensure, to the best of their ability, that properties financed with FHA-insured mortgages meet the Department's Minimum Property Requirements the appraisal, the mortgage

lender's underwriter notes that the appraiser called for repairs which relate to MPR. If the borrower has a home inspection performed, that inspection may also identify a need for repairs which were not identified on the appraisal. In such cases, it is important that the underwriter address such issues. Section 203(b) financing should not be automatically approved simply based on the terms of the sales contract. Mortgage lenders should discuss any discrepancies with the M&M contractor for resolution.

The reverse situation is possible as well. A property may have been offered for sale "uninsured" and the purchaser applies for Section 203(k) financing, but the appraisal reveals no repairs required. It is not HUD's intention to have purchaser(s) obtain financing for repairs which are not required.

As a rule, the M&M contractor will not make repairs to HUD REO properties which are necessary to bring them up to FHA's MPR. Where repairs are determined to be necessary, they will generally have to be accommodated through either Section 203(b) Repair Escrow or Section 203(k).

Where a repair escrow is required, the escrow account should be established and administered in accordance with the procedures outlined in HUD Handbook 4145.1. A completed Form HUD-92300, Mortgagee's Assurance of Completion, should be included in the case binder submitted for insurance endorsement. A completed Form HUD-92051, Compliance Inspection Report, must be submitted after the completion of repairs.

Maximum Mortgage Amount and Minimum Cash Investment

HUD may authorize the M&M contractor to offer sales incentives. Where such incentives have been made available, they shall be specified in writing by the M&M contractor on either the sales contract itself or on an accompanying letter.

Absent such written authorization, maximum mortgages and minimum cash investments shall be calculated in accordance with Mortgagee Letter 98-29, using Form HUD-92900-PUR, Mortgage Credit Analysis Worksheet, Purchase Money Mortgage, except as noted in this Mortgagee Letter. The only exception to this policy is on applications involving Officer Next Door or Teacher Next Door. Specific instructions on processing applications for these properties are provided below.

This does represent a change from the way financing for HUD REO properties has traditionally been processed. Mortgagees should note that:

- o On Section 203(b) applications, the mortgage amount must be based on the lesser of the as-is value or the sales price. On Section 203(k) applications, the acquisition cost must be based on the lesser of the as-is value or the sales price. The reference to Notice H 98-32 on Line C.7. of Form HUD-92700, 203(k) Maximum Mortgage Worksheet, is no longer applicable.
- o Where a discount on the sales price is being provided, the mortgage amount shall be based on the lesser of the as-is value or the discounted sales price, not the contract sales price. In the case of Section 203(k) applications, the acquisition cost shall be based on the lesser of the as-is value or the discounted sales price, not the contract sales price. Specific instructions on calculating the discounted sales price are provided below.

- o Closing costs and pre-pays may not be included in the mortgage (see exceptions below for the Officer Next Door and Teacher Next Door programs).
- o Investors are eligible for Section 203(b) financing only. Investors are not eligible for Section 203(k) financing. Maximum allowable financing for investors is 75% for one unit properties and 85% for two, three, and four unit properties.
- o On Section 203(k) applications, mortgage lenders should first complete Form HUD-92700 (2/99), 203(k) Maximum Mortgage Worksheet. Information from that form should then be transferred to the Form HUD-92900-PUR in accordance with the instructions on page 2 of the Form HUD-92700.

Calculating the Discounted Sales Price

Nonprofit purchasers, law enforcement officers, and teachers participating in the Officer Next Door and Teacher Next Door programs are entitled to a discount against the sales price at settlement. The percentage discount to be applied will be specified on Line 8 of the sales contract. However, this discount will be reduced by the amount of any closing costs that the buyer requests HUD to pay (as specified on Line 5 of the Sales Contract) and any real estate commission that the borrower asks HUD to pay (as specified on Line 6a of the REO sales contract).

For the purposes of mortgage calculation, the sales price should be calculated according to the following formula:

	Contract Sales Price (from Line 3 of REO Sales Contract)	
-	Discount (from Line 8 of REO Sales Contract)	
+	HUD-Paid Closing Costs (from Line 5 of REO Sales Contract)	
+	HUD-Paid Sales Commission (from Line 6a of REO Sales Contract)	
=	Discounted Sales Price	

For example:

Contract Sales Price	\$100,000
- 50% Discount	<u>- 50,000</u>
=	\$ 50,000
+ Sales Commission	+ 5,000
+ HUD-paid closing costs	<u>+ 3,000</u>
= Discounted Sales Price for Mortgage Calculation Purposes	\$ 58,000

If the purchaser is not requesting that HUD pay a sales commission or closing costs of course, the discounted price will be the contract sales price minus the amount of the discount. This calculation should also be undertaken when calculating the acquisition cost for Section 203(k) applications.

Calculating Mortgage Amount for Officer Next Door and Teacher Next Door Program

The Officer Next Door and Teacher Next Door programs are specifically designed to provide a unique opportunity for law enforcement officers and teachers to purchase and occupy REO properties with a minimum cash contribution of \$100.00. In order to accomplish this, these borrowers must be able to finance in their FHA-insured mortgages all closing costs and pre-paid expenses.

NOTE: While nonprofit purchasers may be entitled to a discount on the sales price, they are not permitted to finance closing and financing costs in the mortgage. Aside from using the discounted sales price, applications for nonprofit purchasers shall be processed exactly like those for other owner-occupant borrowers, using Form HUD-92900-PUR (10/98) in accordance with the instructions in Mortgagee Letter 98-29. Only law enforcement officers and teachers participating in the Officer Next Door and Teacher Next Door programs may include closing and financing costs in the mortgage, and qualify with a cash investment of only \$100.00.

In order to calculate mortgage amounts under these circumstances, mortgage lenders must use Form HUD-92900-WS, Mortgage Credit Analysis Worksheet. Line-by-line instructions are as follows:

Enter on Line 4 the as-is value from the appraisal.

Enter on Line 5a all closing and financing costs.

Enter on Line 5b the amount of closing costs to be paid by HUD, if any (from Line 5 of the REO sales contract).

Enter on Line 5c the amount on Line 5a minus the amount on Line 5b.

Enter on Line 10.a. the discounted sales price (as calculated above). Note in the Remarks section that the discounted sales price has been used.

Enter on Line 10.b. the amount of the repair escrow, if any (from Line 4 of the REO Sales Contract).

Enter on Line 10.c. the amount from Line 5.c.

Enter on Line 10.e. the amount on Line 10.a. plus the amounts on Lines 10.b. and 10.c.

Leave Lines 10.f. (1) and (2) blank.

Enter on Line 10.g. the amount on Line 10.e. minus \$100.00.

Enter on Line 10.h. 100.00.

Leave lines 10.i., 10.j., 10.k. and 10.l. blank.

Enter on Line 10.m. 100.00.

All other lines on Form HUD-92900-WS should be completed in accordance with outstanding instructions.

The credit and underwriting standards for officers and teachers are no different than those for other owner-occupant purchasers. Where there is a co-borrower, whether a spouse, another relative or an unrelated person, and whether that co-borrower will be occupying or not, the same standards apply.

NOTE: The officer or teacher must be the borrower and must qualify for the mortgage. It is not acceptable for a spouse or other parties to qualify for the mortgage in their name or names only.

Assistance

If you have questions about this Mortgagee Letter, please contact your local Homeownership Center in Atlanta (1-888-696-4687), Denver (1-800-543-9378), Philadelphia (1-800-440-8647) or Santa Ana (1-888-827-5605).

Sincerely,

William C. Apgar
Assistant Secretary for Housing -
Federal Housing Commissioner