U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

August 6, 2010

MORTGAGEE LETTER 2010 -23

TO: **ALL APPROVED MORTGAGEES**

SUBJECT: FHA Refinance of Borrowers in Negative Equity Positions

On March 26, 2010, the Department of Housing and Urban Development (HUD) and the Department of the Treasury (Treasury) announced enhancements to the existing Making Home Affordable Program (MHA) and Federal Housing Administration (FHA) refinance program that will give a greater number of responsible borrowers an opportunity to remain in their homes. These enhancements are designed to maintain homeownership by providing borrowers, who owe more on their mortgage than the value of their home, opportunities to refinance into an affordable FHA loan. This opportunity allows borrowers who are current on their mortgage to qualify for an FHA refinance loan provided that the lender or investor writes off the unpaid principal balance of the original first lien mortgage by at least 10 percent.

This Mortgagee Letter provides additional guidance for lenders regarding the requirements and administration of these enhancements to FHA's refinance program. These enhancements are effective for loans with case numbers issued on or after September 7, 2010, which are closed on or before December 31, 2012.

As noted below, these enhancements include loss coverage to be provided from funds under the Emergency Economic Stabilization Act of 2008, as amended (EESA). If the availability of such coverage is delayed beyond September 7, 2010, implementation of these enhancements will also be delayed.

<u>Eligibility</u>

Participation is voluntary and requires the consent of lien holders. In order for a loan to be eligible, the following conditions must be met:

1. The homeowner must be in a negative equity position;
2. The homeowner must be current on the existing mortgage to be refinanced;
3. The homeowner must occupy the subject property (1-4 units) as their primary residence;
4. The homeowner must qualify for the new loan under standard FHA underwriting requirements and possess a "FICO based" decision credit score greater than or equal to 500;
5. The existing loan to be refinanced must not be a FHA-insured loan;
6. The existing first lien holder must write off at least 10 percent of the unpaid principal

balance;

7. The refinanced FHA-insured first mortgage must have a loan-to-value ratio of no more than 97.75 percent;
8. Non-extinguished existing subordinate mortgages must be re-subordinated and the new loan may not have a combined loan-to-value ratio greater than 115 percent;
9. For loans that receive a "refer" risk classification from TOTAL Mortgage Scorecard (TOTAL) and/or are manually underwritten, the homeowner's total monthly mortgage payment, including the first and any subordinate mortgage(s), cannot be greater than 31 percent of gross monthly income and total debt, including all recurring debts, cannot be greater than 50 percent of gross monthly income;
10. FHA mortgagees are *not* permitted to use premium pricing to pay off existing debt obligations to qualify the borrower for the new loan;
11. FHA mortgagees are *not* permitted to make mortgage payments on behalf of the borrowers or otherwise bring the existing loan current to make it eligible for FHA insurance; and
12. The existing loan to be refinanced may not have been brought current by the existing first lien holder, except through an acceptable permanent loan modification as described below.

<u>Principal Write off</u>

The mortgagee must ensure that the existing first lien holder writes off at least 10 percent of the unpaid principal balance on the first lien. The short payoff serves as payment in full for any debt extinguished.

<u>Calculating Mortgage</u>

The refinanced FHA-insured mortgage must have a loan-to-value ratio of no more than 97.75 percent and all non-extinguished existing subordinate mortgages must be re-subordinated and may not result in a combined loan-to-value ratio greater than 115 percent.

The new FHA mortgage may be used only to refinance the unpaid principal balance on the first lien, plus the interest charged by the servicing lender when the payoff likely will not be received on the first day of the month, any prepayment penalties assessed, late charges, escrow shortages, closing costs, prepaid expenses, and discount points. The existing mortgagee must write off such amounts as described above.

<u>Underwriting Requirements</u>

All approved lenders must use FHA's TOTAL to obtain risk classifications for each mortgage considered. If TOTAL renders an "accept/approve" result, the lender's underwriter does not need to perform a personal review of the borrower's credit history and capacity to repay. Lenders remain solely responsible for the data they supplied to TOTAL and to ensure that a Direct Endorsement Underwriter has reviewed the appraisal. FHA underwriting requirements at the time the case number was assigned must be used. Lenders must still comply with outstanding rate and term refinance eligibility requirements and ensure the integrity and accuracy of the data used to render a decision.

Current Mortgage

In accordance with existing FHA requirements for rate and term refinance transactions, the mortgage being refinanced must be current for the month due. For example, for a FHA refinanced loan scheduled to close during November, the October payment must have been paid during October.

Borrowers who have undergone loss mitigation which resulted in a completed permanent modification may be eligible under the following circumstances:

- If the modification was made under the terms of the Making Home Affordable Modification Program (HAMP), the loan may close the month following the date the modification was permanent.
- If the modification was a non-HAMP modification, the borrower must have made three monthly payments on time and the modified mortgage must be current for the month due.

If the loan is still in a temporary or trial period, the loan is not eligible.

Acceptable Credit History

Lenders must document an acceptable credit and mortgage payment history on loans referred from TOTAL for traditional manual underwriting. Indications of major derogatory credit events, such as judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. Such explanations must be reasonable and consistent with the borrower's other credit information.

Combined Loan-to-Value Ratio

Notwithstanding 24 CFR 203.32(c)(3), the combined amount of the new FHA-insured first mortgage and any subordinate non FHA-insured lien may not exceed 115 percent.

Permissible Secondary Financing

Secondary financing that permits borrowers to comply with the eligibility requirements of the program is permitted; however, such secondary financing is subject to the following limitations:

1. The terms of the subordinate lien(s) must not provide for a balloon payment before ten years, unless the property is sold or refinanced;
2. The terms must permit prepayment by the borrower, without penalty, after giving 30 days advance notice;
3. Periodic payments, if any, shall be collected monthly; and
4. If payments on subordinate financing are required, they must be included in the qualifying ratios unless payments have been deferred for no less than 36 months.

Borrower Certification

The Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted into law on July 21, 2010. Section 1481(d) of the Act provides that no person shall be eligible to begin receiving assistance under any mortgage assistance program authorized or funded by EESA if such person, in connection with a mortgage or real estate transaction, has been convicted within the last 10 years of any of the following: (a) felony larceny, theft, fraud, or forgery; (b) money laundering; or (c) tax evasion. Section 1481(d) becomes effective on September 19, 2010. As noted above, a portion of the claim amount will be paid under EESA authorities. Therefore, the Treasury Department will be requiring the mortgagor to provide a certification of eligibility under section 1481 for all loan applications dated on or after September 19, 2010. Further guidance on this certification will be issued in a subsequent mortgagee letter.

Mortgage Type and ADP Codes

The refinance type would be conventional to FHA refinance non delinquent. The chart below lists the applicable ADP codes for the refinance loans meeting the conditions in this Mortgagee Letter.

	Fixed	ARM
203(b)	821	822
Condo	831	832

Data Collection

In addition to the data collected at insurance application, FHA will collect the write off amount on the first lien being refinanced.

Paperwork Reduction Act

The information collection requirements contained in this document are pending approval by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0579. In accordance with the Paperwork Reduction Act, 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.

Performance Analysis

HUD will analyze the performance of the refinance loans meeting the conditions in this Mortgagee Letter separately from lenders' traditional FHA portfolios. FHA will develop a separate module in Neighborhood Watch to display a lender's performance compare ratio for these loans. Loans originated in accordance with the above criteria will *not* be included in HUD's performance analysis of a lender's compare ratio with respect to the enforcement of the Credit Watch Termination initiative.

Current monitoring practices such as the Post Endorsement Technical Reviews, Appraiser Watch, and Lender Monitoring Reviews will continue to monitor lenders, underwriters, appraisers for loan compliance under these enhancements. If a violation of the requirements contained herein, and/or of any FHA program requirements is found to have occurred, the lender will be subject to administrative action.

Second Lien Extinguishment and Servicer Incentive

To facilitate the refinancing of new FHA-insured loans under this program, Treasury will provide incentives to existing second lien holders who agree to full or partial extinguishment of liens effective on all case numbers assigned on or after September 7, 2010. To be eligible for incentives, the existing second lien mortgage servicer must:

- Execute a Servicer Participation Agreement with Treasury to participate in the Making Home Affordable Program; and,
- Agree to fully release the borrower from all obligations to repay the amount forgiven.

Existing second mortgage lien servicers will be entitled to a one time incentive of $500 for each successful closing. Existing second mortgage lien investors will be entitled to an incentive based on the combined loan to value of the existing lien and all senior liens associated with the mortgage. The actual incentive pay-out schedule and more information on this program will be available at www.hmpadmin.com.

Claims for Insurance Benefits

In the event of a claim for insurance benefits, funds under EESA authorities will cover a portion of the claim amount. Lenders will not see a reduction in the amount of the insurance claim on any given loan, but they will be required to submit a separate claim filing with the designated disbursement agent to be specified by us in a future Mortgagee Letter for that portion which is payable from EESA funds. This does not apply to home retention loss mitigation claims. Further guidance on the process for claims will be issued in a subsequent Mortgagee Letter.

Additional Items of Note

Mortgagees must make borrowers aware that, as with any loan forgiveness action, the short refinancing under this program may be reflected as a negative feature on a borrower's credit score.

Mortgagees must also advise borrowers that they need to consult with their tax advisors regarding the cancellation of debt and possible tax consequence.

HUD conducted a Regulatory Impact Analysis for the enhancements contained in this mortgagee letter. It is estimated that between 500,000 and 1,500,000 borrowers will refinance using these enhancements and the net economic benefits will be between $11.774 and 35.322 billion. The full analysis is available at www.hud.gov/hudclips.

If you have any questions regarding this Mortgagee Letter, please call the FHA Resource

Center at 1-800-CALLFHA (1-800-225-5342). Persons with hearing or speech impairments may access this number via TDD/TTY by calling 1-877-TDD-2HUD (1-877-833-2483).

Sincerely,

David H. Stevens
Assistant Secretary for Housing-
Federal Housing Commissioner