

CHAPTER 2. HUD ESCROW AND MORTGAGE INSURANCE PREMIUM (MIP)

2-1 ESCROW ACCOUNT - GENERAL (24 CFR 203.550). Mortgagees must establish escrow accounts and require that mortgagors make monthly payments to ensure that funds will be available to pay taxes and insurance premiums when they come due.

- A. Escrow Authority. The basic authority to collect funds for escrow items is provided when the mortgagor signs the security instrument at closing.
- B. Escrow Obligations. Mortgagees must also escrow funds for those items which, if not paid, would create liens on the property positioned ahead of the HUD-insured mortgage.
- C. Common Escrow Periods. Escrow periods are usually annually or semi-annually. However, HUD does not object to a mortgagee using other accrual periods (i.e., quarterly) because of variations in due dates of the escrow items, especially where these accrual periods produce a savings for the mortgagor without causing an undue hardship on him or her.
- D. Items To Be Escrowed. The mortgagee is responsible for collecting a monthly amount that will enable it to pay all the escrow obligations (in accordance with the security instruments). (CFR 203.23)
  - 1. hazard insurance; (mortgagee's option) (See Paragraph 2-8D)
  - 2. mortgage insurance premiums; (HUD required) (See Paragraph 2-6A)
  - 3. taxes; (HUD required) (See Paragraph 2-6A)
  - 4. special assessments; (HUD required)
  - 5. ground rents, if any; (HUD required) and
  - 6. flood insurance premiums, if any, (HUD required) (See Paragraph 2-11E2).

2-2 CAPITALIZED ACCOUNTING. Supervised mortgagees have the option to establish separate accounts for escrow funds

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2-19/94

4330.1 REV-5

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as described in Paragraph 2-7, or they may use the Capitalization

Accounting method. Mortgagees that capitalize must still observe the depository, accounting, periodic escrow analysis requirement and timely payment of escrow item billing established by this Chapter. Mortgagees that capitalize may not capitalize delinquent mortgage payments or late charges (i.e., amounts due but not paid may not be added to unpaid principal unless advances are actually made by the mortgagee).

2-3ESCROW DEPOSITS - (24 CFR 202.12(d)). HUD regulations provide that all mortgagees must segregate all escrow funds received from mortgagors with HUD-insured mortgages, including those funds escrowed at closing under an Assurance of Completion Agreement. A special custodial account must be established with a financial institution whose accounts are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration.

A.Account Requirements. This special custodial account must clearly identify the type of funds being held in that account. Unless these funds are deposited in the "Trust Clearing Account" discussed below, they must be immediately transferred into the above referenced account and the mortgagor's records must be posted accordingly.

B.Trust Clearing Account. For the purpose of expediting the deposit of daily collections, a "Trust Clearing Account" may be established for the deposit of collections received on all types of mortgages.

1.For all payments received on HUD-insured mortgages, that portion received that is to be applied to escrows must be withdrawn from the Trust Clearing Account within 48 hours of the deposit into the Trust Clearing Account and transferred to the escrow account.

2.If all receipts are deposited in the escrow account, the portion representing principal, interest and service charge must be withdrawn within 30 days after deposit.

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9/942-2

4330.1 REV-5

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2-4COMMINGLING - (Supervised and Non-supervised mortgagees) - Without prior approval from HUD, mortgagees may commingle escrow funds for HUD-insured mortgages in a single bank account which also contains escrow funds for mortgages that are not HUD-insured. Escrow funds may not be commingled (not even temporarily) with funds used for the mortgagee's general operating purposes.

2-5PROPER USE OF ESCROW FUNDS. Escrow funds shall be used only for the purpose for which they were collected and are subject to audit and examination by HUD.

A.Improper Application Of Escrow Funds. Late charges, attorney's fees (incurred in foreclosure actions which are not completed), inspection fees, mortgage delinquencies or refunds of overpaid subsidy, etc., shall never be collected by deducting the amount from the mortgagor's escrow account. (See Paragraph 2-9A).

B.Escrow Funds May Be Treated As One Entity. Funds collected for a specific purpose, such as the payment of taxes, are not restricted to the use of only that escrow item. They may also be used for the payment of other mortgage obligations properly paid from the escrow account. The mortgagee has the option of structuring its accounts to segregate funds for specific purposes. However, the mortgagee must comply with any RESPA regulations that may be issued.

C.Interest On Escrows. HUD regulations neither forbid nor require that escrow accounts earn interest. Where escrow funds are invested, the net income derived from this investment must be passed on to the mortgagor in the form of interest as follows:

1.in compliance with any state and/or regulatory agency requirements governing the handling and/or payment of interest earned on a mortgagor's escrow account; and

2.the net earnings from the investment of the mortgagor's funds after deducting the actual cost of administering the interest bearing account.

NOTE:In no case may the expenses charged the mortgagor for maintaining the interest-bearing escrow account exceed the gross interest earned from investing the funds in that account.

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2-39/94

4330.1 REV-5

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2-6INITIAL ESTABLISHMENT OF ESCROW ACCOUNTS (24 CFR 203.550). As part of closing, the mortgagee must establish an accrual amount that is sufficient to cover all escrow obligations before they become delinquent.

A.Once the required amount has been collected at closing and the account established, the mortgagee must collect monthly an amount from the mortgagor that is sufficient to pay the bills as they become due. (Specific instructions as to how to determine the correct amount required to be escrowed are given below for each escrow item.)

1.Mortgage Insurance Premiums (MIP). As a condition of insurance endorsement, insured mortgages are subject to "Up-Front" lump sum payment, "Periodic" premiums paid monthly as a portion of the mortgagor's mortgage payment, or

Up-Front combined with Periodic Premiums (commonly called "risk-based premium"). The risk-based premiums have two components: the up-front premium and the periodic premium and each loan requires both. The risk-based premiums were effective for loans closed on or after July 1, 1991.

a. Mortgages Subject To "Up-Front MIP" (24 CFR 203.259(a) and (b).) Mortgages insured under the Mutual Mortgage Insurance Fund programs (most of the mortgages insured under Section 203, and excluding condominiums), pursuant to conditional commitments issued by HUD or appraisal reports signed by the direct endorsement underwriters on or after September 1, 1983, are subject to "Up-Front" MIP. (Refer to HUD Handbook 4000.2 REV-2.)

\* (1) Up-Front MIP: Required Use of Automated Clearinghouse (ACH) for Remittance.

As published in the Federal Register, it is mandatory as of April 7, 1993, that the Up-Front mortgage insurance premiums be remitted via the ACH system. However, items received at the lockbox will be

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9/942-4

4330.1 REV-5

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accepted during a limited transition period to allow mortgagees time to sign-up, obtain the required software and to begin participating in the program. During the transition period, the mortgagee will continue sending checks to the lockbox using Form HUD-27001, Transmittal for Payment of Up-Front Mortgage Insurance Premium (UFMIP) (Appendix 2A).

The ACH system allows mortgagees to utilize their mainframe and personal computers to authorize electronically the payment of the Up-front mortgage insurance premiums.

The ACH system is designed to process Up-Front premium collections from mortgagees and remit confirmations back to mortgagee using remote terminals in lieu of sending checks and confirmations by mail. The mortgagee's terminal operator dials a number that ties the terminal or microcomputer into the collection agent's telenet system.

Mortgagee Letter 92-13 includes the ACH Information Package. Any additional questions should be directed to the ACH Outreach Team on (703) 845-4991.

(2)Late Receipt of Remittance.

Regardless of the method of remittance, ACH or Lockbox, the Up-front MIP is due to HUD by the 15th calendar day after closing. If the remittance is received after that time, a late charge of 4% of the MIP is due. For any remittance received more than 30 days after closing, interest will be accrued at the interest rate set in conformity with the Treasury Fiscal Requirements Manual until the remittance is received.

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b."Periodic" MIP (Monthly) (24 CFR 203.260-203.268). Mortgages not included in those subject to the "Up-Front" MIP are subject to

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2-59/94

4330.1 REV-5

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"periodic" MIP for the life of the mortgage. Mutual Mortgage Insurance Fund mortgages that are subject to the risk-based premium also are subject to periodic MIP. For a number of years that varies depending on the date the mortgage was made and the size of the mortgagor's down payment. These premiums are paid monthly and escrows must be established for the payment of these premiums.

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(1) Risk-based Periodic Premium

(a)Loans Requiring Risk-based Periodic Premiums.

Risk-based periodic premium is required for loans closed on or after July 1, 1991, insured under the Mutual Mortgage Insurance Fund, i.e., National Housing Act Section 203(b), 203(h), 203(i) and 203(n). This includes mortgages insured under Section 203(b) pursuant to Sections 244 (coinsurance), 245 (graduated payment mortgages and growing equity mortgages) and 251 (adjustable rate mortgages).

(b)Loans Excluded From Risk-based Periodic

Premiums.

(i) Excluded are condominiums,

GPMs, GEMs,  
and ARMs which are not insured under  
Section 203(b). Also excluded are any  
Section 203(b) mortgages insured  
pursuant to Sections 233(e) (older  
declining areas), 238(c) (military  
impacted areas), 247 (Indian  
reservations) and 248 (Hawaiian home  
lands, since those mortgages are not  
obligations of the Mutual Mortgage  
Insurance Fund).

(ii) Streamline Refinances

meeting the  
following criteria are also exempt from  
Risk-based periodic premium:

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9/942-6

4330.1 REV-5

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oThe loan being refinanced must have  
closed before July 1, 1991.

oThe streamline refinance loan must  
close on or after

April 24, 1992.

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NOTE: HUD will provide mortgagees the annual information  
(Advance Premium Notice) on which to base monthly  
collections of MIP after the first premium year  
but initial requirements must be computed by the  
mortgagee.

Mortgagees are reminded to discontinue escrowing  
for the risk-based periodic MIP premium when that  
obligation is over.

2. Taxes. When establishing the initial escrow requirements,  
mortgagees must escrow for taxes. When the exact amount of  
the bill is unknown, the mortgagee should contact the taxing  
authority which has jurisdiction over the property to obtain  
an estimate of the tax bill.

NOTE: In order to avoid a substantial surplus or  
shortage at the time of first escrow analysis,  
care must be taken to assure that the estimate  
used at closing and for the amount escrowed  
monthly is based on assessed value of improved

land (i.e., value of both the house and the land) where new construction is involved and that an unrealistically low figure is not used.

For existing properties, the actual taxes paid in the previous year can serve as a basis for the estimate of the future requirements.

In many tax jurisdictions, mortgagors are eligible for special exemptions on all or part of their property taxes. The most common exemptions are those provided for the elderly and for veterans. The tax estimate may be based on the assumption that the mortgagor qualifies for a homestead exemption or other reduction in property taxes.

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2-79/94

4330.1 REV-5

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Mortgagors shall be informed of the exemptions for which they might qualify at or before the time of loan closing.

Mortgagors shall be advised that it is their responsibility to obtain available exemptions.

Mortgages Insured Under Section 235 - Failure of a Section 235 mortgagor to take advantage of an available tax exemption about which he was informed may result in an adjustment of the assistance payments.

3. Insurance. Initial insurance escrow requirements must be based on the one-year premium actually paid by the mortgagor for the policy unless the mortgagee knows the renewal premium will differ.

B. Additional Collections. The mortgagee may maintain a "cushion" in the escrow account of no more than one-sixth of its estimate of total annual requirements.

2-7 MAINTENANCE OF ESCROW ACCOUNTS - ANALYSIS (24 CFR 203.550(b)). No later than the end of the second year of the life of the mortgage, the mortgagee must begin regular analysis (at least annually) of the escrow account to assure adjustments to provide for adequate but not excessive collections to make anticipated disbursements during succeeding years. Several methods of analyzing escrow accounts are used in the industry. The result must produce a monthly payment to escrow that is neither excessive nor inadequate, so that the amount to pay each bill from escrow when it comes due is available but excessive surpluses are not developed. The mortgagor shall be given at least 10 days notice of adjustments in monthly payments and an adequate explanation of any change.

A. Mortgagees That Capitalize - Refer to Paragraph 2-2.

B. Time Of Analysis. The mortgagee may analyze escrow accounts at any time, but should select a time that produces the least probability of creating large surpluses or shortages. This is most likely the time of payment of the largest single bill from the account.

C. Estimating Future Bills. The mortgagee's estimate of escrow requirements must be a reasonable estimate of

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9/942-8

4330.1 REV-5

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what the actual disbursements from the escrow account will be in the ensuing 12-month period.

Only if estimate is based on the previous year's actual disbursement, the estimate will not be considered "excessive" if it does not exceed 10 percent over the previous year's actual disbursements. (The mortgagee may still require an escrow account up to one-sixth in excess of the current estimated total annual requirement. See Paragraph 2-6B.) If, for any reason, all or a portion of the previous year's actual costs are not a reliable indicator as a basis of estimating the expenses for the current year, the mortgagee should document this fact and make his best estimate for the upcoming year.

NOTE: If state or local law caps annual increases by a specific percentage, the estimate for those jurisdictions shall not exceed the prior year's actual disbursement plus this percentage.

D. Periodic MIP. For mortgages subject to periodic (monthly) MIP, HUD provides mortgagees with a monthly listing on which to base future escrow requirements. This listing includes all mortgages shown by HUD's records as being serviced by the mortgagee having premium anniversary dates thirteen months hence and shows, for each mortgage, the total annual MIP that will be due on that anniversary date. This is not a bill. It is provided to give mortgagees information about future requirements so that mortgagee escrow requirements and future premium remittances will be accurate.

If a mortgage being serviced does not appear on a report received 60 days or more after the acquisition of servicing, the mortgagee should complete Form HUD-92080 (Appendix 1), immediately. If a new loan does not appear on the report 60 days after endorsement, the mortgagee should send a letter accompanied by a copy of the Mortgage Insurance Certificate and the note to the same address as that used for the Form HUD-92080.

When HUD receives this information, it will add the mortgage or

mortgages in question to its next scheduled monthly listing. The fact that a mortgage does not appear on a monthly listing does not relieve the mortgagee from paying MIP when due, or from late charges or

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2-99/94

4330.1 REV-5

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interest on late premiums. In the absence of a listing including a mortgage the mortgagee knows is in the portfolio, the mortgagee must pay the MIP based on its best estimate of the amount due.

E.Mortgages Insured Under Section 235. The above applies equally to mortgages insured under Section 235. With these mortgages, the logical time for escrow analysis is on or just after the anniversary date of the first payment due under the mortgage since it is then that the MIP changes and annual recertification is required. Both of these events may affect the amount of assistance to which the mortgagor is entitled and delays in analysis could result in a need for significant retroactive adjustments.

Both Formulas I and II must be recomputed as of the anniversary date regardless of changes in escrow requirements. Mortgagees may, however, elect to analyze Section 235 escrow accounts at any time, provided assistance is recomputed at the time of annual recertification to reflect any changes in the mortgagor's income or family composition, as well as the annual change in MIP. (See Chapter 10 for detailed instructions.)

2-8PAYMENT OF BILLS AND TAXES FROM ESCROW ACCOUNTS (24 CFR 203.550). It is the mortgagee's responsibility to make disbursements as bills become payable even if it requires the advancing of corporate funds where escrow deposits are inadequate to meet these obligations. When making disbursements for bills and taxes, mortgagees must send payment directly to the billing agency or the taxing authority.

Mortgagees must establish controls to ensure that bills payable from the escrow account or the billing information needed to pay them is obtained on a timely basis. If a bill has not been received within a reasonable time before the payment due date, the mortgagee shall contact the billing agency and request that the bill be provided promptly. The mortgagor may be contacted to determine if the bill was sent to him/her rather than to the mortgagee. However, it is not the mortgagor's responsibility to contact the billing agency or to provide the mortgagee with a bill unless it has been sent to him/her in error.

NOTE:Funds in the escrow account may be used to pay any bill that is properly an obligation of that fund,

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regardless of the specific purpose for which they were collected.

\* A. Remittance of the Risk-Based Periodic Premium and Case Level Detail. The periodic premium is calculated annually, but collected and remitted monthly to be received by the 10th of the following month. Periodic premium must be remitted with Form HUD-2752, Risk-Based Annual Premiums: Monthly Remittance Summary (Appendix 2B).

All loan level premium collection data must be reported each month supporting the Risk-based monthly premium to the FHA Premium Reconciliation Group at the same time the premium is sent to HUD. Submission of the detail is preferred by either tape or diskette. If discrepancies occur between the mortgagee's detail and HUD's expected premiums, a Reconciliation Report will be generated and mailed to the mortgagee for completion.

For additional information on the submission of loan level detail or the reconciliation process, please call (800) 342-3024.

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1.Payment as Received (24 CFR 203.264). This is the basic payment method prescribed by law and regulation. Payments are remitted to HUD as actually received from mortgagors, and individual accounts are adjusted on each anniversary of amortization to assure that the total remitted during the year was accurate.

Payments are due to HUD no later than the tenth day of the month following collection. Premiums from all mortgagors must be submitted at the same time, accompanied by the MIP Remittance Summary Form discussed in Paragraph 2-8A.

2.Payment When Due. The mortgagee remits one-twelfth of the annual premium each month, regardless of whether it was received from the mortgagor. Annual reconciliation is still required.

3.Premium Remittance Summary, Form HUD-2748 (Appendix 2). This summary is to be submitted monthly (even if no payment accompanies it) so long as the mortgagee services any insured mortgages subject to

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"periodic" MIP. (Payment must always accompany the form if the "Payment When Due" option described in Paragraph 2-8A2 is selected. There should be no accompanying payment if the "Payment as Received" option is used and there were no payments from mortgagors in the preceding month).

The summary requires the following:

a. allocating the total MIP remitted with the premium anniversary months of all of the mortgages represented;

b. providing summary totals of all mortgage activity during the preceding month; and

c. certifying that the remittance is complete.

\* 4. Collection of Late Charges and Interest Due on Periodic Payments. A new automated billing system for the collection of late charge and interest due on monthly premiums (excluding Risk-Based premiums) is being implemented.

The charges

new system generates a bill for all outstanding late

and interest for delinquent or late payments each month. (Note: a bill will not be generated until the total accumulated late charges and interest due equals or

exceeds

\$25). This new system does not change the due date for remittances or the current procedures for assessing or calculating late charges or interest. \*

NOTE: Only one form will be accepted from a mortgagee in any one month. Detailed instructions are provided on the reverse of the form. Computer-printed facsimiles are acceptable. Mortgagees can reconcile MIP on magnetic tape by calling (202) 619-8397.

B.MIP. "Periodic" MIP is paid to HUD monthly, using either the "Payment as Received" or "Payment when Due" options described below. The method of payment must be indicated with each remittance by completing the "Certification" section of Form HUD-2748, Premium Remittance Summary, (Appendix 2). The method of payment indicated in the "Certification" section may be changed by the mortgagee from "a" to "b" at the mortgagee's option. However, if the mortgagee wishes to change from "b" to "a", permission from HUD

Headquarters must be requested in writing. Requests must be directed to:

U. S. Department of Housing and Urban Development  
Director, Insurance Operations Division  
451 7th Street, SW  
Washington, DC 20410

Regardless of the option chosen by the mortgagee, payments are due by the tenth of the month following receipt (or expected receipt) from the mortgagor. A 4 percent late charge is due if the payment is received by HUD after the 13th of the month in which due. Payments received by HUD after the last day of the payment month shall include an interest charge at an annual percentage rate announced periodically by the Secretary. This interest is in addition to the late charge, but the late charge is not included in the amount on which the interest is computed.

C.Taxes. (24 CFR 203.550(a)).

1.It is the mortgagee's responsibility to make escrow disbursements before bills become delinquent. Mortgagees must establish controls to insure that bills payable from the escrow fund or the information needed to pay such bills is obtained on a timely basis.

2.Early Payment. Bills should be paid early to take advantage of discounts when it is to the mortgagor's benefit, but mortgagees are not expected to advance their own funds to take advantage of discounts. However, mortgagees are expected to advance their own funds in order to assure that taxes are paid, to avoid penalties and/or the assessment of interest. If a bill is not received within a reasonable time before the known payment due date, the mortgagee is responsible for contacting the billing agency, and the mortgagor if necessary, to obtain the bill or the information needed to pay such bills.

3.Penalties Assessed to Mortgagors. Penalties for late tax bill payments shall not be charged to the mortgagor unless it can be shown that the late payment was the result of the mortgagor's error or omission.

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2-139/94

4330.1 REV-5

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NOTE:Where tax authorities refuse to provide anyone other than the homeowner a copy of the tax bill, whether due to tax authority policy, or State or local law, mortgagees must still attempt to obtain copies of the tax bill from the mortgagor and the

taxing authority and document its efforts to obtain such tax information before a penalty is passed on to the mortgagor.

4. Tax Service. HUD has no objection to the mortgagee contracting with tax service organizations to manage the payment of taxes. No cost of contracting for this service may be passed on to the mortgagor.

D. Hazard Insurance. While HUD does not require mortgagors to carry hazard insurance, the mortgagee does permit mortgagees to require it. If the mortgagee requires the mortgagor to purchase hazard insurance, the mortgagee must escrow for the payment of renewal premiums.

The mortgagee remits the renewal premium when it is due or if the mortgagor is required to pay the renewal premium, the mortgagee must escrow the funds until there is sufficient funds in the account to pay the premium or the mortgagee may advance the funds to pay it. When the mortgagee elects this option, it must renew the same type of policy that had been carried by the mortgagor previously. Where necessary, the mortgagee is expected to advance funds in order to maintain the same coverage.

E. Flood Insurance. Must be escrowed, if coverage is required. (See Paragraph 2-11E2).

F. Homeowners Policies/Long-Term Policies/Life or Disability and Insurance Protecting only the mortgagee. (See Paragraph 2-11E3-6).

2-9 SURPLUSES AND SHORTAGES IN ESCROW ACCOUNTS (24 CFR 203.550(b)). A surplus exists when the balance in the escrow account exceeds the balance as stated in Paragraph 2-6B. A shortage exists either when the balance in the account is negative (an actual shortage) or when the amount being collected is expected to create an actual shortage at some time in the future (an accrual shortage). When the escrow account is analyzed in accordance with 24 CFR 203.550(b), any surplus or shortage must be refunded to or

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9/942-14

4330.1 REV-5

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collected from the mortgagor as provided for in the security instrument.

If there is a surplus, the mortgagee must advise the mortgagor of the amount and of the methods for adjusting the surplus as described below unless the mortgagee chooses to issue a lump-sum cash refund. (See Paragraph 2-9A1d).

This notice to the mortgagor must be provided in such a way as to

leave no doubt that the mortgagor was advised of the options available to adjust the surplus. It can be provided as a part of the notice that a surplus exists, or it can be incorporated in regular billing communications with the mortgagor. If it is included in coupon books or other types of payment billings, it must be separate from the coupons themselves and should be in a format that makes it likely it will be read before the coupons.

A.Methods Of Adjusting Surplus. If there are mortgage delinquencies, late charges, delinquent payments, or other fees and charges properly due to the mortgagee, they may be collected from the escrow surplus before considering the options discussed below. (HUD considers this type of application as a cash refund to the mortgagor and the mortgagor must be advised of this fact.) The mortgagee may not, however, maintain intentional surpluses by overestimating requirements so that the funds can be applied in this manner.

In addition, a refund from an escrow surplus may only be applied to outstanding late charges as a last resort after a mortgagee has first used the mechanism for enforcement of late charges provided in 24 CFR 203.554, and the mortgagor has failed to pay the amount due.

NOTE:If a "cushion" is maintained in accordance with Paragraph 2-7C, that "cushion" may not be increased, beyond what is acceptable under RESPA, to make funds available for application to charges due the mortgagee as provided for here.

1.Cash Refund In A Lump Sum to the Mortgagor. A cash refund is to be made in a lump sum if:

a.it is permitted under the terms of the security agreement;

b.the mortgagor specifically requests it; or

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2-159/94

4330.1 REV-5

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c.the mortgagor fails to indicate how to apply the surplus, the mortgagee must automatically provide the mortgagor with a cash refund. The mortgagee must not retain the funds.

d.the mortgagee chooses not to advise the mortgagor of the options available to adjust the surplus.

2.Application to Regular Monthly Payments or to Principal Curtailment. The surplus may be applied to the regular monthly mortgage payments (application to the next full

monthly installments due until the surplus is exhausted) or to the prepayment of principal if the mortgagor so directs.

3.Application to Reduce Future Mortgage Payments. This is often referred to as "spreading" the surplus. The most common period over which the surplus is spread is the twelve months ending at the next scheduled analysis, but any period is acceptable. Mortgagees must be aware that when the surplus is substantial, this method may create problems if the property is sold to an assumptor. The purchaser may be unaware that a relatively low monthly payment quoted him is not the actual payment, but rather a reduced one based on the surplus. This method may be used only with the permission of the mortgagor. HUD does not object to the mortgagee issuing coupon books which reflect reduced payments resulting from the surplus as long as a letter to the mortgagor is included with the coupon book which advises the mortgagor of the (1) amount of the surplus, (2) the options available to adjust the surplus, (3) an explanation that by using the coupons the mortgagor approves the reduced payment method and (4) that if another option is preferred, the mortgagor must contact the mortgagee to change the method and order new coupons.

4.A Combination of the Methods Described In 1 and 3, above. With the mortgagor's permission, a portion of the surplus may be refunded in a lump sum and the remaining portion of the surplus may be apportioned over a future period.

B.Methods Of Adjusting Actual Or Accrual Shortages. The mortgagee may not begin foreclosure when the only default of the mortgagor is a failure to pay a

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9/942-16

4330.1 REV-5

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substantial escrow shortage in a lump sum (24 CFR 203.550(d)). Shortages should be adjusted in accordance with the following:

1.Lump Sum. The mortgagee may request a lump sum payment from the mortgagor to pay the shortage. After making the request, however, the mortgagee must be prepared to offer a second option if the mortgagor is unable to make the regular mortgage payment and the extra lump sum shortage amount.

2.Addition to Future Monthly Payments. The mortgagee may permit the mortgagor to pay the shortage in monthly installments over a period of time. When this method is applied, the first application of any payment above the regular monthly mortgage payment received from the mortgagor is to repay the mortgagee's advance.

3. Combination of Adjustments 1 and 2. The mortgagee may require a partial lump-sum payment with the balance due in monthly installments.

C. Mortgages Insured Under Section 235. Both surpluses and shortages discovered by analysis of Section 235 escrow accounts require adjustment of the assistance payments before any refund or collection involving the mortgagor. (For detailed instructions, see Chapter 10.)

2-10 PROVIDING LOAN INFORMATION (24 CFR 203.508).

A. Statement of Escrow Account (24 CFR 203.508(a)). At the mortgagor's request, mortgagees shall furnish a statement of the escrow account sufficient to permit the mortgagor to reconcile the account. Mortgagees are to respond promptly to such requests and provide information in a clear and understandable form.

B. Statement For Income Tax Purposes (24 CFR 203.508(c)). By January 30 of each year, the mortgagee must furnish the mortgagor with a statement of taxes and interest paid during the preceding calendar year (24 CFR 203.508(c)). HUD takes no position on the income tax impact of these amounts.

If the mortgage is insured under Section 235, the statement must also include an accounting of the total

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2-179/94

4330.1 REV-5

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amount of assistance paid by HUD and applied to the account during the preceding year (24 CFR 235.1001). This Section 235 Statement may be a part of the escrow accounting or may be in a separate statement accompanying the Income Tax Statement (See Paragraph 10-35B). The mortgagee may either:

1. report the excess of interest payments over assistance payments during the year, or

2. report both the total interest and assistance payments during the year.

NOTE: This Income Tax Statement must include or be accompanied by a statement which includes substantially the following language:

"If you itemize deductions on your income tax returns, please read this notice. Under Section 1.163-1(d) of Federal Income Tax Regulations, you, as the mortgagor, may deduct for Federal income tax purposes only that part, if any, of mortgage interest payments made during the year that exceeded the amount of assistance

payments made by HUD during the year. You are urged to contact your tax advisor or State and local tax offices for guidance regarding the deductibility of payments on your State or local income tax returns."

2-11 INSURANCE COVERAGE.

A.Mortgagor's Choice Of Insurance Carrier. Mortgagors must be permitted to choose their own hazard insurance company. The mortgagor must also be permitted to choose the type and amount of coverage.

If the mortgagor fails to obtain coverage after having been notified of his/her obligations and options, the mortgagee may force coverage (select the carrier and type) and require the mortgagor to pay the premium. If this results in an advance of the mortgagee's funds to pay premiums which are not repaid by the homeowner, there may be an adjustment of the amount reimbursed in a subsequent claim for mortgage insurance benefits.

If the mortgagor fails to renew when it is his or her responsibility to do so, and the mortgagee forces

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9/942-18

4330.1 REV-5

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replacement coverage, the mortgagee is not required to place more coverage than is necessary to protect the mortgagee's interest.

B.Amount Of Coverage. The mortgagee may not insist on more coverage than is necessary to protect its investment. The effect of coinsurance and actual cost value provisions of policies may be considered in determining this amount. If the mortgagor chooses to insure the property for more than the minimum amount required by the mortgagee, he/she must be permitted to do so, and renewal premiums for the entire amount must be escrowed.

C.Reasonable Rate - Insurance coverage must be obtained by the mortgagee at a reasonable rate. A "reasonable rate" is defined for these purposes as the lesser of two following rates. If only one of the following rates are available, it will be considered to be the reasonable rate.

1.Coverage available under a Federally-approved FAIR (Fair Access to Insurance Requirements) Plan, also known as the FAIR Plan rate.

2.A rate not more than 25 percent in excess of the rate set or advised by the principal State-licensed rating organization for essential property insurance in the voluntary market.

If a State has neither a rating organization nor a FAIR Plan,

local HUD Managers must approve rates as "reasonable" if they determine that they are in line with rates for comparable coverage on comparable properties in another State which has a rating organization or FAIR Plan.

\*If one of the three criteria identified above cannot be established, HUD will reimburse an amount not greater than 125% of the premium paid by the mortgagor prior to cancellation for fire insurance coverage unless HUD determines that the reasonable rate as defined in (a) or (b) above was less. \*

D.Mortgagee Option. There may be reasons for the mortgagee to continue coverage initially placed by the mortgagor in amounts or with coverages that are more than necessary to protect the mortgagee. The "coverage

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2-199/94

4330.1 REV-5

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necessary to protect its investment" referred to in the preceding paragraphs should be interpreted to include those situations.

If, in the mortgagee's opinion, it is necessary to continue coverage (and advance mortgagee funds to do so), for example, in order to avoid liability to the mortgagor, the mortgagee is free to do so. Advances of funds to pay for insurance covering other than the dwelling, however, may not be recoverable in a claim for mortgage insurance benefits.

#### E.Types Of Coverage.

1.Dwelling Insurance. This coverage is written in several forms and is most commonly the minimum required by mortgagees. HUD will reimburse mortgagees in claims for advances to pay premiums on any form of dwelling insurance required or forced by the mortgagee in accordance with Paragraph 2-11B and C.

2.Flood Insurance. HUD shall be furnished evidence of flood insurance as a condition of insuring the mortgage in special flood hazard areas, and insurance must be continued in force for the life of the mortgage or so long as such coverage remains available unless the area in which the property is located is no longer considered a flood hazard area. Mortgagees should contact the local HUD Field Office in connection with the applicability of this requirement in a given area.

HUD requires that flood insurance be maintained on any property falling within Special Flood Hazard Areas A (with suffixes) or V (with suffixes) on Flood Hazard Boundary Maps and Flood Insurance Rate Maps. In areas designated B and C

(with suffixes), insurance is available but not required by HUD (although mortgagees may require it under the same terms and conditions as those that apply to other dwelling insurance).

NOTE: The maps referred to are available from the Federal Emergency Management Agency (FEMA) and all mortgagees should have them,

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9/942-20

4330.1 REV-5

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probably in their underwriting departments. Most appraisers also have the maps or have access to them.

Should flood insurance be required on a property due to rezoning after the mortgage has been closed, the mortgagee is responsible for enforcing this requirement once it has been imposed.

3. Homeowner's Policies. These may include coverages not directly related to the property which cover personal liability, personal property, etc. If the mortgagor wishes this added coverage and the mortgagee finds it acceptable, the full renewal premium may be collected and handled as described in Paragraph 2-6. If the combined coverage is included in one premium payment, then HUD expects mortgagees to escrow and disburse that amount.

4. Long-Term Policies. If the mortgagor chooses to purchase a policy with a term of more than one year, and the carrier and amount are otherwise acceptable to the mortgagee, the mortgagee may not reject the policy solely because of its term. The mortgagee may deal with renewals in either of two ways:

a. immediately begin collecting a monthly amount calculated to make funds available 30 days before the policy expires to pay for renewal with the same policy term; or

b. defer collection of monthly escrows until 13 months before the expiration date of the policy and then begin collecting each month one-twelfth of the renewal premium for a policy providing similar coverage, but for a one year term.

NOTE: If the mortgagor wishes to renew for a longer term, he/she may be required to make a lump sum deposit to escrow of the additional amount required to pay the renewal premium with the

mortgagee 30 days before the expiration date of the present policy. If the additional deposit is not made, the mortgagee may renew the policy for one year

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2-219/94

4330.1 REV-5

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and continue to escrow as for a one-year policy.

5.Life or Disability or Optional Coverage Income Policies. The mortgagee may not require the mortgagor to purchase policies of this type as a condition of receiving an insured mortgage.

a.Requirements. The standard mortgage form may not be amended to make the payments on this type of insurance an obligation under the mortgage or to make a failure to pay premiums a condition of default. Mortgagees may not in any way state or imply that a failure to pay premiums on these types of coverage might create a default or result in collection action or foreclosure.

b.Handling Payments. Premiums for this type of coverage may be collected with the regular monthly mortgage payments, but mortgagees must maintain their records so that these elements are identified separately from any other element of the payment. They may not be deposited in the same bank accounts as other escrow payments.

Mortgagees are not required to itemize the mortgagor's monthly contribution for these escrow items on payment coupons. However, the escrow account statement, which must be furnished to mortgagors upon request, must be itemized to reflect these items. (24 CFR 203.508(c)).

If the mortgagee capitalizes, these funds may be deposited in the same bank account as other funds related to the mortgage, but there must be a clear separate accounting for them, and advances of mortgagee funds to pay premiums may not be capitalized. That is, when premiums are paid, the amount added to the unpaid principal balance may not be greater than the amount actually collected for these purposes and earlier deducted from principal, regardless of the amount of the premium paid.

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9/942-22

4330.1 REV-5

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These premiums are applied after all other elements of the payment and, if the payment does not include all or a part of the premium, the mortgagee may not treat the failure to pay as a failure to pay a part of the mortgage payment in its dealings with the mortgagor. Collection of unpaid premiums must be clearly separated from the collection of any unpaid mortgage payment.

c. Advancement of Funds. Advancing funds for payment of premiums for life and disability income or other optional insurance shall not be charged against the escrow account and shall not be recovered by the mortgagee in any claim for mortgage insurance benefits.

d. Section 235 Mortgages. Premiums for these types of insurances may not be used as a part of the mortgage payment in computing the Formula One assistance payments.

6. Insurance Protecting Only the Mortgagee. Mortgagees carry insurance of various sorts that protect only the mortgagee. In some cases, these policies cover damage to the dwelling, in others they do not. Regardless of the nature of the insurance, if it provides no protection to the mortgagor, no part of the cost of the protection may be passed on to the mortgagor. Reimbursement may also not be requested for these premiums when filing a claim for insurance benefits.