CHAPTER 2: COLLECTIONS AND ESCROWS

Section I. Collections

2-1. REGULAR MONTHLY PAYMENTS. The owner must pay monthly the amounts required by the mortgage and regulatory agreement. These payments include the amount of principal and interest required to amortize the mortgage, escrows required for property taxes, hazard insurance, mortgage insurance premiums, deposits to the replacement reserve, and any other impounds required by the mortgage. The owner must pay these amounts in one lump sum. The lender must apply all payments received from the owner, or for the account of the owner, to the following items in the order set forth below:

a. mortgage insurance premiums;

b. ground rents, taxes, special assessments, fire and property insurance premiums, and flood insurance, if required;

c. interest on the note secured by the mortgage;

d. amortization of the principal of the note; and

e. the reserve for replacements.

2-2. LATE CHARGES. All payments are due on the first day of the month. If a monthly payment is received more than 15 days after the due date, the lender may collect a late charge if the mortgage provides for one. The late charge may not exceed four percent of the principal and interest payment due unless HUD has approved a different amount and that amount is stated in the mortgage. A late charge may not be assessed against a delinquent payment until the 17th day of the month because the first day of the month is the due date, the 16th is the fifteenth day after the due date, and only on the 17th is the payment more than 15 days delinquent. Late charges must be separately charged to and collected from the mortgagor; late charges may not be deducted from any monthly payment.

2-3. DELINQUENCY CONTROL. To avoid defaults and to minimize losses on unavoidable defaults, the lender must take prompt action to follow-up on delinquent account. If a payment is not received by the 16th day of the month in which the payment is due, the lender must notify HUD of the delinquency. The notice must be mailed in time for HUD to receive it by the 20th day of that month.

a. The notice must include the following information.

(1) FHA project number
(2) Project name and address
(3) Mortgagor billing name, address and phone number
(4) Outstanding mortgage balance
(5) Interest rate

(6) Number of installments past due
(7) Amount delinquent
(8) Reason for delinquency.

b. The lender must send this notice to the Loan Management Branch Chief at the HUD Field Office having jurisdiction over the project and to HUD Headquarters at the following address:

Department of Housing and Urban Development
Office of Multifamily Housing Management, HMH
Management Operations Division, HMHM
Attention: Delinquency Alert
451 7th Street, S. W.
Washington, D. C. 20410

2-4. LENDER PREMIUM. In addition to the mortgage insurance premium described in Section 4 of this Chapter, beginning with the first anniversary of the first payment to principal, the lender may charge the owner an additional annual lender premium not in excess of 0.25 percent of the average outstanding principal balance of the mortgage, computed without considering delinquent payments or prepayments. The lender may require that the owner pay this additional premium through monthly impounds beginning with the first payment to principal. These funds must remain in the project's escrow account until the premium is earned (i.e., the anniversary of the first principal payment). The lender may disburse these funds to its own account only on or after the date the premium is earned.

2-5. PREPAYMENT. Generally, owners may not prepay mortgages during the five years following the date the mortgage was endorsed for insurance. Section 223(f) of the National Housing Act provides that HUD may permit mortgagors to prepay during this five year period only if one of the following three conditions apply.

a. The owner enters into an agreement with HUD to maintain the project as rental housing for the remainder of the five-year term discussed above.

b. The owner wishes to convert the property to cooperative or condominium ownership, the lender is willing to approve the request and HUD determines that the conversion is sponsored by a bona fide tenants' organization representing a majority of the households in the project.

c. HUD determines that continuation of the property as rental housing is: (1) unnecessary to assure adequate rental housing opportunity for low and moderate-income people in the community; or (2) would have an undesirable and deleterious effect on the surrounding neighborhood.

Subject to the above requirements, the mortgage may include any additional conditions or prepayment penalties acceptable to both the lender and the owner.

Section 2. HUD Escrow Requirements

2-6. REQUIREMENT FOR MONTHLY ESCROWS. HUD requires that lenders establish escrow accounts and that owners make monthly payments to these accounts, for property taxes, hazard insurance premiums, mortgage insurance premiums, and other impounds required by the mortgage. Monthly impounds must be set at an amount which the lender estimates will accumulate sufficient funds to pay all escrow obligations before they become due. The mortgage instrument authorizes the lender to accumulate sufficient escrow funds to pay mortgage insurance premiums one month prior to the date the MIP payment is due HUD and to pay bills for other escrowed items thirty days prior to the time the bills become delinquent. Lenders may establish other accrual periods and payment dates if doing so will enable the owner to obtain discounts. For example, lenders may pay taxes early if the taxing authority offers a discount for early payment.

2-7. USE AND INVESTMENT OF ESCROW FUNDS

a. Use of Funds. Lenders may use escrow funds only for the purpose for which they were collected. This restriction applies collectively to all escrow accounts; it does not apply to each individual escrow account. For example, the lender may use a surplus in the tax escrow to supplement a deficit in an insurance escrow for the same mortgage. The lender may never use escrow funds to pay assumption fees, late charges on delinquent mortgage payments, or any charges other than those allowed in Paragraph 2-7.b., below.

b. Investment of Funds. HUD neither prohibits nor requires that lenders invest escrow accounts. Lenders, however, must comply with any State or local laws regarding investment of escrow accounts.

(1) If a lender voluntarily decides, or is required, to invest escrow accounts, the lender may invest the funds only in the accounts listed in Paragraph 5-2.a. of this Handbook.

(2) All net income derived from the investment must accrue to the benefit of the project. Net income is gross investment earnings less reasonable fees for administering the invested funds. These fees may not exceed the lesser of the costs that the lender actually incurs in administering the invested funds or the amount other lenders usually charge for comparable services.

2-8. PAYMENT OF BILLS FROM ESCROW ACCOUNTS. Lenders must establish controls to insure that bills are received on a timely basis and must pay all bills on or before the due date. Lenders may pass a late charge on to a project owner only if the late charge was incurred because of the owner's action. If the lender has not received a bill 30 days before the date payment is normally due, the lender must request the bill.

2-9. PERIODIC ANALYSIS OF ESCROW ACCOUNTS. At least annually, the lender must evaluate whether escrow balances and scheduled deposits will provide sufficient funds to pay anticipated bills. After analyzing the accounts, the lender must promptly adjust monthly impounds, as necessary to accumulate sufficient funds to pay expected bills. The lender must give the owner a written statement of the reasons for any change in monthly payments.

a. Applying Surpluses. The lender must apply any surplus in accordance with the mortgage and Paragraph 2-7.a. of this Chapter.

b. Collecting Shortages. HUD does not consider it prudent servicing for a lender to institute foreclosure when the only default is the owner's temporary inability to pay a substantial escrow shortage in a lump sum. To collect escrow shortages, the lender may (1) request the owner to pay the shortage in one lump sum; (2) permit the owner to pay the shortage in monthly payments over a period of time; or (3) use a combination of methods (1) and (2).

2-10. INFORMATION FURNISHED TO OWNERS. Lenders must promptly respond to owners' requests for clarification of escrow requirements or account balances. It is particularly important that the lender promptly supply escrow and other mortgage data that the project will need to prepare the annual financial statements required by Chapter 3 of this Handbook.

Section 3. Hazard Insurance

2-11. AMOUNT AND TYPE OF INSURANCE REQUIRED. The mortgage and HUD regulations require that projects carry a fire and extended coverage insurance policy in an amount that meets the coinsurance requirements of the insurer and is at least equal to 80 percent of the actual cash value of the project's insurable improvements and equipment. These insurance requirements apply as long as the coinsurance contract is in force and regardless of the unpaid principal balance of the mortgage. A standard mortgagee clause, making any loss payable to the lender, must be attached to the policy.

a. To determine the amount of insurance required at the time of project completion, lenders must use the estimate of insurable value shown on Form HUD-92329, Property Insurance Schedule (Appendix 8). In later years Form HUD-92329's insurable value figures must be updated to reflect changes in construction costs that have occurred since project completion. After the first year of project operation, HUD will consider insurance coverage to be adequate if the insurance coverage met the insurer's coinsurance requirements at the time the policy was issued and:

(1) the policy is endorsed with an agreed amount clause in which the insurer acknowledges the adequacy of the insurance coverage and agrees not to invoke any coinsurance penalty;

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(2) the insurer annually certifies that the insurance coverage meets its coinsurance requirements; or

(3) the mortgagor/the insurance agent/the lender annually correctly recomputes the project's insurable value by applying cost factors published in one of the nationally recognized building cost indices and insurance coverage is increased to 80% (or any higher percentage required by the insurer's coinsurance clause) of the revised insurable value.

b. If the owner refuses to pay any higher premiums associated with required increases in insurance coverage, the lender must pay the additional premiums and bill the mortgagor for those premiums.

2-12. PROCESSING LOSS SETTLEMENT DRAFTS. The owner must immediately notify the lender of any loss or damage to the coinsured property. Such notification must include a description of the nature and extent of the loss, the estimated cost of repairs and/or replacements and an assessment of the impact of the loss on the operation of the project. The owner must promptly initiate insurance claim processing and repair work. If the damage is extensive, the lender should require the owner to submit the plans and specifications for restoration for its approval. The owner should direct the insurance company to mail the loss settlement draft directly to the lender. The loss draft must name the owner and the lender as payees.

a. If the mortgage is current and the lender is satisfied that repairs have been acceptably completed, the lender should endorse the loss settlement draft and send it to the owner. If the damage to the property is extensive, the lender may require the owner to place the proceeds in an escrow account controlled by the lender and make payments as phases of the work are completed.

b. If the mortgage is delinquent, the lender should generally require the owner to apply the proceeds of the loss settlement draft to the mortgage delinquency. The lender must obtain the HUD Field Office's approval before using the insurance proceeds for any purpose other than curing the delinquency.

c. If the owner has diverted funds, the lender may endorse the loss settlement draft to the owner only after the owner has repaid the amount diverted. (Note: Paragraph 9-4 of this Handbook requires lenders to report all diversions to HUD.)

Section 4. Mortgage Insurance Premiums (MIP)

2-13. AMOUNTS DUE HUD. To cover HUD's share of the coinsurance risk and the costs of administering the coinsurance program, HUD collects a mortgage insurance premium at loan closing and annually thereafter so long as the coinsurance contract remains in force. These two types of premiums are discussed below. These premiums are paid out of the MIP which the

lender collects from the owner. The lender may make MIP payments in cash or debentures.

a. Initial MIP. At endorsement, the lender must pay HUD an initial MIP equal to one percent of the face amount of the mortgage. Following endorsement, HUD's Office of Finance and Accounting (OFA) will adjust the initial MIP so that it equals one percent of the average outstanding balance of the mortgage from the date of endorsement to the date 12 months after the date of the first payment to principal. If this adjusted amount is more than the amount the lender paid at endorsement, OFA will bill the lender for the difference. If the adjusted amount is lower than the amount the lender paid at endorsement, OFA will send the excess amount to the lender for application to the owner's account.

b. Recurring Annual Payments. Beginning on the anniversary of the date the first principal payment was due and continuing annually thereafter, the lender must pay HUD a MIP equal to 0.4 percent of the average outstanding principal balance for the 12 months following the date the premium becomes payable. The average outstanding principal balance is computed using the project's amortization schedule. No adjustments may be made for delinquent payments or mortgage prepayments. The lender must pay annual premiums when the Remittance Advice (billing) is received from OFA. OFA will mail the MIP billing to the servicer reported on the most recent Form HUD-92080, Mortgage Record Change. The lender must write the project's FHA number on the payment instrument and check to see if the FHA number on the billing is accurate. The lender must line out any incorrect FHA number and write in the correct number. Payments must be mailed to the address shown on the billing.

2-14. LATE CHARGES. If HUD receives a premium more than 15 days after the later of the billing date or due date, the lender must pay a late charge of four percent of the amount due. If HUD receives a premium payment more than 30 days after the later of the billing or due date, the lender must pay both the four percent late charge and interest. HUD will charge interest from the later of the billing date or the due date at a rate set in conformity with the Treasury Fiscal Requirements Manual. That rate will vary according to the government's cost of borrowing.

2-15. COLLECTING FROM THE OWNER. The payments discussed in Paragraph 2-14 are paid from the following amounts the lender collects from the borrower.

a. Amount Collected at Closing. At loan closing, the lender collects an amount equal to one percent of the average outstanding principal balance of the coinsured mortgage for the period from the date of the endorsement to one year after the due date of the first payment to principal.

b. Monthly Impounds. Beginning with the first principal payment, the lender must collect from the owner monthly impounds sufficient to accumulate .5 percent of the average principal balance outstanding

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during the upcoming year. Out of this amount, 10 basis points are retained by the lender and 40 basis points must be paid to HUD, as prescribed in Paragraph 2-13.b.

2-16. DURATION OF MIP. MIP payments must continue annually until one of the following occurs:

a. the mortgage is paid in full;

b. a deed to the lender is filed for record; or

c. the contract of coinsurance is otherwise terminated with the consent of HUD.

2-17. PRO RATA REFUND OF MIP UPON TERMINATION OF INSURANCE. If the coinsurance contract is terminated by prepayment or voluntary termination after the due date of the first annual MIP, HUD will refund any insurance premium paid for the period subsequent to the date the termination of insurance was effective. HUD will mail the refund to the lender for credit to the owner's account. When computing the refund, HUD will consider the coinsurance contract to be terminated as of the last day of the month in which the mortgage is prepaid or a voluntary termination request is received by HUD. No refunds will be made if insurance is terminated pursuant to a default or prior to the date the first annual MIP is due.