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U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

March 17, 1994

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER
MORTGAGEE LETTER 94-11

TO: ALL APPROVED MORTGAGEES

SUBJECT: Single Family Loan Production - Revisions To The 203(k)
Rehabilitation Mortgage Insurance Program

The purpose of this Mortgagee Letter is to inform you of a number of substantial changes that are being made to the Section 203(k) Rehabilitation Mortgage Insurance Program to make it more streamlined and user-friendly for lenders and borrowers. As you know, the Section 203(k) program is the Department's primary program for the rehabilitation and repair of single family properties. As such, it is an important tool for community and neighborhood revitalization and for expanding home ownership opportunities. Since these are the primary goals of HUD, the Department believes that Section 203(k) is an important program and we intend to continue to strongly support the program and the lenders that participate in it.

Many lenders have successfully used the Section 203(k) program in partnership with state and local housing agencies and nonprofit organizations to rehabilitate properties. These lenders, along with state and local government agencies, have found ways to combine Section 203(k) with other financial resources, such as HUD's HOME and Community Development Block Grant Programs, to assist borrowers. Several state housing finance agencies have designed programs specifically for use with Section 203(k) and some lenders have also used the expertise of local housing agencies and nonprofit organizations to help manage the rehabilitation processing. We urge lenders to explore these opportunities for partnerships with state and local governments and nonprofits.

The Department also believes that the Section 203(k) program is an excellent means for lenders to demonstrate their commitment to lending in lower income communities and to help meet their responsibilities under the Community Reinvestment Act(CRA). HUD is committed to increasing homeownership opportunities for families in these communities and Section 203(k) is an excellent product for use with CRA-type lending programs.

A strong secondary market for Section 203(k) mortgages has developed over the last few years. Attached to this Mortgagee Letter

(Attachment 1), is a list of lenders who are interested in purchasing Section 203(k) mortgages; Fannie Mae and Freddie Mac will also purchase these mortgages. Many of these secondary lender will also assist

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originating lenders in developing a successful Section 203(k) program.

The Department is arranging with the Mortgage Bankers Association of America (MBA) a series of training sessions for lenders to learn more about the Section 203(k) program. It is expected that three training sessions will be held this year in various parts of the country. You will be receiving further notice about these sessions in the near future.

Many of the program changes described below are the result of a series of workshops that the Department conducted over the past several months with lenders, community organizations, state and local government agencies and HUD Field Office staff. The Department wishes to thank all of those who participated in these workshops. These revisions are effective immediately, unless otherwise stated and will supersede the Department's policies described in HUD Handbook 4240.4 REV-2, dated December 6, 1991, and Mortgagee Letter 92-33, dated September 28, 1992.

1. FIELD OFFICE APPROVAL OF DIRECT ENDORSEMENT (DE) LENDERS.

Some HUD Field Offices require DE lenders to be approved for the 203(k) program in their jurisdiction even when the DE lender has already been approved for 203(k) by another HUD Field Office. Duplicate HUD approval is not necessary. DE Underwriters who have received training in 203(k) procedures from one HUD Field Office do not need to be trained again in another HUD Field Office. A DE lender

does not have to submit 203(k) cases on a preclosing basis, if it has already been unconditionally approved for 203(k) by any other HUD Field Office.

If, on a post-endorsement basis, the HUD Field Office determines that

the DE lender's 203(k) cases are being improperly processed and submitted for insurance, the HUD Field Office can require more training for the DE Underwriter and if necessary, place the DE lender

in a preclosing status until it is shown that the DE lender is complying with program requirements.

2. CORRESPONDENT LENDERS. Loan Correspondents working with approved DE sponsors may originate 203(k) mortgages. Also, the correspondent

lender may use the DE sponsor's staff appraisers, inspectors and plan reviewers for processing.

3. DEFINITION OF A FIRST TIME HOMEBUYER. For the purpose of using the Escrow Commitment Procedure, lenders have requested further guidance on the definition of "first time homebuyer." A first time homebuyer is a single person(s) or an individual and his or her spouse who have not owned a home (as a tenant in common or as a joint tenant by the entirety) during the three years immediately

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proceeding the date of application for the 203(k) loan.

Any individual who is legally separated or divorced cannot be excluded from consideration as a first time homebuyer on the basis that the individual owned a home with his or her spouse or resided in a home owned by the spouse. In this case, the three year waiting period does not apply, provided the individual no longer has an interest in the home.

4. 203(k) BORROWER'S ACKNOWLEDGEMENT. Form HUD-92700-A (Attachment 2) must be completed prior to closing the 203(k) loan. The form notifies the borrower(s) of their responsibilities as they relate to the rehabilitation of the property. This form replaces the 203(k) Applicant Acknowledgement in Appendix 4 of HUD Handbook 4240.4 REV-2. The new Form 92700-A should be used for all loans closed on or after May 1, 1994.

5. SEVEN UNIT LIMIT. The Section 203(k) program is the only FHA program that can be used by private, profit motivated investors. However, HUD regulations and policies still restrict, under certain conditions, the number of rental units in which an investor may have an interest. In general, a borrower may not have an interest in more than seven units in the same subdivision or contiguous area. For 203(k) purposes, HUD defines a contiguous area as within a two block radius. In addition, Handbook 4240.4 REV-2, paragraph 4-6, states that an investor should not be allowed to rapidly accumulate FHA insured properties that

clearly and collectively constitute a multifamily project. Lenders should be cognizant of these restrictions on investor participation.

The local HUD Field Office can determine that units in a neighborhood are not subject to the seven unit limit described above if: (1) the neighborhood has been targeted by a State or local government for redevelopment or revitalization; and (2) the State or local government has submitted a plan to HUD that defines the area, extent and type of commitment to redevelop the area. Nevertheless, the HUD Field Office may still impose restrictions within a redevelopment area (or sub-area) in order to prevent undesirable concentrations of units under a single (or group) ownership. Therefore, in addition to the above requirements, the HUD Field Office will determine that the seven unit limit is inapplicable only if: (1) the investor will own no more than 10 percent of the housing units (regardless of financing type) in the designated redevelopment area or sub-area; and (2) the investor has no more than eight units on adjacent lots.

DE Lenders must submit requests in writing to the HUD Field Office for determination that the seven unit limitation does not apply.

6. NONRESIDENTIAL USE OF A 203(K) PROPERTY. A 203(k) mortgage may be originated on a "mixed use" residential property provided: (1) The property has no greater than 25 percent (for a one story building); 33 percent (for a three story building); and 49 percent (for a two story building) of its floor area used for commercial (storefront) purposes; (2) the commercial use will not affect the health and safety of the occupants of the residential property; and (3) the rehabilitation funds will only be used for the residential functions of the dwelling and areas used to access the residential part of the property. It is the intent of this change to allow storefront properties to be eligible for Section 203(k).
7. APPRAISALS. Paragraph 2-2, Handbook 4240.4, requires an appraisal, for all properties except a HUD-owned property, to determine the As-Is Value of the property and another appraisal to determine the value of the property after rehabilitation.

However, this requirement is now being revised. The lender must still establish an As-is value, but the lender may now determine that an As-is appraisal is not feasible or necessary. The lender may use the contract sales price (on a purchase transaction) or the existing debt on the property (on a refinance transaction) as the As-Is value when it is clear to the lender that this amount does not exceed a reasonable estimate of value. On a refinance transaction, when a large amount of existing debt (i.e., first and secondary mortgages) suggests to the lender that the borrower has little or no equity in the property, the lender should always obtain an As-Is appraisal on which to base the estimate of As-Is value.

For a HUD-owned property an As-is appraisal is not required and a DE HUD lender may request the HUD Field Office to release the outstanding Property Disposition appraisal on the property to the lender to establish the maximum mortgage for the property. The HUD appraisal will be considered acceptable for use by the lender if: (1) it is not over one year old prior to bid acceptance from HUD; and (2) the sales contract price plus the cost of rehabilitation does not exceed 110 percent of the "As-Repaired Value" shown on the HUD appraisal. If the HUD appraisal is insufficient to make the loan viable, the DE Lender may order another appraisal to assure the market value of the property will be adequate to make the purchase of the property feasible.

Paragraph 2-4.A of Handbook 4240.4 REV-2, which describes the appraised value to be placed on the Conditional Commitment / DE Statement of Appraised Value (Form HUD 92800.5B) is changed to read as follows:

Homebuyer's Statement of Appraised Value (Homebuyer's Copy of Form HUD 92800.5B.). The value of the property is the market value accepted by HUD or the DE Underwriter after reviewing the Uniform Residential Appraisal Report, if one is obtained.

8. PURCHASE OF HUD-OWNED PROPERTIES. Homebuyers (including investors) who purchase HUD-owned property can refinance the property using 203(k) within six (6) months of purchase, the same as if the buyer purchased the property with a 203(k) insured loan to begin with. Evidence of interim financing is not required; the mortgage calculations will be done the same as a purchase transaction. Cash back will be allowed to the borrower in this situation; Lines D2

through D4 of the 203(k) Maximum Mortgage Worksheet, Form HUD 92700, will be used to determine the maximum allowable mortgage on the property. A copy of the HUD Sales Contract and the HUD-1 Settlement Statement must be submitted to verify the accepted bid price (As-Is value) of the property and the closing date.

See paragraph 7, above, for additional information on the appraisal of HUD owned properties.

9. REVISION TO THE DRAW REQUEST FORM. Effective for mortgages closed on or after May 1, 1994, the new Form HUD 9746-A in Attachment 3 must

be used on all draw requests. The Compliance Inspection Report (Form HUD 92051) is no longer required to be submitted with the Draw Request

form; however, the back side of the draw request form has been revised

to include an Inspection Report that must be completed by the fee or staff inspector on each inspection of the property during the rehabilitation period. The cost of the inspection will also be included on the back side of the form; therefore, the fee inspector will no longer need to bill the lender for the inspection fee. The inspection report must be completed for the fee to be paid by the lender.

10. ARCHITECTURAL EXHIBITS. To streamline the submission requirements for

the architectural exhibits, paragraph 3-2.C, Handbook 4240.4 REV-2, the list of exhibits, is revised as follows:

1) A Plot Plan of the Site is required only if a new addition is being made to the existing structure. Show the location of the structure(s), walks, drives, streets, and other relevant detail.

Include finished grade elevations at the property corners and building corners. Show the required flood elevation.

2) Proposed Interior Plan of the Dwelling. Show where structural or planning changes are contemplated, including an addition to the dwelling. (An existing plan is no longer required.)

3) Work Write-up and Cost Estimate. Any format may be used for these documents, however, quantity and the cost of each item must

be shown. Also include a complete description of the work for each item (where necessary). The Rehabilitation Checklist in Appendix 1 of Handbook 4240.4 REV-2 should be used to ensure

all work items are considered. Transfer the costs to the Draw Request (Form HUD 9746-A).

Cost estimates must include labor and materials sufficient to complete the work by a contractor. Homebuyers doing their own work cannot eliminate the cost estimate for labor, because if they cannot complete the work there must be sufficient money in the escrow account to get a subcontractor to do the work. The Work Write-up does not need to reflect the color or specific model numbers of appliances, bathroom fixtures, carpeting, etc., unless they are non-standard units.

The consultant who prepares the work writeup and cost estimate (or an architect, engineering or home inspection service) needs to inspect the property to assure: (1) there are no rodents, dryrot, termites and other infestation; (2) there are no defects that will affect the health and safety of the occupants; (3) the adequacy of the existing structural, heating, plumbing, electrical and roofing systems; and (4) the upgrading of thermal protection (where necessary).

11. REHABILITATION LOAN AGREEMENT. This Agreement (see Attachment 4) has been revised to help the lender and borrower more fully understand their responsibilities when the 203(k) loan is closed. The revisions include the following:

The Rehabilitation Escrow Account will cease paying interest to the borrower when: (1) the loan payments are delinquent for more than 30 days; (2) the completion date (or an approved extension) has expired.

During this period, the interest will be paid down on the mortgage principal. If the borrower(s) cure the delinquent or default status and/or the completion date has not expired or an extension has been approved, then the interest on the escrow account will begin again to be paid according to the request on the 203(k) Borrowers Acknowledgement (Form HUD 92700-A, Attachment 2).

In cases where the loan has gone into default and all attempts to get the borrower(s) to make their payments have been exhausted, HUD permits the DE Lender to pay the interest accumulated in the escrow account down on the unpaid principal of the mortgage, without seeking advance approval from the local HUD Field Office.

The DE Lender no longer needs to submit change orders to the HUD Field

Office for an extension of time to complete improvements. However,
DE Underwriters are reminded that an extension can only be granted if
the loan payments are current.

12. ALLOWABLE DISCOUNT POINTS. Mortgagee Letter 92-33, dated September 28, 1992, discussed the allowable discount points for a 203(k) loan. The following examples will help your processors and underwriters properly implement the Department's policy.

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The discount is determined between the lender and the borrower on each loan and is not regulated by the Department. A portion of the total discount paid by the borrower can be financed and is included as part of the Total Rehabilitation Costs on the Maximum Mortgage Worksheet (MMW). The discount that may be financed (Discount Points on the Repair Costs) is equal to the number of discount points multiplied by Line B10 on the MMW and shown on Line B12.

NOTE: The number of discount points charged on the rehabilitation amount CANNOT be more than the number of discount points charged on the total loan, and must be equal to or less than the points that will be paid in cash.

The cash discount is the difference between the discount on the total loan, and the amount of discount being financed as discount on the rehabilitation. This is the cash that the borrower will bring to closing to pay for discount points. To calculate, multiply the number of discount points by the total loan amount and deduct the discount on the repairs (Line B12 of the MMW), where applicable.

Example 1: On a \$100,000 loan with Line B10 equal to \$25,000, the discount on the total loan is \$2,000 (2% of \$100,000). The portion that can be financed is up to 2% of Line B10, which would be \$500 (2% of \$25,000). The firm commitment should reflect the total loan discount. The HUD 1 will show the difference of \$1,500 (\$2,000 - \$500), as cash discount and the rest (\$500) is shown in the Total Rehabilitation Cost. Regardless of whether or not any discount is financed, if 2% is charged on this loan, the total discount points, whether paid in cash or financed, cannot exceed \$2,000.

Example 2: There is a loan of \$75,000 with 3 discount points, none of which are being paid by the seller; the subtotal on

Line

B10 for repairs and fees is \$12,500. The discount would be shown as \$2,250 on the total loan, and of that amount, the borrower decides to finance two of the three discount points which could be financed on Line B12. The borrower would finance \$250 into the Total Rehabilitation Cost (2% of \$12,500) and the balance of the discount points (\$2,000) would be paid in cash at closing.

When the seller has agreed to pay any portion of the total discount, multiply the amount of the discount on the loan times the Sales Contract Price in Line A1 of the MMW. If the seller pays a financing concession to include discount points for both the sales price and rehabilitation costs of the dwelling, then the sales contract must be very clear and concise to assure that the seller completely understands the concession agreement. On HUD-owned properties, any amount HUD has agreed to pay towards the purchaser's closing and/or financing costs (Line 5 of the Sales Contract, form HUD 9548), applies only to the contract sales price and not to the total of the purchase price plus cost of rehabilitation.

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Example 3: There is a loan of \$120,000; \$40,000 in repairs and fees on Line B10; 3% discount points; the total discount is \$3,600 (3% of \$120,000). The seller agrees to pay 2% of the discount points on the sales price of the home (2% of \$80,000), or \$1,600. The remaining \$2,000 needs to be paid by the borrower. The borrower can finance up to 3% of the repair costs from Line B10 (3% of \$40,000 = \$1,200) leaving the remaining \$800 to be paid in cash at closing. (This is not a HUD-owned property).

Example 4: There is a loan of \$90,000 with a subtotal for repairs and fees of \$30,000 on Line B10. The discount on the loan is 2.5%, or \$2,250. The seller agrees to pay 2% discount (\$1,800) on the total loan (stated in the sales contract) at closing. The borrower is responsible for the remaining \$450 by either financing the entire amount on Line B12, paying cash at closing or a combination of both.

Example 5: The borrower has purchased a HUD-owned property for \$46,000 and the seller, HUD, has agreed in the sales contract to pay \$2,200 in closing costs. The loan will be \$58,000, with \$12,000 as a subtotal on Line B10 of the MMW; the discount on the

of loan is 2%. (HUD only pays discount points on the sale price of the HUD-owned property, not on the sale price plus cost of rehabilitation; see the sales contract; Line 5, form HUD 9548). Therefore, HUD would be responsible to pay \$920 (2% of \$46,000) on only the sales price of the property. The remaining amount, up to \$1,280, could be used for other closing costs on the loan.

**** POINTS TO REMEMBER:

1. The discount points on the total loan (both financed and paid in cash) should be shown on the Firm Commitment.
 2. Any discount points paid in cash at closing should be shown on the Mortgage Credit Analysis Worksheet, Form HUD 92900WS.
 3. The financed discount points on rehabilitation costs should be shown on Line B12; where applicable for a refinance transaction, Line D1 of MMW.
 4. The 203(k) Maximum Mortgage Worksheet (Form HUD 92700) must be attached to the Conditional Commitment/DE Statement of Appraised Value (Form HUD 92800.5B) and the Firm Commitment (HUD 92900.4).
13. HUD ACCEPTED 203(k) CONSULTANTS. The most time consuming and difficult part of a 203(k) loan is for the borrower to properly prepare the required architectural exhibits listed in Handbook 4240.4 REV-2, paragraph 3-2. To help DE Lenders streamline their processing time on a 203(k) loan, HUD Field Offices have the authority to designate fee plan reviewers who have been trained in the

requirements of the 203(k) program, to also act as consultants to borrowers, for the purpose of preparing the architectural exhibits. Since the consultant already knows how to properly prepare the exhibits, no plan review will be required (no fee charged) and the case can be sent directly to the appraiser to be appraised. This consultant, who is also a plan reviewer and HUD approved fee inspector, can inspect the property during construction.

A DE Lender can also nominate persons to be independent consultants to the local HUD Field Office. This consultant is not authorized to inspect the property for a draw inspection during the construction, because he/she is not on the HUD approved fee inspectors panel. The nominee must be trained by the HUD Field Office on 203(k) procedures

and requirements and how to properly prepare the architectural exhibits. A plan review is required until such time as the HUD Field

Office is satisfied that the consultant is properly preparing the exhibits. When fully trained, the consultant can be placed on a HUD Field Office list of accepted 203(k) consultants and DE lenders may refer their borrowers to these consultants for the preparation of the architectural exhibits.

NOTE: A borrower can use a contractor to prepare the construction exhibits or prepare the exhibits themselves. The use of a consultant is not required, however, the borrower should consider using this service in order to expedite the processing of the 203(k) loan. When a consultant is used, the DE lender must notify the borrower that HUD, because it has included a consultant's name on a list, does not warrant the competence of the consultant or the quality of the work the consultant may perform for the borrower.

The fee charged by the consultant can be included on Line B7 of the 203(k) Maximum Mortgage Worksheet (MMW). The consultant must enter into a written agreement with the borrower that completely explains what services the consultant will perform for the borrower and the fee charged.

A fee of \$400 is acceptable for a property with repairs less than \$7,500; \$500 for repairs between \$7,501 and \$15,000; \$600 for repairs between \$15,001 and \$30,000; and \$700 for repairs greater than \$30,000. For this fee, the consultant would inspect the property and provide all the required architectural exhibits. State licensed Architect or Engineer fees are not restricted by this fee schedule and should be shown on line B6 on MMW. (However, these architect and engineering fees must be customary and reasonable for the type of project.)

When a loan on a property does not close within 120 days of the date the plan reviewer signs the Draw Request, Form HUD 9746-A, the DE Underwriter should require a reinspection of the property to assure that further damage to the

property has not occurred. An inspection fee of \$50 can be charged. If additional items need to be added to the work writeup and cost estimate, the DE Underwriter must reflect the change in the mortgage amount (if the market value is not affected) or obtain cash from the borrower to make the repairs.

14. ELIMINATION OF 203(k) SECOND MORTGAGES. Although the law allows HUD to insure 203(k) second mortgages (provided there are no insured advances), the Department considers this type of second mortgage to be an unacceptable risk. For this reason and because there is no

secondary market for 203(k) second mortgages, the Department will not insure 203(k) second mortgages. The Federal Regulations will be revised to remove this provision in 24 CFR 203.50(i).

15. HOMEOWNER / CONTRACTOR AGREEMENT. Where the borrower uses a contractor to rehabilitate the property, the Department recommends that the borrower enter into an Agreement with the contractor(s) to assure that the parties to the Agreement understand the applicable provisions of the 203(k) program. (A suggested Agreement is provided in Attachment 5). At a minimum, it is suggested that the Agreement (1) describe the work to be done by the contractor; (2) when the work will begin and when it will be completed; (3) the total amount to be paid to the contractor for doing the work; (4) provide for binding arbitration on any disputes; and (5) provide a one year warranty on all work completed by the contractor.

Where the lender will allow the borrower(s) to do their own work or act as the general contractor, the Department recommends that the lender obtains a Self-Help Agreement (Attachment 6) from the borrower(s). This will assure that the borrower understands their responsibilities during the rehabilitation of the property.

16. REVISION TO CONTINGENCY RESERVE REQUIREMENTS. Effective immediately, where the construction is not completed, the contingency reserve account can be used by the borrower to make additional improvements to the dwelling. A Request for Change, Form HUD 92577, must be submitted with the applicable cost estimates. However, the change can only be accepted when the DE lender determines: (1) It is unlikely that any deficiency that may affect the health and safety of the property will be discovered; and (2) the mortgage will not exceed 95% (Owner-Occupant) or 85% (investor) of the appraised value of the property. If the mortgage exceeds 95% or 85% of the appraised value (shown in line A3 of the 203(k) Maximum Mortgage Worksheet, Form HUD 92700), then the contingency reserve must be paid down on the mortgage principal.

If the borrower (or anyone else) provides their own funds for the contingency reserve account, then Line B2 on the 203(k) Maximum Mortgage Worksheet should show "0," because the funds are not being provided by mortgage proceeds and will not be used in the calculation of the maximum mortgage amount.

The Plan Reviewer must suggest to the DE Underwriter what the Contingency reserve amount should be. The DE Underwriter is responsible for making the final decision. For a property where only the foundation remains and basically all rehabilitation will be new construction, the DE Underwriter can waive the requirement for a contingency reserve.

17. SWEAT EQUITY. Labor to be performed by the borrower on the property being rehabilitated may be used to create additional equity in the property, but the borrower cannot receive any cash back for the labor performed. The borrower can only be reimbursed for the cost of any materials that the borrower may have purchased.

The Borrower must request reimbursement for the actual cost of any materials on the Draw Request form. The difference between the estimated cost to complete the work and the actual cost of any materials must remain in the escrow account until all work on the property is complete. After completion of all work, any excess funds remaining in the escrow account may be used for (1) cost overruns, where applicable; or (2) additional improvements to the property; or (3) prepayment of the principal on the mortgage.

(This change affects paragraph 5-2.C.2) in Handbook 4240.4 REV-2 and Mortgage Letter 92-33, item 6.)

18. REVISION TO ELIGIBLE IMPROVEMENTS. Paragraph 1-7, Handbook 4240.4 REV-2 is revised as follows:

Mortgage proceeds must be used in part for rehabilitation and/or improvements to a property. There is a minimum \$5000 requirement for the eligible improvements on the existing structure(s) on the property. Rehabilitation or improvements to a detached garage, a new detached garage, or the addition of an attached unit(s) (if allowed by the local zoning ordinances) can also be included in this first \$5,000. Properties with separate detached units are acceptable, however, a newly constructed unit must be attached to an existing unit to be eligible under 203(k).

Any repair is acceptable in the first \$5,000 requirement that may affect the health and safety of the occupants. Minor or cosmetic repairs by themselves cannot be included in the first \$5,000, but may be added after the \$5,000 threshold is reached.

Examples of eligible improvements are listed below. (This list is not all inclusive.)

- A. Structural alterations and reconstruction (e.g., repair or replacement of structural damage, chimney repair, additions to

the structure, installation of an additional bath(s), skylights, finished attics and/or basements, repair of termite damage and the treatment against termites or other insect infestation, etc.)

- B. Changes for improved functions and modernization (e.g., remodeled bathrooms and kitchens, including permanently installed appliances, i.e., built-in range and/or oven, range hood, microwave, dishwasher).
- C. Elimination of health and safety hazards (including the resolution of defective paint surfaces or lead-based paint problems on homes built prior to 1978).
- D. Changes for aesthetic appeal and elimination of obsolescence (e.g., new exterior siding, adding a second story to the home, covered porch, stair railings, attached carport).
- E. Reconditioning or replacement of plumbing (including connecting to public water and/or sewer system), heating, air conditioning and electrical systems.

Installation of new plumbing fixtures is acceptable, including interior whirlpool bathtubs.
- F. Installation of Well and/or Septic System. The well or septic system must be installed or repaired prior to beginning any other repairs to the property. A property less than 1/2 acre with a separate well or septic system is not acceptable; also, a property less than 1 acre with both a well and a septic system is unacceptable. Lots smaller than these sizes, usually have problems in the future; however, the local HUD Field Office can approve smaller lot size requirements where the local health authority can justify smaller lots.

The installation of a new well or the repair of an existing well (used for the primary water source to the property) can be allowed provided there is adequate documentation to show there is reason to believe the well will produce a sufficient amount of potable water for the occupants. (A well log of surrounding properties from the local health authority is acceptable documentation.) Refer to HUD Handbook 4910.1, Appendix K, for additional information.
- G. Roofing, gutters and downspouts.
- H. Flooring, tiling and carpeting.

- I. Energy conservation improvements (e.g., new double pane windows, steel insulated exterior doors, insulation, solar domestic hot water systems, caulking and weatherstripping, etc.).
- J. Major landscape work and site improvement, patios, decks and terraces that improve the value of the property equal to the dollar amount spent on the improvements or required to preserve the property from erosion. The

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correction of grading and drainage problems is also acceptable. Tree removal is acceptable if the tree is a safety hazard to the property. Repair of existing walks and driveway is acceptable if it may affect the safety of the property.

(Fencing, new walks and driveways, and general landscape work (i.e., trees, shrubs, seeding or sodding) cannot be in the first \$5,000 requirement.)

- K. Improvements for accessibility to the Handicapped (e.g., remodeling kitchens and baths for wheelchair access, lowering kitchen cabinets, installing wider doors and exterior ramps, etc).

When basic improvements are involved, the following costs can be included in addition to the minimum \$5,000 requirement:

- New free standing range, refrigerator, washer and dryer, trash compactor and other appurtenances (Used appliances are not eligible).
- Interior and exterior painting.
- The repair of a swimming pool, not to exceed \$1,500. Repair costs exceeding the \$1,500 limit must be paid into the contingency reserve fund by the borrower. The installation of a new swimming pool is not allowed.

Luxury items and improvements that do not become a permanent part of the real property are not eligible as a cost of rehabilitation. The items listed below (not limited to this list) are not acceptable under the 203(k) program, including the repair of any of the following:

Barbecue pit; bathhouse; dumbwaiter; exterior hot tub, sauna, spa and whirlpool bath; outdoor fireplace or hearth; photo mural;

installation of a new swimming pool; gazebo, television antenna; satellite dish; tennis court; tree surgery. Additions or alterations to provide for commercial use are not eligible.

19. ENERGY EFFICIENT MORTGAGE (EEM) PILOT PROGRAM. Effective immediately, 203(k) insured loans (for a one or two unit property) in the States of Alaska, Arkansas, California, Vermont and Virginia, are eligible for an Energy Efficient Mortgage.

Under the FHA EEM Pilot Program, a borrower can finance in the mortgage 100% of the cost of eligible energy efficient improvements, subject to certain dollar limitations, without an appraisal of the energy efficient improvements. The mortgage includes the cost of the energy efficient improvements in addition to the usual mortgage amount permitted by Regulations.

To be eligible for inclusion in the mortgage, the energy efficient improvements must be "cost effective," i.e., the total cost of the improvements (including maintenance costs) must be less than the total present value of the energy saved over the useful life of the improvements.

The detailed program requirements and processing and underwriting procedures for the EEM Pilot Program are in Mortgagee Letter 93-13, dated May 24, 1993.

If you have any questions concerning this letter, please call your local HUD Office or the Valuation and Technical Support Branch in Headquarters at (202) 708-2720.

Very sincerely yours,

Nicolas P. Retsinas
Assistant Secretary for Housing
- Federal Housing Commissioner

Attachments

203(k) SECONDARY LENDERS
(February 28, 1994)

1. Broadview Mortgage

7. Federal National Mortgage

(Ohio Lenders Only)
95 E. Wilson Bridge Road
Worthington, OH 43085

Contact: Lenny Zangardi
(614) 436-2000

Association
(FANNIE MAE)
3900 Wisconsin Avenue, NW
Washington, D.C. 20016-2899

Contact: Herb Moses
(202) 752-6011

2. Federal Savings Bank and Mortgage
2800 Cantrell Road, Suite 500
Little Rock, AR 72202

Contact: Dennis Mills
(501) 280-3500
(800) 395-6001

8. Miami Valley Bank
P.O. Box 5000
Lakeview, OH 43331-5000

Contact: Mary Ann Tomczyk
(513) 843-4000

3. Liberty Mortgage Company
473 E. Rich Street
Columbus, OH 43215

Contact: Vickie Harmon
(614) 224-4000

9. Malone Mortgage Corporation
8214 Westchester, Suite 606
Dallas, TX 75225

Contact: William McGuire
(214) 696-0386

4. MLA, Incorporated
Corporation
24315 Northwestern Highway
Southfield, MI 48075

Contact: Jack Goodman (800) 877-2130
Jim Milliken (800) 366-6522

10. Statewide Funding
P.O. Box 390
Clifton Park, NY 12065

Contact: Jane King
(518) 877-3500
(800) 755-5851

5. Tidewater First Financial Group, Inc.
4500 Holland Office Park, Suite 312
Virginia Beach, VA 23452

Contact: William F. "Toby" Harris
(804) 456-0155

11. Waters Mortgage Corporation
6190 Northwest 11th Street
Fort Lauderdale, FL 33313

Contact: John Gordon
(305) 792-5666

6. Sun West Mortgage Company, Inc.
18303 Gridley Road
Cerritos, CA 90701

Contact: Sanat Shankardass
(714) 898-8538
(800) 453-7884

12. Federal Home Loan Mortgage
Corp.
(Freddie Mac)
1410 Springhill Road
McLean, VA 22102

Contact: Alyssa Lloyd
(703) 903-2366

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4240.4 ref. Handbook

Attachment 3

Rehabilitation
Inspection Report

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