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

October 22, 1998

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

MORTGAGEE LETTER 98-29

TO: ALL APPROVED MORTGAGEES

SUBJECT: Single Family Loan Production - Mortgage Calculation Simplification

Recent legislation amended the National Housing Act to provide a revised mortgage calculation process for most purchase transactions using FHA mortgage insurance. The new formulas permit the maximum mortgage amount to be based on a fixed percentage of the property's sales price (or appraised value, if less) exclusive of closing costs.

Accordingly, the property's sales price (or appraised value, if less) exclusive of any borrower-paid closing costs will be multiplied by a percentage that is determined by both the sales price (or value, if less) *and* the average closing cost for that State. This determines the maximum mortgage amount that FHA will insure *provided* that the mortgagor makes a cash investment of at least three percent into the property, which may include closing costs.

The National Housing Act requires the minimum cash investment to be 3 percent of the Secretary's estimate of the *cost of acquisition.* FHA has determined that the minimum cash investment be based on sales price without considering closing costs to further Congressional objectives of simplifying the FHA maximum mortgage amount calculation without significantly increasing FHA's risk. Closing costs will not be included in *calculating* the 3 percent cash requirement, but may be included in *satisfying* the 3 percent requirement.

The revised mortgage amount calculation procedure applies to those *purchase money mortgages* currently subject to the two-step mortgage calculation process described in paragraph 1-6B of the mortgage credit analysis handbook (HUD Handbook 4155.1 REV-4 Chg 1) and insured under the following Sections of the Act: Section 203(b) (Home Mortgages), 203(i) (Outlying Areas), 203(n) (Cooperative Units), 203(k) (Rehabilitation Home Mortgage Insurance), 223(e) (Home Mortgages in older, declining urban areas), and 234(c) (Condominiums). It does not apply to mortgages insured under Section 203(h) (Housing for Disaster Victims), and 221 (d)(2) (Low Cost and Moderate Income) since these programs have their own loan-to-value limits. At this time, the revised mortgage amount calculation does not apply to properties under construction or less than one year old without prior FHA approval, and these remain limited to 90 percent financing. The Department plans to expand this authority to these transactions within 60 days following the issuance of regulations in the Federal Register.

Sellers may continue to provide financing concessions up to 6 percent of the sales price, with amounts exceeding six percent subtracted from the sales price (or value, if less) before applying the appropriate loan-to-value multiplier shown below. Other inducements to purchase, as described in the mortgage credit analysis handbook must also be subtracted from the sales price or value, as appropriate, in calculating the maximum mortgage amount.

While the 3 percent cash investment requirement applies to all *eligible* transactions in all States regardless of value, the legislation provides a sliding scale for mortgage calculations based on average State closing costs and values/sales prices. The maximum mortgage may not exceed the amounts described below:

Maximum Loan-to-Value Percentages

Low Closing Costs States

- **98.75 percent:** For properties with values/sales price equal to or less than $50,000.

- **97.65 percent:** For properties with values/sales prices in excess of $50,000 up to $125,000

- **97.15 percent:** For properties with values/sales prices in excess of $125,000.

High Closing Costs States

- **98.75 percent:** For properties with values/sales prices equal to or less than $50,000.

- **97.75 percent:** For properties with values/sales prices in excess of $50,000,

The effect of the legislation is to eliminate closing costs in the mortgage calculation process on nearly all purchase transactions. The $250 latitude in closing cost estimates is no longer applicable since borrowers *must* have the 3 percent minimum cash investment, and that investment cannot also consist of discount points, prepaid expenses, etc., or any portion of such charges. Attachment A to this mortgagee letter lists all States and Territories by low- and high-average closing costs. This list must be used in choosing the maximum loan-to-value percentage.

Existing credit policies remain intact for those transactions not typically eligible for the previous 97/95/90 percent financing, such as identity-of-interest transactions, purchases where there are non-occupying co-borrowers, and other situations where FHA has determined that the percentage of financing must be restricted below the statutorily permitted maximums due to the increased risk such transactions represent. In these cases, the mortgage calculation process for these transactions will remain as described in paragraph 1-8 of Handbook 4155. 1 REV-4, Chg 1. Mortgage calculation instructions on refinance transactions are not changed at this time.

The examples in Attachment B illustrate the process for calculating the maximum mortgage on purchase transactions under these revised terms and conditions. The mortgage amount calculation examples are also demonstrated on the attached spreadsheets and/or mortgage credit analysis worksheets. Excel Spreadsheets are available through:
http://www.hudclips.org/sub_nonhud/html/forms.htm
Go to the above web site and search on MORTCA

Original Text was:
`downloading through FHA's Single Family Business pace on the Internet located at http://www.hud.gov/fha/fhasf.html.`
The URL has changed and the word pace should have read page.

In addition, a new mortgage credit analysis worksheet (HUD-92900-PUR) has been created to accommodate these new procedures for purchase transactions. The new form also asks for the source of gift funds and secondary financing, captures cash reserves following closing, and modifies the loan-to-value calculation used for risk-based premium collection terms. HUD forms, including this revised analysis worksheet, can be retrieved on the Internet at ***http.//hud.gov/forms/formwrhs.html.***

These revised procedures are available to homebuyers immediately, and become mandatory for all mortgage loan applications signed on or after December 21, 1998. Unless renewed or otherwise extended by Congress, this legislation applies only to those mortgages executed for insurance on or before September 30, 2000. Questions regarding these instructions should be addressed to the FHA Homeownership Centers in Atlanta, Denver, Philadelphia, and Santa Ana, California.

Sincerely,

Ira G. Peppercorn
General Deputy Assistant
Secretary for Housing

Attachments