



An Article Of Interest...

Rehab a Home w/HUD's 203(k)

The Federal Housing Administration (FHA), which is part of the Department of Housing and Urban Development (HUD), administers various single family mortgage insurance programs. These programs operate through FHA-approved lending institutions which submit applications to have the property appraised and have the buyer's credit approved. These lenders fund the mortgage loans which the Department insures. HUD does not make direct loans to help people buy homes.

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 homeownership 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, HOPE**, 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 rehabilitation processing.

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.

If you have questions about the 203(k) program or are interested in getting a 203(k) insured mortgage loan, we suggest that you get in touch with an FHA-approved lender in your area or the Homeownership Center in your area.

Introduction

Section 101(c)(1) of the Housing and Community Development Amendments of 1978 (Public Law 95557) amends Section 203(k) of the National Housing Act (NHA). The objective of the revision is to enable HUD to promote and facilitate the restoration and preservation of the Nation's existing housing stock. The provisions of Section 203(k) are located in Chapter II of Title 24 of the Code of Federal Regulations under Section 203.50 and Sections 203.440 through

203.494. Program instructions are in HUD Handbook 4240-4. HUD Handbooks may be ordered online from The HUD Compendium or from HUDCLIPS.

203(k) - How It Is Different

Most mortgage financing plans provide only permanent financing. That is, the lender will not usually close the loan and release the mortgage proceeds unless the condition and value of the property provide adequate loan security. When rehabilitation is involved, this means that a lender typically requires the improvements to be finished before a long-term mortgage is made.

When a homebuyer wants to purchase a house in need of repair or modernization, the homebuyer usually has to obtain financing first to purchase the dwelling; additional financing to do the rehabilitation construction; and a permanent mortgage when the work is completed to pay off the interim loans with a permanent mortgage. Often the interim financing (the acquisition and construction loans) involves relatively high interest rates and short amortization periods. The Section 203(k) program was designed to address this situation. The borrower can get just one mortgage loan, at a long-term fixed (or adjustable) rate, to finance both the acquisition and the rehabilitation of the property. To provide funds for the rehabilitation, the mortgage amount is based on the projected value of the property with the work completed, taking into account the cost of the work. To minimize the risk to the mortgage lender, the mortgage loan (the maximum allowable amount) is eligible for endorsement by HUD as soon as the mortgage proceeds are disbursed and a rehabilitation escrow account is established. At this point the lender has a fully-insured mortgage loan.

Eligible Property

To be eligible, the property must be a one- to four-family dwelling that has been completed for at least one year. The number of units on the site must be acceptable according to the provisions of local zoning requirements. All newly constructed units must be attached to the existing dwelling. Cooperative units are not eligible.

Homes that have been demolished, or will be razed as part of the rehabilitation work, are eligible provided some of the existing foundation system remains in place.

In addition to typical home rehabilitation projects, this program can be used to convert a one-family dwelling to a two-, three-, or four-family dwelling. An existing multi-unit dwelling could be decreased to a one- to four-family unit.

An existing house (or modular unit) on another site can be moved onto the mortgaged property; however, release of loan proceeds for the existing structure on the non-mortgaged property is not allowed until the new foundation has been properly inspected and the dwelling has been properly placed and secured to the new foundation.

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.

Condominium Unit

The Department also permits Section 203(k) mortgages to be used for individual units in condominium projects that have been approved by FHA, the Department of Veterans Affairs, or are acceptable to FNMA under the guidelines listed below.

The 203(k) program was not intended to be a project mortgage insurance program, as large scale development has considerably more risk than individual single-family mortgage insurance. Therefore, condominium rehabilitation is subject to the following conditions:

- ▶ Owner/occupant and qualified non-profit borrowers only; no investors;
- ▶ Rehabilitation is limited only to the interior of the unit. Mortgage proceeds are not to be used for the rehabilitation of exteriors or other areas which are the responsibility of the condominium association, except for the installation of firewalls in the attic for the unit;
- ▶ Only the lesser of five units per condominium association, or 25 percent of the total number of units, can be undergoing rehabilitation at any one time;
- ▶ The maximum mortgage amount cannot exceed 100 percent of after-improved value.

After rehabilitation is complete, the individual buildings within the condominium must not contain more than four units. By law, Section 203(k) can only be used to rehabilitate units in one-to-four unit structures. However, this does not mean that the condominium project, as a whole, can only have four units or that all individual structures must be detached.

Example: A project might consist of six buildings each containing four units, for a total of 24 units in the project and, thus, be eligible for Section 203(k). Likewise, a project could contain a row of more than four attached townhouses and be eligible for Section 203(k) because HUD considers each townhouse as one structure, provided each unit is separated by a 1 1/2 hour firewall (from foundation up to the roof).

Similar to a project with a condominium unit with a mortgage insured under Section 234(c) of the National Housing Act, the condominium project must be approved by HUD prior to the closing of any individual mortgages on the condominium units.

How the Program Can Be Used

This program can be used to accomplish rehabilitation and/or improvement of an existing one-to-four unit dwelling in one of three ways:

- ▶ To purchase a dwelling and the land on which the dwelling is located and rehabilitate it.
- ▶ To purchase a dwelling on another site, move it onto a new foundation on the mortgaged property and rehabilitate it.
- ▶ To refinance existing liens secured against the subject property and rehabilitate such a dwelling.

To purchase a dwelling and the land on which the dwelling is located and rehabilitate it, and to refinance existing indebtedness and rehabilitate such a dwelling, the mortgage must be a first lien on the property and the loan proceeds (other than rehabilitation funds) must be available before the rehabilitation begins.

To purchase a dwelling on another site, move it onto a new foundation and rehabilitate it, the mortgage must be a first lien on the property; however, loan proceeds for the moving of the house cannot be made available until the unit is attached to the new foundation.

Eligible Improvements

Luxury items and improvements are not eligible as a cost rehabilitation. However, the homeowner can use the 203(k) program to finance such items as painting, room additions, decks and other items even if the home does not need any other improvements. All health, safety and energy conservation items must be addressed prior to completing general home improvements.

Required Improvements

All rehabilitation construction and/or additions financed with Section 203(k) mortgage proceeds must comply with the following:

A. Cost Effective Energy Conservation Standards

(1) Addition to existing structure. New construction must conform with local codes and HUD Minimum Property Standards in 24 CFR 200.926d.

(2) Rehabilitation of Existing Structure. To improve the thermal efficiency of the dwelling, the following are required:

a) Weatherstrip all doors and windows to reduce infiltration of air when existing weatherstripping is inadequate or nonexistent.

b) Caulk or seal all openings, cracks or joints in the building envelope to reduce air infiltration.

c) Insulate all openings in exterior walls where the cavity has been exposed as a result of the rehabilitation. Insulate ceiling areas where necessary

d) Adequately ventilate attic and crawl space areas. For additional information and requirements, refer to 24 CFR Part 39.

(3) Replacement Systems.

a) Heating, ventilating, and air conditioning system supply and return pipes and ducts must be insulated whenever they run through unconditioned spaces.

b) Heating systems, burners, and air conditioning systems must be carefully sized to be no greater than 15 percent oversized for the critical design, heating or cooling, except to satisfy the manufacturer's next closest nominal size.

B. Smoke Detectors. Each sleeping area must be provided with a minimum of one (1) approved, listed and labeled smoke detector installed adjacent to the sleeping area.

Determining Upon One or Two Appraisal Reports

The appraiser must provide an opinion of the After-Improved value of the subject property, and in some cases, may be directed by the lender to provide the As-is value.

In those cases for which both As-is and After-improved values are required, the valuation analysis may consist of either one or two separate appraisal reports.

The number of appraisals depends on the complexity, scope and lender review of the proposed rehabilitation and nature of the work.

A. As-is Value. A separate appraisal (Uniform Residential Appraisal Report) may be required to determine the as-is value. However, the lender may determine that an as-is appraisal is not feasible or necessary. In this instance, the lender may use the contract sales price on a purchase transaction, or the existing debt on a refinance transaction, as the as-is value, when this does not exceed a reasonable estimate of value.

Further, on a refinance transaction, when a large amount of existing debt (i.e., first and second mortgages) suggests that the borrower has little or no equity in the property, the lender must obtain a current as-is appraisal on which to base the estimated as-is value.

On a refinance, the borrower may have substantial equity in the property to assure that no further down payment is required on the new loan amount. In some cases, the borrower will not have an existing mortgage on the property. In this case, the lender should obtain some comparables from a real estate agent/ broker to estimate an approximate as-is value of the property.

Another way of establishing the as-is value is to obtain a copy of the local jurisdiction tax valuation on the property.

B. Value After Rehabilitation. The expected market value of the property is determined upon completion of the proposed rehabilitation and/or improvements.

For a HUD-owned property an as-is appraisal is not required and a DE lender may request the HUD Field Office to release the outstanding HUD 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, 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. For a HUD-property, down payment for an owner-occupant or non-profit organization is 3.5% of the accepted bid price of the property and 100 percent financing on all other costs.

Recently Acquired Properties

Homebuyers who purchase a property with cash 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 less any down payment and closing cost requirement for the 203(k) loan. A copy of the 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.

Architectural Exhibits

The improvements must comply with HUD's Minimum Property Standards (24 CFR 200.926d and/or HUD Handbook 4905.1) and all local codes and ordinances. The homebuyer may decide to employ an architect or a consultant to prepare the proposal. The homebuyer must provide the lender with the appropriate architectural exhibits that clearly show the scope of work to be

accomplished. The following list of exhibits are recommended, but may be modified by the local HUD Field Office as required.

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

B. 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.)

C. 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 nonstandard units.

The consultant who prepares the work write-up 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).

Definitions for Use in the 203(k) Program

A. Insurance of Advances. This refers to insurance of the 203(k) mortgage prior to the rehabilitation period. A mortgage that is a first lien on the property is eligible to be endorsed for insurance following mortgage loan closing, disbursement of the mortgage proceeds, and establishment of the Rehabilitation Escrow Account.

The mortgage amount may include funds for the purchase of the property or the refinance of existing indebtedness, the costs incidental to closing the transaction, and the completion of the proposed rehabilitation. The mortgage proceeds allocated for the rehabilitation will be escrowed at closing in a Rehabilitation Escrow Account.

B. Rehabilitation Escrow Account. When the loan is closed, the proceeds designated for the rehabilitation or improvement, including the contingency reserve, are to be placed in an interest bearing escrow account insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA). This account is not an escrow for the paying of real estate taxes, insurance premiums, delinquent notes, ground rents or assessments, and is not to be treated as such. The net income earned by the Rehabilitation Escrow Account must be paid to the mortgagor. The method of such payment is subject to agreement between mortgagor and mortgagee. The lender (or its agent) will release escrowed funds upon completion of the proposed rehabilitation in accordance with the Work Write-Up and the Draw Request (Form HUD-9746,A).

C. Inspections. Performed by HUD-approved consultants/inspectors or HUD-accepted staff of the DE lender. The consultant is to use the architectural exhibits in order to make a determination of compliance or non-compliance. When the inspection is scheduled with a payment, the inspector is to indicate whether or not the work has been completed. Also, the inspector is to use the Draw Request form (Form HUD-9746-A). The first draw must not be scheduled until the lender has determined that the applicable building permits have been issued.

D. Holdback. A ten (10) percent holdback is required on each release from the Rehabilitation Escrow Account. The total of all holdbacks may be released only after a final inspection of the rehabilitation and issuance of the Final Release Notice. The lender (or its agent) may retain the holdback for a maximum of 35 calendar days, or the time period required by law to file a lien, whichever is longer, to ensure that no liens are placed on the property.

E. Contingency Reserve. At the discretion of the HUD Field Office, the cost estimate may include a contingency reserve if the existing construction is less than 30 years old, or the nature of the work is complex or extensive. For properties older than 30 years, the cost estimate must include a contingency reserve of a minimum of ten (10) percent of the cost of rehabilitation; however, the contingency reserve may not exceed twenty (20) percent where major remodeling is contemplated. If the utilities were not turned on for inspection, a minimum fifteen (15) percent is required. If the scope of work is well defined and uncomplicated, and the rehabilitation cost is less than \$7500, the lender may waive the requirement for a contingency reserve.

The contingency reserve account can be used by the borrower to make additional improvements to the dwelling. A Request for Change Letter must be submitted with the applicable cost estimates. However, the change can only be accepted when the 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 the appraised value of the property less the statutory investment requirement. If the mortgage exceeds the appraised value less the statutory investment, then the contingency reserve must be paid down on the mortgage principal. If a borrower feels that the contingency reserve will not be used and he wishes to avoid having the reserve applied to reduce the mortgage balance after issuance of the Final Release Notice, the borrower may place his own funds into the contingency reserve account. In this case, if monies are remaining in the account after the Final Release Notice is issued, the monies may be released back to the borrower.

If the mortgage is at the maximum mortgage limit for the area or for the particular type of transaction, but a contingency reserve is necessary, the contingency reserve must be placed into an escrow account from other funds of the borrower at closing. Under these circumstances, if the contingency reserve is not used, the remaining funds in the escrow account will be released to the borrower after the Final Release Notice has been issued.

F. Mortgage Payment Reserve. Funds not to exceed the amount of six (6) mortgage payments (including the mortgage insurance premium) can be included in the cost of rehabilitation to assist a mortgagor when the property is not habitable during rehabilitation. The number of mortgage payments cannot exceed the completion time frame required in the Rehabilitation Loan Agreement. The lender must make the monthly mortgage payments directly from the interest bearing reserve account. Monies remaining in the reserve account after the Final Release Notice must be applied to the mortgage principal.

G. Approval of Non-Profit Agencies. A non-profit agency, before it can be approved as an eligible mortgagor and obtain the same mortgage amount as available to owner-occupants on Section 203(k) mortgages, must demonstrate its experience as a housing provider to HUD and meet all other requirements described in HUD Handbook 4155.1

REV-4, paragraphs 1-5. It must also be able to provide satisfactory evidence that it has the financial capacity to purchase the properties.

Maximum Mortgage Amount

The mortgage amount, when added to any other existing indebtedness against the property, cannot exceed the applicable loan-to-value ratio and maximum dollar amount limitations prescribed for similar properties under Section 203(b). The down payment requirements are the same as under the Section 203(b) program. The Mortgage Payment Reserve is considered a part of the cost of rehabilitation for determining the maximum mortgage amount. Also refer to the [requirements for incentives](#) to acquire HUD-owned properties.

The form [HUD-92700](#) (Maximum Mortgage Worksheet) must be used to determine the maximum mortgage amount.

A. Maximum Mortgage Calculation

REFINANCE:

Based on the lesser of:

- 1) The existing debt on the property before rehabilitation, plus the estimated cost of rehabilitation and allowable closing costs or
- 2) The lesser of the As-Is value plus rehabilitation costs or 110 percent of the After-Improved value multiplied by the appropriate LTV factor.

NOTE: If the property was owned less than one year, the acquisition cost plus the documented rehabilitation costs must be used.

PURCHASE:

The maximum mortgage amount is based on the lesser of 1) or 2) of the below multiplied by the appropriate LTV factor.

- 1) The As-is value or the purchase price of the property before rehabilitation, whichever is less, plus the estimated cost of rehabilitation or
- 2) 110 percent of the After-Improved value of the property.

Principal Residence (Owner-Occupant) & HUD Approved Non-Profit Organization.

For purchases with 203(k) financing: the maximum mortgage amount is to be based upon the HUD estimate of value in 1) or 2) above, less the statutory investment requirement. For refinances under the 203(k) program: the maximum mortgage amount is to be based upon 97/95/90 percent of the HUD estimate of value in 1) or 2) above.

B. Cost of Rehabilitation. Expenses eligible to be included in the cost of rehabilitation are materials, labor, contingency reserve, overhead and construction profit, up to six (6) months of mortgage payments, plus expenses related to the rehabilitation such as permits, fees, inspection fees by a qualified home inspector, licenses and consultant and/or architectural/engineering fees. The cost of rehabilitation may also include the supplemental origination fee which the mortgagor is permitted to pay when the mortgage

involves insurance of advances, and the discounts which the mortgagor will pay on that portion of the mortgage proceeds allocated to the rehabilitation.

C. Exemption of the Market Value Limitation. The 203(k) regulations allow for a waiver request of the market value limitation, which allows the appraiser to go outside the targeted area to obtain the value of comparable properties. Such requests must be forwarded to the Assistant Secretary of Housing-Federal Housing Commissioner at the HUD Headquarters.

Requests must include documentation that the following conditions are present:

- 1) The property is located within an area which is subject to a community sponsored program of concentrated redevelopment or revitalization (See 24 CFR Part 220).
- 2) The market value loan limitation prevents the use of the program to accomplish rehabilitation in the subject area.
- 3) The interests of the borrower and the Secretary of HUD are adequately protected.

D. Solar Energy Increase. The mortgage is eligible for an increase of up to 20 percent in the maximum insurable mortgage amount if such an increase is necessary for the installation of solar energy equipment.

The solar energy system's contribution to value will be limited by its replacement cost or by its effect on the value of the dwelling.

E. Energy Efficient Mortgage Program. Under the FHA EEM Program, a borrower can finance into the mortgage 100 percent of the cost of eligible energy efficient improvements, subject to certain dollar limitations, without an appraisal of the energy improvements and without further credit qualification of the borrower. To be eligible for inclusion into 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 cost of any improvement to the property that will increase the property's energy efficiency and that is determined to be "cost effective" is eligible for financing into the mortgage and its cost may be added to the mortgage amount up to the greater of:

- 1) 5 percent of the property's value (not to exceed \$8000) or,
- 2) \$4000.

"Cost effective" means that the total cost of the improvements, including any maintenance costs, is less than the total present value of the energy saved over the useful life of the energy improvement. The FHA maximum loan limit for the area may be exceeded by the cost of the energy efficient improvements. However, the entire mortgage cannot exceed 110 percent of the value of the property

The cost of the energy improvements and the estimate of the energy savings must be determined based upon a physical inspection of the property by a home energy rating system (HERS) or energy consultant. For a 203(k) loan, the entire cost of the HERS or the energy consultant can be included in the mortgage.

On new construction (an addition or new building on an existing foundation), the energy improvement must be over and above those required for compliance with the current FHA energy conservation standards for new construction. The estimate of the energy savings in new construction must be based upon a comparison of plans and specification of the house with the additional energy saving improvements to those of the basic house which complies with the current FHA energy conservation standards. Presently, these standards are those of the 1992 CABO Model Energy Code (MEC).

The energy inspection of the property must be performed prior to completion of the work writeup and cost estimate to assure there is no duplication of work items in the mortgage. After the completion of the appraisal, the cost of the energy improvements are calculated by the lender to determine how much can be added to the mortgage amount.

Seven Unit Limitation

HUD regulations and policies state that a real estate owner/entity should not be allowed to rapidly accumulate FHA insured properties that clearly and collectively constitute a multifamily project. In general, a borrower may not have an interest in more than seven rental units (FHA, VA, conventional or owned free and clear of any mortgage) in the same subdivision or contiguous area. For 203(k) purposes, HUD defines a contiguous area as within a two block radius.

The seven unit limitation does not apply 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. A restriction may still be imposed (by HUD) within a redevelopment area (or sub-area) in order to prevent undesirable concentrations of units under a single (or group) ownership. HUD will determine that the seven unit limit is inapplicable only if: (1) the real estate owner/entity 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 real estate owner/entity has no more than eight units on adjacent lots.

Interest Rate and Discount Points

These are not regulated and are negotiable between the borrower and the lender. The amortization of the loan will be for 30 years; however, provisions of the Section 203(k) mortgage (described in Section 203.21 of the Regulations) are the same as prescribed under Section 203(b).

Discount Points on Repair Costs and Fees

Discount points the borrower pays on the rehabilitation portion of the mortgage proceeds are allowable rehabilitation costs.

Maximum Charges and Fees

The statutory requirements and administrative policies of Section 203(k) result in deviations from the maximum amount of charges and fees permitted under Section 203(b).

A. Supplemental Origination Fee. When the Section 203(k) mortgage involves insurance of advances, the lender may collect from the mortgagor a supplemental origination fee. This fee is calculated as one and one-half percent (1-1/2%) of the portion of the mortgage allocated to the rehabilitation or \$350, whichever is greater. This

supplemental origination fee is collected in addition to the one percent origination fee on the total mortgage amount.

B. Independent Consultant Fee. A borrower can have an independent consultant prepare the required architectural exhibits. A borrower can also 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, HUD does not warrant the competence of the consultant or the quality of the work the consultant may perform for the borrower. 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. The fee charged by the consultant can be included in the mortgage. 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 between \$30,001 and \$50,000; \$800 for repairs between \$50,001 and \$75,000; \$900 for repairs between \$75,001 and \$100,000; and \$1,000 for repairs over \$100,000. An additional fee of \$25 can be charged for each additional unit in the property under the same FHA case number. 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. The architect and engineer fees must be customary and reasonable for the type of project.)

C. Fee Consultant. Prior to the appraisal, a HUD-accepted fee consultant must visit the site to ensure compliance with program requirements. The utilities must be on for this site review to take place. The fee is as follows and may not be changed without HUD Headquarters approval:

1) Initial review prior to appraisal:

Cost of Repairs/Fee: <\$15,000=\$100.00, >\$15,001 but less than or equal to <\$30,000=\$150.00, >\$30,001=\$200.00

2) Additional unit review (two to four units with same case number)-\$50.00/unit.

3) Additional review (reinspection of the same unit)-\$50.00. When travel distance exceeds 30 miles round trip from the reviewer's place of business, a mileage charge (established by HUD Field Office) may be applied to the above charges, including toll road and other charges where applicable.

D. Appraisal Fee. The lender may charge a borrower no more than the actual amount the lender pays the appraiser, whether the appraiser is on the lender's staff, or external to the organization. The lender may include the appraisal fee in the closing costs.

E. Inspection Fee (during the rehabilitation construction period). Established by the local HUD Field Office.

(1) Fees for a maximum of five draw inspections will be allowed for inclusion in the cost of rehabilitation. If all inspections are not required, remaining funds will be applied to the principal after the Final Release Notice is issued.

(2) If additional inspections are required by the lender to ensure satisfactory compliance with exhibits, the borrower or contractor will be responsible for payment; however, the lender has ultimate responsibility.

F. Title Update Fee. To protect the validity of the mortgage position from mechanic's liens on the property, reasonable fees charged by a title company may be included as an allowable cost of rehabilitation. When the mortgage position is protected and is not in jeopardy, this fee may not apply. Borrowers may wish to obtain lien protection, but the fees must be paid by the borrower where such lien protection is not required to ensure the validity of the security instrument. The allowable fee should not exceed \$50.00 per draw release. If all draw inspections are not made, monies left in escrow must be applied to reduce the mortgage balance.

Application Process

This describes a typical step-by-step application/mortgage origination process for a transaction involving the purchase and rehabilitation of a property. It explains the role of HUD, the mortgage lender, the contractor, the borrower, consultant, the plan reviewer, appraiser and the inspector.

A. Homebuyer Locates the Property.

B. Preliminary Feasibility Analysis. After the property is located, the homebuyer and their real estate professional should make a marketability analysis prior to signing the sales contract. The following should be determined:

- 1) The extent of the rehabilitation work required;
- 2) Rough cost estimate of the work; and
- 3) The expected market value of the property after completion of the work. Note: The borrower does not want to spend money for appraisals and repair specifications (plans), then discover that the value of the property will be less than the purchase price (or existing indebtedness), plus the cost of improvements.

C. Sales Contract is Executed. A provision should be included in the sales contract that the buyer has applied for Section 203(k) financing, and that the contract is contingent upon loan approval and buyer's acceptance of additional required improvements as determined by HUD or the lender.

D. Homebuyer Selects Mortgage Lender. Call HUD Field Office for a list of lenders.

E. Homebuyer Prepares Work Write-up and Cost Estimate. A consultant can help the buyer prepare the exhibits to speed up the loan process.

F. Lender Requests HUD Case Number. Upon acceptance of the architectural exhibits, the lender requests the assignment of a HUD case number, the plan reviewer, appraiser, and the inspector.

G. Fee Consultant Visits Property. The homebuyer and contractor (where applicable) meet with the fee consultant to ensure that the architectural exhibits are acceptable and that all program requirements have been properly shown on the exhibits.

H. Appraiser Performs the Appraisal.

I. Lender Reviews the Application The appraisal is reviewed to determine the maximum insurable mortgage amount for the property

J. Issuance of Conditional Commitment/Statement of Appraised Value. This is issued by the lender and establishes the maximum insurable mortgage amount for the property.

K. Lender Prepares Firm Commitment Application. The borrower provides information for the lender to request a credit report, verifications of employment and deposits, and any other source documents needed to establish the ability of the borrower to repay the mortgage.

L. Lender Issues Firm Commitment. If the application is found acceptable, the firm commitment is issued to the borrower. It states the maximum mortgage amount that HUD will insure for the borrower and the property.

M. Mortgage Loan Closing. After issuance of the firm commitment, the lender prepares for the closing of the mortgage. This includes the preparation of the Rehabilitation Loan Agreement. The Agreement is executed by the borrower and the lender in order to establish the conditions under which the lender will release funds from the Rehabilitation Escrow Account. Following closing, the borrower is required to begin making mortgage payments on the entire principal amount for the mortgage, including the amount in the Rehabilitation Escrow Account that has not yet been disbursed.

N. Mortgage Insurance Endorsement. Following loan closing, the lender submits copies of the mortgage documents to the HUD office for mortgage insurance endorsement. HUD reviews the submission and, if found acceptable, issues a Mortgage Insurance Certificate to the lender.

O. Rehabilitation Construction Begins. At loan closing, the mortgage proceeds will be disbursed to pay off the seller of the existing property and the Rehabilitation Escrow Account will be established. Construction may begin. The homeowner has up to six (6) months to complete the work depending on the extent of work to be completed. (Lenders may require less than six months.)

P. Releases from Rehabilitation Escrow Account. As construction progresses, funds are released after the work is inspected by a HUD-approved inspector. A maximum of four draw inspections plus a final inspection are allowed. The inspector reviews the Draw Request (form HUD-9746-A) that is prepared by the borrower and contractor. If the cost of rehabilitation exceeds \$10,000, additional draw inspections are authorized provided the lender and borrower agree in writing and the number of draw inspections is shown on form HUD-92700, 203(k) Maximum Mortgage Worksheet.

Q. Completion of Work/Final Inspection. When all work is complete according to the approved architectural exhibits and change orders, the borrower provides a letter indicating that all work is satisfactorily complete and ready for final inspection. If the HUD-approved inspector agrees, the final draw may be released, minus the required 10 percent holdback. If there is unused contingency funds or mortgage payment reserves in the Account, the lender must apply the funds to prepay the mortgage principal.

This article was provided by the Department of Housing & Urban Development (HUD), and is available online at: <http://www.hud.gov/offices/hsg/sfh/203k/203kabou.cfm>