Fairway Independent Mortgage Corporation

Navigating the New FHA Origination Handbook

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INTRODUCTION

- FHA Created 81 Years Ago
  - Provides homeownership opportunities
  - Over 40 million single-family home loans insured
  - Provides 100% insurance policy on the unpaid principal balance

- 100% Insurance Coverage Brings Lender Accountability
  - FHA is extremely rules-based
  - Requires strict compliance with FHA requirements

- Strict Compliance Requirements Extend to Origination
  - Today we will drill down on the new Origination Handbook
  - Single Family Housing Policy Handbook 4000.1

NEW ORIGINATION HANDBOOK

- On September 30, 2014, HUD issued the final origination section of its Single Family Housing Policy Handbook 4000.1.

- These new sections of the Handbook govern the origination, underwriting, closing, post-closing and endorsement of FHA-insured loans
  - Effective September 14, 2015

- Time is of the Essence

OBJECTIVES FOR TODAY'S WEBINAR

1. Provide a brief overview of how HUD will implement the new Origination Handbook sections

2. Describe many of the most significant origination and underwriting changes contained in the new Origination Handbook

3. Emphasize the importance of Quality Control and the continued risk of enforcement for non-compliance with FHA origination requirements

BACKGROUND – HOW DID WE GET HERE?

- New Origination Handbook sections are part of HUD's larger effort to streamline and consolidate all FHA guidelines
- HUD's goal is to provide clear and concise expectations through a single-source document
- Over the last year, HUD has issued several sections in draft and then final form, including: Quality Control, Doing Business with FHA, Servicing, Other Participants, and origination guidelines regarding appraisals and 203(k) loans.
- Recently issued the claims section in draft form for review and comment.
- Sections governing HECMs and Title I loans have not yet been released in draft.

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EFFECTIVE DATES AND VERSION HISTORY

- **Effective for FHA Case Numbers assigned on or after September 14th**

- Current policies and requirements will remain in effect until then

- HUD will continue to issue Mortgagee Letters to announce changes to FHA policy, which will result in corresponding updates to the new Handbook

- In March of 2015, HUD issued an updated version of the origination section, along with a list of Handbooks, Mortgagee Letters and Housing Notices that will be superseded in whole or in part by the new Origination section of 4000.1

EFFECTIVE DATES AND VERSION HISTORY

- In May, HUD and AllRegs launched an online version of Handbook 4000.1. AllRegs will maintain version update control.

  - New Single-Family Housing Policy Handbook website: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/handbook_4000-1

  - PDF Version can be found on HUDCLIPS: http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/handbooks/hsgh
    - Will be removed on September 11, 2015

EFFECTIVE DATES AND VERSION HISTORY

- In June, HUD issued a **preview** of Frequently Asked Questions and answers related to the new Handbook 4000.1 sections
  - FAQ Preview website: http://portal.hud.gov/hudportal/documents/huddoc?id=SFH_FAQ_Preview.pdf
  - FAQs will be posted in the FHA Resource Center once the new Handbook sections become effective
  - Until then, FAQs regarding existing guidelines can be found in the FHA Resource Center

WHOLE NEW BALLGAME

- The new handbook significantly revises the current underwriting requirements
- It is organized differently and consolidates relevant information by topic
- Given the significant changes, lenders should read the new handbook carefully from beginning to end
  - Differences in wording change the substantive requirements
  - HUD is not going to publish a list of items that have changed

ORIGINATION AND PROCESSING

- Origination and processing requirements under the new Handbook include:
  - Loan applications
  - Disclosures
  - Eligibility requirements

- While many of the requirements consolidated in this section have not changed, note:
  - Differences in wording change certain substantive requirements
  - Addition of brand-new requirements

LOAN APPLICATION & DISCLOSURES

- **Handling of Documents**
  - Current guidelines prohibit use of documents transmitted from or through equipment of interested third parties
  - New guidelines prohibit use of documents transmitted from or through equipment of interested parties or *unknown parties*
- **Loan Application Signatures**
  - Current guidelines require borrower signature on *either* initial or final loan application
  - New guidelines require borrower signature on *both* initial and final loan application

LOAN APPLICATION & DISCLOSURES

- **Electronic Signatures**
  - Current guidelines contain requirements related to electronic signatures on third-party documents
  - New guidelines contain requirements related to electronic signatures on *all* documents where signature is required
    - Establish Electronic Signature Performance Standards
      - Lender's technology must comply with E-Sign
      - Intent to sign
      - Authentication
      - Attribution
    - Use industry-standard encryption
    - Electronic "audit trail" reflecting changes to documents

LOAN APPLICATION AND DISCLOSURES

- **Verification Information**
  - Current guidelines state that lender *may* obtain the borrower's authorization to verify information needed to process the loan application
  - New guidelines *require* the lender to obtain the borrower's (and non-borrowing spouse, where applicable) authorization to verify the information needed to process the loan application
    - Authorization may be accomplished through a blanket authorization form
- **Disclosures**
  - Current guidelines contain requirements for HUD-required disclosures throughout Handbooks and Mortgagee Letters
  - New guidelines organize all HUD-required disclosures into a single list

ELIGIBILITY REQUIREMENTS

- **Delinquent Federal Debt**
  - Presence of delinquent federal debt still makes borrower ineligible for FHA loan
  - Lender still required to check CAIVRS
  - New guidelines introduce verification requirement
    - If delinquent federal debt reflected in a public record or through CAIVRS, the lender must verify the validity and delinquency status of the debt by contacting the creditor agency to whom the debt is owed
    - Lender prohibited from denying a loan solely on the basis of CAIVRS information that has not been verified by the lender

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ELIGIBILITY REQUIREMENTS

- **Excluded Parties**
  - Presence of a party to the transaction on HUD's LDP list or in SAM continues to make loan ineligible for FHA insurance
  - New guidelines expand explicit list of persons that must be checked against the LDP list and SAM Loan officer
    - Processor
    - Underwriter
    - Appraiser
    - 203(k) consultant

ELIGIBILITY REQUIREMENTS

- **Occupancy Types**
  - Guidelines continue to restrict FHA insurance to only one property as a principal residence for any borrower
  - Eligibility requirements for relocation exception have changed
    - Current guidelines permit a borrower relocating for employment reasons to be eligible for another FHA loan, as long as borrower establishes a new principal residence more than a *reasonable commuting distance* from the current principal residence
    - New guidelines change this to *more than 100 miles* from current principal residence

ELIGIBILITY REQUIREMENTS

- **Property Eligibility**
  - Guidelines continue to dictate a required flood insurance amount
  - Current guidelines are worded to require an amount equal to X
  - New guidelines make this amount a minimum standard (require an amount *at least* equal to X)
  - New guidelines also change calculation – an amount at least equal to the lesser of either:
    - The outstanding balance of the mortgage, less estimated land costs; or
    - The maximum amount of the NFIP insurance available with response to the property improvements

ALLOWABLE MORTGAGE PARAMETERS

- The second section of the new handbook covers allowable mortgage parameters, including:
  - Maximum mortgage amounts
  - Loan-to-Value limits
  - Minimum required investment
  - Mortgage insurance premiums
- While many of the requirements consolidated in this section have not changed, it is worth noting one instance of new terminology

CALCULATION OF MAXIMUM MORTGAGE

- Current guidelines require calculation of maximum mortgage amount on purchase loans by multiplying the appropriate loan-to-value factor by the lesser of the property's sales price, subject to certain required adjustments, or appraised value.
- New guidelines reflect new terminology
  - The maximum mortgage amount is calculated as a percentage of the Adjusted Value
  - The Adjusted Value is the lesser of:
    - Purchase price less any inducements to purchase, or
    - The Property Value

INCREASED UNDERWRITER ACCOUNTABILITY

- Experience is no longer enough
- Identify and internalize the countless changes
  - Most provide additional clarity and remove discretion
  - Some changes reflect outright reversals of policy
    - Ensure software systems capture all changes
    - Ensure Quality Control Plans incorporate all changes
    - Assume enforcement will be aggressive
- Some of the most significant changes involve
  1. Age of documentation
  2. Credit analysis
  3. Liabilities and projected obligations
  4. Employment documentation
  5. Income documentation
  6. Earnest money and cash to close

AGE OF DOCUMENTATION

Current Rule	New Rule Effective 9/14/15
At loan closing, all documents must meet the following time limits: • 180 Days for New Construction • 120 Days for Existing Construction	Documents used in origination and underwriting may not be more than **120 days old at disbursement date** • Clock starts to run on the day after the effective or issue date of the document, whichever is later • Disbursement date is the date on which the mortgage proceeds are made available to the borrower • New Construction documents will no longer enjoy a longer age limit • Policy change

CREDIT ANALYSIS

What constitutes satisfactory credit?

Current Rule	New Rule Effective 9/14/15

• Borrower has an acceptable credit history if
  • no late housing or installment debt
  and
  • no major derogatory credit on revolving accounts
• No definition of major derogatory credit, except to state that major indications of derogatory credit include judgments, collections, and other recent credit problems
	• Lender may approve borrower if
	  • "acceptable payment history"
	  and
	  • no "major derogatory credit" on revolving accounts in last 12 months
	• "Acceptable payment history" means:
	  • borrower made all housing and installment debt payments on time for previous 12 months, and
	  • no more than two 30-day late mortgage or installment payments in last 24 months
	• "Major derogatory credit" means:
	  • payments made more than 90 days after due date, or
	  • 3 or more payments made more than 60 days after the due date

CREDIT ANALYSIS, CONT.

What constitutes satisfactory credit?

Current Rule	New Rule Effective 9/14/15
Significant underwriter discretion paved the way for Monday morning quarterbacking by HUD	Underwriter may approve a borrower who does not meet satisfactory credit history only if: • Document analysis of delinquent accounts and determination that late payments were not based on disregard for financial obligations or inability to manage debt and • Document that delinquent accounts were related to extenuating circumstances

CREDIT ANALYSIS, CONT.

When is a non-traditional mortgage credit report required?

Current Rule	New Rule Effective 9/14/15

Lender must obtain an NTMCR whenever it uses alternative credit to qualify a borrower, unless an NTMCR is not available	An NTMCR is not required before developing alternative credit
	
	For borrowers without a credit score, either:
	
	• obtain an NTMCR, <u>or</u>
	
	• develop a credit history using alternative references subject to documentation and verification guidelines, including:
	
	  • review of public records to verify provider's existence,
	  • verification of credit information using published addresses and telephone numbers, and
	  • retention of most recent 12 months of cancelled checks or equivalent proof of payment

LIABILITIES AND PROJECTED OBLIGATIONS

When do you have to include recurring debts?

Current Rule	New Rule Effective 9/14/15
• Revolving or open-ended accounts are counted regardless of balances, even if they are likely to be paid off within 10 months. • Installment debts with fewer than 10 months remaining may be excluded from ratio calculations if the debts will not negatively affect borrower's ability to make mortgage payments during the early months after closing, especially if the borrower will have limited or no cash assets after closing.	Closed-end debts with 10 or fewer payments remaining may be excluded from ratio calculations only if (1) cumulative payments on all such debts are less than or equal to 5% of gross monthly income, and (2) the borrower has not paid the debts down to achieve this percentage. If the borrower is an authorized user on such an account, the payments must be included unless 3 or more payments have been required in the past 12 months and the primary holder of the account has made all payments due for the last 12 months.

LIABILITIES AND PROJECTED OBLIGATIONS, CONT.

When do you have to include deferred loans?

Current Rule	New Rule Effective 9/14/15

• Loans deferred for more than a year are not included in the ratios.
 	
• Debt payments scheduled to begin within 12 months of loan closing must be included as anticipated monthly obligations.
 	
• Debt payments deferred to a period outside the 12-month timeframe may be excluded if the lender receives written evidence of the deferral.
	• All deferred obligations, regardless of when they will commence, must be included in the qualifying ratios.
	
	• The lender must obtain evidence of:
	  • the deferral;
	  • the outstanding balance;
	  • the terms of liability; and
	  • the anticipated monthly payment.
	
	• The lender must use
	  • the actual monthly payment, or
	  • if the actual payment is unknown
	    • the terms of the debt or 5% of the outstanding balance, but
	    • if it is a student loan, then 2% of the outstanding balance.

LIABILITIES AND PROJECTED OBLIGATIONS, CONT.

How do you handle collections and charge offs?

Current Rule	New Rule Effective 9/14/15

Collections are a major indication of derogatory credit and require sufficient written explanation that makes sense and is consistent with other credit information in the file.
 	
Charge offs and medical collections are expressly excluded from the general guidance concerning collection accounts and judgments and do not require resolution.
	Each collection requires a written explanation from the borrower that is supported by documentation.
	
	Whole section dedicated to charge offs
	
	• Defined as loans or debts written off by the creditor.
	
	• The lender must:
	  • determine why they exist;
	  • document reasons for approving the loan; and
	  • obtain a letter of explanation from the borrower and supporting documentation.
	
	Medical collections are excluded from the definition of debt altogether.

LIABILITIES AND PROJECTED OBLIGATIONS, CONT.

How do you handle alimony and child support?

Current Rule	New Rule Effective 9/14/15

Alimony and/or child support may be treated as a reduction from gross income <u>or</u> as a monthly obligation.	• Alimony and/or child support still may be treated either as a reduction from gross income <u>or</u> as a monthly obligation.
	• Obtain:
	  • Official signed divorce decree, separation agreement, maintenance agreement, or other legal document to verify the obligation, and
	  • Pay stubs covering at least 28 <u>consecutive</u> days to verify whether the borrower is subject to any order of garnishment.
	• Calculate the monthly obligation from the greater of:
	  • the amount shown on the most recent decree or agreement establishing the obligation, or
	  • the monthly amount of the garnishment.

LIABILITIES AND PROJECTED OBLIGATIONS, CONT.

How do you treat revolving accounts?	
Current Rule	**New Rule Effective 9/14/15**
Revolving accounts are described as credit arrangements where there is an outstanding balance but no specific minimum monthly payment. Lenders must calculate the monthly payment at: • the greater of 5% of the balance or $10 or • the actual monthly payment if it is documented from the creditor or the lender obtains a current statement showing it	Revolving Account • A credit arrangement that requires periodic payments but does not require full repayment by a specified point in time. • The lender must use the payment shown on the credit report if available. If the credit report does not show it, the lender must use the current account statement or 5% of the outstanding balance. 30-Day Account • A credit arrangement requiring the borrower to pay the outstanding balance every month. • Not included in the borrower's ratios if the lender verifies the borrower paid the balance in full every month for the past 12 months. • If there were any late payments in the last 12 months, the lender must include 5% of the balance in the ratios. • The lender must document sufficient funds are available to pay off the balance and close the loan.

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EMPLOYMENT DOCUMENTATION

Basic changes to general employment requirements.

	Current Rule	New Rule Effective 9/14/15
Alternative Employment Documentation	VOE + pay stubs covering most recent 30-day period	VOE + most recent pay stubs covering 30 consecutive days. If borrower is paid weekly or bi-weekly, then obtain pay stubs covering 28 consecutive days and showing YTD.
Reverification of Employment	No requirement to reverify employment after closing, unless part of a Quality Control review.	The lender must reverify the borrower's employment – verbally or electronically - within 10 days prior to the date of the Note.
Gaps in Employment	The borrower must explain any gaps in employment of 1 month or more.	The borrower must explain any gaps in employment of 6 months or more.
Part-Time Employment	The underwriter has discretion to include part-time income that has been received for less than two years if the underwriter justifies and documents that the income is likely to continue.	Two years of uninterrupted part-time income is required. • Average the income over the prior 2 years, or • Use a 12-month average of hours at the current pay rate if the lender documents an increase in pay rate.

EMPLOYMENT DOCUMENTATION, CONT.

How do you handle frequent changes in employment?

Current Rule	New Rule Effective 9/14/15
• There is no minimum required length of employment. • If a borrower changes jobs frequently, the lender should consider the borrower favorably if the borrower continues to advance in income or benefits. • Income stability takes precedence over job stability.	If the borrower has changed jobs more than 3 times in the prior 12 months, or has changed lines of work, the lender must obtain: • transcripts of training and education demonstrating qualification for the new position, or • employment documentation evidencing continual increases in income and/or benefits. • If employment has not yet begun, it may be included upon written verification from employer that it is guaranteed to be received within 60 days of closing

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EMPLOYMENT DOCUMENTATION, CONT.

How do you handle declining income of self-employed borrowers?

Current Rule	New Rule Effective 9/14/15

• Establish borrower's earnings trend from the prior two years using tax returns.
  • Stable or increasing annual earnings are acceptable.
  • Significant declines in income are not acceptable, even if current income and ratios meet FHA guidelines.
• If the borrower's earnings trend for the previous two years is downward and the most recent tax return or P&L is less than the prior year's tax return, the borrower's most recent year's tax return or P&L must be used to calculate income.
	• Income from a business with stable or increasing earnings is acceptable.
	• Income from a business with a greater than 20% decline in income over the analysis period is not acceptable.
	  • If using an AUS, the lender must downgrade to manual underwriting.
	• If there has been a 20% or greater decline, the income is still deemed stable if:
	  • the reduction was the result of documented extenuating circumstances,
	  • the income has been stable or increasing for at least 12 months, and
	  • the borrower qualifies using the reduced income.

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INCOME DOCUMENTATION

How do you calculate different types of income?	
Current Rule	**New Rule Effective 9/14/15**

In general, no specific calculation requirements.
 	
• Guidelines pertaining to some types of income, such as bonus and overtime income.
 	
• Methods of calculation generally left up to the underwriter.
	The new handbook removes underwriter discretion and dictates how to calculate different types of income. For example:
	
	• <u>Salaried Employees</u> – Use the current salary if consistently earned.
	
	• <u>Hourly Employees</u>
	    • If the hours do not vary, use the hourly rate.
	    • If the hours vary, use a two-year average.
	    • If the hours vary and there is a documented increase in pay rate, use a 12-month average of hours at the current pay rate.

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INCOME DOCUMENTATION, CONT.

How do you calculate overtime and bonus income?

Current Rule	New Rule Effective 9/14/15

• General Rule – Overtime or bonus income must have been received for the past 2 years.
 	
• Exception – *Periods of less than 2 years may be acceptable* if the lender can justify and document in writing why its use is acceptable.
 	
• How to calculate the income
  • Average over 2 years.
  • Average over more than 2 years if the income varies significantly from year to year.
	• General Rule - Overtime or bonus income must have been received for the past 2 years.
	
	• Exception – *Periods between 1 and 2 years may be acceptable* if consistently earned for at least 1 year and likely to continue.
	
	• How to calculate the income
	  • Average over 2 years.
	  • If the income from the current year decreases by 20% or more from the prior year, use the current year's income.

INCOME DOCUMENTATION CONT.

How do you define and calculate commission income?

Current Rule	New Rule Effective 9/14/15

• Definition = Receives over 25% of annual income from commissions.
• General Rule = Earned for at least 2 years
• Exceptions to 2 year requirement
  • If earned for more than 1 year but less than 2 years, the underwriter must document it is likely to continue and rationalize its use.
  • If earned less than 1 year, it qualifies if:
    • Pay was changed from salary to commission within a similar position with same employer, or
    • the borrower would qualify when income not attributed to commissions would be sufficient.
• Documentation
  • 2 years of tax returns, and
  • Most recent pay stub
• Calculation = Average over prior two years.
  • If income has decreased over the past two years, significant compensating factors are required for approval.
	• Definition = Paid contingent on conducting a business transaction or performing a service.
	• General Rule = Earned for at least 1 year in the same or a similar line of work and likely to continue.
	• Documentation
	  • If commission income constitutes 25% or less of the borrower's total income, traditional or alternative documentation is required.
	  • If commission income exceeds 25% of the borrower's total income, the lender must obtain 2 years of tax returns and schedules.
	• Calculation = Subtract unreimbursed business expenses from the lesser of:
	  • the average net commission earned over the past 2 years, or however long it's been earned if less than that; and
	  • the average income earned over the prior 1 year.

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INCOME DOCUMENTATION CONT.

How do you handle alimony and child support?

Current Rule	New Rule Effective 9/14/15

For manual loans, income is effective if:
 	
1. Payments will likely be received for 3 years
2. Borrower provides a copy of the:
  a. Final divorce decree,
  b. Legal separation agreement,
  c. Court order, or
  d. Voluntary payment agreement
3. Evidence payments have been received during the last 12 months, such as:
  a. Cancelled checks,
  b. Deposit slips,
  c. Tax returns, or
  d. Court records
4. Payments for less than 12 months may be acceptable if the lender documents the borrower's ability and willingness to make timely payments.
 	
For AUS loans, income is effective if:
 	
1. Bank statements or cancelled checks for the most recent 3 months support the amount, and
2. The income will continue for at least 3 years.
	For both manual and AUS loans, income is effective if:
	
	1. Payments will likely be received for 3 years
	2. Borrower provides a copy of a fully executed:
	  a. Final divorce decree,
	  b. Legal separation agreement,
	  c. Court order, or
	  d. Voluntary payment agreement
	3. If using a final divorce decree, legal separation agreement, or court order, the lender:
	  a. obtains evidence payments have been received for the most recent 3 months using bank statements, canceled checks, or documentation from the child support agency, &
	  b. may use current payment to calculate income
	4. If using a voluntary payment agreement, the lender:
	  a. obtains 12 months canceled checks, deposit slips, or tax returns,
	  b. if there is evidence of receipt for the most recent 6 months, may use the current payment to calculate income, &
	  c. if there are not 6 months of consistent payments, may average the income received over the prior 2 years, or less if the income has not been received that long.

INCOME DOCUMENTATION, CONT.

How do you handle rental income?

Current Rule	New Rule Effective 9/14/15

• <u>To include existing rents received, obtain:</u>
  ◦ current lease or agreement to lease,
  ◦ evidence of a 24-month history of rent with no unexplained gaps over 3 months, and
  ◦ Schedule E
• <u>To include projected rents from borrower-occupied unit of a multi-unit property:</u>
  ◦ Effective income includes actual rent minus 25% or HOC vacancy and maintenance factor minus PITI and HOA dues.
  ◦ Rent may not be used as a direct offset to the mortgage.
• <u>For a single-family property occupied by the borrower as a primary residence</u>, <u>rent from roommates may not be included, but rent from boarders</u> may be included if:
  ◦ boarders are related by blood, marriage, or law
  ◦ rent is shown on the tax return.
	• <u>Different documentation and income calculations depending on the type of property, length of ownership, and history of rental income.</u>
	• For the subject property (<u>i.e.</u>, a multi-unit property where the borrower occupies one unit or a single-family property occupied by the borrower as a primary residence) <u>when there is **NO** history of rental income since the prior tax filing</u>:
	  ◦ For 2-4 unit properties:
	    ▪ small residential income property appraisal showing fair market rent, and
	    ▪ prospective leases.
	  ◦ For 1-unit properties:
	    ▪ URAR,
	    ▪ single family comparable rent schedule,
	    ▪ operating income statement showing fair market rent, and
	    ▪ prospective leases.
	  ◦ Calculate income as the lesser of:
	    ▪ monthly operating income on Freddie Mac 998 <u>or</u>
	    ▪ 75% of the lesser of
	      – fair market rent reported by the appraiser or
	      – rent reflected in the lease.

INCOME DOCUMENTATION, CONT.

How do you handle rental income?	
Current Rule	**New Rule Effective 9/14/15**

	For the subject property when there **IS** a history of rental income since the prior tax filing:
	• The lender must obtain:
	  • Most recent tax returns, including Schedule E, from prior 2 years
	  • If there is less than a 2 year rental history, documentation of the date of acquisition with a deed, Settlement Statement, or other legal document.
	• Calculate income as the average amount shown on Schedule E plus depreciation, mortgage interest, taxes, insurance, and HOA dues.
	• If the property has been owned for less than 2 years, annualize the income for the length of time the property has been owned.

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INCOME DOCUMENTATION, CONT.

How do you handle rental income?

Current Rule	New Rule Effective 9/14/15

For a property the borrower is vacating in favor of another principal residence, either:
 	
• the borrower must be relocating for employment outside a reasonable commuting distance and there must be a lease agreement for at least 1 year (and lenders are encouraged to obtain evidence of payment of a security deposit or the 1st month's rent), or
 	
• the borrower must have an LTV of 75%
	For other properties, including a property the borrower is vacating in favor of another principal residence:
	
	• The borrower must be relocating at least 100 miles away.
	
	• There must be a lease agreement for at least 1 year after closing and evidence of payment of a security deposit or the 1st month's rent.
	
	• If no history of rental income since the last tax filing:
	  • URAR evidencing market rent and that the borrower has at least 25% equity.
	  • If 2-4 units, obtain small residential income property appraisal showing fair market rent and prospective leases if available.
	  • If 1 unit, obtain URAR, comparable rent schedule, operating income statement, and prospective lease if available.
	  • To calculate income, deduct PITI from lesser of
	    • monthly operating income on the income statement or
	    • 75% of the lesser of
	      • fair market rent reported by the appraiser or
	      • rent reflected in the lease.

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INCOME DOCUMENTATION, CONT.

How do you handle rental income?	
Current Rule	**New Rule Effective 9/14/15**

	• If a history of rental income since prior tax filing:
	  • At least 2 years' tax returns with Schedule E.
	  • Calculate income as the average amount shown on Schedule E plus depreciation.
	  • If property was owned for less than 2 years, annualize the rental income for the length of time the property was owned and document the date of acquisition with the deed, Settlement Statement, or other legal document.
	• Rent from boarders is acceptable if:
	  • 2-year history of receiving it
	  • Borrower is currently receiving it
	  • Obtain 2 years' tax returns and current lease, and in purchase transactions, executed agreement from boarder documenting intent to continue boarding
	  • User lesser of 2-year average or current lease

INCOME DOCUMENTATION CONT.

What other calculations have changed?

	Current Rule	New Rule Effective 9/14/15
Nontaxable Income	• The lender must use the same tax rate the borrower used to calculate his or her income tax the prior year. • If the borrower did not file a Federal tax return the prior year, the lender may use a tax rate of 25%.	• The lender must use the greater of 15% or the tax rate based on the borrower's filing the prior year. • If the borrower did not file a Federal tax return the prior year, the lender must use a tax rate of 15%.

Social Security Income	• The lender must obtain a copy of the most recent award letter and either a letter from the SSA or Federal Tax Returns.
	• If any benefits will expire within 3 years, then only use it as a compensating factor.
		• The lender must obtain a copy of last Notice of Award Letter, or equivalent document establishing the benefits, and one of the following:
		  • federal tax returns,
		  • most recent bank statement showing receipt,
		  • proof of income or benefits letter from the SSA, or
		  • benefit statement.
		• Must continue for at least 3 years
		• Must use current amount to calculate effective income.

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INCOME DOCUMENTATION, CONT.

What other calculations have changed?

	Current Rule	New Rule Effective 9/14/15
Pensions	• Obtain verification from the former employer or through federal tax returns.	• Obtain verification through federal tax returns, most recent bank statement showing receipt, or copy of pension/retirement letter from former employer. • If the amount has been and will remain consistent, use the current amount to calculate income. • If the amount fluctuates, use the average over the prior 2 years (or time of receipt if less than 2 years).
401K	• Obtain verification from the former employer or through federal tax returns.	• Obtain verification through federal tax returns or most recent bank statement evidencing receipt of income. • If the amount has been and remains consistent, use current amount to calculate income. • If the amount fluctuates, use average over prior 2 years (or time of receipt if less than that).

EARNEST MONEY AND CASH TO CLOSE

	Current Rule	New Rule Effective 9/14/15
Earnest Money Deposit	Document the source of funds if the EMD exceeds 2% of the sales price or appears excessive based on the borrower's savings history.	Document the source of funds if the EMD exceeds 1% of the sales price or appears excessive based on the borrower's savings history.
Tax Service Fees	Prohibited	Not mentioned – FAQs state that mortgagee and TPO may charge customary and reasonable closings costs necessary to close the mortgage and that charges may not exceed actual costs.
Origination Fees	Mortgagees and third-party originators may charge origination fees not limited to 1%.	Mortgagees and third-party originators must charge "reasonable" origination fees.
Prepaid Items	Prepaid items include "other similar fees and charges" and the lender must use at least 15 days of per diem interest when estimating prepaids on the GFE.	Prepaid items include flood and hazard insurance premiums, MIPs, real estate taxes, and per diem interest. There is no longer a 15-day requirement.

CASH TO CLOSE

	Current Rule	New Rule Effective 9/14/15
Checking & Savings Accounts	• For manually underwritten loans, if there is a large increase in the account or the account was opened recently, obtain: • a credible explanation and • documentation of the source of funds.	• If there is a deposit greater than 1% of Adjusted Value (i.e., for purchase transactions, the lesser of the purchase price minus inducements or the appraised value) or the account was recently opened, obtain • documentation of deposits and • verification that no debts were incurred to obtain part or all of the minimum required investment. • If the account is jointly owned, obtain a written statement from the other parties that the borrower has full access and use of the funds.

CASH TO CLOSE, CONT.

	Current Rule	New Rule Effective 9/14/15
Retirement Accounts	• Most recent account statement. • Evidence of liquidation is not required unless the lender is using more than 60%.	• Most recent monthly or quarterly account statement • Use 60% and deduct existing loans unless there is “conclusive” evidence that a higher percentage may be withdrawn. • Evidence of liquidation is required if any portion is required for funds to close.
Stocks and Bonds	• Most recent monthly or quarterly statement	• Statements for the most recent 2 months. • A copy of the bond or certificate for stocks and bonds not held in a brokerage account.

CASH TO CLOSE, CONT.

	Current Rule	New Rule Effective 9/14/15
Gifts	• Includes a list of impermissible donors (i.e., seller, real estate broker/agent, builder, associated entity)	• No longer includes a list of impermissible donors. Instead, section on permissible sources for the borrower's minimum required investment lists impermissible sources as the seller, anyone who benefits financially, and anyone reimbursed by the seller or by one who benefits financially. ◦ Permissible donors include family members, employer or labor union, close friend with clearly defined, documented interest in borrower, charitable organization, or government agency/public entity with homeownership assistance.
	• Expressly states that "FHA is not concerned with how a donor obtains gift funds, provided that the funds are not derived in any manner from a party to the sales transaction."	• No longer includes this statement.
	• If the funds are verified in the borrower's account, obtain the donor's withdrawal document + the borrower's deposit slip and bank statement.	• If the funds are verified in the borrower's account, obtain the donor's bank statement + evidence of deposit into the borrower's account.
	• The mortgagee must be able to determine that the gift funds were not from an unacceptable source?	• The mortgagee must be able to make a reasonable determination that the gift funds were not from an unacceptable source.

CASH TO CLOSE, CONT.

	Current Rule	New Rule Effective 9/14/15
Premium Pricing	• May be used to pay a borrower's closing costs and/or prepaid items. • Must be disclosed on the GFE and HUD-1 • Must be used to reduce the principal balance if the premium pricing agreement establishes a specific dollar amount for closing costs and prepaids, with remaining funds over the costs reverting to the borrower.	• Defined as a credit from a lender for the interest rate chosen. • Must be disclosed in accordance with RESPA. • Must be used to reduce the principal balance if the credit amount exceeds the actual dollar amount for closing costs and prepaids.

A WHOLE NEW BALL GAME

- Numerous changes to substantive requirements
- Changes are being made on a rolling basis
- Significant software and systems changes will be necessary
- Ensure personnel are intimately familiar with new requirements
- Given HUD's aggressive enforcement posture, compliance should be a top priority

PROGRAMS AND PRODUCTS

- The final section of the new handbook contains program- and product-specific requirements, including:
  - Section 203(k) rehabs
  - Section 203(n) disaster victims
  - Energy Efficient mortgages
  - Refinances and Short Refi
  - Section 251 ARMs
  - Section 248 Indian Land
  - Section 247 Hawaiian Home Lands
  - New Construction
  - Construction to Permanent
  - Building on Own Land
  - Weatherization
  - Solar and Wind Technologies
  - Assumptions
  - HUD REO purchasing

REFINANCES

- New handbook identifies types of refinances, eligibility requirements, and maximum mortgage requirements for refinance transactions

- Many requirements are the same, but:
  - New documentation requirements
  - Changes in terminology
  - Some policy changes

REFINANCES

- **Types of Refinances**
  - Cash-out refinance
  - No cash-out refinance
    - Rate and Term refinance
      - Refinance of any mortgage
    - *Simple refinance*
      - Refinance of an existing FHA-insured mortgage
    - Streamline refinance
      - Credit qualifying
      - Non-credit qualifying
        - No more requirements related to streamline refinance loans with an appraisal or without an appraisal

REFINANCES

- **Changes applicable to all refinance types:**
  - Different “no skipped payment” requirement
    - Current guidelines require the borrower to be current on the loan being refinanced for the month due prior to the month in which he/she closes the refinancing, *and for the month in which he/she closes*
    - New guidelines state that the payments for all mortgages secured by the subject property must have been paid within the month due for the month prior to mortgage disbursement
  - Required documentation standards
    - To evidence occupancy for required period of time
    - To establish the required payment history
    - To establish payoff amounts

REFINANCES

- **Cash-out refinance**
  - Current guidelines contain different maximum mortgage amounts depending on length of ownership
  - New guidelines require the borrower to own the property securing the loan as a principal residence for the 12 months prior to date of case number assignment
- **Rate and Term refinance**
  - Current guidelines permit new subordinate lien financing in a short payoff scenario
  - New guidelines permit a rate and term refinance in a short payoff scenario, as long as the existing note holder writes off the remaining amount of debt

REFINANCES

- **Streamline refinance**
  - Payment history requirements
    - Current guidelines require:
      - If fewer than 12 months payment history, make all payments within month due
      - If 12 months or more payment history, make all mortgage payments within the month due; experience no more than one 30 day late payment in the preceding 12 months; and make all mortgage payments within the month due for the three months prior to the date of the loan application
    - New guidelines require the borrower to have made all mortgage payments within the month due for the 6 months prior to case number assignment; have no more than one 30-day late payment for the previous 6 months for all mortgages; and made the payments for all mortgages within the month due for the month prior to mortgage disbursement

REFINANCES

- **Streamline refinance (cont'd)**
  - New standards for net tangible benefit
    - Current guidelines define net tangible benefit as a reduction in the mortgage payment, or a change in interest rate when switching from ARM to fixed-rate loan
    - New guidelines define net tangible benefit as "a reduced Combined Rate, a reduced term, and/or a change from an ARM to a fixed-rate mortgage that results in a financial benefit to the Borrower"
      - Combined Rate refers to the interest rate on the mortgage plus the MIP rate

REFINANCES

- **Streamline refinance (cont'd)**
  - New standards for net tangible benefit
    - New guidelines identify the required net tangible benefit for the following streamline refinance transactions:
      - Fixed rate to Fixed rate, 1-year ARM, or Hybrid ARM
      - Any ARM with less than 15 months to next payment change date to Fixed rate, 1-year ARM, or Hybrid ARM
      - Any ARM with greater than or equal to 15 months to next payment change date to fixed rate, 1-year ARM, or hybrid ARM
    - Reduction in term alone constitutes net tangible benefit, if the new interest rate does not exceed the current interest rate, and the principal, interest, and MIP payment does not increase by more than $50

CLOSING REQUIREMENTS

- Closing section streamlined
  - In Handbook 4155.2, closing and post-closing requirements included requirements regarding loan eligibility and instructions regarding certain loan types (ARMs, Section 248 loans, etc.)
  - These requirements have been moved to the loan and property eligibility section or new sections regarding specific loan programs
  - New closing section includes only those requirements needed to ensure the loan is ready to close
  - Overall, the requirements have not changed

NEW MODEL NOTE & MORTGAGE FORMS

- New Handbook requires that mortgagees develop or obtain separate mortgage and note documents that generally conform to Fannie/Freddie forms and state/local requirements and include specific modifications required by FHA
  - State and other jurisdiction-specific requirements have been removed from HUD's Handbook
- HUD has provided new model documents for the promissory note and security instrument that contain the required FHA language
  - More closely track the Fannie/Freddie forms
  - FHA-specific amendments include, among others, FHA's specific payment application hierarchy and language that permits the mortgagee to charge only those fees authorized by HUD
  - Can be found in the "List of Linked References" on the new Single Family Housing Policy Handbook website
- Unlike in the past, HUD will not <u>require</u> use of the forms, but we recommend using the model forms

NEW MODEL NOTE & MORTGAGE FORMS

- New model note documents have been updated to conform with HUD's regulatory amendments regarding the elimination of post-payment interest charges and ARM notification requirements
- Instructions to the model mortgage and note specify which amendments to the GSE forms HUD views as FHA-specific modifications that must be adopted
- New model mortgage document does not include the language in paragraph 9(d) of the FHA model form
  - Old paragraph 9 incorporated certain servicing regulations into the security instrument
  - Cited in foreclosure litigation as the basis for enjoining FHA-insured loan foreclosures
  - New paragraph 20 also makes clear that the borrower cannot enforce any agreement between the lender and HUD unless authorized by applicable law

POST-CLOSING REQUIREMENTS

- New Handbook 4000.1 consolidates the post-closing requirements for non-Lender Insurance (“LI”) mortgagees and LI mortgagees
- Contains sections regarding pre-insurance review of case binder documents and case binder compilation that apply to both non-LI and LI mortgagees
- Contains separate sections for non-LI and LI mortgagees with instructions on endorsement and case binder submission depending on the mortgagee’s LI status

PRE-INSURANCE REVIEW

- Handbook 4000.1 requires that all mortgagees conduct a pre-insurance review to ensure that all applicable documents as described in the Uniform Case Binder Stacking Order are included in the endorsement submission

- Pre-insurance review must be conducted by staff that is not involved in the originating, processing, or underwriting of the mortgage

PRE-INSURANCE REVIEW

- Review and verification of information on several documents, which must be legible and reflect all required signatures, including:
  - Form 92900-LT, Underwriting and Transmittal Summary, the note and security instrument, settlement statement and settlement certification
  - Final URLA and Form 92900-A Addendum, credit report, clear CAIVRS, SSN evidence
  - Income and asset documentation, including gift and secondary financing documents
  - Late submission letter, if applicable
  - Complete appraisal report, all required property and inspection forms, and any specialized program-specific documents
  - Sales contract, addenda, and the Amendatory Clause
- New Handbook 4000.1 also includes specific instructions on inspection and repair escrow requirements for loans pending closing or endorsement in Presidentially-Declared Major Disaster Areas

CASE BINDER SUBMISSION

- Handbook 4000.1 contains a general requirement for mortgagees to complete the insurance application in FHA Connection and compile the uniform case binder

- As with prior guidance, the new Handbook includes a list of documents that must be included in the case binder

- New Handbook also contains separate sections governing case binder submission for LI and non-LI mortgagees
  - Non-LI mortgagees’ case binders must be received by the HOC no later than 60 days after the disbursement date
  - LI mortgagees must only submit case binders involving severe case warnings or if requested to do so by HUD

FHA INSURANCE ENDORSEMENT

- New Handbook continues to require:
  - timely remittance of MIP by all mortgagees,
  - timely submission of case binders by non-LI mortgagees, and
  - timely endorsement by LI lenders

- Instructions for late case endorsement for both LI and non-LI lenders remain unchanged

DO NOT FORGET ABOUT ENFORCEMENT

- HUD continues to be vigilant in its enforcement of FHA origination rules

- Increased risks involving FHA Insurance Fund
  - the economic downturn and foreclosure crisis put focus on the increased risks regarding originating FHA loans
  - increased OIG and QAD demands
  - astronomical False Claims Act settlements

- Lenders must ensure strict adherence to the new origination and underwriting guidelines in the new Handbook to avoid indemnification and civil money penalties

IMPORTANCE OF QUALITY CONTROL

- Imperative that each lender's Quality Control Department is well-versed in the new origination requirements
- Ensure Quality Control tests are revised to reflect the updated underwriting guidelines
- Test for compliance with the new requirements once they become effective
- Important to ensure loan officers and underwriters are adhering to the requirements, and that means training sessions for affected personnel
- Lenders will be required to demonstrate Quality Control procedures that are in line with current HUD guidelines during future HUD audits

CONCLUSION

- There is a lot to digest in the new Origination Handbook

- Many requirements on origination, underwriting, and closing will change significantly from the current FHA guidelines

- Imperative to familiarize staff with these new lending guidelines and ensure that systems, procedures, underwriting practices, and personnel will be ready to go

QUESTIONS?