

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

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OFFICE OF THE ASSISTANT SECRETARY  
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

**MORTGAGEE LETTER 00-25**

**TO:** ALL APPROVED MORTGAGEES  
ALL 203(k) CONSULTANTS

Proceed to page 6, paragraph 3 for  
**Clarification on the Acceptance of Contractors**

**SUBJECT:** 203(K) Rehabilitation Mortgage Program- Single Family Loan Production

This Mortgagee Letter announces changes to the 203(k) procedures relating to mortgagee responsibilities, 203(k) consultant requirements, and loan processing. Mortgagees must assure that they adhere to requirements contained under the heading "Responsibilities of the Mortgagee." In addition, both current and prospective 203(k) consultants will be evaluated pursuant to the standards and procedures set forth in this Mortgagee Letter. Unless otherwise stated, the procedures described in this Mortgage Letter and attachments are effective on August 21, 2000, and apply to all 203(k) loans using case numbers ordered on or after that date.

**INFORMATION FOR CURRENT AND PROSPECTIVE 203(k) CONSULTANTS**

Individuals who want to participate as 203(k) consultants must follow FHA's new uniform standards for participation in the 203(k) Rehabilitation Mortgage Insurance Program. All current 203(k) consultants must re-apply for placement on the FHA 203(k) Consultant Roster (described below) by submitting application materials to an FHA Homeownership Center (HOC). If an application package is not received within 60 days from the date of this Mortgagee Letter, the consultant's name will be removed from the Roster. Only those consultants listed on this Roster may participate in the 203(k) program. Going forward, prospective consultants can review the instructions listed below and apply for placement on this list at any time.

**FHA 203(k) Consultant Roster**

FHA has established an FHA 203(k) Consultant Roster for individuals who meet the criteria set forth below. FHA will initially populate this 203(k) Consultant Roster with those consultants who currently are listed on the Homeownership Center (HOC) websites. The website for this FHA 203(k) Consultant Roster is located at the address listed below under the "Work Online" Section.

<http://www.hud.gov/lendersl.html>

Those consultants who do not return application packages within 60 days from the date of this Mortgagee Letter will have their names removed from the FHA 203(k) Consultant Roster. Individuals who meet the criteria will be assigned identification numbers and will be listed on the FHA 203(k) Consultant Roster. The application process is fully described below. The duties and responsibilities of 203(k) consultants are fully explained in Mortgagee Letter 95-40.

### **Application Process**

To apply for placement on the FHA 203(k) Consultant Roster, an applicant must submit the information listed below to the HOC in the area in which he/she will be conducting business. Placement on the roster by one HOC will be recognized by all HOCs. However, the 203(k) consultant must notify the HOC if his/her primary location of business changes.

The application information should be submitted in the following format. A list or resume documenting:

- A minimum of three years experience as a remodeling contractor, general contractor or home inspector. A state license as a state certified engineer or architect may be submitted in lieu of the documentation of the three years experience;
- Education;
- Licensing (general contractor, home inspector, etc.). In those states where a Home Inspector is required to be licensed, the Department requires the applicant to be licensed and to provide proof of that licensing;
- A narrative description of the current/prospective consultant's ability to perform home inspections, prepare architectural drawings, use proper methods of cost estimating and complete draw inspections; and,
- The applicant must also submit a certification verifying that the consultant has read and fully understands the requirements of HUD Handbook 4240.4, REV 2 (203(k) Handbook) and all related materials listed in Attachment 1 of this Mortgagee Letter.

### **Future Program Enhancement**

To further evaluate the 203(k) consultant's program knowledge, the Department will soon develop a formal examination process similar to the test FHA appraisers must now complete. The Department will issue additional guidance about this examination in the near future.

### **Information Collection Requirements**

The information collection requirements referred to in this Mortgagee Letter have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). The OMB number issued for this requirement is OMB 2502-0527.

### Incomplete Application Packages

An individual who submits an incomplete application package (defined above in the section entitled "application process") will receive a letter indicating the information required to cure the deficiency. This letter will give the individual 15 days to correct any deficiencies. If the response does not satisfy the outstanding requirement in its entirety and within the prescribed deadline, the individual must wait an additional 90 days prior to re-applying.

### Application Approval or Denial

FHA will approve or deny the consultant's application to be listed on the FHA 203(k) Consultant Roster, based upon the information submitted. Inclusion of a consultant on the list means only that the consultant has met the qualifications prescribed by FHA for placement on the Roster; it does not create or imply a warranty or endorsement by FHA of the consultant, nor does it represent a warranty of any work performed by the consultant. If a consultant already on the Roster is found to not be in compliance with requirements of the 203(k) program, the consultant may be removed from the roster.

### Participation Letters and Consultant Identification Numbers

Each applicant who meets the 203 (k) program requirements will be issued a participation letter. This letter will contain the consultant's name, business address and a consultant identification number. This number will be needed by the consultant prior to doing any work associated with any 203(k) loan. This consultant identification number will be used to assist the Department in evaluating the work of consultants. Mortgagees must enter the consultant's identification number on the insurance application screen and will not be able to process 203(k) cases without it.

Each consultant will be provided with only one participation letter. After the letter is mailed, mortgagees, consultants and others can verify that the consultant has been placed on the FHA Connection. The website for this information is located at the address listed below under the "Work Online" Section.

<http://www.hud.gov/lendersl.html>

### **Monitoring and Reporting Process**

FHA will perform periodic field reviews of the work performed by 203(k) consultants. The purpose of these reviews is to ensure compliance with FHA requirements. These reviews shall include, but not be limited to, the cost write-up and the adequacy of the scope of work. 203(k) consultants must provide any applicable information requested by monitors to assist them in properly evaluating the work performed.

## **RESPONSIBILITIES OF THE MORTGAGEE**

### **Mortgagees Select 203(k) Consultants from the FHA 203(k) Consultant Roster**

Mortgagees now have the sole responsibility to select 203(k) consultants when processing a mortgage loan application under the 203(k) Program. A consultant must be selected from the FHA 203(k) Consultant Roster. The cost attributed to architectural and construction engineering activities will continue to be included in the rehabilitation cost. The mortgagee selection of the consultant does not affect the scope of the consultant's services, as described in Mortgagee Letter 95-40, but does permit the mortgagee to exercise greater control over those services. The Department believes that vesting full authority with mortgagees in selecting consultants will allow the Department to hold mortgagees and 203(k) consultants fully accountable for the loan proceeds and thus reduce the incidence of deficient work write-ups, incorrect cost estimates and improper progress payments.

### **Entering Consultant Identification Number into the FHA Connection on the Insurance Application Screen**

Mortgagees will be required to enter the consultant identification number into the FHA Connection during case number assignment; failure to provide it will result a 'fatal error' and preclude further processing. The FHA Connection will automatically cross reference this identification number entered with the national database that resides in CHUMS of all 203(k) consultants listed on the FHA 203(k) Consultant Roster.

### **Authorizing Inspections and Draws**

Mortgagees are fully responsible for authorizing draw inspections, managing the rehabilitation escrow account, and approving the associated draws from the account. Consultants selected from the FHA 203(k) Consultant Roster may perform the inspections on the mortgagee's behalf, but it remains the mortgagee's responsibility to assure that the inspections are completed in a quality manner and in a timely fashion.

### **Monitoring and Evaluating Quality of Services**

Mortgagees must exercise due diligence with regard to the full scope of the 203(k) consultant's services. Standards for the 203(k) consultant's performance must be clearly defined in the mortgagee's Quality Control Plan and should be provided to each consultant that the mortgagee relies on in the 203(k) program. Mortgagees must evaluate and document the performance of these consultants on at least an annual basis, to include a review of the consultant's actual work product.

Mortgagees must not use the services of consultants who have demonstrated previous poor performance. Mortgagees are responsible for resolving disagreements between borrowers, contractors and consultants. Fraud or malfeasance should be documented and reported to the Department for possible administrative action.

## **ADDITIONAL 203(k) PROGRAM CHANGES AND CLARIFICATIONS**

### **Automated Processing of 203(k) Close-outs**

Effective August 21, 2000, the Department will require electronic certification of closeout of 203(k) cases. The mortgagee will enter information onto the 203(k) Close-out screen on the FHA Connection and thereby certify, electronically, that the 203(k) loan has been properly closed out. Mortgagees are responsible for making sure that the loan packages are complete at close-out certification and must still submit the actual case binder to the HOC. Proper close-out means that the mortgagee will certify that they have reviewed and verified for accuracy the following documents without limitations: final release notice, mortgagor's letter of completion, title update/lien waiver, draw request forms (interim and final), rehabilitation inspection reports, the lender accounting of the 203(k) rehabilitation funds, change orders, payment ledgers, extensions for completion and contingency release letters.

The Department will track close-out timeliness and accuracy and this process will be reviewed during the Department's monitoring activities. Failure to properly close out 203(k) cases will result in the lender being placed on pre-closing test case status for 203(k) loans.

### **Determining Eligible Work Items**

Although the minimum amount of improvements to be eligible for a 203(k) loan remains at \$5,000, this threshold is no longer limited by the eligible improvements outlined in HUD Handbook 4240.2, REV-2, Section 1.7. Luxury items and improvements that do not become a permanent part of the real property are still not eligible as a cost rehabilitation. However, the homeowner can now 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. The work write-up must demonstrate that, when the rehabilitation is completed, the property will meet HUD's minimum property standards. Mortgagees are reminded that the Department is particularly concerned about the value of property after the improvements are completed. To assure that the mortgage is adequately supported by the property value, the maximum 203(k) mortgage amount must be based on the LESSER of the: "as-is" value plus the cost of repairs (and improvements), or if an "as-is" appraisal is not performed, the contract sales price on a purchase transaction plus the repairs costs, or the existing debt on a refinance plus the repair costs, or 110 percent of the "after improved" value.

## Processing Streamline Refinances of 203(k) Loans to 203(b) Loans

No streamline refinance of a 203(k) can occur until the work is complete. "Complete" means that the rehabilitation work is finished as documented by a fully executed certificate of completion and that the Rehabilitation Escrow Account has been closed with a Final Release AND that the loan has been properly closed out and this transaction has been certified electronically, as previously described. The new mortgage will be subject to the appropriate insurance premium applicable to a new Section 203(b) mortgage.

## Clarification on Chain of Title Requirement

Mortgagee Letter 95-40 states the Direct Endorsement lender must obtain evidence of prior ownership when a property was sold in the last year and that prior ownership must be reviewed for undisclosed identity of interest transactions. Lenders are reminded that this is a continuing requirement and applies to **all** transactions. The 203(k) mortgage must be based on the lowest sales price in the last year.

## Clarification on the Acceptance of Contractors

Mortgagee Letter 98-11 required mortgagees to "approve" contractors prior to closing and numerous questions have surfaced regarding the intent of this requirement. The Department does not expect mortgagees to actually approve contractors, but rather assure that an "acceptable" general contractor (or specialized contractor) has been hired and by contract agrees to complete the work described in the work write-up for the amount of the cost estimate and within the allotted time frame. The mortgagee must review the following items pursuant to the proposed contractor: credentials, work experience, licensing information, type of work performed, experience, and client references. Also, it is **required** that borrowers and contractors complete an agreement that outlines the rights and responsibilities of each party. Attachment 3 of this Mortgagee Letter contains a sample Homeowner/Contractor agreement. It is suggested that all agreements contain a provision for binding arbitration or mediation for unresolved contract disputes.

**SIDE NOTE: How can a contractor be "acceptable" if they are not properly educated on the 203k? <http://203kContractors.com> does this for you.**

## Approving Borrowers as General Contractors

While not prohibited, the Department urges mortgagees to exercise extreme caution in approving 203(k) loan applications where the borrower wants to act as the General Contractor. Only in those cases where the mortgagee has verified that the borrower **is** a general contractor or can document experience in completing rehabilitation projects, may it approve "self-help" arrangements. As a reminder, the borrower must also understand that they will get paid only for materials **and not** for their labor ("sweat equity") on work that they perform. The mortgagee also must make sure that the borrower understands the 203(k) program at the construction stage and the risks inherent in rehabilitation projects. It is recommended that the borrower sign a Self-Help Agreement. A sample of this agreement can be found in Attachment 3 of

Mortgagee Letter. In the case of a "self-help" arrangement, the mortgagee should make sure that the work write-up clearly states the cost of labor and of materials for the work items. The borrower should maintain records documenting actual costs and lien waivers in the same way that a General Contractor would.

### **Completing Form HUD-92564-VC (Valuation Conditions)**

FHA appraisers are **not required** to complete Form HUD-92564-VC (VC Form) when determining the 'after-improved' value of a property financed with a 203(k) Rehabilitation Mortgage loan because the appraiser is relying on the 203(k) consultant's work write-up. However, in preparing the valuation, the appraiser must inform lenders of any FHA Minimum Property Requirements that the proposed scope of the repair work (work write-up) does not address and it *may* be prudent to report this finding on the VC Form. Using the VC Form will necessitate additional disclosure requirements to the homebuyer. The work write-up should be reviewed and modified by the consultant to include those additional items noted by the appraiser.

### **Verification of Proper Disbursement of Loan Proceeds**

The Department is concerned about proper disbursement of loan proceeds. Therefore, lenders must take the following actions to assure that this occurs. Lenders are responsible for ensuring that loan proceeds are disbursed in the proper amount to the borrower and the seller, or in the case of a refinance transaction, to the debt holder. The originating lender will be required to verify the borrower's debts to be refinanced to assure they were not incurred for the purpose of providing cash to the borrower. The Department is concerned about increased insurance risks from refinance schemes in which the borrower obtains cash from a loan on a property, uses the cash for purposes other than property improvements, and a short period later refinances the debt with a 203(k) loan.

*During the rehabilitation phase*, lenders must verify that loan proceeds from draw inspections are correctly disbursed to the proper borrower and/or contractor (or subcontractors) to avoid mechanic liens on the property.

### **Identity of Interest Issues**

The Department wants assurance that there are no identity of interest issues between parties participating in the 203(k) transaction. Therefore, effective 60 days from the date of this Mortgagee Letter, borrowers and consultants must sign certifications for all loans with mortgage credit applications signed on or after this date. These certifications must be placed in the case binder. The required language is listed below:

**Borrower's Identity-of-Interest Certification.** The borrower must sign a certification stating the following:

"I hereby certify to the Department of Housing and Urban Development (HUD) and (lender), that I/We do not have an identity-of-interest with the seller of the property. I also Certify that I/We do not have a conflict-of-interest with any other party to the transaction, including the realtor, lender, contractor, consultant and/or the appraiser. In addition, I certify that I am not obtaining any source of funds or acting as a "strawbuyer" for another individual, partnership, company or investment club and I/We \_\_\_\_\_ will/will not \_\_\_\_\_ occupy the residence I/We are purchasing or refinancing."

**Warning: HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802).**

\_\_\_\_\_  
**Borrower's Signature**

\_\_\_\_\_  
**Date**

\_\_\_\_\_  
**Co-borrower's Signature**

\_\_\_\_\_  
**Date**

**Consultant's Identity-of-Interest Certification.** All consultants and plan reviewers are required to sign the following certification after preparing/reviewing the work write-up and cost estimate, stating:

"I hereby certify that I have carefully inspected this property for compliance with the general acceptability requirements (including health and safety) in Handbook 4905.1. I have required as necessary and reviewed the architectural exhibits, including any applicable engineering and termite reports, and the estimated rehabilitation cost and they are acceptable for the rehabilitation of this property. I have no personal interest, present or prospective, in the property, applicant, or proceeds of the mortgage. I also certify that I have no identity-of-interest or conflict-of-interest with the borrower, seller, lender, realtor, appraiser, plan reviewer, contractor or subcontractor. To the best of my knowledge, I have reported all items requiring correction and that the rehabilitation proposal now meets all HUD requirements for 203(k) Rehabilitation Mortgage Insurance."

**Warning: HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (18 U.S.C 1001, 1010, 1012; 31 U.S.C 3729, 3802).**

\_\_\_\_\_  
Consultant/Plan Reviewer's Signature

\_\_\_\_\_  
Date



**REVISED 203(k) MAXIMUM MORTGAGE WORKSHEET**

The 203(k) Maximum Mortgage Worksheet (HUD-92700) was last revised in February of 1999 to accommodate the required 3% investment by the borrower. The revised worksheet is attached to this Mortgagee Letter as Attachment 5 or can be downloaded electronically from HUD's website at: <http://www.hudclips.org>. A description of the changes to the Maximum Mortgage Worksheet can be found in Attachment 6 of this Mortgagee Letter.

Questions regarding this Mortgagee Letter should be directed to the FHA Homeownership Centers in Atlanta (1-888-696-4687), Denver (1-800-543-9378), Philadelphia (1-800-440-8647) and Santa Ana (1-888-827-5605).

Sincerely,

William C. Apgar  
Assistant Secretary for Housing-  
Federal Housing Commissioner

Attachments:

- Attachment 1: Sample Certification form for 203(k) Consultant Approval
- Attachment 2: Sample Homeowner/Contractor Agreement
- Attachment 3: Sample Rehabilitation (Self-Help) Loan Agreement
- Attachment 4: Revised 203(k) Maximum Mortgage Worksheet
- Attachment 5: Detailed information on the Revised 203(k) Maximum Mortgage Worksheet