



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

MORTGAGEE LETTER 2007-11

September 5, 2007

**TO: ALL APPROVED MORTGAGEES
ALL FHA ROSTER APPRAISERS**

**SUBJECT: The *FHASecure* Initiative and Guidance on Appraisal Practices in
Declining Markets**

The Federal Housing Administration is pleased to announce an initiative that will enable homeowners to refinance various types of adjustable rate mortgages (ARMs) that have recently “reset.” This mortgagee letter describes how lenders and homeowners may refinance mortgages that, due to the increased mortgage payment following the reset, have become delinquent. The mortgagee letter also reiterates guidance to lenders about making objective decisions regarding the underlying collateral in declining markets. The *FHASecure* initiative, which is a temporary program designed to provide refinancing opportunities to homeowners and to increase liquidity in the mortgage market, requires that the loan application be signed no later than December 31, 2008.

Refinancing Non-FHA Adjustable Rate Mortgages Following Resets

FHA is currently doing a significant business in refinancing non-FHA mortgages for borrowers who are current under their existing mortgage. This mortgagee letter extends eligibility to borrowers who became delinquent under their current mortgage following the reset of the interest rate.

FHA recognizes that many lenders are engaged in a variety of loss mitigation activities to keep borrowers in their homes, and applauds these efforts. This mortgagee letter explains credit policies for refinance transactions involving non-FHA adjustable rate mortgages where the homeowner’s mortgage payment history during the 6 months prior to the reset showed no instances of making mortgage payments outside the month due.

These instructions are designed to permit homeowners, who previous to their reset, demonstrated an ability to meet their mortgage obligations, an opportunity to refinance into a prime-rate FHA-insured mortgage. In many cases homeowners may be permitted to include mortgage payment arrearages into the new loan amount, subject to existing geographical mortgage limits and the loan-to-value limit shown below.

Eligibility Highlights of the *FHASecure* Initiative

- The mortgage being refinanced must be a non-FHA ARM that has reset.
- The mortgagor's payment history on the non-FHA ARM must show that, prior to the reset of the mortgage, the mortgagor was current in making the monthly mortgage payments, i.e., the homeowner's mortgage payment history during the 6 months prior to the reset showed no instances of making mortgage payments outside the month due.
- If there is sufficient equity in the home, under additional eligibility instructions provided below, FHA will insure mortgages that include missed mortgage payments.
- Under certain conditions explained below, FHA will insure first mortgages where (1) the existing note holder writes off the amount of indebtedness that cannot be refinanced into the FHA insured mortgage; or (2) either the FHA-approved lender making the new mortgage or the existing note holder may take back a second lien that includes closing costs, arrearages or previous secondary financing if the indebtedness exceeds FHA prescribed LTV and maximum mortgage amount limits.
- Mortgagees must determine, as part of the underwriting process, that the reset of the non-FHA ARM monthly payments caused the mortgagor's inability to make the monthly payments and that the mortgagor has sufficient income and resources to make the monthly payments under the new FHA-insured refinancing mortgage.

Additional Information About the *FHASecure* Initiative

- *Maximum FHA loan-to-value ratios*

The maximum loan-to-value limits are shown below and are applied to the appraiser's estimate of value, exclusive of any upfront mortgage insurance premium.

Maximum Loan-to-Value Ratios

States with Average Closings Costs At or Below 2.1 Percent of Sales Price

- **98.75 percent:** For properties with appraised values equal to or less than \$50,000.
- **97.65 percent:** For properties with appraised values in excess of \$50,000 up to \$125,000
- **97.15 percent:** For properties with appraised values in excess of \$125,000.

States with Average Closings Costs Above 2.1 Percent of Sales Price

- **98.75 percent:** For properties with appraised values equal to or less than \$50,000
- **97.75 percent:** For properties with appraised values in excess of \$50,000

- ***Calculating the Maximum FHA Mortgage Amount***

The amount of the *FHASecure* mortgage may not exceed either the geographical maximum mortgage limits or the loan-to-value ratios shown above. FHA will permit the inclusion of the existing first lien, any purchase money second mortgage, closing costs, prepaid expenses, discount points, prepayment penalties, and late charges. FHA will also permit arrearages (principal, interest, taxes and insurance) to be added into the new loan amount provided the arrearages arose after the reset.

- ***Subordinate Financing Under the FHASecure Initiative***

If the new maximum FHA loan is not enough to pay off the existing first lien, closing costs and arrearages, the lender may execute a second lien at closing to pay the difference. The combined amount of the *FHASecure* first mortgage and any subordinate non-FHA insured lien may exceed the applicable FHA loan-to-value ratio and geographical maximum mortgage amount. If payments on the second are required, they must be included in qualifying the borrower. If payments are deferred, they must be so for no less than 36 months to not be considered in the qualifying ratios. Borrowers need not yet have missed any mortgage payments to be eligible for this type of subordinate financing.

- ***Underwriting the Mortgage/Qualifying the Borrower***

FHA encourages all approved lenders to use FHA's TOTAL Mortgage Scorecard to obtain risk classifications on each mortgage originated under the *FHASecure* initiative. If TOTAL renders an "accept/approve," the mortgagee's underwriter need not perform a personal review of the borrower's credit history and capacity to repay. However, in the more likely event that the risk class is a "refer," the underwriter must:

1. Determine that the homeowner has the capacity to make future mortgage payments as well as pay all other obligations. The payment-to-income ratio and debt-to-income ratios remain 31 percent and 43 percent, respectively. Compensating factors are to be provided by the underwriter when the ratios are exceeded.
2. Analyze the homeowner's overall credit history, especially payments on the existing mortgage. The underwriter must determine that the homeowner's mortgage payment history during the 6 months prior to the reset showed no instances of making mortgage payments outside the month due and that other recurring obligations were paid on time. If the borrower was offered partial forbearance after interest rate reset, the underwriter must determine that he/she has made payments under the forbearance agreement in a timely manner.
3. Provide comments in the "remarks" section of the mortgage credit analysis worksheet that he or she has determined that the cause of the borrower's inability to make payments was directly related to the increased payment attributable to the reset and not due to a disregard for obligations.

- *Tax consequences for a borrower when the note holder writes off a portion of the amount to pay off the first mortgage*

FHA recognizes that there may be tax consequences resulting from debt relief. However, since FHA does not provide tax guidance, it recommends borrowers—and mortgage lenders—in such situations seek competent tax advice.

- *Other considerations of which the mortgagee must be aware when refinancing these mortgages.*

The *FHASecure* initiative for refinancing borrowers harmed by non-FHA ARMs that have recently reset is not to be used to solicit homeowners to cease making timely mortgage payments; FHA reserves the right to reject for insurance those mortgage applications where it appears that a loan officer or other mortgagee employee suggested that the homeowners could stop making their payments, refinance into a FHA insured mortgage, and keep, as cash, the amount of payments not made on time.

Appraisal Practices in Declining Markets

Historically, FHA has provided a counter-cyclical force in helping to stabilize declining housing markets and will continue to do so. In fact, much of FHA's business activity this year has been in those states (e.g., Ohio, Michigan, Indiana) that have suffered sustained depreciation of home prices due to job losses and increased foreclosures. Nevertheless, recent property value declines in certain markets suggest the need to reiterate our guidance to mortgage lenders to ensure that appraisers are providing accurate property valuations. A declining market could be as small as a neighborhood or as large as an entire state, and no standard definition exists other than home prices are falling.

Appraiser Responsibilities

The purpose of the appraisal is to provide the lender/client with an accurate, and adequately supported, opinion of market value. It is the appraiser's responsibility to determine whether a property being appraised is located in a declining market.

The neighborhood section of each property specific appraisal form contains a housing trends section where the appraiser marks a box indicating property values are increasing, stable or declining. Whichever box is selected, the appraiser is certifying that he/she has performed an objective analysis of quantifiable data supporting the observations made.

If a property is located in a declining market, the appraiser must provide an explanation in the "Market Conditions" section of the appraisal report that includes relevant information in support of the conclusions relating to trends in property values, demand/supply and marketing time. The appraiser must also provide a description of the prevalence and impact of sales and financing concessions and/or down payment assistance in the subject's market area. Other areas of discussion may include days on market, list-to-sale price ratios, and/or financing availability.

Lender Responsibilities

The mortgagee's responsibility is to properly review the appraisal and determine that the appraised value used to support the mortgage is accurate and adequately supported.

Lenders are reminded that if the appraiser they selected provides a poor or even fraudulent appraisal that leads the Department to insure a mortgage at an inflated amount, the lender is held equally responsible with the appraiser for the violation if the lender knew or should have known. FHA will pursue appropriate enforcement actions against both or either party if necessary. Lenders accept responsibility, equally with the appraisers for the integrity, accuracy and thoroughness of the appraisal submitted to FHA for mortgage insurance purposes.

If you should have any questions concerning this Mortgagee Letter, call 1-800-CALLFHA.

Sincerely,

Brian D. Montgomery
Assistant Secretary for Housing-
Federal Housing Commissioner

