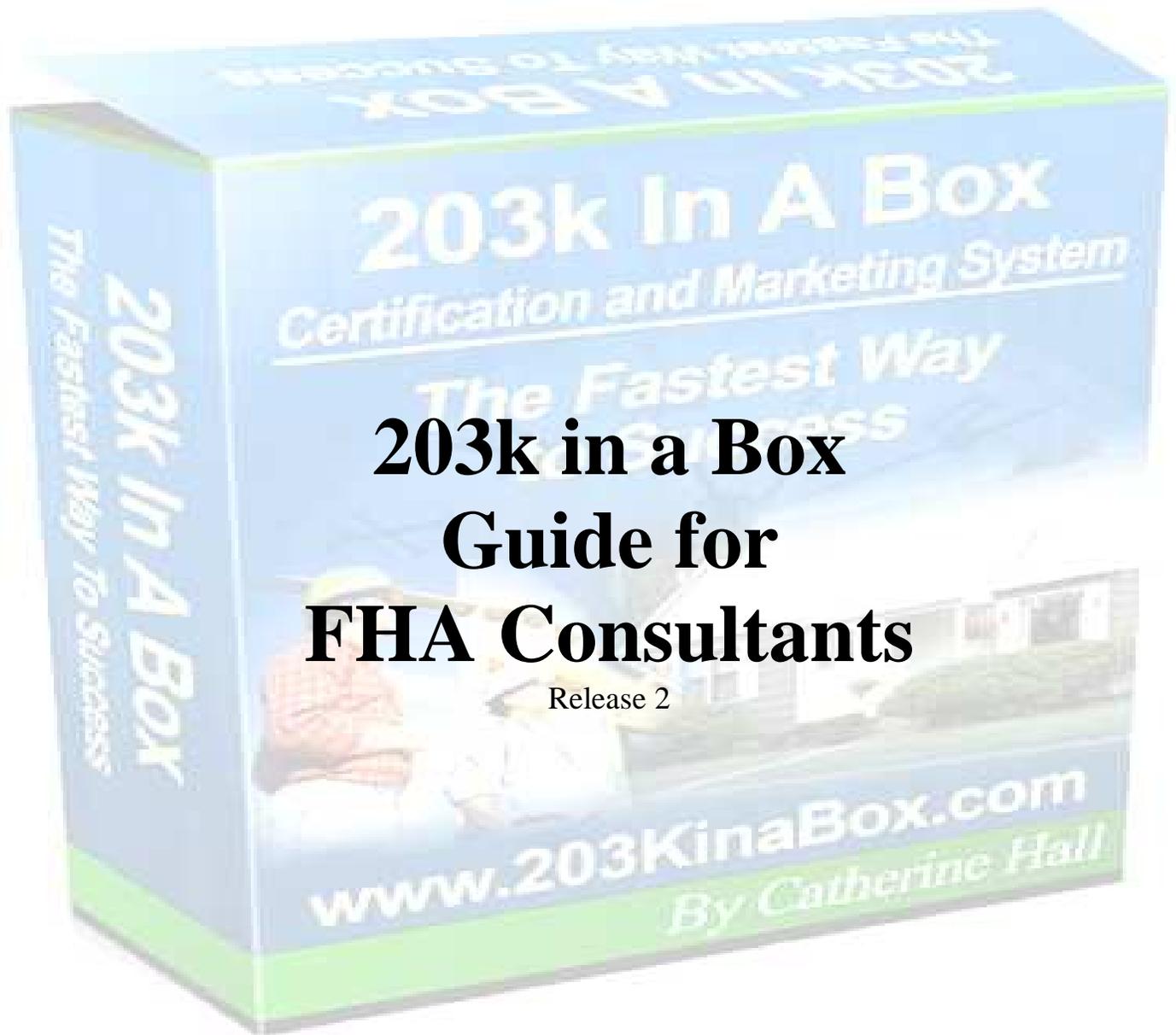




203k in a Box
FHA Consultant Training System



203k in a Box
Guide for
FHA Consultants

Release 2

DEDICATION

This book is dedicated to family; my children Adele, Samantha, Christopher, and my father Richard without whom this book and my incredibly wonderful life would not be possible.

Special thanks to my staff at Value Home Inspections for all the loyalty, support and hard work.

But most important I dedicate all my success and all the happiness and joy I experience every day to God for sending me a husband in Tom who has kept me focused and been the soft nudge and sometimes the stronger shove in the back that keeps me going. I love you Tommy.

All my love,

Catherine Hall



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FORWARD

As I write this book in the spring of 2010, I am seeing a great surge of interest in the 203k loan process. Unfocused and uninformed people in all areas of the real estate industry are looking for ways to re-capture some of the momentum – not to mention money – that seemed to be everywhere in the home buying industry just 3 short years ago.

Real estate agents, loan officers and others joined at the hip are sinking together in the tidal wave of foreclosures, short sales, and bank repossessions. Buyers, hard working and responsible are being swept away by the wave of distrust that is preventing them from finding a lender who will trust them with a mortgage in light of the meltdown of the past 15 months.

During these challenging times, like the phoenix rising from the ashes if it's previous life; the FHA 203k loan seems to have been reborn. With it comes a hope and possibility for all members of the real estate industry.

At the time of this publication, proposed modifications are pending to change the way FHA manages its loan programs. As the changes suggested haven't been formally adopted, I have chosen to refer to these modifications as possibilities only. I do believe that these alterations make too much sense not to be put into "law". However, should my crystal ball be cloudy and I have miss-read the mood of the times, I apologize.

That being said, it is my firm belief that the other 98% of the information in this book should be as relevant and valid as FHA itself.

I can only hope and pray that as time writes the future chapters of this book, that it will show the FHA 203k as one of the heroes that helped save our home buying industry – and in its way saved *The American Dream*.

Catherine Hall



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Introduction

In this rapidly changing real estate environment, we are all looking for new ways to generate home inspections to supplement and in some cases replace the dwindling supply of retail business available in our communities.

Thankfully, there is a frequently under-utilized but lucrative stream of business available through various levels of our government system...from the Local Township or municipality up to the federal government. This manual is designed to show you how to tap into one of these streams of income – the FHA 203k Consultant service with little or no expense on your part.

This manual does not profess to be an all-inclusive guide to business opportunities available for qualified home inspectors through all of the numerous government organizations. It does endeavor to provide useable information on the best, quickest and least costly avenues for experienced home inspectors to utilize their specialized and hard-earned skills in a different and in most cases equally profitable way.

This manual makes the assumption that the reader is an experienced, certified¹ home inspector. It does not teach home inspection practices. It does provide descriptions of the activities and functions necessary to successfully perform the inspection service being discussed. Those individuals who have not achieved the level of professional training and/or certification required by your state or municipality in order to describe yourself as a “home inspector” should do so by first contacting your local chapter of a national home inspectors association (i.e. ASHI, CREIA,NAHI, InterNACHI) and then execute the steps needed to become a compliant and credible building consultant.



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The History of FHA

When I was young, I would often run up to my father and begin pouring out some story or event in an excited rush -- eager to get to the element of the story that was most important to me. My father invariably would stop my eruption and tell me to "begin at the beginning". Only then, would he understand the full picture. So while much of what I'm going to share in this chapter may be common knowledge, I believe the adage I learned from Anthony Robbins- "Repetition is the mother of skill".



The economic climate that existed when FHA was created, some 76 years ago, in 1934, was one of the worst in our country's history. The Great Depression saw the banking system failing (much like that experience in 2008 – 10). At that time, the financial crisis and absence of liquid capital experienced by the banks in the 1930s, forced the lenders to "call the mortgages." held by borrowers. The



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banks and mortgage holders believed they would be able to recoup the revenue by forcing their mortgage holders to use whatever means available to pay off the mortgages so they could stay in their home. But what the lenders failed to realize was that many homeowners, themselves were experiencing financial crises of their own due to the nearly 80% unemployment rate. These distressed families found they could not pay the mortgages and without the option of refinancing, many homes were quickly foreclosed. This caused the housing market to crash just like the financial sector before it. As there was no one to buy the foreclosed properties, the banks soon found that the value of their newly reclaimed assets had declined to a level that only served to further strain the lending community.



Thousands of families in cities all across the country were put out of their home. This developed into a serious housing crisis. Some of the rich who already owned big houses were able to keep them by renting out a few of the rooms to some of the newly homeless people. However the majority of the people who were not so rich to start out with lost their homes because they could not pay the rents, the mortgages or the bills. These people were forced to just live in the streets, or try to get to a Hooverville and set up a tent.



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These Hoovervilles (shantytowns) formed coast to coast in cities large and small. Homeless men, women and children were forced to take up residence in these shacks as a result of the Great Depression. Angry, cold and hungry Americans, who had no other place to reside, dubbed groups of those shacks in honor of President Herbert Hoover. Those desperate folks blamed Mr. Hoover for the downfall of economic stability and apparent absence of government help.



One of the largest Hoovervilles was created in 1932 in Washington DC. About 20,000 US veterans of World War-1 marched on DC seeking to get an early pay out of a war time bonus they had received as a result of their service in World War I. Most of these veterans had been unemployed since before the Depression began, and many before that. These men and their families were desperately trying to obtain financial relief during the depression by demanding the full and immediate payment of this bonus despite the fact that the bonus did not mature until 1945- 20 years after issuance. These bonds had only been issued to the veterans eight years earlier in 1924. These veterans, along with their families and other affiliated groups, numbered close to 43,000 people. They established a sprawling Hooverville on government lands while their pleas were being considered by the Congress.



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To the shame of all involved, the US Army, commanded by Army Chief of Staff General Douglas MacArthur, along with Major, later President, Dwight D. Eisenhower and Major George Patton, was called in to burn out and disperse the protesters.

When Franklin D. Roosevelt became president of the United States on March 4, 1933, he knew he needed to revive the housing market if unemployment was to be conquered and banks were to again serve as mortgage lenders.

President Roosevelt held the very American notion that the ideal home was a single, privately owned structure on a small plot of land. Roosevelt decided on a path of stopping foreclosures and making private homes more affordable. In 1933 and 1934 New Deal legislation concentrated on these issues as well as the related goal of stimulating the home construction industry.

On June 13, 1933, Congress passed the Home Owners' Refinancing Act, which created the Home Owners' Loan Corporation (HOLC). Next, on June 28, 1934, Congress passed the National Housing Act, which created the Federal Housing Administration (FHA).



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With it, came the lending practices that increased the number of people who could afford a down payment on a house, as well as the monthly mortgage payments.

FHA played an important part in the increase in homeownership. This was especially true for returning World War II veterans and their families. Returning G.I.s and their families faced a severe shortage of housing in 1946. The government assisted these war heroes with the G. I. Bill and FHA helped by providing low interest rate loans to veterans and their surviving families.

The housing act became part of the U.S. Office of Housing and Urban Development (HUD) in 1965 when President Lyndon Johnson signed the Department of Housing and Urban Development Act. In it's more than 70 year history; FHA has insured more than 34 million home mortgages. During this time, the 203k Rehabilitation Loan was also created.



When FHA originally created the 203k Loan Program in 1962, owner-occupied buyers, non-profit organizations as well as investors were permitted to use the product to purchase and renovate home.



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However in 1996, due to what appeared to be abuses of the product, investors were barred from using a 203k mortgage to buy homes. This ban, which at the time was thought to be only temporary is now a permanent restriction. There are other options for investors- such as the Fannie Mae Home Style Mortgage.

As the new millennium dawned, low interest rates and large inflows of foreign funds created easy credit conditions. The ability to obtain a conventional mortgage was available to all but the most challenged homebuyer. Because the need for government insurance was not considered necessary, FHA saw significant declines in the number of those using FHA insured mortgages. Real estate agents would discourage borrowers from using FHA insured loans. It was a “Sellers Market” with many sellers refusing to accept offers from FHA buyers’ altogether due to the fact that repairs were being ordered by the FHA appraisers- repairs that the seller would be required to make prior to settlement.

FHA saw the decline and made some changes to the 203b appraisal requirements in an attempt to be more competitive with conventional loans. FHA has eliminated many defects from the list of appraisal required safety and soundness considerations. For example, no longer is it required for handrails to be added to steps of three or more treads, nor are repairs needed to concrete walkways that are cracked and damaged.



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Most real estate professionals hailed this relaxing in appraisal requirements as a good thing for buyers and sellers alike. But in some cases, it only allowed sellers to transfer problems to unprepared and unsuspecting new homeowners.



Many believe that the easing of FHA appraisal requirements was one of the biggest reasons FHA loans started to show an increase in usage, but FHA didn't need to do anything to see this increase in selection of FHA mortgages by borrowers -- the subprime mortgage crisis that began in 2007 was all it took. Because of the mortgage meltdown, FHA was re-established as the preeminent source of much of the mortgage financing in America. In just four years, the share of FHA mortgages went from 2% to over 33% of mortgages in the United States. With the sub prime market gone, many of the riskiest and not so riskiest borrowers are now turning to FHA as the only way to get qualified to buy a home.

Like the conventional lending community, FHA has suffered from the alarming number of loans defaulting. However, despite the unprecedented rise in defaults and foreclosures -- a record 7.7% of loans, FHA, backed by Congress and if necessary, the American taxpayer, will continue to provide



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insured loans to Americans as our country works to recover from the crisis that is evidenced by so much unsold housing inventory and declining values.

The goal of FHA was to improve housing standards and conditions, provide adequate home financing systems or insurance of mortgage loans and to stabilize the housing market. What many people don't realize however was that FHA offers many different forms of housing programs to meet the variety of homebuyer needs.

The most popular and easy to obtain is the fixed rate 30 year mortgage. There are other types of mortgages, including an adjustable-rate mortgage that FHA offers.

FHA continues to reinvent itself to better address the needs of the home buying consumer in the United States. By convincing banks to lend again -- following the Depression, as well as standardizing procedures and mortgage products, homeownership has increased from 40% in the 1930s to almost 70% in 2001. Much to the surprise of those members of Congress who wanted to terminate the FHA in the early 2000's, FHA has played a major and increasingly larger role in the housing market during the mortgage meltdown -- helping to fight the effects of the recent deterioration in the credit markets and the overall economic recession.



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FHA is the only government agency that is completely self-funded -- operating solely from its own income, at no cost to the taxpayers. But, in times of need, there is an implicit guarantee the US taxpayers will help if needed. In 2008, HUD identified a projected \$143 million budget shortfall due to losses suffered by the FHA. It is the first time in 30 years and the reason that FHA has requested Congress for a subsidy bill that will cost taxpayers a half billion dollars over the three-year period of 2008- 2011 if FHA is unable to make changes in the way they do business.

In an effort to do just that- strengthen the soundness of the loans that are being insured, FHA is proposing sweeping changes to its insurance practices. By the mid to late 2010, FHA would like to change the guidelines and parameters of those eligible to receive government insured loans. FHA proposes to lower the amount a seller can assist a borrower with closing costs (expenses and fees needed to purchase a home above the down payment for the actual property) from 6% to 3%. With the average cost of buying a home in America being \$290,000; closing costs are approximately 14,500 (4-6% of sale price). The proposed change would increase the amount a borrower must have for settlement costs by at least 3,000 or more.

Additionally, until this projected change, FHA had not required any minimum credit score, if adopted, FHA will mandate an increased down



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payment requirement for those borrowers who have credit scores lower than 580.

Other changes to required fees like the PMI (private mortgage insurance) and the MIP (mortgage insurance premium) may make it more difficult for marginal borrowers to obtain loans but it is believed that these are necessary and reasonable responses that will help provide those best qualified to get a mortgage and screen out those who should wait and prepare a little longer before taking on the responsibility of home ownership.

One of its best and most useful products helps both the homebuyer and the neighborhood -- the 203K Rehabilitation Mortgage. With the creation of the FHA 203K loan, neighborhood blight and urban decline is reversing as will be further explained in the next chapter.



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What Is A 203K Loan?

It's May 2010, and Tony and Monica have decided to purchase a home. It's their first house, so they selected a home in a modest neighborhood, right on the edge of the city. But the home shows signs of age and poor maintenance on the part of the current owner. This seller doesn't have the money to make the needed repairs in order to have the home qualify for the FHA insured mortgage Tony and Monica are looking to get. Also the couple would like to see some of the areas in the home updated and modernized. What can they do? How can they “Have their cake and eat it too?” or in this case – buy a rundown home and get the money to fix it up at the same time?



Answer: The FHA 203k Rehabilitation Mortgage

A 203k Rehab mortgage provides a buyer with the ability to buy a home that is in need of significant repairs with an FHA insured loan and get the



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repairs completed after closing. In the past, when a homebuyer wanted to purchase a house in need of repair or modernization, the homebuyer usually had to obtain financing first to purchase the dwelling; additional financing to do the rehabilitation construction; and a permanent mortgage when the work was completed to pay off the interim loans. Often the interim financing (the acquisition and construction loans) involved relatively high interest rates and short amortization periods. Those days are gone as virtually no lenders offer conventional renovation mortgage financing as a result of the mortgage meltdown.

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, less the acquisition price of the dwelling.

The process may involve an inspection performed by a certified FHA 203k consultant. HUD does not require a consultant be used on all loans (see Chapter 8 on the 203k Streamline Program), but strongly recommends it. Most lenders will insist that an independent consultant be involved to ensure the work write-up has been



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created based on HUD standards for those loans of \$35,000 or more. This consultant is the buyer's representative just as in the normal home inspection process, but additionally the consultant also represents the federal government and the lender.

As will be explained in upcoming chapters, the FHA 203k consultant plays a key role in all phases of the home buying / ownership process-

- Assisting the buyer in evaluation of the home to be purchased
- Guiding the buyer in the decisions on the repairs and improvements to include in the rehab mortgage
- Helping the client with the selection and negotiation with the contractor or contractors who will complete the repairs
- Monitoring the progress of the rehab work throughout the course of the renovation,

And generally being the mentor, trouble shooter, arbitrator – and sometimes judge and jury during conflicts that sometimes arise in the project.

This may sound like a very demanding, time- and labor intensive undertaking and compared to the activities involved in a typical pre-purchase home inspection- it is. That being said- FHA Consultants are paid



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higher fees than home inspectors without having the liability and risk of recourse that home inspections bring with them.

The key to success as a 203k consultant as I have learned in the 13+ years I have been an FHA inspector can be summed up in five words:
ORGANIZATION AND ATTENTION TO DETAILS.

We will start that organization in the next chapter- The Certification Process.



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203k Consultant Certification

Five decades ago, when the 203K loan was created, home inspections did not exist. FHA did not have a specific methodology for determining an applicant was qualified to become a certified 203k consultant – so they used the one established for becoming an appraiser. For that reason, and because they were the only ones who knew about the program, almost all the people who became certified as 203K consultants came from the roles of existing FHA appraisers. This was okay at the beginning. Now the home inspection industry has generated professionals who possess the knowledge of residential building construction, while also having the advantage of being better positioned in the real estate process to help borrowers take advantage of benefits available to them through the 203K process. If I seem prejudiced toward home inspectors as the best candidates for 203K consultants -- I am. But it doesn't mean individuals from other types of professions cannot be equally successful in the role of an FHA consultant. Residential building contractors, engineers and architects, to name the most obvious, all possess many of the necessary qualifications FHA recognizes as prerequisites for



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certification. I also know several well-qualified former firefighters and teachers who are now great 203K consultants.

BACKGROUND/EXPERIENCES

The first step in assessing your qualifications to become a 203k Consultant is to create a resume of all of your relevant experiences and work history. FHA is typically looking to see a minimum of three years experience in one of the building trades (home inspector, contractor, appraiser, etc.). If you have changed careers but stayed inside the same industry, you need to show combined experience of three years or more.

Example 1 --

A licensed electrician with two years experience became a home inspector. He now has two years experience in that job. Based upon the combined experience in both the positions of electrician and home inspector, it is very likely that he will meet the experience qualification requirement. I say likely because the verification/certification process is conducted by the FHA regional field office personnel. The review process and determination can be subjective. As there is no recognized standard certification course or test, each field office judges candidates on a slightly different basis.



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(I'm working on a course now, and I have created a knowledge assessment test that you should take to show your competence in understanding the HUD mortgagee letters, etc. See Appendix)

Additionally, your ability to be certified may also depend on the licensing requirements your particular state has for the industry you are describing relevant experience.

Example 2--

A contractor seeking certification based on his experience as a general contractor in the state of Florida must have a Florida general contractor's license.

Example 3--

A home inspector working in Harrisburg, PA, would not have to provide a home inspector's license but if she were a home inspector in Philadelphia Pennsylvania-she would -- as the City of Philadelphia has a licensing requirement for home inspectors.

Fewer than half of states require a license to become a home inspector; more than 80% require general contractors, to be licensed work in your state. For current information, check your individual states website regarding home



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inspection licensing. For a current list of states which require a contractor's license, you should visit www.contractors-license.org.

It should go without saying-so I am going to say it-your resume needs to include all relevant licensing and certification numbers along with information on any affiliations and/or courses you have completed- especially those that provided documentation of your successful completion. As proof, you should provide copies of the licenses, certifications, etc.

COMPETENCE AS A 203K CONSULTANT

The second part of the certification application is a narrative that describes your skills and abilities to do those activities necessary for a 203K consultation. In this narrative, the FHA certification reviewer is looking to see the way you will be performing your cost estimations and work write-ups as well as a description of your knowledge and understanding of architectural plans-including an explanation of where you obtained this knowledge. You will need to describe the cost estimating tool you are or would be using to provide the costs in your rehab work write-ups. If you are not currently using a cost estimator, you may want to consider one of the following products:



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www.get-a-quote.com

<http://craftsman-book.com>

www.meanscostwork.com/free

Each of these sites offer reasonably priced products in a variety of formats (digital, online, print) to assist with your cost estimating needs as you start out. In the CD Working with Contractors, I describe a more accurate method of ensuring your cost estimates are correct, not just based on industry averages, but from actual pricing in your area.



TIP-

Once you have done 8-10 write-ups, you won't really need to refer to an estimator that often. Bear that in mind when considering the costlier products.

Another element that you need to include in this narrative or cover letter is a description of how you want to be listed on the 203K consultant roster (name, company, contact information, etc.). You also need to include your Social Security number (not your company's tax ID number) in your resume or your narrative. A 203K consultant certification is linked to the individual-the same as with most licenses and certifications



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CERTIFICATION AFFADAVIT

The final component of the application is the completion of a certification statement that you submit, stating that you have read and understand all the information published by HUD that pertains to the 203K program. The most important of these forms are 4240.4 Rev.2 - 203K Handbook and 4910.1 Minimum Property Standards. Careful review and understanding of these two forms is critical-but by no means should you ignore the other forms and documents provided by HUD. In the Appendix at the end of this book, you will find copies of all the FHA 203K related HUD documents as well as a certification checklist, and sample text to use as an example for your cover letter/narrative.

To assist with your preparation and to help you gauge your understanding of the 203K Program, I have created a knowledge assessment test as mentioned earlier. It is a good tool to show where your strengths and weaknesses are in your understanding of the FHA Renovation Loan Program. A copy of this test is n the appendix of this book. You can also download a copy of the test by going to the link "Knowledge Test" from the Power Group section of the 203kinaBox.com website.

When your package is complete, you need to mail it to the regional Homeownership Center (HOC) that serves your state. There are 4 centers



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that manage all HUD activity throughout the country: Atlanta, Denver, Philadelphia and Santa Ana. Placement on the roster by one HOC will be recognized by all HOCs.

- **Philadelphia, Pennsylvania:**

U.S. Department of Housing and Urban Development
Philadelphia Homeownership Center
The Wanamaker Building
100 Penn Square East
Philadelphia, PA 19107-3389

Serves: Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, Vermont, Virginia and West Virginia.

- **Denver, Colorado:**

U.S. Department of Housing and Urban Development
Denver Homeownership Center
UMB Plaza Building
1670 Broadway
Denver, CO 80202-4801

Serves: Arkansas, Colorado, Iowa, Kansas, Louisiana, Missouri, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oklahoma, South Dakota, Texas, Wisconsin, Wyoming and Utah.

- **Santa Ana, California:**

U.S. Department of Housing and Urban Development
Santa Ana Homeownership Center
Santa Ana Federal Building
34 Civic Center Plaza, Room 7015
Santa Ana, CA 92701-4003



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Serves: Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Washington, American Samoa, Guam, and the Commonwealth of the Northern Marianas.

- **Atlanta, Georgia:**

U.S. Department of Housing and Urban Development
Atlanta Homeownership Center
Five Points Plaza
40 Marietta Street
Atlanta, GA 30303-2806

Serves: Alabama, Florida, Georgia, Kentucky, Illinois, Indiana, Mississippi, North Carolina, South Carolina, Tennessee, and the Caribbean.

Expect a response from FHA within two weeks. In some cases, you may receive a request for additional information. Make sure to respond to these requests promptly. As you will learn from HUD Mortgagee Letter 00-25; if you fail to reply with requested information within 15 days, your application will be suspended. You will not be able to reapply for 90 days.



If you do receive a letter stating your application is incomplete, please feel free to call the HUD officer who sent the letter to you. I know for a fact that the people at the HOC's are very helpful and cooperative in giving any information you need to satisfy their information request.



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I am frequently asked how long it takes to complete the certification process. Obviously, every person's situation will be different, but if you have all the required documents available and are able to devote the time required to study the HUD documents, (and of course this training manual). You should be able to submit your application to FHA in as little as two weeks. Allowing for their processing activities, FHA will probably have a certification notice mailed to you in another 2 to 3 weeks. So all in all, 4 to 6 weeks from start to finish is a reasonable amount of time to expect to get certified to perform 203k consultations. But those last 2 to 3 weeks, while you await your certification will not be wasted-there are a lot of things to be done before you want to accept your first appointment. The next chapters will be devoted to an analysis of the consultation process-obviously critical to your certification application.



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The 203k Process- Part 1 Feasibility Analysis

The process of assisting a borrower complete FHA renovations identified in an FHA 203K mortgage can be divided into three parts:

1. Feasibility Analysis/Inspection
2. Work Write-Up and Contract Preparation
3. Post Settlement-Renovations.

While each 203K project can be as unique as the people involved, the best way to achieve success comes from one skill that if used throughout the project will ensure you will always be viewed as the ultimate professional--that skill is --organization. Many of the tips and suggestions I will offer throughout this chapter and the entire book were developed in a continuing effort to stay organized and consistent. These two attributes make for the most successful and profitable 203K consultants in our industry.

While a discussion of ways to generate 203k clients is provided in other elements of the 203k In A Box System, there is one important fact that I choose to regard as a “rule” in my office regarding the source of customers.



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For my consulting business -203K consultation requests come from the lender-and only the lender. I will be describing the players in Chapter 6, but take my word on it, the only member of the borrower's team that should request the 203K consultation is the loan officer. The best thing to do if a real estate agent or borrower calls to requests an appointment is find out who the lender is. Let the borrower or the real estate agent know that you are happy to assist them but you will need to have a consultation request form completed by the loan officer before you can schedule the inspection appointment.



When my office gets a call to schedule a 203k consultation from a buyer or agent, we will book the appointment but mention that we will need to have the consultation request form from the lender by the day of the inspection. Usually the borrower will call the lender and get the loan officer to call us.

You may say that the only people you need are the buyer, contractor if one has already been identified and the real estate agent who provide access to the property-right? Not necessarily.

Here's an example –

The borrower and the agent decided to use the FHA 203K loan to help purchase a property but didn't mention this to the lender/mortgage company



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they spoke with before they started to look at homes. That borrower may be working with the lender who doesn't even offer 203K financing. If that is the case-the loan needs to be referred to a company that can provide the rehab mortgage for the buyer. Days, even weeks may pass before that borrower is ready- if in fact they do qualify at all-for you to perform a feasibility assessment.

Upon receipt of the consultation request form completed by the loan officer, you should contact the borrower to get the additional information you need to schedule the appointment. A sample of the consultant request form I created and use very successfully is shown on the next page.* ¹

There are several questions key to the successful start of the consultation process:

1. Obviously, as you would do for a regular home inspection appointment you will get the general facts about the property (address, type, size, age of building, means of access).
2. You will want to find out if utilities are on or can be turned on for your inspection. If they are not or cannot be turned on, it may affect the total cost of the renovation as well as the cost of the loan. Every effort should

¹ A copy of the Consultant Request form is also available in the Power Team Section of the 203k In a Box website.



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be made to make sure utilities, if at all possible are one prior to performing the feasibility / home inspection.

3. Additionally, it is very important to know if a contractor has given any estimates for the work requesting to be done.

All of this information along with the consultant request form is very useful in helping you plan the project.

In the below sample consultant request form, the borrower is purchasing a home for a sales price of \$200,000. The lender lists the estimated repair amount to be \$35,000 and the maximum amount the borrower qualifies for is \$250,000.


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**203(k)/Conventional Renovation Mortgage
Consultation Request Form**

Mortgage Company: ABC Loan Co
Mortgage Specialist/Officer: Donna Rogers Phone # 877-778-8778x12
Mortgage Officer Email Address: dprogers@abcloansci.com
Borrower: David & Margaret Washington Email: dwash342@myemail.com
Home Address: 34 W. Daniels St Apt 3A City/Zip: Smithville Pa 18787
Home Phone No: 678-768-1231 Cell Phone: 847-981-3409
Property Address: 725 Sellersville Pike City/Zip: Smithville Pa 18787
of Units: 2 Owner Occupied Investor
203(k) Mortgage HomeStyle (Fannie Mae) Renovation Mortgage
Estimated Loan/Purchase Amount: 200,000
Maximum Loan Amount: 250,000
Estimated Rehab Amount: 35,000
Date Plan Ordered: 4/4/2009
Date Plan needed by: 4/15/09
Projected Settlement Date: 05/30/09
FHA Case # or Loan # _____

119 S. Easton Road • Suite #6 • Glenside PA 19038
Phone (215) 886-0010 • Fax (215) 886-0011
Email info@valuehomeinspections.com



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In your initial conversation with the borrowers, you learn they visited the property only one time and at that time the utilities were off. They further explained that no other professional inspector or contractor had seen the property and that it is in “pretty bad shape” with problems in almost every area. What does all this say to you? To me, it says that this may be a project that might die at the feasibility inspection.



TIP

Borrowers typically underestimate the cost and scope of work needed to make a home meet their expectations and/or minimum property standards by usually **100%**!

Looking at the maximum amount of mortgage the borrower will qualify for in relation to the sales price of the property, I would be concerned right up front that the repairs needed plus the contingency (which may need to be increased if utilities cannot get turned on for my inspection) may easily and quickly exceed their budgeted qualifying amount.

Granted these are assumptions and many variables can alter this scenario, but based on the preliminary data-I would encourage the buyer to schedule a feasibility home inspection- not a 203K full work write-up at this time.



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What's the difference?

First of all, as mentioned in the Introduction – if you are already a qualified home inspector-and you are performing this evaluation in lieu of a separate home inspection, you are able to charge a home inspection fee; your usual fee-not the \$100 fee HUD states is allowed for a feasibility evaluation.

As the FHA consultant, the report you create will determine whether the 203K project should be considered feasible and as the home inspector, you are giving a report that may be used by the borrower and their agent to assist in the negotiations, as would be considered normal with most pre-purchase inspection scenarios. If you do a feasibility home inspection for the borrower and in that report you identify significant safety and soundness concerns that would normally be considered valid items for negotiation with the seller for compensation and/or repair, your report may help assist in getting the sales price of the house lowered enough to offset the higher mortgage that will be created by the repairs you identified in your evaluation. This change in sales price might bring the borrower back in line with their qualification range. If not, your home inspection report/ feasibility assessment may be used to allow the borrower to withdraw their offer and get their deposit refunded (obviously it will depend upon the terms of the agreement for sale and other factors that would best be discussed with an individual real estate agent on a case by case basis) Along this same line, another important question to ask



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when scheduling the inspection, is the amount of time the borrower has to complete the home inspection in order to be compliant with the home inspection addendum of the agreement of sale. You want to perform your inspection of the property within that time frame to give your borrower the maximum benefit of this report.

WHAT TO LOOK FOR IN YOUR FEASIBILITY / HOME INSPECTION?

The reason a home inspector makes the best FHA 203K consultant, is because as inspectors, we are ideally suited for the job of assessing minimum property standards deficiencies as well as reporting on the needs for correcting the problems viewed. When you are in the property, you are going to be performing assessments similar to those that you would perform during a home inspection. The level and depth of the evaluation you perform will depend on the condition of the property, the scope of work suggested, and the desires of the borrower.

For example, if the borrower is describing that they are planning to completely renovate the interior of the property down to the framing of the walls, it isn't critical for you to check outlets, operate windows or identify deficiencies in the finished surfaces – as these components will all be removed. The evaluation you will perform in this example will basically be an assessment of the overall structural soundness of the property and to



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evaluate the major systems- unless the borrower is planning to replace them as well. You will want to get approximate dimensions of all the affected room areas as creating your work write up will be based upon the costs to renovate the property and bring it up to its fully remodeled condition. That inspection will be largely an information gathering activity from the borrower as to the scope of work and the type of systems, components, fixtures and features they are looking to have installed in the property. This type of inspection, which I prefer over a limited renovation of a home, is one where you need to explain to the borrower the different price range for materials and components (i.e. builders or standard grade, economy grade, and premium).



Most borrowers have “champagne tastes with beer budget”. It is up to you to help them understand what they can afford for the money they have available to spend. If you are fortunate enough to have a borrower who has both the “champagne taste” as well as a “champagne budget” it is a very enjoyable project to describe all of the features and additional finishing treatment that can be done in the home.

The other type of evaluation is one where you are asked to identify only existing minimum property standards deficiencies. This is where a borrower has said to you, or the lender has said that this borrower can only afford to do those items that are required by the FHA appraiser. At that point, you are



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the appraiser's eyes and ears. The appraiser will be using your report to confirm the fact that all minimum property standards deficiencies have been addressed in your work write up. In the appendix is a PDF file offered by HUD that describes areas of that home that you need to ensure you evaluate in your inspection of the property. Your evaluation of the property- the actual function of inspecting the home – does not differ from the procedure you use when you perform a home inspection. The difference is in the degree and severity of the repairs you identify an FHA appraiser would require be corrected in order for the home to qualify for an FHA loan. Health and safety hazards that you would find unsatisfactory in a typical home inspection, for the most part, will be items that would fall under the heading of minimum property standards defects. It is very important that you carefully evaluate aging systems such as the heating system, hot water heating and cooling system and electrical systems.

For example: You are in a home that has a 50-year-old heater. It is operational and does not show any indications of obvious defect. However, you see rusting inside and outside the unit and you notice significant wear and poor maintenance. You may want to report on your feasibility study that you recommend replacement of the heating as the likelihood is that the unit may not have a remaining life expectancy of two years.



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This two year expected longevity is a general standard or “rule of thumb” and should be kept in the back of your mind as you go through every home. When you are inspecting a roof and it looks in poor condition, or you are speaking to the owner of the property and they tell you that the roof has had no activity in the form of ongoing maintenance, repair or replacement within the last 10 years, my automatic documentation on my FHA feasibility assessment is that the main roof needs to be recoated at the very minimum (this refers to flat roofs) or replaced (if it is a shingled roof with shingles that appear brittle, damaged, curling or show other signs of excessive wear) as the roof shows signs that there is a potential for leaks in the very near future.

Your job as a 203K consultant is to make recommendations, as well as mandate certain repairs. When you are writing up your report, be careful not to overly insist on the items to be mandated that may only need to be reported a recommendations for the borrower to consider.

As home inspectors, we are always concerned about the liability that we incur when we make a statement that something is or can be considered functional at the time of our inspection. With an FHA 203K inspection, that liability is largely removed and passed onto the contractor. In your report,



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you may identify items that if found during a regular home inspection, you would record as “marginal”. As a 203k consultant, you should put in your feasibility assessment that you are only *recommending* that this “marginal” item be repaired or replaced as a result of its advanced age or present condition. As it will appear in your report, the contractors who will be bidding on the repairs will give their “expert” opinion and cost estimate for the amount and type of work needed in order to address the risk of future defect in the system. It will then be up to the borrower to decide if they want to make that correction as part of their renovation. If the borrower chooses not to, you have no liability if the system fails after closing as the borrower and the contractor had decided correction of the system was not desired or viewed as a necessity. As with a regular home inspection, it is not uncommon for components that showed no signs of defect (except perhaps advanced age) to develop problems or fail altogether after settlement.

We had mentioned earlier the situation of trying to ensure utilities are on at the time of the consultation. At this point may be saying to yourself- “*so what if the utilities are off?*”

If the utilities were not on for your inspection, then you will need to plan to increase the contingency allowance to account for any unforeseen problems that may arise when the utilities are activated- after settlement. The amount of the increase in contingency is a variable. For the typical full 203k rehab



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loan there is a mandatory minimum 10% contingency added to the rehab amount.

If you are doing a 203K consultation and the borrower is replacing everything in the home- all major systems and components (i.e. completely new heating system, electrical system, a total plumbing system replacement)- in short all of the elements that are not evaluated because the utilities were off- then there will be no need to increase the contingency. There most likely will not be any unforeseen problems – everything will be new.

The corollary to this scenario is when a borrower does not want to replace any of the major systems or only wants to do minimal repairs (if indicated) to the major systems. As the utilities were off and a thorough inspection of the major systems was not possible, you may want to increase the contingency reserve proportional to the likelihood that problems may be uncovered after settlement. The maximum increase to the contingency is an additional 10%. You can increase your contingency any amount you like from one additional percent up to the full 10% extra making the total contingency 20% of the project cost.

An important element to mention to a borrower when discussing the fact that there will be a contingency reserve is the possibility that the unused



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contingency funds may be used at the end of the renovation project to effect repairs that were not listed on the Work Write-up.

The formal definition and expected usage of the contingency is defined below:

The contingency reserve is an extra amount of money that represents 10% of all the categories of improvement. FHA has determined that in the normal course of a renovation project, there may be up to an additional 10% of cost changes or required additional repairs per line item. When you are increasing the contingency, you are not increasing any specific category of improvement but are increasing the overall reserve percentage for the entire project. Therefore, if you are increasing the contingency to 15%- in theory- the reserve amount for each line item is increased by that 15%.

The true purpose of the contingency, again, is to ensure funds are available in the escrow amount to address any unforeseen problems that may arise during the renovation. This is FHA's way to help protect the borrower from having to incur any out-of-pocket expenses to complete the rehab of the home. It is the expected course of action that at the completion of the renovation project, any unused portion of the contingency will be applied to the principal balance of the loan. However, life does not always go as expected- nor do most (dare I say- all) home remodeling projects.



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An alternative use of the contingency is one that helps a borrower be more willing to accept this contingency as part of the write up. It makes it easier for the borrower to feel comfortable with this extra amount being added to their loan. When discussing the contingency reserve and it's usage with borrower, explain that if towards the end of the renovation, the contingency funds may be used to complete repairs or upgrades that were not included in the formal work write up.



TIP

I often use the example that if the borrower was planning to purchase major appliances for their new home, the cost of these appliances may be paid out of the contingency reserve.

Many times if the 203k project is a very large renovation, of over \$100,000, it usually is a very comprehensive scope of work affecting most if not all areas and systems of the home (i.e. whole house additions, total “gutting”, etc.). In these circumstances, the contractor will put in his specification of repairs, every element and component that will be included in the renovation. For example- if the borrower is planning to have granite countertops and ceramic tile flooring in the kitchen, the contractor will include the cost of these higher end items in his contract bid. All of these finishing treatments- and they usually are the most expensive portion of the



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renovation- add up. Many times the inclusion of these more costly elements will cause the project to exceed the borrower's financial limits. When this situation arises, suggest to the borrower that they budget for less expensive elements, thereby keeping the overall project cost low. Explain that the additional costs for the more expensive items may be deducted from the contingency at the end of the project - which, conveniently is also when most of the expensive components are installed.

(Remember- there is going to be a very large contingency - \$10,000 using the \$100,000 total project cost used as the example at the beginning of this section.)



It is very important to ensure the borrower clearly understands and accepts the fact that if a major, unforeseen problem is identified after settlement, the contingency funds must be used to correct that issue first and foremost. If this should happen and not enough money is available in the contingency to pay for the higher priced components, the borrower must agree to either be satisfied with the lower priced items being used or to using their own funds to pay for the price increase to get the desired higher cost components.

So using the example that the borrower was looking to install ceramic tile flooring in the kitchen- the specification of repairs would list the cost of goods as vinyl in the Finished Flooring Category- a much less expensive



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material than ceramic tile. When it comes time to install the flooring- and if funds are available in the contingency- the borrower may select to have the higher priced ceramic tile flooring installed. During your draw inspection, after the floor has been installed; you will complete a change order indicating a cost increase for the extra cost to change from vinyl flooring to ceramic tile.



Tip

You may want to tell the borrower not to mention this plan to the loan officer (or anyone other than the contractor). Many loan officers, underwriters and processors do not like any discussion of planned use of the contingency. If this is the first time you are working with a specific mortgage company, make sure you identify the procedures for submitting changes at the beginning of the project- **before** you actually need to submit one.

The 203k home inspection / feasibility study will involve you using some of the tools you already have in your tool bag, but may require the purchase of some additional tools in order to easily and quickly complete the evaluation and information gathering needed to prepare the 203k documents. As mentioned, the 203k feasibility study is usually not as exhaustive as a typical home inspection. If the borrower has already had a home inspection performed by some one else, you should request a copy of that report as use as supporting information for your evaluation. In that case, the tools you



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would need to do your evaluation may be as few as your flashlight and digital camera. Depending on the expected scope of work and the status of the utilities at the home, I always take with me to the property regardless of whether or not another inspector has evaluated the home, my outlet tester and tape measure.



If you do not have one, as a 203k consultant, you should invest in a laser tape measure- one that can calculate the area and square footage. I find the use of a laser tape measure is invaluable in a 230k assessment for the purpose of quickly generating usable figures for square footage in rooms that will need drywall, flooring or painting work performed. The one I used when I first started is made by Strait Line. It costs around \$20.

If you are asked to do a full home inspection in addition to the feasibility analysis, you may choose to bring your entire tool bag. It is not a requirement, however, my staff and I use carbon monoxide and combustion gas detection meters as well as moisture meters in our standard home inspections. These tools help assess the condition of the major system and give clues and indications if repairs or replacement needs are warranted in ways that a visual only inspection may not provide.



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We find it very professional and useful to create an inspection report binder with the forms that will be needed along with a separate binder that I use to put all the information I need for my records and reporting. I have found it a good practice to print these forms using 2-part NCR paper and provide them to the client at the initial consultation appointment. When the borrower has signed these contractors, agreements and other information forms- they will keep one copy in the inspection binder and we have a copy that we place in our binder for our records.

At a minimum, you should provide your borrower the following forms:

1. Consultant's Allowable Fee Agreement

This forms explains the duties you will be performing and the associated costs for these services

2. Consultant's Limitation of Liability Agreement

This form describes the contractual limitations of your services. (It should be very similar to your home inspection agreement/contract)

You may want to give these forms to the borrower in advance of your appointment by email in addition to having the printed forms at the inspection for the borrower to read and sign in your presence.



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Additionally, I have created a form called the Independent Consultant Fee Schedule. It provides a complete breakdown of the fees for all services you will be performing on a sliding scale based on the total cost of the project.

Another form I created and find very useful is the Introduction to Contractor Release. This form is printed on 2– part NCR paper and is signed by the borrower at the initial consultation if the borrower does not have a contractor or would like to get competitive bids from other qualified contractors. You should “introduce” the borrower to contractors from your database only after they complete this form. This release holds you harmless in the event of any dispute that may arise between the borrower and the contractor after work begins. If you like, you may want to show your attorney this form to make sure it is correct for your state/area.



Note I used the word “*introduce*” when describing how you connect your borrower with contractors in your database. Do not use the words “recommend”, or “refer” when talking about the contractors you have worked with in the past. If the borrower feels in any way that you are steering them to use a specific contractor and things go bad after settlement (and it happens to the best contractors), you will be enjoined in any legal proceedings the borrower initiates against the contractor. You don’t want that!



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When you are scheduling your 203k consultation / home inspection, you will want to allow at least 2 hours – longer if it a larger project.

Carefully photograph all areas of the home, even those that are not being renovated for your personal record of the condition of all areas of the home prior to settlement. Let the borrower know that based on the information required and their plans for obtaining bids from contractors another appointment at the property may be necessary.

Always explain the timeline for the 203k loan process to the borrower, detailing the steps needed to get to closing. Explain to the borrower and more importantly their real estate agent that the 203k loan does close in a reasonable amount of time. But the timeframe is based upon the point at which the borrower has selected and completed negotiations with the contractor who will take on the renovation project. I usually explain to the client and the agent that settlement can be expected to take place 8-9 weeks from the day of the appointment – if the borrower already has a contractor. If they do not have a contractor and will need to send out requests for bids, review bids submitted, etc. the borrower should plan on going to settlement 6-7 weeks from the date estimates from the selected contractor are submitted to you for use in the final work write-up. The most important thing that everyone needs to be aware of is that the underwriting of the loan usually requires 3-4 weeks to process the 203k mortgage and they cannot begin that



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process until the borrower, contractor and consultant are all in agreement with the scope of work to be performed.



Remember, the appraisal can not be completed until the Specification of Repairs and Work Write-up is submitted by you because the appraiser needs your information to calculate the after repaired value.

If you have been given a settlement date on the consultant request form, and it is within the same month as your initial consultation appointment, you may want to let everyone know that it is most likely an unrealistic date. You will want to find out if moving the settlement date will pose a problem with the seller. Some transactions are so time sensitive that a postponement can mean a cascade failure of other closings and can actually jeopardize the borrower's ability to buy the home. Letting the borrower and their agent know right up front, gives the borrower and their real estate agent time to determine what ramifications a delay in settlement will cause. It may even be the difference between a feasible 203k renovation project and one that is D.O. A. (dead on appointment)

AFTER THE PHYSICAL INSPECTION

O.K., you have completed your initial assessment and feasibility analysis of the property, collected all your information about the desired renovations and mandatory repairs that you identified at the home and have taken all the photographs you feel necessary to process the package; now the work



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begins. (Oh, did I mention that you should have received a payment for at least the cost of the feasibility home inspection that you performed. You should never walk away from the property without collecting a fee. But you knew that, right?)



At some point, you will encounter a lender, real estate agent or borrower who says that they were told the consultant is paid at settlement. Don't take the bait. Think about it- the purpose of your feasibility study is to determine whether or not settlement takes place. Tell the borrower that you require payment at the time of service but they will be refunded at the settlement table.

The form that you will complete to help the borrower decide how they will proceed with the purchase of the home is called the Feasibility Analysis. It should include all the required, recommended and desired renovation line items with the estimates for the cost of each. I also create the minimum property standards checklist available in the Rehab Estimator software. This form has a description of the components and the unsatisfactory findings that mirrors much of the information on a standard home inspection report. Many real estate agents will use this form in the same way as a home inspection report to negotiate with sellers for price concessions based on the findings in the report.



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Always “cc” the real estate agent on any forms you send to your borrower (as with a regular HI). Caution: it is not always a good idea to “cc” the loan officer on the feasibility analysis. Loan officers are always in a rush to get to closing, as are realtors as are borrowers.

A confusing situation may occur if the loan officer misinterprets that initial report as a final work write-up and submits it to the underwriting department to complete the processing of the loan. (If you are using the Rehab Estimator software, there is a paragraph at the very top of the feasibility analysis report that warns that the feasibility report should not be considered a final document to be used for underwriting purposes.) If it is accidentally used for the underwriting process, the loan, unbeknownst to you, may be based upon those preliminary figures and have no bearing or relationship to the numbers the contractor actually agreed to do the work for. This has happened to me on more than one occasion and it was very difficult coordinating the project after settlement. For that reason, I usually do not send a copy of the feasibility assessment to the lender. I will send them a copy of the Minimum Property Standards and the photo album I created. This lets the lender know that the borrower has received their feasibility study. Once you have delivered the reports to the borrower, the ball is in their court. Schedule the file for a planned follow-up telephone call within 5-7 days.



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It is a good idea at the end of your evaluation to tell the borrower to contact their lender as soon as they get the feasibility report to discuss whether or not the projected rehab costs are “do-able” considering the borrower’s financial situation. You may also want to remind them of this in the cover letter email you send to your borrower with the completed feasibility report.

Large projects requiring architectural exhibits.

If the project described to you is a large renovation that includes structural modifications (addition of a floor, addition to the front, side or back of the home, complete redesigning of the interior living space), architectural drawings will most likely be required by the contractor, as well as the Township in order for permits to be generated for the work to be done. You will save time and confusion if you suggest the borrower get at least a preliminary set of plans created prior to your evaluation. Without them, your estimates may be inaccurate as the borrower will probably change their minds and the scope of work when the architect finishes sharing his or her thoughts on the project. Also, most contractors will not give bids until the architectural plans are completed. I always have several architects who I “introduce” (I almost said refer) to the borrower.



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Tip-

I screen architects based on the areas they serve, their fees and the turnaround time for delivery of plans. Some architects do great work but take 8 weeks to get even the preliminary plans completed.

You have now completed the feasibility report and delivered it to the borrower. The next phase of the project will be what gets the borrower to the settlement table and beyond.



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The 203k Process Phase 2 The Work Write-Up

If things go well at the feasibility inspection, then a few days after you deliver the report you should expect the borrower to notify you that they want to proceed to the next step. What is the next step? Creating the Specification of Repairs.

The Specification of Repairs (S.O.R) is the actual name used by members of the lending community for the Work Write Up (WWU). The terms are used interchangeably prior to settlement but after closing when talking to the disbursement officer, always refer to the document as a Specification of Repairs.

The creation of the S.O R package is the most important phase of the entire renovation project. Careful attention to detail at this stage, more than anywhere else will all but guarantee a successful post closing renovation. Not taking the time to completely address all the potential issues that may arise after settlement will cause you to get caught in Murphy's Law of 203k



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renovation: Whatever repairs are not clearly specified in the Work Write Up will be the ones that cause conflicts after settlement.

When you created you feasibility analysis you may or may not have provided a lot of detail. Most consultants believe that for the most part expending a lot of work on the feasibility report is counter productive (basically a waste of time-especially if you know the borrower will not be purchasing the property based on the amount and cost of the defects found at the feasibility inspection).



Tip

After the many years I have been a consultant, I usually know the projects that will be D.O. A. (Dead On Analysis). On those projects, I usually create a very generalized feasibility report-enough detail to allow the buyer and “OUT” without providing exhaustive details no one else will probably ever need.

In the Rehab Estimator software, the feasibility analysis data entry sub-menu creates a report that looks very similar to the full Specification of Repairs. In fact, the data entered into the Feasibility Report screen will populate the Specification of Repairs fields without you having to re-type anything. (I am pleased to say that this was my suggestion to Larry-creator of the system).



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When you enter the repair items into the Feasibility Report, you should always indicate the “Level”- an M, R, or D. This will be important at the bidding process if the buyer finds the need to remove repair items from the project in order to stay within the mortgage loan limit. If you didn’t put this key next to each item at the feasibility state- you definitely should now.

Items with a Level “M” will denote those repair needs that are mandatory health or safety corrections. At the very least, these are the repairs the borrower must complete as part of the 203k project. These are the repairs/corrections the FHA appraiser will be checking against his physical inspection findings.



Remember chipping, peeling paint usually does not rate as an unsatisfactory finding in a home inspection but in a home built before 1979-for the 203k process it is.

A Level “R” is given to those repair items on the Specification of Repairs that you or the contractor “recommend” the borrower include in the 203k project. These are items that are perhaps marginal in condition but functional at the time of inspection. Also use any repair items that you suggest would improve the energy or cost efficiency of the home. (For example I



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“R”ecommend upgrading to on demand water heating units where the family size is large or the location of the water heater is far from the baths or kitchen.) Usually, a borrower will try to keep these repair items in the scope of work.

The wish list or “dream home” items the borrower mentioned to you as you entered practically every room in the house during the feasibility inspection are marked with a “D” for Desired (or in some cases “Dream On”) items. You can usually tell the borrower is about to “share” when they start by saying “Now in here we though...” Or my personal favorite “We saw on the HGTV channel where...” I start to cringe when I hear that because I know the suggestion is probably going to be too expensive or completely impractical for this project. You don’t want to discourage the borrower from telling you everything they are thinking of doing to the home - better to know now before settlement. After settlement is the worst time to find out the borrower wants to completely change the planned project. (More about that in the next chapter.) Be honest with the client. Tell them what the desired items will cost and how they will affect other required work. In most cases the borrower will eliminate these “D” renovation items before the project is finalized.

Self Help Loans



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FHA allows a borrower to complete repairs themselves provided the borrower has verifiable qualifications. This Self Help 203k loan can be a little more involved than a 203k project using a general contractor.

FHA only allows a self-help borrower to receive escrow funds for the materials required to complete the renovation. When a project using a general contractor includes both materials and labor-the government does not allow a borrower to be paid for labor to renovate their own home.

A self-help borrower is allowed to escrow labor cost for repairs that will be completed by a sub-contractor. You will need to carefully review the planned number of sub-contractors the borrower plans to use. As with a non self-help 203k a borrower is allowed to use up to 4 individual sub-contractors in lieu of a general contractor. Make sure the borrower fully understands the draw process will be different from a general contractor 203k. Payments are paid based on submission of receipts only.

Because self-help 203k loans appear riskier to lenders the underwriter may require that you create a Specification of Repair that shows the costs for a general contractor who charge to complete the project. The lender may require as a condition for getting the mortgage that the self help borrower accept the higher amount be escrowed for the rehab amount. This is an insurance measure protecting the lenders investment.



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If when you begin the draw process you determine the self-help borrower is not or cannot complete the work as required, a general contractor can be brought in with adequate funds available to cover the increased costs that having a general contractor will entail. The borrower will still only be paid for work supported by receipts for those items that they completed themselves. If the project goes well with the self-help borrower correctly and properly completing the renovations, the unused extra funds can be applied to the principal as with all 203k projects.

Contractor Bids

When the borrower notifies you they are ready to get contractors involved, you should review with the borrowers the items in the feasibility report you created for their project. You need to discuss with them any changes they want to make to the scope of work before the bids go out to the contractors. If you created a very generalized feasibility report, you will now need to revise it to add sufficient details for the contractors to clearly understand the bidding requirements.



I advise my borrowers leave in all the “D”’s and “R”’s and lets see what the contractors estimates will be for those items. I do this for 2 reasons: 1.-I get



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information on costs of the more unusual items for my future reference and 2- the borrower can always ask the contractor to perform the deleted “D” renovation later and all but forcing the contractor to honor the price quoted from his bid.

Using the Rehab Estimator software – you can create the SOR and the contractor’s bid package in the one step. Actually you can create and deliver all three reports – feasibility, SOR and Contractors Bid at the same time. In the Rehab Estimator software, the work write up differs from the feasibility report however in that the feasibility report only shows the total costs for each category of improvement. The SOR shows all costs – line item pricing as separate materials and labor figures or a combination of both. You and the contractor decide how detailed your will choose to make the pricing of the items. A detailed breakdown of labor, material, time, etc. is not required by the lender or FHA. The contractor’s bid form called a Bid On Repairs, shows all line items and descriptions but hides all pricing estimates.

You may want to counsel the borrowers not to show the feasibility report or SOR to the contractor- even one the borrower brought in to the project. If the contractor sees a figure higher than the one they would have put in their bid, the contractor might change his estimate to the higher number, using the rationalization that the borrower already saw this higher number and probably accepts this as the expected cost for the work to be completed. Many factors affect a contractor’s bid- variables such as location of the



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project, time of year, amount of projects they are currently working. The same contractor in the beginning of winter may reduce his price for a project hoping to get a job that will at least keep his workers busy through the slow winter months.

When making your revisions to the SOR, pay close attention to the cost of goods for those items where great extremes in cost can cause friction after settlement. Cabinetry, light fixtures and flooring are just a few of the areas you must specifically list a cost allowance for the actual component. Never assume a borrower understands the methodology behind contract job costing. It is not unlikely for a borrower to assume they can spend the entire \$3000 on the refrigerator selection when they see the reference in the SOR of “Materials 7 Labor - \$3000. Borrowers and contractors will end up fighting over what portion of that \$3000 is for the unit purchase and what amount is for the pick-up, assembly, hook-up, etc. Somewhere in the category- either on the specific line or under the comments section- list a cost of goods price for every questionable item. When the borrower sees they can only choose a refrigerator that costs \$2250, there will be no conflicts later.

You should expect payment at the completion of the update to the S.O.R. when you are ready to forward this report and the contractors bid on repairs



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form to the borrower. Notify them that they need to pay for these forms but no further payments will be required when the time comes to update the report with the successful bidders costs.



I used to give the Feasibility Report and contractors bid forms after the initial consultation and not ask for the WWU payment until bids comes back from contractors. I found myself waiting weeks, even months before I saw the balance of the money due me. In some cases the borrower “forgot” they even owed me any more money. As described above, I no longer process the flow of payments or reports this way.

Before you deliver the completed package to the borrower you know who the borrower will be using to complete the repairs. If the borrower has asked you to introduce contractors to them- you may want to plan a contractor bid meeting at the property after you have completed the SOR and Bid forms to allow the borrower to meet prospective bidder as also to review the planned scope of work with these interested contractors. As this constitutes another site visit, you can charge a fee for your participation at this evaluation.

It is always a good idea to have a meeting with the contractor who will be completing the renovation project. If the borrower had already chosen the contractor before you first start the process, you should strongly encourage



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that contractor to attend the initial feasibility inspection. If there will be a bidding contest, walking through the property with the contractors and borrowers, bid form in hand, help keeps everyone on the same page- especially the borrower.

Give a specific deadline for contractors to submit their bids. You determine how involved you want to be in the contractor selection process- from nothing to personally reviewing all bids with the borrower. However, the borrower makes their choice- once made – you need to get a copy of the winning contractor's bid to make sure it is complete. Don't be surprised when you have gone to all the trouble of listing 12 items to be included in the plumbing section and the contractor puts one number for all. You will need to do one of two things when this happens:

1. Split the number using your judgment and tell the contractor he will be paid based on the new breakdown.

Or

2. Give the bid back to the contractor and tell them to break everything down and put a number next to every line item.

Most township and municipalities require permits for all renovations to the major systems. Put a separate line item on the S. O. R. for permit fees in every category where you expect one will be needed- making the notation in



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the comment section that all permits are required to be submitted with the first draw-because they are.

Once you have finalized the S.O.R. based on the contractor's bid you are ready to create the 203k package. At a minimum it needs to include the following forms signed by you:

1. S.O.R
2. Initial Draw Request
3. Consultants Certification Statement
4. Consultant's Identity of Interest
5. Permits and Certifications
6. Homeowner and Contractor Agreement

Forward these documents to the loan officer. The loan officer will in turn send them to the appraiser and underwriter to complete the mortgage processing.

You may think your work is done-that all you have to do is wait for notification that settlement has take place-you'd be wrong. Underwriters and appraisers will scrutinize every word, every checked box on your forms. Don't be surprised if you have to make a last minute adjustment and sometimes whole sale revisions as required by the members of the



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mysterious world of mortgage underwriting. In some cases it is just the storm before the storm-Post Settlement Renovation.



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The 203k Process Phase 3 Post Settlement Renovation

Congratulations! Your borrower completed settlement last week. You know this not because the lender sent you a notification or because the borrower called you-but because you called them. When you do learn the settlement concluded, you should send an email to the borrower and the contractor advising that work should start as soon as possible.

Never assume anything you said before settlement will be remembered. Remind the contractor that all permits must be obtained before the lender will pay on any repairs. The whining will begin usually at this point. When the contractor complains that he doesn't understand why he must get permits for work that will not take place for weeks or even months to come.

Your response or explanation can be a long and detailed explanation of how by getting the contractor to pull permits in the beginning of the project, the lender is ensuring all the required sub-contractors or required professionals are already involved on the project. Or you can simply say No permits-No pay.



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You also need to stress the importance of the contractor notifying you immediately if something happens on the project that requires a change to the scope of work. The contractors must inform you and get your approval of any additional work in writing before he makes the proposed changes or risk not being paid for the work performed.



Be aware that after settlement Borrowers will still want to change the contract. Changes they seem to think should take place for no extra cost. I tell all contractors I work with to make sure no one they send to the property communicates anything with the borrower. All sub-contractors need to refer the borrower back to the general contractor for any proposed changes no matter how insignificant it may seem at the time.

When a contractor reports a need to make a change- you may need to advise the lender before you submit the change order request. Most lenders will not disburse contingency funds until 80-90% of the work on the original contract has been successfully completed. The exception are changes that are required for Health and Safety Reasons or because the change was required to complete items from the S.O.R.



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Typically the borrower will make one or more requests for changes that are not necessary corrections but merely a “desired” upgrade. The contractor may decide that this “D” upgrade or renovation need to be completed sooner in the rehab process-before the 80-90% completion threshold has been met. Your advice to the contractor and the borrower both should be that the contractor should use his or her standard of billing procedures to be paid from the borrower for the extra work at the time the work is performed. When the time comes and there are available funds in the contingency reserve, you will submit a change request to reimburse the borrower for the repairs. The contractor who does extra work without payment expecting to get payment from the contingency may get burned if unforeseen problems deplete the contingency. Getting money from a borrower after the work has been completed messy-even legal process.

Draw inspection should be performed at least every 30 days of renovation. It is the responsibility as the 203k consultant to keep track of the intervals between draws and demand one when there has been an extended lapse of time.



With so many open projects, I found contractors were calling everyday to get draw inspections scheduled. To keep the chaos down to a minimum, I dedicated



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Thursday of each week as my 203k draw day. Now all the contractors know what day they can expect to be scheduled to have a draw appointment.

When the contractor requests a draw, you should email or fax the draw request form. Instruct them to enter amounts in the lines where he has completed work and fax it back to you prior to the day of the draw appointment. Why? Why not just find out when you arrive at the property?

Good Question!

Answer: The number of draws is fixed-set prior to settlement-by having the contractor show you the amounts and areas he is requesting payment you are making sure an adequate amount of work has been done so the draw is not “wasted”. Also, by knowing what categories the contractor is drawing against, you will know what tools to bring to the appointment.

At the draw appointment, at the very least you should take a copy of the S.O.R., the draw request form, lien waiver release and of course your camera.

Scheduling the draw appointment should include the borrower as well as the contractors. There is no specific requirement in the HUD regulations that either or both of them attend. That being said to ensure that everyone is



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happy with the flow of events, both borrower and contractor should attend every draw inspection.

When the borrower is two people-both signatures need to be on the draw paperwork. I always send a blank copy of the 2nd page of the draw request to the borrower by email. I ask that if both borrowers will not attend the one not attending needs to sign the form so that the borrower who will attend can bring it to the appointment.

Check the completed work against the S.O.R. You want to make sure that the contractor has not requested more money than what is represented by the work completed. Here is where the whining begins again. Contractors will state making excuses that the rain prevented the work from being finished before you got there or the sub-contractor didn't show up, the dog ate my permits etc. Don't get sucked in. Always make deductions as needed to accurately reflect exactly what is viewed at the draw-no more. You never know when the relationships between the contractor and borrower will turn. It is really hard to get money back from a contractor when he has been overpaid based on promises.

Always remember that you , the inspector are representing the lender and the federal government. FHA is insuring the funds given by the lender. It is your responsibility to ensure the contractor performing the work is only



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receiving payment for the amount equal to the work successfully completed and visually inspected by you. This is critical because if you authorize a disbursement to a contractor for work not performed and for some reason the work does not get done, you, the inspector could be subject to legal action from the buyer and the lender as well as receive sanctions from the FHA.

On the surface this looks like a “no brainer”, but you can easily find yourself in the position where the contractor and the buyer are standing in front of you professing a cooperative relationship stronger than many newly wed couples...assuring you that they need you to authorize a large disbursement because of a variety of seemingly innocent reasons

For example:

- ❖ I expected to be finished before you got here but my sub had an emergency.

Or

- ❖ I'll be done before the check gets here so go ahead and give me the amount I requested.

Or, (my personal favorite)

- ❖ I need the money now to pay the sub-contractors, because I still owe them from another job.

Please, don't give in to the temptation! You will be glad you didn't give in when 2 months into the process, the “happily married couple” are now



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talking divorce because promises were not kept, guaranteed timelines were not met and the quality of work is now totally unacceptable by the buyer. At this point, when the contractor gets fired, and they sometimes will, you will be able to report without fear of contradiction; that the contractor was compensated exactly as described on the draw request forms.

Back at your office-package your draw paperwork and fax it to the loan disbursement office. If you can get an email address for the person who will process the draw –email the draw directly to them. Some lenders will require the photos be sent to them with the draw request. Remember this as you do your draw inspection. You need to make sure you photograph everything that is being requested on the draw or there will be a delay in processing (you may even have to go back out to get the missed photo).

The complexities and variables of the post settlement – renovation phase of the 203k renovation cannot be contained in one book. A lot of the time, you, as the consultant – the neutral, objective expert, will need to be very creative and inventive in order to help all parties stay motivated and focused on the only goal- to complete the required repairs by the deadline. The players involved each have their own agendas and pressures. Understanding them will help you through all the phases of the project



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VII

The Players

The FHA 203K rehabilitation mortgage has gotten a real boost over the last few years as the “conventional” home buying opportunities have dwindled due to the fear created by the recent mortgage meltdown. The “203k mortgage” product was design to help FHA borrowers purchase homes that require repairs- getting the repairs completed after settlement under the one mortgage. It has been around since the early 60s, but due to difficulties in processing the loans, and the overall complexities experienced in the early years, the 203K loan earned a black eye from the real estate community. It was thought of as a time-consuming and difficult product that most loan processors and real estate agents preferred to avoid at all costs, opting instead to suggest second mortgages, home equity loans and seller seconds to satisfy home repairs needed for eligibility for FHA appraisal and insurance. But with the advent of the computer and lightening speed data processing, the 203K loan is now beginning to be perceived as an ideal and valuable tool that is “saving deals” every day.

The addition of the 203K streamline mortgage has made it even easier for people who are looking to do simple repairs along with purchasing a home.



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I am very encouraged by all the excitement and positive interest that is being generated surrounding the FHA 203K loan. I can't help but smile when real estate agents ask me with surprised looks on their faces following an educational seminar **“Is this something new?”**

But as with any relationship, its success is only as good as the interest and dedication of the parties involved. And I'm sad to say, recently, a few lenders have not been making it very easy for 203K borrowers, their contractors or their consultants. In fact they are preventing homeowners from effectively completing renovations in a timely and cost-effective manner.

I speak from first hand experience. On more than one occasion I have received a telephone call from a contractor who informed me that after protracted delay, they could not continue to work on a home because they had not been paid on a draw I had submitted to the loan processor many weeks prior. I know the frustration of dialing a toll-free number at a lenders disbursement center that went into voice mail oblivion never allowing me to speak to a human being... And when I did finally speak to a representative, I was met with such a lack of cooperation that it bordered on rudeness.

The difficulties caused by lenders have even reached the point of media attention. Recently in the Philadelphia Pennsylvania area, is an article



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released by Alan J. Heavens, the Real Estate Department contributing editor for the Philadelphia Inquirer. In his article dated January 4, 2010, Mr. Heavens describes the problems of one South Jersey couple who came close to bankruptcy because the lender failed to pay their contractor for a simple streamlined K loan project.

Tip

http://www.philly.com/inquirer/real_estate/20100103_On_the_House_Renovation_mortgage_turms_scary.html

How should the 203K construction process work, and why it is important that lenders put the consideration of their borrowers first should be obvious.

The 203k process is designed to get needed safety and soundness repairs completed as quickly as possible- rejuvenating the home, neighborhood and communities by allocating the money **up front** through an escrow account. When the players are all performing correctly – it is a wonderful and gratifying process to watch unfold.

Who are these players and what should each of them do and when to ensure a successful renovation project?



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First is the borrower. The home buyer looking to purchase a home and have it repaired to meet FHA guidelines or make it a more desirable property or the home owner seeking to refinance his existing mortgage and complete renovations or improvements to his home at the same time. It is important that the borrower be realistic about the project and the value in the property. Many borrowers who are looking to use the Streamline 203k Loan do not realize that \$35,000 is NOT a lot of money. It has been my experience that most borrowers, every day otherwise intelligent people simply have no clue what it costs to make repairs to a property – by a QUALIFIED contractor! That is the key phrase: Qualified Contractor. The borrowers don't realize that the \$75 toilet really costs around \$225 to have a contractor purchase and install it. The new home buyer visits their neighborhood home improvement center and prices individual components not taking into consideration all the smaller parts that are involved much less the labor expense.

If you are working with an informed, down-to-earth borrower; ideally one who has consulted a contractor before planning on the purchase or refinancing project, then the transaction is so much smoother. An alternative to referring the borrower to a contractor before starting the loan paper work is to suggest they have the property evaluated by an FHA 203k consultant. If it is for a new purchase, try and find a consultant who is also a qualified (licensed if applicable) home inspector. You can “kill two birds with one stone” by having the borrower get a feasibility inspection report that can be



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used for the sales negotiations as well. The consultant/inspector will give the borrower an objective, un-biased assessment of the merits and opportunities in the home. A contractor, no matter how respectable will always have a personal vested interest in showing a borrower how “improved” the home can be. An inspector/consultant has no such conflict of interest.

The next player in the game is the contractor. A qualified GENERAL CONTRACTOR is needed for the majority of 203k projects. Smaller streamlined 203k rehab jobs can be done with as little as a single subcontractor. (I.e. a septic company must drain the system and repair the pump- a costly process but not complicated and only requiring the one contractor). When the borrower has been advised that the 203k will work for them, they must identify qualified contractors.

What is a qualified contractor? In some lucky states such as Florida – contractors must apply for a license and their qualifications are carefully scrutinized before the license is issued. However, in many areas, becoming a licensed contractor requires nothing more than going to the township office and paying a fee- usually a nominal one. For the FHA 203k underwriting process most contractors are required to submit “Verification” documentation. This is to help protect the borrower (really the investor) from the contractor who has shown themselves to be unprofessional or unworthy of the project.



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I have found many contractors that I meet for the first time at a consultation will walk right out when they hear the phrase “no upfront funds are provided to the contractor”. If when they hear that sentence they don’t blink, I think to myself “that’s a good sign”.

I am glad there is a verification process and while I know lenders are not allowed to recommend contractors to their borrowing clients, I would suggest that lenders spread the word to all qualified contractors to contact local 203k lenders/brokers in order to get the verification paperwork so the loan process is not delayed or stalled entirely when the contractor is unable to successfully complete the verification.

The 203k consultant is the third corner of the foundation- to use construction terminology. This individual orchestrates and oversees the renovation project many times from the moment the borrower decides to buy the home to the point where the contractor’s last dumpster is hauled away as the job concludes. I am going to devote an entire article on this very critical participant in next month’s issue.

I have saved the best and most important participant in the 203k loan process for last-the lender/loan officer/broker. I haven’t forgotten about the real estate agent, but their involvement usually precedes the activities of



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generating a 203k loan by helping the buyer find the home first. And in the case of a 203k refinance, a real estate agent is not involved at all.

It is so important for a borrower to be working with a good 203k loan officer or mortgage broker. This is someone who works in concert with the 203k consultant to ensure all the activities are being completed quickly and accurately. This loan officer keeps the borrower to task with the necessary paperwork for completing the mortgage and makes sure the package is complete when submitted to underwriting. The mortgage broker or agent sometimes has to function as a motivator/mediator/spiritual counselor in some cases as the road to closing can be rough and protracted – especially in the more extensive renovation projects. I have worked with some tireless loan officers who struggled for months with appraisal issues, contractor changes, underwriting exceptions only to have the home sold out from under the 203k borrower from a cash buyer. I can't applaud these tireless and many times unappreciated members of the real estate community enough.

Then comes the settlement and the loan is now being serviced- usually after being sold to the investor. When you think about it the servicing of the loan sets the lasting impression in the borrower's mind of the entire process. Making sure the borrower has the funds needed to keep the work moving smoothly and quickly is the best way to limit problems with the contractor / borrower relationship. Nothing is more upsetting to a borrower and time



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consuming for the consultant than having to replace a contractor half-way through a project because the contractor wasn't being paid in a timely manner. The residential building community while large is very well connected. It is very hard to find a contractor to pick up a job when word gets out that the first one quit because he wasn't getting his money. Borrowers get angry because they feel they are doing their part by paying their mortgage on time – wondering in frustration “why is their *bank* not holding up their end?”

Fortunately, the disbursement departments of most of the lenders who are funding the 203k renovation mortgage are supplying and training staff to meet the every growing demand for this product. As you get more consultation projects from more and different lenders, you will develop relationships with the loan officers and disbursement representatives. They will come to respect your professionalism and attention to detail and will be quick to make sure you and your clients (their borrowers) are serviced.



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FHA 203k Certification Package Checklist

- Completed 203k Certification Form (see list of documents below)
- Resume showing relevant residential construction inspection experience
 - Should include all license and certification numbers
 - Your social security number
- Copies of all licenses.
- Copies of all affiliations and certifications
- Cover letter explaining following items: (see samples below)
 - How do you plan to handle Draw Inspections
 - How you gained experience on reading architecture prints, and how you can use them to determine a price on deck/porch
 - Description of way you want to be listed on site as an FHA Consultant
- Passed the Knowledge Assessment Test

<http://www.203kinabox.com>

FHA Existing Property Condition Screening Checklist

This list is for reference only and does not guarantee compliance with FHA Minimum Property Requirements

Minimum Property Requirements are to insure the health and safety of the occupants and/or the marketability of the property.

Site Hazards and Nuisances

Presence of the following may indicate unacceptable property condition:

- Sinkholes
- Active or planned gas-drilling within 300 feet
- Within 75 feet of operating oil/gas well with no visible mitigation measures

- Abandoned oil or gas well within 10 feet

- Slush pits

- Excessive noise or hazard from heavy traffic area

- Dwelling or improvements within 10 feet of easement for high-pressure gas or petroleum line

- Dwelling or improvements within fall distance for overhead towers (high-voltage, radio/TV, cell phone etc)

- Excessive smoke, fumes, offensive noises or odors

- Stationary storage tanks with more than 1000 gallons of flammable or explosive material

Soil Contamination

Presence of the following may indicate unacceptable property condition:

- Surface evidence of underground storage tank

- Proximity to dumps, landfills, industrial sites that could contain hazardous materials

- Presence of pools of liquid, pits, ponds, lagoons, stained soils or pavement

Grading and Drainage

Presence of the following may indicate unacceptable property condition:

- Grading does not provide drainage away from structures

- Standing water near structures

FHA Existing Property Condition Screening Checklist

Individual Water and Sewage Systems

Presence of the following may indicate unacceptable property condition:

- Private sewage system show evidence of system failure
- Property lacks connection to public water (Lender/jurisdiction may require water test and connection to public water if feasible)
- Separation between well and septic drain field less than 100 ft, (75 ft may be acceptable if local authorities allow.)
- Separation between well and property line is less than 10 ft. (If local authority requires greater distance that requirement must be met.)

Wood Destroying Insects

Presence of the following will require a termite inspection and treatment if infestation is present:

- Structure is ground level and wood is touching ground
- House or other structure show obvious evidence of infestation
- Local jurisdiction requires inspection
- Inspection is customary to the area

Private Road Access

Presence of the following may indicate unacceptable property condition:

- Property inaccessible by foot or vehicle
- Property accessible only by private road without permanent recorded easement

Floor Support Systems

Presence of the following may indicate unacceptable property condition:

- Significant cracks
- Evidence of water damage
- Evidence of spongy/weak/rotted flooring

Framing/Walls/Ceiling

Presence of the following may indicate unacceptable property condition:

- Significant cracks
- Visible holes in exposed areas that could affect structure
- Damaged plaster, sheetrock, or ceiling materials in homes constructed before 1978
- Significant water damage

FHA Existing Property Condition Screening Checklist

Attic

Presence of the following may indicate unacceptable property condition:

- Inadequate access
- Evidence of holes
- Support structure damaged
- Significant water damage visible from interior
- No ventilation by vent, fan, or window

Basement

Presence of the following may indicate unacceptable property condition:

- Blocked or inadequate access
- Evidence of significant water damage
- Significant cracks or erosion in exposed areas that affect structural soundness

Crawl Space

Presence of the following may indicate unacceptable property condition:

- Blocked or inadequate access
- Space inadequate for maintenance (recommended 18 inches)
- Support beams not intact
- Excessive dampness or ponding of water

Slab

Presence of the following may indicate unacceptable property condition:

- Significant cracks that could affect structural soundness

Roof

Presence of the following will require a roof inspection and possible repair:

- Missing tiles, shingles, flashing etc
- Holes
- Signs of leakage

Furnace/Heating System

Presence of the following may indicate unacceptable property condition:

- Unit does not turn on
- Heat is not emitted
- Unusual noise
- Smoke or irregular smell
- Significant holes or deterioration on unit

Central Air Conditioning

Presence of the following may indicate unacceptable property condition:

- Unit does not turn on
- Cool air is not emitted
- Unusual noise
- Smoke or irregular smell
- Significant holes or deterioration on unit

FHA Existing Property Condition Screening Checklist

Paint

Presence of the following may indicate unacceptable property condition:

- Chipped or peeling paint on interior or exterior of home and/or structures and improvements if home built before 1978.
- Chipped or peeling paint on exterior surfaces if finish is unprotected (ie, bare wood) if home built after 1978.

Electrical System

Presence of the following may indicate unacceptable property condition:

- Electrical switches don't work
- Outlets don't work
- Presence of smoke or sparks from outlet
- Exposed frayed or unconnected wiring

Plumbing System

Presence of the following may indicate unacceptable property condition:

- Significant drop or limitation in water pressure
- No hot water
- Toilets don't function or have been removed
- Toilet leaks
- Sinks/bathtub/shower leaks (very minor leaks may be acceptable)
- Swimming pools not operational, in bad repair or not maintained

203k Certification Study Material

In order to complete the consultant certification statement below, you should review and have a good understanding of the following documents:

- HUD Handbooks:

4240.4 REV-2- 203(k) Handbook *

4155.1 REV-4- Underwriting Handbook

4150.2 and Applicable Provisions of 4150.1 REV-1 Appraisal Handbooks

4145.1 Architectural and Engineering Handbook *

4905.1 REV-1 - Requirements for Existing Housing *

4910.1 Minimum Property Standards *

- Mortgage Letters:

Mortgage Letter Program	92-33	Modifications to the 203(k) Rehabilitation Program
Mortgage Letter	94-11	Revisions To The 203(k)Program
Mortgage Letter	95-40	Revisions to the 203(k) Program
Mortgage Letter and Other Issues	96-18	Refinance Transactions, Property Inspections
Mortgage Letter	96-21	Using Section 203(k) with Grant Programs
Mortgage Letter	96-23	Seven Unit Limitation
Mortgage Letter	96-52	Non-Profit Agencies as Mortgagors
Mortgage Letter	96-59	Moratorium on Investor Loans
Mortgage Letter	97-05	Revised Escrow Commitment Procedure
Mortgage Letter	97-26	Credit Policy Issues
Mortgage Letter 203(k) Program	99-02	Applying the Energy Guidelines to the Section 203(k) Program
Mortgage Letter	98-11	Concerns about 203(k) Underwriting
Mortgage Letter	98-29	Mortgage Calculation Simplification
Mortgage Letter Extension	98-31	Mortgage Calculation Simplification
Mortgage Letter	00-1	Impact of EPA Lead Rules on Contractors
Mortgage Letter Storm Shelters	00-4	Insured Financing for the Construction of Storm Shelters
Mortgage Letter Activities	00-8	Nonprofit Agency Participation in FHA
Mortgage Letter 203k Consultants	00-25 *	Information for current and prospective

*** Denotes a document which has been included in this appendix**

Certification for 203(k) Consultant

I certify that I have read and understand the materials listed below with regard to the Section 203(k) Program. Further, I understand that these procedures are to be followed when working as a 203(k) Consultant.

Name of 203(k) Consultant or Prospective

Consultant _____

Signature _____

Date _____

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)

- HUD Handbooks:

4240.4 REV-2- 203(k) Handbook

4155.1 REV-4- Underwriting Handbook

4150.2 and Applicable Provisions of 4150.1 REV-1 Appraisal Handbooks

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Mortgage Letter Program	92-33	Modifications to the 203(k) Rehabilitation
Mortgage Letter	94-11	Revisions To The 203(k)Program
Mortgage Letter	95-40	Revisions to the 203(k) Program
Mortgage Letter and Other Issues	96-18	Refinance Transactions, Property Inspections
Mortgage Letter	96-21	Using Section 203(k) with Grant Programs
Mortgage Letter	96-23	Seven Unit Limitation
Mortgage Letter	96-52	Non-Profit Agencies as Mortgagors
Mortgage Letter	96-59	Moratorium on Investor Loans
Mortgage Letter	97-05	Revised Escrow Commitment Procedure
Mortgage Letter	97-26	Credit Policy Issues
Mortgage Letter 203(k) Program	99-02	Applying the Energy Guidelines to the Section
Mortgage Letter	98-11	Concerns about 203(k) Underwriting
Mortgage Letter	98-29	Mortgage Calculation Simplification
Mortgage Letter Extension	98-31	Mortgage Calculation Simplification
Mortgage Letter	00-1	Impact of EPA Lead Rules on Contractors
Mortgage Letter Storm Shelters	00-4	Insured Financing for the Construction of
Mortgage Letter Activities	00-8	Nonprofit Agency Participation in FHA

Sample wording for description of 203k activities

Writing a Feasibility/Specification of Repairs Estimate for a Deck

This is for a deck build on grade. I would request the drawing of the deck and review the materials needed list and determine the following: Construction Item: Labor + Materials or Lump Sum= Item Total. I will use the following tools to help determine the estimated cost: List of hourly rates for contractors in the area, (Plumbers, Electricians, Painters, etc.), National Home Improvement Estimator and the Building Construction Cost Data 2009 Book to assist in the completion of cost estimation. I will request that the Contractor provide me information on any permits that would be required to complete the project and the cost estimated for any permit/inspection fees from the local municipality. I will use this information to breakdown all elements into the appropriate categories of improvement on the Feasibility Report. (i.e. Under category Exteriors: Provide and install pressure treated wood beams for deck columns, flooring, railing 45 LF @ \$20 / LF materials, \$1200 – labor = 2100.00).

How to perform a Draw Request

When I am notified that the contractor has completed work at the property and is ready to have a progress inspection, or when I notice that it is close to 30 days since the close on the loan or the last draw inspection, we will set up an appointment to meet with the client and contractor at the job site. I will supply the borrower/contractor with a draw request form for them to complete in advance of my arrival. If this is the first draw, I will require that all permits be available to me at this appointment. I will visit the site with Architectural drawings (if applicable) and using the Specification of Repairs. I will evaluate the work that has been completed. All improvements must be satisfactorily completed in compliance with HUD habitability standards, local & state practices and according to the

Specification of Repairs. Escrow funds may be partially release based on the percentage of completion of each line item shown on form HUD 9746-A. should there be any changes, I will obtain a change order form (HUD -92577) form along with an invoice from the contractor detailing the reason for the changes. These changes will be evaluated along with other completed work. I will make any needed adjustments to the draw amounts based on the acceptability of the work completed. I will complete a Form HUD 92051, Compliance Inspection Report and the Draw Request (Form HUD 9746), along with the Lien Waiver and Release that has been provided by the lender (getting signatures of both the borrower and the contractor on all required documents). A holdback of 10% will be made to all intermediate draws. I will send all documents to the loan holder via facsimile within 1 business day of the inspection.

Should the project involve multiple specific contractors in lieu of or in addition to the general contractor, I will perform the same process for all participating service providers.

4240.4 Rev-2 FHA 203(k) Handbook

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.

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 construction relatively 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:

1. Owner/occupant and qualified non-profit borrowers only; no investors;
2. 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;
3. 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;
4. 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:

- A. To purchase a dwelling and the land on which the dwelling is located and rehabilitate it.

- B. To purchase a dwelling on another site, move it onto a new foundation on the mortgaged property and rehabilitate it.
- C. To refinance existing indebtedness and rehabilitate such a dwelling.

For A and C above, 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.

For B above, 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

Mortgage proceeds must be used in part for rehabilitation and/or improvements to a property. There is a minimum \$5000 requirement for the eligible improvements on the existing structure(s) on the property. Rehabilitation or improvements to a detached garage, a new detached garage, or the addition of an attached unit(s) (if allowed by the local zoning ordinances) can also be included in this first \$5000. Properties with separate detached units are acceptable, however, a newly constructed unit must be attached to an existing unit to be eligible under 203(k).

Any repair is acceptable in the first \$5000 requirement that may affect the health and safety of the occupants. Minor or cosmetic repairs by themselves cannot be included in the first \$5000, but may be added after the \$5000 threshold is reached.

Examples of eligible improvements are listed below. (This list is not all inclusive.)

- A. Structural alterations and reconstruction (e.g., repair or replacement of structural damage, chimney repair, additions to the structure, installation of an additional bath(s), skylights, finished attics and/or basements, repair of termite damage and the treatment against termites or other insect infestation, etc.).
- B. Changes for improved functions and modernization (e.g., remodeled bathrooms and kitchens, including permanently installed appliances, i.e., built-in range and/or oven, range hood, microwave, dishwasher).

- C. Elimination of health and safety hazards (including the resolution of defective paint surfaces or lead-based paint problems on homes built prior to 1978).
- D. Changes for aesthetic appeal and elimination of obsolescence (e.g., new exterior siding, adding a second story to the home, covered porch, stair railings, attached carport).
- E. Reconditioning or replacement of plumbing (including connecting to public water and/or sewer system), heating, air conditioning and electrical systems. Installation of new plumbing fixtures is acceptable, including interior whirlpool bathtubs.
- F. Installation of Well and/or Septic System. The well or septic system must be installed or repaired prior to beginning any other repairs to the property. A property less than 1/2 acre with a separate well or septic system is not acceptable; also, a property less than one acre with both a well and a septic system is unacceptable. Lots smaller than these sizes usually have problems in the future; however, the local HUD Field Office can approve smaller lot size requirements where the local health authority can justify smaller lots. The installation of a new well or the repair of an existing well (used for the primary water source to the property) can be allowed provided there is adequate documentation to show there is reason to believe the well will produce a sufficient amount of potable water for the occupants. (A well log of surrounding properties from the local health authority is acceptable documentation.) Refer to HUD Handbook 49 10. 1, Appendix K, for additional information. HUD Handbooks may be ordered online from The HUD Compendium or from HUDCLIPS.
- G. Roofing, gutters and downspouts.
- H. Flooring, tiling and carpeting.
- I. Energy conservation improvements (e.g., new double pane windows, steel insulated exterior doors, insulation, solar domestic hot water systems, caulking and weatherstripping, etc.).
- J. Major landscape work and site improvement, (e.g. patios, decks and terraces that improve the value of the property equal to the dollar amount spent on the improvements or required to preserve the property from erosion). The correction of grading and drainage problems is also acceptable Tree removal is acceptable if the tree is a safety hazard to the property. Repair of existing walks and driveway is acceptable if it may affect the safety of the property. (Fencing, new walks and driveways, and general landscape work (i.e., trees, shrubs, seeding or sodding) cannot be in the first \$5000 requirement.)

K. Improvements for accessibility to a Disabled Person (e.g., remodeling kitchens and baths for wheelchair access, lowering kitchen cabinets, installing wider doors and exterior ramps, etc.).

When basic improvements are involved, the following costs can be included in addition to the minimum \$5000 requirement:

New free standing range, refrigerator, washer and dryer, trash compactor and other appurtenances. (Used appliances are not eligible

Interior and exterior painting.

The repair of a swimming pool, not to exceed \$1,500. Repair costs exceeding the \$1,500 limit must be paid into the contingency reserve fund by the borrower. The installation of a new swimming pool is not allowed.

Luxury items and improvements that do not become a permanent part of the real property are not eligible as a cost of rehabilitation. The items listed below (not limited to this list) are not acceptable under the 203(k) program, including the repair of any of the following: Barbecue pit; bathhouse; dumbwaiter; exterior hot tub; sauna, spa and whirlpool bath; outdoor fireplace or hearth; photo mural; installation of a new swimming pool; gazebo; television antenna; satellite dish; tennis court; tree surgery. Additions or alterations to provide for commercial use are not eligible.

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.

REQUIRED APPRAISALS

In order to determine the maximum mortgage amount, the 203(k) valuation analysis consists of two separate determinations of value.

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 three percent 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 require, meant for the 20 3 (k) loan. A copy of the Sales Contract and the H U D- 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, dry rot, 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 fee inspectors or on the HUD-accepted staff of the DE lender. The fee inspector 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 (whether a principal residence or an investment property) when the property is not occupied 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 Mortgage Payment Reserve is considered a part of the cost of rehabilitation for determining the maximum mortgage amount.

A. Maximum Mortgage Calculation. The value is defined as the lesser of:

1) The as-is value of the property before rehabilitation plus the cost of rehabilitation; or

2) 110 percent of the expected market value of the property upon completion of the work.

Principal Residence (Owner-Occupant) & HUD Approved Non-Profit Organization. For purchases with 203(k): 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 with 203(k): 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 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 an investor 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. H U D will determine that the seven unit limit is inapplicable only if- (1) the investor 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 investor 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).

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 greater than \$30,000. 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. Plan Review Fee. Prior to the appraisal, a HUD-accepted plan reviewer (or 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, >\$15,001but 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. To process a Section 203(k) mortgage, two appraisals can be performed: (1) As-is value of the property; and (2) Estimated market value of the property assuming completion of the rehabilitation. The maximum fee which a lender may collect for these two appraisals is one and one-half times the amount permitted for a Section 203(b) proposed construction appraisal, as established by the HUD Field Office. If only one appraisal is done, the fee will be the same as a proposed construction appraisal.

D. Appraisal Fee. To process a Section 203(k) mortgage, two appraisals can be performed; (1) As-is value of the property; and (2) Estimated market value of the property assuming completion of the rehabilitation. The maximum fee which a lender may collect for these two appraisals is one and one-half times the amount permitted for a Section 203(b) proposed construction appraisal, as established by the HUD Field Office. If only one appraisal is done, the fee will be the same as a proposed construction appraisal.

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 mechanics 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 realtor 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. If a plan reviewer is the consultant, item G can be skipped and the exhibits can go directly to the appraisal stage.

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. Plan Reviewer Visits Property. The homebuyer and contractor (where applicable) meet with the plan reviewer 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.

4145.1 Architectural and Engineering Handbook

(Click this link to open handbook through hyperlink from web browser)

<http://www.hud.gov/offices/adm/hudclips/handbooks/hsg/4145.1/index.cfm>

Handbook
Transmittal: Architectural Processing and Inspections for Home
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APPENDIX 8: SITE GRADING AND DRAINAGE GUIDELINES
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4905.1 Rev-1 Requirements for Existing Housing

(Click this link to open handbook through hyperlink from web browser)

<http://www.hud.gov/offices/adm/hudclips/handbooks/hsg/4905.1/index.cfm>

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CHAPTER 1: APPLICATION
CHAPTER 2: GENERAL ACCEPTABILITY CRITERIA



FHA 203k Consultant Knowledge Assessment

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Questions
<p>1. True or False: T F</p> <p>Heating systems, burners, and air conditioning systems must be carefully sized to be no greater than 20 percent oversized for the critical design, heating or cooling, except to satisfy the manufacturer's next closest nominal size.</p>
<p>2. Name 3 of the 5 required rehabilitation steps to improve the thermal efficiency of the dwelling.</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>
<p>3. True or False: T F</p> <p>A condominium project might consist of four buildings each containing six units, for a total of 24 units in the project and, thus, a renovation of one of these units would be eligible for Section 203(k).</p>



203k in a Box

Step-by-Step Guide to Quick Certification

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<p>4. True or False: T F</p> <p>It is acceptable for a 203k loan to purchase a dwelling on another site, move it onto a new foundation on the mortgaged property and rehabilitate it.</p>
<p>5. Within how many months after purchasing a home can a homeowner use the 203(k) to refinance the property and make repairs or renovations?</p> <p>_____</p>
<p>6. What percentage of the dwelling can be used for nonresidential purposes?</p> <p>_____</p>
<p>7. True or False: T F</p> <p>The title of the HUD publication that provides the most information on 203(k) Rehab Mortgage Program is 4240.4 Rev 2</p>
<p>8a. What is the maximum contingency reserve allowed on the cost estimate?</p> <p>_____</p> <p>8b. What would justify this large of a contingency?</p> <p>_____</p> <p>_____</p> <p>_____</p>



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9.
What is the maximum number of days allowed between draw inspections?

10.
For the 203(k) program, under what circumstances (if any) can a contractor receive funds in advance of performing work?

11.
True or False: T F

In Chapter 5 of the HUD 203k handbook 4204.4 Rev 2, a description of the maximum number of draws for a project is given.

12.
What is the maximum number of dwelling units that can be in the building being purchased with the 203(k) rehab mortgage?

13.
What is the amount of the hold-back taken out of each draw payment made to the contractor?



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14.

Choose A B C or D

- A. The borrower can choose to add up to 6 months of his mortgage payments to the rehab costs.
- B. The borrower can choose to have up to one month's mortgage payment after the proposed completion date added to the rehab costs provided it is less than 6 months.
- C. The lender can release funds held for the mortgage payments to do needed repairs.
- D. All of the above

15.

True or False: T F

Permits are required to be submitted at the final draw inspection.

16.

In Appendix 12 of 4204.4 what is the answer to the question posed below?

What happens if the cost of the rehabilitation increases during the rehabilitation period? Can the 203(k) mortgage amount be increased to cover the additional expenses?

17.

True or False: T F

FHA 203k rehab loan can be used to refinance a home that has been gutted and is currently vacant.



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18.

Under what conditions can a 203k loan be used to rehab new construction.

19.

True or False: T F

A borrower can use both the EEM and the 203k rehab loan on one purchase/refinancing mortgage

20.

True or False: T F

All 203k mortgages require the services of a certified consultant.

21.

Describe how a borrower can get the utilities tested on a HUD owned home that has been winterized.

Extra Credit Question: (worth 3 points)

There is a program that allows certain professionals and public servants to purchase HUD homes for $\frac{1}{2}$ of the list price. This program is ideal for a 203k rehab loan. What is it called?

Score _____

Resource Guide

HUD – FHA 203k Home page

<http://www.hud.gov/offices/hsg/sfh/203k/203kmenu.cfm>

HUD Handbook 4240.4, REV 2 (203(k) Handbook)

<http://www.hud.gov/offices/adm/hudclips/handbooks/hsg/4240.4/index.cfm>

FHA Consultant Roster

<https://entp.hud.gov/idapp/html/f17cnsldata.cfm>

FHA 203k Program Overview

<http://www.hud.gov/offices/hsg/sfh/203k/203kabou.cfm>

HUD Approved Lender Search Page

<http://www.hud.gov/ll/code/llslcrit.html>