

**ARCHIVE VERSION**

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## a. 203(k) Rehabilitation Mortgage Insurance Program (09/14/15)

Effective for case numbers assigned on or after September 14, 2015

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### i. Overview

The Section 203(k) Rehabilitation Mortgage Insurance Program is used to:

- rehabilitate an existing one- to four-unit Structure, which will be used primarily for residential purposes;
- rehabilitate such a Structure and refinance outstanding indebtedness on the Structure and the Real Property on which the Structure is located; or
- purchase and rehabilitate a Structure and purchase the Real Property on which the Structure is located.

Structure refers to a building that has a roof and walls, and stands permanently in one place that contains single or multiple housing units that are used for human habitation.

Mortgages to be insured under Section 203(k) must be processed and underwritten in accordance with the requirements in Origination Through Post-Closing/Endorsement, except where noted otherwise in this appendix.

#### (A) Types of 203(k) Rehabilitation Mortgages

There are two types of 203(k) Rehabilitation Mortgages: Standard 203(k) and Limited 203(k), as described below. The guidance in this appendix is applicable to both Standard 203(k) and Limited 203(k) Mortgages unless noted otherwise.

##### (1) Standard 203(k)

The Standard 203(k) Mortgage may be used for remodeling and repairs. There is a minimum repair cost of \$5,000 and the use of a 203(k) Consultant is required.

##### (2) Limited 203(k)

The Limited 203(k) may only be used for minor remodeling and non-structural repairs. The Limited 203(k) does not require the use of a 203(k) Consultant, but a Consultant may be used. The total rehabilitation cost must not exceed \$35,000. There is no minimum rehabilitation cost.

#### (B) Eligible Supplemental Programs and Products

A 203(k) Mortgage may be used in conjunction with the following:

- Section 203(h) Mortgage Insurance for Disaster Victims

- Energy Efficient Mortgages
- Solar and Wind Technologies

## **ii. Borrower Eligibility**

The Borrower must meet the eligibility requirements found in the Borrower Eligibility section, and the additional guidance provided here related to nonprofit agency Borrowers.

The Mortgagee must verify and document the nonprofit agency Borrower's caseload. The Mortgagee must review the Nonprofit List in FHA Connection (FHAC), and ensure the maximum 203(k) case load limitation is not exceeded for nonprofit Borrowers.

## **iii. Property Eligibility**

The Property must be an existing Property that has been completed for at least one year prior to the case number assignment date. If the Mortgagee is unsure whether the Property has been completed for at least one year, the Mortgagee must request a copy of the Certificate of Occupancy (CO) or equivalent.

A Property that is not eligible for a 203(b) Mortgage due to health and safety or security issues may be eligible under 203(k) if the rehabilitation or repair work performed will correct such issues.

A Property with an existing 203(k) Mortgage is not eligible to be refinanced until all repairs are completed and the case has been electronically closed out.

The following property types may be financed:

- a one- to four-unit Single Family Structure;
- an individual condominium unit, meeting the following requirements:
  - the unit must be located in an FHA-approved Condominium Project and must comply with all other requirements for condominiums;
  - rehabilitation or improvements are limited to the interior of the unit, except for the installation of firewalls in the attic for the unit;
  - no more than five units per condominium association, or 25 percent of the total number of units, whichever is less, can undergo rehabilitation at any time; and
  - after rehabilitation is complete, the unit is located in a Structure containing no more than four units. For townhouse style condominiums, each townhouse is considered as one Structure, provided each unit is separated by a one and one-half hour firewall from foundation to roof;
- a Site Condominium unit;
- Manufactured Housing where the rehabilitation does not affect the structural components of the Structure that were designed and constructed in conformance with the Federal Manufactured Home Construction and Safety Standards and must comply with all other requirements for Manufactured Housing;
- a Mixed Use Property with one- to four-residential units, provided:
  - 51 percent of the Gross Building Area (GBA) is for residential use; and
  - commercial use will not affect the health and safety of the occupants of the residential Property; and
- a HUD Real Estate Owned (REO) Property:
  - the Property is identified as eligible for 203(k) financing as evidenced in the sales contract or addendum. Investor purchases of HUD REO Properties are not eligible for 203(k) financing.

### **(A) Dwelling Unit Limitation**

A Mortgagee may determine that units in a neighborhood are not subject to the Dwelling Unit Limitation of no more than seven Dwelling Units within a two block radius when:

- the neighborhood has been targeted by a state or local government for redevelopment or revitalization;
- the state or local government has approved and submitted a plan to HUD describing the program of neighborhood redevelopment and revitalization, including the geographic area targeted for redevelopment, and the nature and proportion of public or private commitments that have been made in support of the redevelopment;
- the nonprofit agency borrower will own no more than 10 percent of the Dwelling Units (regardless of financing type) in the designated redevelopment area; and
- the nonprofit agency borrower will have no more than eight Dwelling Units on adjacent lots.

The Mortgagee must review the approved redevelopment plan to ensure that the units in which the nonprofit agency has or will have a financial interest are located within the targeted geographic area. The Mortgagee must also review public records to determine that the agency does not exceed the limitations on the number of units that they may own in the redevelopment area, and that they have no more than eight adjacent units.

### **(B) Required Documentation**

The Mortgagee must obtain the following documentation:

- a copy of the redevelopment plan; and
- evidence that the state or local government approved the plan.

The Mortgagee must submit the documentation to HUD in the case binder.

## **iv. Application Requirements**

The Mortgagee must provide the Borrower with the form HUD-92700-A, *203(k) Borrower's Acknowledgment*.

## **v. Case Number Assignment Data Entry Requirements**

In order to request a case number for a 203(k) Mortgage, the Mortgagee must enter the following information:

### **(A) 203(k) Program Type Indicator**

The Mortgagee must select either Standard 203(k) or Limited 203(k) as the program type.

### **(B) Consultant Identification Number**

The Mortgagee must enter the Consultant identification number into the "Consultant ID" field on the Case Number Assignment screen in FHAC. For a Limited 203(k) with no Consultant, the Mortgagee must enter "203KS" in the "Consultant ID" field.

**(C) Automated Data Processing Code**

The Mortgagee must enter the appropriate 203(k) Automated Data Processing (ADP) code.

**(D) Construction Code**

The Mortgagee must enter "Substantial Rehabilitation" in the drop-down menu labeled "Construction Code."

**(E) Refinance Type**

For a refinance transaction, the Mortgagee must select "Not Streamlined" in the drop-down menu labeled "All Refinances."

**(F) Converting From a Non-203(k) to a 203(k) Mortgage**

If the Mortgagee had originally requested the case number assignment for a non-203(k) Mortgage, the Mortgagee must update the existing case data in the Case Number Assignment screen, changing the ADP Code to a valid 203(k) ADP Code and the "Construction Code" to "Substantial Rehabilitation."

## **vi. Standard 203(k) Transactions**

**(A) Standard 203(k) Eligible Improvements**

The Standard 203(k) requires a minimum of \$5,000 in eligible improvements.

**(1) Types of Improvements**

Types of eligible improvements include, but are not limited to:

- converting a one-family Structure to a two-, three- or four-family Structure;
- decreasing an existing multi-unit Structure to a one- to four-family Structure;
- reconstructing a Structure that has been or will be demolished, provided the complete existing foundation system is not affected and will still be used;
- repairing, reconstructing or elevating an existing foundation where the Structure will not be demolished;
- purchasing an existing Structure on another site, moving it onto a new foundation and repairing/renovating it;
- making structural alterations such as the repair or replacement of structural damage, additions to the Structure, and finished attics and/or basements;
- rehabilitating, improving or constructing a garage;
- eliminating health and safety hazards that would violate HUD's Minimum Property Requirements (MPR);
- installing or repairing wells and/or septic systems;
- connecting to public water and sewage systems;
- repairing/replacing plumbing, heating, AC and electrical systems;
- making changes for improved functions and modernization;
- making changes for aesthetic appeal;
- repairing or adding roofing, gutters and downspouts;
- making energy conservation improvements;
- creating accessibility for persons with disabilities;
- installing or repairing fences, walkways, and driveways;
- installing a new refrigerator, cooktop, oven, dishwasher, built-in microwave oven, and washer/dryer;
- repairing or removing an in-ground swimming pool;
- installing smoke detectors;
- making site improvements;
- landscaping;
- installing or repairing exterior decks, patios, and porches;
- constructing a windstorm shelter; and
- covering lead-based paint stabilization costs, if the Structure was built before 1978, in accordance with the Single Family mortgage insurance lead-based paint rule (24 CFR 200.805 and 200.810(c)) and the U.S. Environmental Protection Agency's (EPA) Renovation, Repair, and Painting Rule (40 CFR 745, especially subparts E and Q).

**(2) Improvements Standards**

**(a) General Improvement Standards**

All improvements to existing Structures must comply with HUD's MPR and meet or exceed local building codes. For a newly constructed addition to the existing Structure, the energy improvements must meet or exceed local codes and the requirements of the **latest energy code standard that has been adopted by HUD** through a Federal Register notice.

**(b) Specific Improvement Standards**

Any addition of a Structure unit must be attached to the existing Structure. Site improvements, landscaping, patios, decks and terraces must increase the As-Is Property Value equal to the dollar amount spent on the improvements or be necessary to preserve the Property from erosion.

**(B) Standard 203(k) Ineligible Improvements/Repairs**

The 203(k) mortgage proceeds **may not** be used to finance costs associated with the purchase or repair of any luxury item, any improvement that does not become a permanent part of the subject Property, or improvements that solely benefit commercial functions within the Property, including:

- recreational or luxury improvements, such as:

- swimming pools (existing swimming pools can be repaired)
- an exterior hot tub, spa, whirlpool bath, or sauna
- barbecue pits, outdoor fireplaces or hearths
- bath houses
- tennis courts
- satellite dishes
- tree surgery (except when eliminating an endangerment to existing improvements)
- photo murals
- gazebos; or
- additions or alterations to support commercial use or to equip or refurbish space for commercial use.

**(C) Standard 203(k) Establishing Repairs and Improvements**

The Mortgagee must select an FHA-approved 203(k) Consultant from the the FHA 203(k) Consultant Roster in FHAC. The Mortgagee must not use the services of a Consultant who has demonstrated previous poor performance based on reviews performed by the Mortgagee. The Consultant must inspect the Property and prepare the Work Write-Up and Cost Estimate.

The Work Write-Up refers to the report prepared by a 203(k) Consultant that identifies each Work Item to be performed and the specifications for completion of the repair.

Cost Estimate refers to a breakdown of the cost for each proposed Work Item, prepared by a 203(k) Consultant.

Work Item refers to a specific repair or improvement that will be performed.

**Exception for Borrowers Doing Own Work**

For Borrowers performing their own work under a Rehabilitation Self-Help Agreement, the Consultant must identify on the Work Write-Up each Work Item to be performed by the Borrower. The Borrower must not be reimbursed for labor costs.

**(D) Standard 203(k) Financeable Repair and Improvement Costs and Fees**

The following repair and improvement costs and fees may be financed:

- costs of construction, repairs and rehabilitation;
- architectural/engineering professional fees;
- the 203(k) Consultant fee subject to the limits in the 203(k) Consultant Fee Schedule section;
- inspection fees performed during the construction period, provided the fees are reasonable and customary for the area;
- title update fees;
- permits; and
- a Feasibility Study, when necessary to determine if the rehabilitation is feasible.

Any costs for Energy Efficient Mortgages and Solar Energy Systems must not be included in financeable repair and improvement costs.

For Borrowers performing their own work, the Mortgagee must include the costs for labor and materials for each Work Item to be completed by the Borrower under a Rehabilitation (Self-Help) Loan Agreement.

**(E) Standard 203(k) Financeable Contingency Reserve**

Contingency Reserve refers to funds that are set aside to cover unforeseen project costs.

The Mortgagee must refer to the following chart to determine when a Contingency Reserve is required. The minimum and maximum Contingency Reserve is established as a percentage of the Financeable Repair and Improvement Costs.

For Structures with an actual age of less than 30 years:

	<b>Minimum</b>	<b>Maximum</b>
Required when evidence of termite damage	10%	20%
Discretionary	No Minimum	20%

For Structures with an actual age of 30 years or more:

	<b>Minimum</b>	<b>Maximum</b>
Required	10%	20%
Required when utilities are not operable as referenced in the Work Write-Up	15%	20%

The Borrower may provide their own funds to establish the Contingency Reserves. Where the Borrower has provided their own funds for Contingency Reserves, they must be noted under a separate category in the Repair Escrow Account.

**(F) Standard 203(k) Financeable Mortgage Payment Reserves**

A Mortgage Payment Reserve refers to an amount set aside to make Mortgage Payments when the Property cannot be occupied during rehabilitation.

A Mortgagee may establish a financeable Mortgage Payment Reserve, not to exceed six months of Mortgage Payments. The Mortgage Payment Reserve may include Mortgage Payments only for the period during which the Property cannot be occupied. The number of Mortgage Payments cannot exceed the completion time frame required in the Rehabilitation Loan Agreement.

For multi-unit properties, if one or more units are occupied, the Mortgage Payment Reserve may only include the portion of the Mortgage Payment attributable to the units that cannot be occupied. To calculate the amount that can be included in the Mortgage Payment Reserve, the Mortgagee will divide the monthly Mortgage Payment by the number of units in the Property, and multiply that figure by the number of units that cannot be occupied. The resulting figure is the amount of the Mortgage Payment that will be paid

through the Mortgage Payment Reserve. The Borrower is responsible for paying the servicing Mortgagee the portion of the Mortgage not covered by the Mortgage Payment Reserve.

**(G) Standard 203(k) Financeable Mortgage Fees**

The Mortgagee may finance the following fees and charges.

**(1) Origination Fee**

The Mortgagee may finance a portion of the Borrower-paid origination fee not to exceed the greater of \$350, or 1.5 percent of the total of the Financeable Repair and Improvement Costs and Fees, Financeable Contingency Reserves and Financeable Mortgage Payment Reserves.

**(2) Discount Points**

The Mortgagee may finance a portion of the Borrower-paid discount points not to exceed an amount equal to the discount point percentage multiplied by the total of Financeable Repair and Improvement Costs and Fees, Financeable Contingency Reserves and Financeable Mortgage Payment Reserves.

**(H) Standard 203(k) Required Documentation and Review**

**(1) Review of Contractor Qualifications**

Prior to closing, the Mortgagee must ensure that a qualified general or specialized contractor has been hired and, by contract, has agreed to complete the work described in the Work Write-Up for the amount of the Cost Estimate and within the allotted time frame. To determine whether the contractor is qualified, the Mortgagee must review the contractor's credentials, work experience and client references, and ensure that the contractor meets all jurisdictional licensing and bonding requirements.

**(2) Consultant's Work Write-Up and Cost Estimate**

The Mortgagee must obtain the Consultant's Work Write-Up and Cost Estimate for all Standard 203(k) Mortgages. The Mortgagee must ensure the Work Write-Up/Cost Estimate specifies the type of repair and cost of each Work Item. The Mortgagee must review the Work Write-Up and ensure that all health and safety issues identified were addressed before, including additional Work Items.

**(3) Architectural Exhibits**

The Mortgagee must obtain and review all applicable architectural exhibits.

**(4) Sales Contract**

The Mortgagee must ensure the sales contract includes a provision that the Borrower has applied for Section 203(k) financing, and that the contract is contingent upon mortgage approval and the Borrower's acceptance of additional required improvements as determined by the Mortgagee.

When the Borrower is financing a HUD REO Property, the Mortgagee must ensure that the first block on Line 4 of form HUD-9548, *Instructions and Sales Contract*, is checked, as well as the applicable block for 203(k).

**vii. Limited 203(k) Transactions**

**(A) Limited 203(k) Eligible Improvements**

The Limited 203(k) may only be used for minor remodeling and non-structural repairs. The total rehabilitation cost may not exceed \$35,000. There is no minimum repair cost.

**(1) Types of Improvements**

Eligible improvement types include, but are not limited to:

- eliminating health and safety hazards that would violate HUD's MPR;
- repairing or replacing wells and/or septic systems;
- connecting to public water and sewage systems;
- repairing/replacing plumbing, heating, AC and electrical systems;
- making changes for improved functions and modernization;
- eliminating obsolescence;
- repairing or installing new roofing, provided the structural integrity of the Structure will not be impacted by the work being performed; siding; gutters; and downspouts;
- making energy conservation improvements;
- creating accessibility for persons with disabilities;
- installing or repairing fences, walkways, and driveways;
- installing a new refrigerator, cooktop, oven, dishwasher, built-in microwave oven and washer/dryer;
- repairing or removing an in-ground swimming pool;
- installing smoke detectors;
- installing, replacing or repairing exterior decks, patios, and porches; and
- covering lead-based paint stabilization costs (above and beyond what is paid for by HUD when it sells REO properties) if the Structure was built before 1978, in accordance with the Single Family mortgage insurance lead-based paint rule and EPA's Renovation, Repair, and Painting Rule.

**(2) Improvements Standards**

**(a) General Improvement Standards**

All improvements to existing Structures must comply with HUD's MPR and meet or exceed local building codes.

**(b) Specific Improvement Standards**

Patios and decks must increase the As-Is Property Value equal to the dollar amount spent on the improvements.

## **(B) Limited 203(k) Ineligible Improvements/Repairs**

The Limited 203(k) mortgage proceeds **may not** be used to finance major rehabilitation or major remodeling. FHA considers a repair to be "major" when any of the following are applicable:

- the repair or improvements are expected to require more than six months to complete;
- the rehabilitation activities require more than two payments per specialized contractor;
- the required repairs arising from the appraisal:
  - necessitate a Consultant to develop a specification of repairs/Work Write-Up; or
  - require plans or architectural exhibits; or
- the repair prevents the Borrower from occupying the Property for more than 15 Days during the rehabilitation period.

Additionally, the Limited 203(k) mortgage proceeds **may not** be used to finance the following specific repairs:

- converting a one-family Structure to a two-, three- or four-family Structure;
- decreasing an existing multi-unit Structure to a one- to four-family Structure;
- reconstructing a Structure that has been or will be demolished;
- repairing, reconstructing or elevating an existing foundation;
- purchasing an existing Structure on another site and moving it onto a new foundation;
- making structural alterations such as the repair of structural damage and New Construction, including room additions;
- landscaping and site improvements;
- constructing a windstorm shelter;
- making additions or alterations to support commercial use or to equip or refurbish space for commercial use; and/or
- making recreational or luxury improvements, such as:
  - new swimming pools;
  - an exterior hot tub, spa, whirlpool bath, or sauna;
  - barbecue pits, outdoor fireplaces or hearths;
  - bath houses;
  - tennis courts;
  - satellite dishes;
  - tree surgery (except when eliminating an endangerment to existing improvements);
  - photo murals; or
  - gazebos.

## **(C) Limited 203(k) Establishing Repair and Improvement Costs**

The Borrower must submit a work plan to the Mortgagee and use one or more contractors to provide the Cost Estimate and complete the required improvements and repairs. The contractors must be licensed and bonded if required by the local jurisdiction. The Borrower must provide the contractors' credentials and bids to the Mortgagee.

The Mortgagee must review the contractors' credentials, work experience and client references and ensure that the contractors meet all jurisdictional licensing and bonding requirements. The Mortgagee must examine the work plan and the contractors' bids and determine if they fall within the usual and customary range for similar work.

The Mortgagee may require the Borrower to provide additional Cost Estimates if necessary.

### **Exception for Borrowers Doing Own Work**

For Borrowers performing their own work under a Rehabilitation Self-Help Agreement, the Borrower must submit a work plan detailing the Work Items to be performed by the Borrower and a Cost Estimate from a contractor other than the Borrower that provides a breakdown of the cost for labor and materials for each Work Item. The contractor must be licensed and bonded if required by the local jurisdiction. The Borrower must not be reimbursed for labor costs.

## **(D) Limited 203(k) Financeable Repair and Improvement Costs and Fees**

The following costs and fees may be financed:

- costs of construction, repairs and rehabilitation;
- inspection fees performed during the construction period, provided the fees are reasonable and customary for the area;
- title update fees; and
- permits.

Any costs for Energy Efficient Mortgages and Solar Energy Systems must not be included in financeable repair and improvement costs.

For Borrowers performing their own work, the Mortgagee must include the costs for labor and materials for each Work Item to be completed by the Borrower under a **Rehabilitation (Self-Help) Loan Agreement**.

## **(E) Limited 203(k) Financeable Contingency Reserves**

A Contingency Reserve is not mandated; however, at the Mortgagee's discretion, a Contingency Reserve account may be established and may be financed. The Contingency Reserve account may not exceed 20 percent of the Financeable Repair and Improvement Costs.

The Borrower may provide their own funds to establish the Contingency Reserves. Where the Borrower has provided their own funds for Contingency Reserves, they must be noted under a separate category in the Repair Escrow Account.

## **(F) Limited 203(k) Financeable Mortgage Fees**

The Mortgagee may include the following fees and charges in the rehabilitation Cost Estimates.

### **(1) Origination Fee**

The Mortgagee may include a portion of the Borrower-paid origination fee not to exceed the greater of \$350, or 1.5

percent of the total of the Financeable Repair and Improvement Costs and Fees and Financeable Contingency Reserves.

**(2) Discount Points**

The Mortgagee may include a portion of the Borrower-paid discount points not to exceed an amount equal to the discount point percentage multiplied by total of Financeable Repair and Improvement Costs and Fees and Financeable Contingency Reserves.

**(G) Limited 203(k) Ineligible Fees and Costs**

The following fees and costs **may not** be financed under the Limited 203(k):

- Mortgage Payment Reserves
- architectural/engineering professional fees
- 203(k) Consultant fee
- a Feasibility Study

**(H) Limited 203(k) Required Documentation**

The following documentation is required for the Limited 203(k).

**(1) Work Plan**

The Mortgagee must obtain a work plan from the Borrower detailing the proposed repairs or improvements. The Borrower may develop the work plan themselves or engage an outside party, including a Contractor or a 203(k) Consultant, to assist. There is no required format for the work plan.

**(2) Written Proposal and Cost Estimates**

The Mortgagee must obtain a written proposal and Cost Estimate from a contractor for each specialized repair or improvement. The Mortgagee must ensure that the selected contractor meets all jurisdictional licensing and bonding requirements. The written proposal must indicate Work Items that require permits and state that repairs are non-structural. The Cost Estimate must state the nature and type of repair and cost for each Work Item, broken down by labor and materials.

The Mortgagee must obtain written Cost Estimates for each Work Item, broken down by labor and materials, to be performed by the Borrower under a self-help agreement.

**(3) Sales Contract**

The Mortgagee must obtain a copy of the sales contract and ensure that the sales contract includes a provision that the Borrower has applied for Section 203(k) financing, and that the contract is contingent upon mortgage approval and the Borrower's acceptance of additional required improvements as determined by the Mortgagee.

When the Borrower is financing a HUD REO Property, the Mortgagee must ensure that the first block on Line 4 of the form HUD-9548, *Instructions and Sales Contract* is checked, as well as the applicable block for 203(k).

**viii. Appraisals for Standard 203(k) and Limited 203(k)**

**(A) Establishing Value**

The Mortgagee must establish both an Adjusted As-Is Value and an After Improved Value of the Property.

**(1) Appraisal Reports**

An appraisal by an FHA Roster Appraiser is always required to establish the After Improved Value of the Property. Except as described below in cases of Property Flipping and refinance transactions, the Mortgagee is not required to obtain an as-is appraisal and may use alternate methods mentioned below to establish the Adjusted As-Is Value. If an as-is appraisal is obtained, the Mortgagee must use it in establishing the Adjusted As-Is Value.

**(2) Adjusted As-Is Value**

The Mortgagee must establish the Adjusted As-Is Value as described below.

**(a) Purchase Transactions**

For purchase transactions, the Adjusted As-Is Value is the lesser of:

- the purchase price less any inducements to purchase; or
- the As-Is Property Value.

The As-Is Property Value refers to the as-is value as determined by an FHA Roster Appraiser, when an as-is appraisal is obtained.

In the case of Property Flipping, the Mortgagee must obtain an as-is appraisal if needed to comply with the Property Flipping guidelines.

**(b) Refinance Transactions**

**(i) Properties Acquired Greater Than or Equal to 12 Months Prior to the Case Assignment Date**

The Mortgagee must obtain an as-is appraisal to determine the Adjusted As-Is Value when the existing debt on the Property plus the following items exceeds the After Improved Value:

- Financeable Repairs and Improvement Costs;
- Financeable Mortgage Fees;
- Financeable Contingency Reserves; and
- Financeable Mortgage Payment Reserves (for Standard 203(k) only).

When an appraisal is obtained, the Adjusted As-Is Value is the As-Is Property Value.

The Mortgagee has the option of using the existing debt plus fees associated with the new Mortgage or obtaining an as-is appraisal to determine the Adjusted As-Is Value when the existing debt on the Property plus the following items does not exceed the After Improved Value:

- Financeable Repairs and Improvement Costs;
- Financeable Mortgage Fees;
- Financeable Contingency Reserves; and
- Financeable Mortgage Payment Reserves (for Standard 203(k) only).

Existing debt includes:

- the unpaid principal balance of the first Mortgage as of the month prior to mortgage Disbursement;
- the unpaid principal balance of any purchase money junior Mortgage as of the month prior to mortgage Disbursement;
- the unpaid principal balance of any junior liens over 12 months old as of the date of mortgage Disbursement. If the balance or any portion of an equity line of credit in excess of \$1,000 was advanced within the past 12 months and was for purposes other than repairs and rehabilitation of the Property, that portion above and beyond \$1,000 of the line of credit is not eligible for inclusion in the new Mortgage;
- interest due on the existing Mortgage(s);
- Mortgage Insurance Premium (MIP) due on existing Mortgage;
- any prepayment penalties assessed;
- late charges; and
- escrow shortages.

**(ii) Properties Acquired Less Than 12 Months Prior to the Case Assignment Date**

For properties acquired by the Borrower within 12 months of the case number assignment date, an as-is appraisal must be obtained.

The Adjusted As-Is Value is the As-Is Property Value.

For properties acquired by the Borrower within 12 months of the case assignment date by inheritance or through a gift from a Family Member, the Mortgagee may utilize the calculation of Adjusted As-Is Value for properties acquired greater than or equal to 12 months prior to the case assignment date.

**(3) After Improved Value**

To establish the After Improved Value, the Mortgagee must obtain an appraisal of the Property subject to the repairs and improvements.

**(B) Documents to be Provided to the Appraiser at Assignment**

The Mortgagee must provide the Appraiser with a copy of the Consultant's Work Write-Up and Cost Estimate for a Standard 203(k), or the work plan, contractor's proposal and Cost Estimates for a Limited 203(k).

**ix. Maximum Mortgage Amount for Purchase**

The maximum mortgage amount that FHA will insure on a 203(k) purchase is the lesser of:

- the appropriate Loan-to-Value (LTV) ratio from the Purchase Loan-to-Value Limits, multiplied by the lesser of:
  - the Adjusted As-Is Value, plus:
    - Financeable Repair and Improvement Costs, for Standard 203(k) or Limited 203(k);
    - Financeable Mortgage Fees, for Standard 203(k) or Limited 203(k);
    - Financeable Contingency Reserves, for Standard 203(k) or Limited 203(k); and
    - Financeable Mortgage Payment Reserves, for Standard 203(k) only; or
  - 110 percent of the After Improved Value (100 percent for condominiums); or
- the Nationwide Mortgage Limits.

For a HUD REO 203(k) purchase utilizing the Good Neighbor Next Door (GNND) or \$100 Down sales incentive, the Mortgagee must calculate the maximum mortgage amount that FHA will insure in accordance with HUD REO Purchasing.

**x. Maximum Mortgage Amount for Refinance**

The maximum mortgage amount that FHA will insure on a 203(k) refinance is the lesser of:

1. the existing debt and fees associated with the new Mortgage, plus:
  - Financeable Repair and Improvement Costs, for Standard 203(k) or Limited 203(k);
  - Financeable Mortgage Fees, for Standard 203(k) or Limited 203(k);
  - Financeable Contingency Reserves, for Standard 203(k) or Limited 203(k); and
  - Financeable Mortgage Payment Reserves, for Standard 203(k) only; or
2. the appropriate LTV ratio below, multiplied by the lesser of:
  - the Adjusted As-Is Value, plus:
    - Financeable Repair and Improvement Costs, for Standard 203(k) or Limited 203(k);
    - Financeable Mortgage Fees, for Standard 203(k) or Limited 203(k);
    - Financeable Contingency Reserves, for Standard 203(k) or Limited 203(k); and
    - Financeable Mortgage Payment Reserves, for Standard 203(k) only); or
  - 110 percent of the After Improved Value (100 percent for condominiums); or
3. the Nationwide Mortgage Limits.

**(A) Loan-to-Value Ratios for Refinance**

The table below describes the relationship between the Borrower's Minimum Decision Credit Score and the LTV ratio for which they are eligible.

If the Borrower's Minimum Decision Credit Score is:	Then the Borrower is:
at or above 580	eligible for maximum financing of 97.75%.
between 500 and 579	limited to a maximum LTV of 90%.

For Secondary Residences, the maximum LTV is 85 percent.

**(B) Required Documentation**

The Mortgagee must obtain the mortgage payoff statement for existing debt.

**x. Maximum Mortgage Amounts for Energy Efficient Mortgages, Weatherization Items, and Solar Energy Systems**

The Mortgagee must calculate the maximum mortgage amount without factoring in the cost of Energy Efficient Mortgage (EEM) items, weatherization items, and solar energy systems. The Mortgagee may then add the cost of these improvements to determine the Base Loan Amount. The Base Loan Amount may not exceed 110 percent of the After Improved Value of the Property (100 percent for condominiums).

For Limited 203(k) transactions, the costs for energy improvements can be in addition to the \$35,000 limit on total rehabilitation cost.

**xii. Combined Loan-to-Value**

**(A) Secondary Financing Provided by Governmental Entities, Homeownership and Opportunity for People Everywhere Grantees, and HUD-Approved Nonprofits**

There is no maximum Combined Loan-to-Value (CLTV) for secondary financing meeting the requirements found in Governmental Entities, Homeownership and Opportunity for People Everywhere (HOPE) Grantees, and HUD-Approved Nonprofits.

**(B) Secondary Financing Provided by Family Members**

There is no maximum CLTV for secondary financing meeting the requirements found in Family Members.

**(C) Secondary Financing Provided by Private Individuals and Other Organizations**

The maximum CLTV for secondary financing provided by private individuals and other organizations is 110 percent of the After Improved Value. Secondary financing provided by private individuals and other organizations may not be used to meet the Borrower's minimum downpayment requirement.

**xiii. Mortgage Insurance Premium**

The Mortgagee must comply with the MIP requirements found in the MIP Chart.

For the purpose of calculating the LTV for application of the MIP, the Mortgagee must divide the Base Loan Amount by the After Improved Value.

**xiv. Underwriting**

The Mortgagee must comply with the underwriting requirements found in Origination Through Post-Closing/Endorsement and the additional guidance provided below.

**(A) Required Documentation Standard 203(k) and Limited 203(k)**

**(1) Identity-of-Interest Certification**

Identity of Interest refers to a transaction between Family Members, business partners or other business affiliates.

Conflict of interest refers to any party to the transaction who has a direct or indirect personal, business, or financial relationship sufficient to appear that may cause partiality and influence the transaction.

Sales transactions between Family Members are permitted. The Mortgagee must ensure there are no other instances of Identity of Interest or conflict of interest between parties in the 203(k) transaction. The Borrower and the 203(k) Consultant must each sign an Identity-of-Interest certification that is placed in the case binder.

If the Borrower selected a 203(k) Consultant to perform a Feasibility Study, the Mortgagee may select the same 203(k) Consultant for the project without creating an Identity of Interest.

**(a) Borrower's Certification**

The Borrower must sign a certification stating the following:

*"I hereby certify to the Department of Housing and Urban Development (HUD) and (Mortgagee), that I/We \_\_\_\_ do or \_\_\_\_ do not have an identity-of-interest with the seller. I/We do not have an identity-of-interest with the 203(k) Consultant of the property. I also certify that I/We do not have a conflict-of-interest with any other party to the transaction, including the real estate agent, mortgagee, contractor, 203(k) Consultant and/or the appraiser. In addition, I certify that I am not obtaining any source of funds or acting as a buyer for another individual, partnership, company or investment club and I/We \_\_\_\_ will or \_\_\_\_ will not occupy the residence I/We are purchasing or refinancing."*

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

Borrower's Signature

Date

Co-borrower's Signature Date

Date

**(b) 203(k) Consultant's Certification**

All 203(k) Consultants are required to sign the following certification after preparing/reviewing the Work Write-Up and Cost Estimate, stating:

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

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

*Consultant's Signature*

*Date*

**(2) Borrower Acting as General Contractor or Doing Own Work (Self-Help)**

The Mortgagee must document approval for the Borrower to act as the general contractor or to complete their own work.

- The Mortgagee must verify and document that the Borrower is either a licensed general contractor or can document experience in completing rehabilitation projects.
- The Mortgagee must ensure the Borrower demonstrates the necessary expertise and experience to perform the specific repair competently and timely.
- The Mortgagee must instruct the Borrower of the requirement to maintain complete records showing the actual cost of rehabilitation, including paid receipts for materials and Lien Waivers from any subcontractors.
- The Mortgagee must ensure all permits are obtained prior to commencement of work.
- The Mortgagee must obtain Cost Estimates that clearly state the cost for completion of each Work Item, including the cost of labor and materials; however, only materials cost will be reimbursed.
- The Mortgagee must obtain a signed **Rehabilitation (Self-Help) Loan Agreement** from the Borrower.

**(3) Repairs Noted by the Appraiser**

When an appraisal report identifies the need for health and safety repairs that were not included in the Consultant's Work Write-Up, Borrower's work plan, or contractor's proposal, the Mortgagee must ensure the repairs are included in the Consultant's final Work Write-Up or the Borrower's final work plan.

**(4) 203(k) Borrower's Acknowledgment (Form HUD-92700-A)**

The Mortgagee must obtain an executed form HUD-92700-A, *203(k) Borrower's Acknowledgment*.

**(5) Feasibility Study**

If a Feasibility Study was performed to determine if the project is financially feasible, the Mortgagee must obtain a copy of the study.

**(6) Borrower Contractor Agreement**

The Mortgagee must obtain a written agreement between the Borrower and the general contractor, or if there is no general contractor, for each contractor. The contractor must agree in writing to complete the work for the amount of the Cost Estimate and within the allotted time frame.

**(B) Required Documentation for Standard 203(k) Only**

**(1) Consultant Final Work Write-Up and Cost Estimate**

The Mortgagee must obtain the final Work Write-Up and Cost Estimate from the Consultant. The final Work Write-Up must include all required repairs and improvements to meet HUD's Minimum Property Standards (MPS) and MPR (as applicable) and the Borrower's electives.

The Cost Estimate must state the nature and type of repair and cost for each Work Item, broken down by labor and materials. Lump sum costs are permitted only in line items where a lump sum estimate is reasonable and customary.

**(2) Architectural Exhibits**

The Mortgagee must obtain and review all required architectural exhibits included in the Consultant's final Work Write-Up.

**(3) Consultant/Borrower Agreement**

The Mortgagee must obtain a written agreement between the Consultant and the Borrower that fully explains the services to be performed and the fees to be charged for each service. The written agreement must disclose to the Borrower that any inspection performed by the Consultant is not a "Home Inspection," as detailed in the disclosure form HUD-92564-CN, *For Your Protection Get a Home Inspection*.

**(C) Required Documentation for Limited 203(k) Only**

**Contractor's Cost Estimate**

The Mortgagee must obtain the final contractor's itemized estimate of the repairs and improvements to be completed for all Work Items.

**xv. Closing**

**(A) Standard**

The Mortgagee must comply with requirements found in the Closing section and the additional guidance provided below.

There is only one closing that includes the rehabilitation funds. The rehabilitation funds are escrowed and disbursed as the work is satisfactorily completed.

**(1) Establishing the Rehabilitation Escrow Account**

**(a) Standard 203(k)**

The Mortgagee must establish an interest bearing rehabilitation escrow account to include, as applicable:

- Standard 203(k) Financeable Repair and Improvement Costs and Fees;
- Standard 203(k) Financeable Contingency Reserves;
- Standard 203(k) Financeable Mortgage Payment Reserves;
- the cost of EEM, weatherization or solar energy systems improvements; and
- the Borrower's own funds for Contingency Reserves.

**(b) Limited 203(k)**

The Mortgagee must establish an interest bearing rehabilitation escrow account to include, as applicable:

- Limited 203(k) Financeable Repair and Improvement Costs and Fees;
- Limited 203(k) Financeable Contingency Reserves;
- the cost of EEM, weatherization or solar energy systems improvements; and
- the Borrower's own funds for Contingency Reserves.

**(c) Escrow Closeout Certification Screen**

The Mortgagee must complete all applicable fields on the Escrow Closeout Certification screen in FHAC.

**(2) Initial Draw at Closing**

The Mortgagee must document the amount and purpose of an initial draw at closing on the form HUD-92900-LT, *FHA Loan Underwriting and Transmittal Summary*.

**(a) Standard 203(k)**

For Standard 203(k) transactions, Mortgagees may disburse the following at closing:

- permit fees (the permit must be obtained before work commences);
- prepaid architectural or engineering fees;
- prepaid Consultant fees;
- origination fees;
- discount points;
- materials costs for items, prepaid by the Borrower in cash or by the contractor, where a contract is established with the supplier and an order is placed with the manufacturer for delivery at a later date; and
- up to 50 percent of materials costs for items, not yet paid for by the Borrower or contractor, where a contract is established with the supplier and an order is placed with the manufacturer for delivery at a later date.

For any Disbursements paid to the contractor, the Mortgagee must hold back 10 percent of the draw request in the Contingency Reserve.

**(b) Limited 203(k)**

For Limited 203(k) transactions, Mortgagees may disburse the following at closing:

- permit fees (the permit must be obtained before work commences);
- origination fees;
- discount points; and
- up to 50 percent of the estimated materials and labor costs before beginning construction only when the contractor is not willing or able to defer receipt of payment until completion of the work, or the payment represents the cost of materials incurred prior to construction. A statement from the contractor is sufficient to document.

**(B) Required Documentation**

**(1) Rehabilitation Loan Agreement**

The Mortgagee and Borrower must execute the **Rehabilitation Loan Agreement**, which establishes the conditions under which the Mortgagee will disburse the rehabilitation escrow account funds.

The **Rehabilitation Loan Agreement** is incorporated by reference and made a part of the security instrument.

**(a) Standard 203(k) Rehabilitation Period**

The Mortgagee must review the 203(k) Consultant's Work Write-Up to determine the time frame for completion of repairs not to exceed six months.

**(b) Limited 203(k) Rehabilitation Period**

The Mortgagee must consult the Borrower Contractor Agreement to determine the time frame for completion of repairs not to exceed six months.

**(2) Security Instrument and Rehabilitation Loan Rider**

If the Mortgage involves releases from the rehabilitation escrow account, the following language must be placed in the security instrument:

"Provisions pertaining to releases are contained in the Rehabilitation Loan Rider, which is attached to this mortgage and made a part hereof."

The **Rehabilitation Loan Rider** is a required modification to a security instrument.

## xvi. Data Delivery/203(k) Calculator

The 203(k) Calculator enables Mortgagees to calculate the Maximum Mortgage amount, LTV for MIP, and the amount to establish a repair escrow when required for all 203(k) transactions.

Mortgagees may begin to use the 203(k) Calculator in FHAC when the functionality becomes available, but must use the 203(k) Calculator prior to endorsement for all 203(k) transactions with case numbers assigned on and after October 31, 2016.

Required data for the 203(k) Calculator are:

- 203(k) Program Type (Standard 203(k) or Limited 203(k));
- As-Is Property Value;
- Adjusted As-Is Value;
- After Improved Value;
- existing debt on the Property for a refinance;
- credit for lead-based paint stabilization per HUD REO contract (if applicable);
- Financeable Repair and Improvement Costs, for Standard 203(k) or Limited 203(k);
- Financeable Contingency Reserves, for Standard 203(k) or Limited 203(k);
- Financeable Mortgage Payment Reserves, for Standard 203(k) only;
- Financeable Mortgage Fees, for Standard 203(k) or Limited 203(k);
- cost of EEM or solar energy systems improvements; and
- principal balance of secondary financing provided by private individuals and other organizations.

For applications to be endorsed prior to the availability of data delivery functionality in FHAC, the Mortgagee must detail the data delivery requirements shown above on form HUD-92900-LT, or include the applicable 203(k) Maximum Mortgage Calculation Worksheet.

## xvii. Post-Closing and Endorsement

The Mortgagee must comply with requirements in Post-Closing and Endorsement.

203(k) Mortgages are eligible for endorsement after the initial mortgage proceeds are disbursed and a rehabilitation escrow account is established.

### (A) Rehabilitation Period

The rehabilitation period starts when the Mortgage is funded.

The rehabilitation period is specified in the **Rehabilitation Loan Agreement**.

### (B) Extension Requests

If the work is not completed within the rehabilitation period specified in the Rehabilitation Loan Agreement, the Borrower may request an extension of time and must submit adequate documentation to justify the extension. The Mortgagee may grant an extension at its discretion only if the Mortgage Payments are current.

#### (1) Required Documentation

The Mortgagee must obtain:

- evidence that the Mortgage is current;
- an explanation for the delay from the Borrower, contractor, or Consultant; and
- a new estimated completion date.

#### (2) Escrow Closeout Certification Screen

The Mortgagee must complete the required fields on the Escrow Closeout Certification screen in FHAC to document the approval or the denial for the extension request of the rehabilitation period specified in the Rehabilitation Loan Agreement.

### (C) Failure to Start or Complete Work

As stated in the **Rehabilitation Loan Agreement**, the Mortgagee may consider the Mortgage to be in default if work:

- has not started within 30 Days of the Disbursement Date;
- ceases for more than 30 consecutive Days; or
- has not been completed within the established time frame, or an extended time frame approved by the Mortgagee.

If the Mortgagee considers the Mortgage to be in default for failure to start or complete work, and the Mortgage is not in payment default, the Mortgagee must apply any unused rehabilitation funds towards the principal amount.

## xviii. Rehabilitation Escrow Account

When the Mortgage closes, the Mortgagee must place all proceeds designated for the rehabilitation, including the Contingency Reserve, inspection fees and any Mortgage Payments, in an interest bearing escrow account.

- The Mortgagee must pay the net income earned by the rehabilitation escrow account to the Borrower through an agreed upon method of payment.
- The Mortgagee may allow net income to accumulate and be paid in one lump sum after completion of the rehabilitation.
- The Mortgagee that is the custodian of the repair escrow funds is responsible for ensuring all funds from the escrow account are properly distributed.

### (A) Accounting of 203(k) Rehabilitation Funds

The Mortgagee must utilize an accounting system that records all transactions from the rehabilitation escrow account and which documents the amount escrowed for each of these categories:

- repairs
- Contingency Reserve
- inspection fees
- title update fees
- Mortgage Payments
- other fees (i.e., architectural and engineering fees, Consultant fees, permits, supplemental origination fee and discount points on repair costs)

The accounting system must provide:

- the Borrower's name and property address
- the FHA case number
- the Closing Date
- the scheduled completion date
- the amount of funds in the rehabilitation escrow account
- the interest rate provided on the escrow account

For each draw on the escrow account, the accounting system must record:

- a list of Disbursements
- the number of Days in escrow
- the amount of money in the account
- the interest earned for the applicable time period
- the balance of interest remaining in the account

## **(B) Project Management**

Mortgagees must ensure work is completed on schedule and workmanship is acceptable.

When notified of an issue, Mortgagees must intercede in disagreements among Borrowers, contractors, or Consultants.

### **(1) Health and Safety**

The Mortgagee must ensure that all health and safety items not in the original Work Write-Up or work plan that are discovered during the rehabilitation period are addressed by completion of a change order.

### **(2) Change Order Request**

The Mortgagee must obtain form HUD-92577, *Request for Acceptance of Changes in Approved Drawings and Specifications*, from the Consultant or inspector if there are any deviations from the Work Write-Up. The Mortgagee must approve the change order before any work can be done.

## **(C) Escrow Administration**

The Mortgagee is fully responsible for authorizing draw inspections, managing the rehabilitation escrow account, and approving the associated draws from the account.

It is the Mortgagee's responsibility to ensure that any inspections are completed in a quality and timely manner, regardless of who performs the inspections.

### **(1) Release of Funds**

**The Mortgagee may release funds only when repairs and improvements per the draw request, whether made by the contractor or Borrower, meet all federal, state, and local laws, codes and ordinances, including any required permits and inspections.**

The Mortgagee may release funds for lead-based paint stabilization only when a state- or EPA-certified lead-based paint inspector, certified risk assessor or sampling technician, independent of the firm that performed the stabilization, performs the clearance examination and clearance is obtained.

For an existing Structure moved to a new foundation or a Structure that will be elevated, the Mortgagee must not release mortgage proceeds for the existing Structure on the non-mortgaged Property until the new foundation has been properly inspected and the Structure has been properly placed and secured to the new foundation.

The Mortgagee must obtain Lien Waivers, or equivalent, at the time of any Disbursement of funds to ensure the validity of the first lien on the Property. If all Work Items performed by a contractor have not been completed at the time of draw request, the Mortgagee must obtain a partial conditional Lien Waiver for the Work Items that have been completed for each draw request.

For repairs made by the Borrower under a self-help agreement, the Mortgagee is permitted to release funds for materials only.

When the rehabilitation escrow account includes Mortgage Payment Reserves, the Mortgagee must make monthly Mortgage Payments directly from the interest bearing reserve account. Once the Property is able to be occupied, application of the Mortgage Payment Reserves will cease. Mortgage Payment Reserves remaining in the reserve account after occupancy of the Property must be used to reduce the mortgage principal.

#### **(a) Draw Request**

The Mortgagee must obtain an executed form HUD-9746-A, *Draw Request Section 203(k)*, from the 203(k) Consultant, or from the Borrower when there is no 203(k) Consultant, requesting the release of escrow funds for completed Work Items.

The Mortgagee must review and approve each draw request to ensure that the work for which funds are being requested has been completed satisfactorily and that the form has been properly executed by the Borrower, contractor and Consultant, if any.

**The Mortgagee may not approve a draw request for work that is not yet complete.**

**The Mortgagee may not approve draw requests for materials for work that is not completed, except for:**

- materials costs for items prepaid by the Borrower in cash or by the contractor, where a contract is established with the supplier and an order is placed with the manufacturer for delivery at a later date; and
- up to 50 percent of materials costs for items, not yet paid for by the Borrower or contractor, where a contract is established with the supplier and an order is placed with the manufacturer for delivery at a later date.

**(b) Change Orders**

Work must be 100 percent complete on each change order item before the release of funds for the Work Items from the rehabilitation escrow account.

**(c) Holdbacks**

The Mortgagee must hold back 10 percent of each draw request prior to release of funds from the rehabilitation escrow account.

**Exception**

When a subcontractor is 100 percent complete with a Work Item, the work completed is acceptable to the inspector, and the contractor and subcontractor provide the necessary Lien Waivers, or equivalent, the Mortgagee is not required to hold back funds; the Mortgagee has discretion to hold back funds if not required.

**(d) Timeliness of Release**

The Mortgagee must release funds within five business days after receipt of a properly executed draw request and title update when necessary.

**(i) Standard 203(k) Release of Funds**

**Maximum Draw Requests**

The Mortgagee may approve a maximum of five draw requests (four intermediate and one final).

**Contingency Reserve**

To allow use of contingency funds for improvements other than health and safety when rehabilitation is incomplete, the Mortgagee must determine that it is unlikely that any health or safety deficiency will be discovered, and that the Mortgage will not exceed 95 percent of the appraised value.

When the rehabilitation is complete, the Borrower may use the Contingency Reserve account to fund additional improvements not included in the original Work Write-Up.

The Mortgagee must obtain a change order detailing the additional improvements, including the costs of labor and materials.

The Mortgagee must inform the Borrower in writing of the approval or rejection of the request to use funds from the Contingency Reserve account for additional improvements within five business days.

**Method of Payment**

The Mortgagee will release escrow funds upon completion of the rehabilitation in compliance with the Work Write-Up.

The Mortgagee must issue checks to both the Borrower and contractors as co-payees, unless the Borrower provides written authorization, at each draw, to issue the check directly to the contractor.

The Mortgagee may issue the check directly to the Borrower alone if the release is for:

- materials for work performed under a self-help agreement; or
- materials for items prepaid by the Borrower under contract with the supplier.

**(ii) Limited 203(k) Release of Funds**

**Maximum Number of Draw Requests**

The Mortgagee may approve a maximum of two draw requests per contractor or the Borrower (if acting as the contractor).

When necessary, the Mortgagee may arrange a payment schedule, not to exceed two releases, per specialized contractor (an initial release plus a final release).

**Total Repair Costs Less Than or Equal to \$15,000**

The Mortgagee must ensure that the repairs and/or improvements have been completed by obtaining contractor's receipts or a signed Borrower's Letter of Completion. The Mortgagee is not required to perform or have others perform inspections of the completed work.

The Mortgagee may choose to obtain or perform inspections if they believe such actions are necessary for program compliance or risk mitigation. If the Mortgagee determines that an inspection by a third party is necessary to ensure proper completion of the proposed repair or improvement item, the Mortgagee may charge the Borrower for the costs of no more than two inspections per contractor.

**Total Repair Costs Exceeding \$15,000**

The Mortgagee must ensure that the repairs and/or improvements have been completed by performing an inspection or by obtaining an inspection by a third party to determine that the repairs have been satisfactorily completed. The Mortgagee must obtain a signed Borrower's Letter of Completion.

**Contingency Reserve**

The Mortgagee must ensure funds escrowed in the Contingency Reserve are used solely to pay for the proposed repairs or improvements and any unforeseen items related to these repair items.

**Method of Payment**

The Mortgagee will release rehabilitation escrow funds upon completion of the rehabilitation in compliance with the work plan.

The Mortgagee may issue checks solely to the contractor, or issue checks to the Borrower and the contractor as co-payees.

The Mortgagee may issue the check directly to the Borrower alone if the release is for:

- materials for work performed under a self-help agreement; or
- materials for items prepaid by the Borrower under contract with the supplier.

## **(2) Final Escrow Closeout**

The Mortgagee must include the interest earned in the final payment on the rehabilitation escrow account and may include the total of all holdbacks. However, if it is required to protect the priority of the security instrument, the Mortgagee may retain the holdback for a period not to exceed 35 Days (or the time period required by law to file a lien, whichever is longer), to ensure compliance with state Lien Waiver laws or other state requirements.

### **(a) Standard**

#### **(i) Standard 203(k)**

Before final release of rehabilitation escrow funds, the Mortgagee must approve the final inspection and draw request signed by the Consultant, contractor, and Borrower.

#### **(ii) Limited 203(k)**

Before a final release is made to any contractor, the Mortgagee must determine that all work by the contractor has been completed, is acceptable by the Borrower, and all necessary inspections have been made with acceptable documentation.

### **(b) Required Documentation for both Standard 203(k) and Limited 203(k)**

The Mortgagee must:

- obtain the Borrower's Letter of Completion signed by the Borrower indicating satisfaction with the completed work and requesting a final inspection and final release of funds;
- obtain a CO, or equivalent, if required by the local jurisdiction;
- obtain all inspections required by the local jurisdiction;
- complete the Final Release Notice authorizing the final payment;
- provide the Mortgagee's extension approval if applicable; and
- obtain a release of any and all liens arising out of the contract or submission of receipts, or other evidence of payment covering all subcontractors or suppliers who could file a legal claim.

## **(3) Contingency Release**

The Mortgagee must inform the Borrower of its approval or rejection of the Borrower's request for funds to be made available from the Contingency Reserve account for the purpose of improvements.

A Borrower who established the Contingency Funds with their own funds may receive a refund of their funds, or may request the remaining funds be applied towards the principal balance.

For Standard 203(k), the Mortgagee must either make funds available for additional improvements or apply the funds towards the principal balance if the Contingency Reserve was financed.

For Limited 203(k), the Mortgagee must apply the funds towards the principal balance if the Contingency Reserve was financed.

## **(4) Mortgage Payment Reserve**

Mortgage Payment Reserves remaining in the reserve account after the Final Release Notice is issued must be used to reduce the mortgage principal.

## **(5) Escrow Closeout Certification**

### **(a) Standard**

After the rehabilitation escrow account is closed, the Mortgagee must complete the Escrow Closeout Certification screen in FHAC within 30 Days after the escrow account is closed.

### **(b) Required Documentation**

The Mortgagee must certify that the following documents were reviewed and verified for accuracy:

- Final Release Notice
- Borrower's Letter of Completion
- title update/Lien Waivers
- draw request forms and inspection reports
- change orders
- Mortgagee accounting of the rehabilitation escrow account and payment ledgers
- contingency release letters

## **xix. Quality Control**

HUD will hold Mortgagees and 203(k) Consultants fully accountable for the mortgage proceeds.

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

## **xx. Servicing**

### **(A) Delinquencies**

If the Mortgage is delinquent, the Mortgagee may refuse to make further releases from the rehabilitation escrow account.

### **(B) Payment Default**

The project must stop if the Mortgage is in payment default. The Mortgagee must obtain an inspection of all repairs that have been completed up until this point by the 203(k) Consultant for a Standard 203(k), or for a Limited 203(k) by a third party. The Mortgagee may approve a release of funds for Work Items that have already been completed as of the date the work was stopped.

The inspection obtained by the Mortgagee must also note any items that are required to be completed to protect the interest of the collateral from deteriorating, such as a roof, and health and safety items for a Property that is occupied. The Mortgagee must ensure the completion of any Work Item that the inspection determines is necessary to protect the occupants and/or the collateral. The Mortgagee may use the services of the mortgagor's contractor, if appropriate, or may engage the services of another qualified contractor to complete the Work Item. The Mortgagee may approve a subsequent release of funds for that Work Item.

The Mortgagee has the option to call the Mortgage due and payable.

If the default is cured, the project may resume.

### **(C) Bankruptcy**

The Mortgagee may not approve further advances if the Borrower declares bankruptcy unless otherwise required by law or as needed to protect FHA's first lien position. The Mortgagee must obtain an inspection of all repairs that have been completed by the 203(k) Consultant for a Standard 203(k), or for a Limited 203(k) by a third party. The Mortgagee may approve a release of funds for Work Items that have already been completed as of the date the work was stopped.

### **(D) Foreclosure of Mortgage during Rehabilitation Period**

In the event of a foreclosure during rehabilitation, the Mortgagee must obtain a final inspection to determine the amount of work that has been completed since the start of construction and the cost for the work.

Using a format similar to the Final Release Notice, the Mortgagee will authorize release of rehabilitation escrow funds for the completed work and holdbacks on any previous Disbursements.

If funds remain in the rehabilitation escrow account, the Mortgagee will reduce the amount of claim (unpaid mortgage principal balance) by the unexpended funds in the rehabilitation escrow account.

The Mortgagee must submit a copy of the Final Release Notice with any insurance claim.