



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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

May 7, 2008

MORTGAGEE LETTER 2008-13

TO: ALL APPROVED MORTGAGEES

SUBJECT: Expansion of *FHASecure*

In Mortgagee Letter 2007-11, the Federal Housing Administration announced *FHASecure*, a temporary initiative to permit lenders to refinance delinquent adjustable rate mortgages (ARMs) and/or to offer new subordinate financing where the combined loan-to-value ratio exceeds the applicable FHA loan-to-value ratio and geographical maximum mortgage amount. The Department has decided to expand *FHASecure* as follows:

- To include borrowers delinquent on their non-FHA ARM's due to a rate reset or the occurrence of an extenuating circumstance but experienced no more than two 30-day or one 60-day late payment in the 12 months prior to the rate reset or extenuating circumstance that caused the delinquency; or
- To include borrowers delinquent on their non-FHA ARM's due to a rate reset or the occurrence of an extenuating circumstance but experienced no more than one 90-day late payment or no more than three 30-day late payments prior to the rate reset or extenuating circumstance that caused the delinquency provided the loan-to-value on the FHA insured first mortgages does not exceed 90 percent.
- Borrowers delinquent on their interest-only and/or payment option ARM's are *not* eligible for this expansion: borrowers with these types of mortgages must demonstrate that a rate reset caused the delinquency and that they were making the monthly mortgage payments within the month due during the 6 months prior to the rate reset.
- For borrowers refinancing delinquent non-FHA ARM's the Up-front mortgage insurance premium (UFMIP) is set at 2.25 percent of the base loan amount (loan amount excluding UFMIP) regardless of the loan-to-value (LTV) ratio. For LTV ratios greater than 95 percent (excluding UFMIP) the Annual premium (collected monthly) is set at .55 percent.

This mortgagee letter replaces the specific guidance regarding *FHASecure* issued in Mortgagee Letter 2007-11 and is effective for case numbers assigned on or after July 14, 2008. FHA is implementing the policies in this letter simultaneously with the implementation of risk-based pricing through notice in the Federal Register May 13, 2008. Mortgagees are reminded that

the eligibility criteria for delinquent borrowers and new subordinate financing under the *FHASecure* initiative are temporary and require that the loan application be signed no later than December 31, 2008. Mortgagees are also reminded that FHA has not changed its underwriting guidelines, but rather its eligibility criteria. Existing policies are still applicable, such as those involving bankruptcy. This mortgagee letter also clarifies guidance issued in Mortgagee Letter 2005-43 regarding cash-out refinance transactions.

I. *FHASecure* Eligibility Criteria

All conventional-to-FHA rate and term refinances are considered *FHASecure*, regardless of whether the borrower is delinquent or current. Cash-out refinance transactions *are not* acceptable under this initiative. The following items are the eligibility criteria for originating mortgages under *FHASecure*.

Borrowers Current on Their Mortgages

- The mortgage being refinanced must be a non-FHA fixed rate or adjustable rate mortgage.
- Mortgagees are reminded that they need to verify the borrower's mortgage payment history through the mortgage servicer or through cancelled checks to determine if it is acceptable under FHA's standard underwriting guidelines.
- If there is insufficient equity in the home, FHA will insure first mortgages where there is a:
 - 1) Write Down. The existing note holder(s) writes off the amount of indebtedness that cannot be refinanced into the FHA insured mortgage (a short pay-off); or
 - 2) New Subordinate Financing. The FHA-approved lender making the new mortgage, the existing note holder or other interested party may take back a second lien by the amount which the payoff is short, including closing costs, arrearages, other reasonable and customary costs that are standard servicing practices and are included in all payoff statements or previous secondary financing if the indebtedness exceeds FHA prescribed LTV and maximum mortgage amount limits; and/or
 - 3) Re-subordination/Modification. The note holder(s) of existing subordinate financing must re-subordinate or modify the existing subordinate lien(s) and re-execute at closing if the lien is to remain in effect after closing; and/or
 - 4) Other options. State/local programs or "Rescue Funds" administered by nonprofit organizations.
- Mortgagees must determine that the borrower has sufficient income and resources to make the monthly payments under the new FHA-insured refinancing mortgage as well as pay other recurring obligations.

Borrowers Delinquent on Their Mortgages

- The mortgage being refinanced must be a non-FHA adjustable rate mortgage.
- When refinancing a delinquent mortgage where the delinquency was caused by a rate reset¹ or the occurrence of an extenuating circumstance² the borrower's payment history must show that:
 1. The borrower was making the monthly mortgage payments within the month due during the 6 months prior to the rate reset or extenuating circumstance; **OR**
 2. In the 12 months prior to the rate reset or extenuating circumstance the borrower's payment history shows no more than one 60-day late payment or two 30-day late payments. Borrowers with less than a full 12 months payment history (i.e., 7-11 months payment history) must show that they have made their monthly mortgage payments within the month due during the 6 months prior to the rate reset or occurrence of the extenuating circumstance; **OR**
 3. If the borrower is unable to meet the payment history requirements specified above, the lender may still proceed with the refinance transaction provided that the loan-to-value ratio on the new FHA-insured mortgage does not exceed 90 percent and the borrower has no more than one 90-day late or no more than three 30-day late payments over the 12 month period prior to the rate reset or extenuating circumstance.
- Mortgagees must determine that the rate reset or extenuating circumstance that caused the delinquency does not affect the borrower's overall capacity to repay the new FHA-insured mortgage.
- Borrowers delinquent on their interest only and/or payment option ARMs must demonstrate that the delinquency was caused by a rate reset and that they were making their monthly mortgage payments within the month due during the 6 months prior to the rate reset.
- If there is insufficient equity in the home, FHA will insure first mortgages where there is a:
 - 1) Write Down. The existing note holder(s) writes off the amount of indebtedness that cannot be refinanced into the FHA insured mortgage (a short pay-off); or
 - 2) New Subordinate Financing. The FHA-approved lender making the new mortgage, the existing note holder or other interested party may take back a second lien by the amount

¹ In the case of payment option ARMs, the ultimate 'reset' or 'recasting' of the loan to fully amortizing is an acceptable cause of default to qualify a borrower for *FHASecure*.

² Extenuating circumstance is defined as an event that caused the default, including but not limited to reduction in income, emergency expenditure for repairs, illness of borrower/family, etc., which will not impede the borrower's ability to make the payment on the new FHA-insured mortgage.

which the payoff is short, including closing costs, arrearages, other reasonable and customary costs that are standard servicing practices and are included in all payoff statements or previous secondary financing if the indebtedness exceeds FHA prescribed LTV and maximum mortgage amount limits; and/or

- 3) Re-subordination/Modification. The note holder(s) of existing subordinate financing must re-subordinate or modify the existing subordinate lien(s) and re-execute at closing if the lien is to remain in effect after closing; and/or
 - 4) Other options. State/local programs or “Rescue Funds” administered by nonprofit organizations.
- Mortgagees must determine that the borrower has sufficient income and resources to make the monthly payments under the new FHA-insured refinancing mortgage as well as pay other recurring obligations.
 - In most of the FHA insurance programs, there is an Up-Front Mortgage Insurance Premium (UFMIP) and an Annual premium. For borrowers refinancing delinquent non-FHA loans the UFMIP is set at 2.25 percent of the base loan amount (loan amount excluding Up-front MIP) regardless of the loan-to-value (LTV) ratio. For LTV ratios greater than 95 percent (excluding UFMIP) the Annual premium (collected monthly) is set at .55 percent. These premiums reflect the relative risk associated with new borrowers under the *FHASecure* expansion, within the limits applicable law places upon FHA’s premium-setting authority.

Maximum FHA loan-to-value ratios

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

Maximum Loan-to-Value Ratios

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

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

States with Average Closings Costs Above 2.1 Percent of Sales Price

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

Calculating the Maximum FHA Mortgage Amount

The amount of the *FHASecure* mortgage may not exceed either the geographical maximum mortgage limits or the loan-to-value ratios shown above. FHA will permit the inclusion in the new loan amount the existing first lien, any purchase money second mortgage, closing costs, prepaid expenses, discount points, prepayment penalties, late payment charges, attorney fees, inspection fees, and those other charges traditionally associated with servicing mortgages. FHA will also permit arrearages (principal, interest, taxes and insurance) to be added into the new loan amount provided the arrearages arose after the reset or occurrence of an extenuating circumstance.

Subordinate Financing and Combined Loan-to-Values

If the new maximum FHA loan is not enough to pay off the existing first lien, closing costs and arrearages, the new or existing lender may execute a subordinate lien at closing to pay the difference. This new subordinate lien does not have to be supported by the value of the property. The combined amount of the *FHASecure* first mortgage and any subordinate non FHA-insured lien may exceed the applicable FHA loan-to-value ratio and geographical maximum mortgage amount. If payments on the new subordinate lien are required, they must be included in qualifying the borrower unless payments have been deferred for no less than 36 months. If payments on the new subordinate lien are deferred for 36 months, underwriters should consider the repayment terms to ensure that when the payments begin they do not exceed the borrower's reasonable ability to pay.

While it is permissible to establish equity sharing agreements or other similar arrangements for providing a subordinate lien, the terms agreed to must not trigger a default on the FHA-insured first mortgage. Therefore, FHA has established the following conditions:

- The terms of the subordinate lien(s) must *not* provide for a balloon payment before ten years, unless the property is sold or refinanced;
- The terms must permit prepayment by the borrower, without penalty, after giving 30 days advance notice;
- The required monthly payment under both the new FHA-insured mortgage and the subordinate lien(s) – regardless of when payments begin – plus other housing expenses and all recurring charges, cannot exceed the borrower's reasonable ability to pay; and
- Any periodic payments due on the subordinate lien(s) are due monthly and are essentially the same in dollar amount.

FHA is also simplifying its policies involving combined loan-to-value (CLTV) ratios to make them as consistent as possible regardless of the type of refinance transaction. The following chart provides additional guidance to mortgagees regarding CLTV ratios for refinance transactions, including cash-out and FHA-to-FHA refinance transactions.

Loan-to-value and Combined Loan-to-Value Maximum Mortgage Calculation			
Criteria	FHA Secure	FHA 95% Cash-out Refinance	FHA-to-FHA Refinance
LTV	Standard LTV on FHA first mortgage; <i>or</i> 90% LTV on FHA first mortgage if the borrower has one 90-day late or three 30-day late payments over the specified period.	Up to 95% LTV on FHA first mortgage provided loan amount will not exceed \$417,000. Otherwise, capped at 85% LTV.	Standard LTV on FHA first mortgage.
CLTV	Unlimited CLTV on new and/or re-subordination or modification of existing subordinate financing.	<u>New</u> subordinate financing is not permissible. Unlimited CLTV for re-subordination or modification of <u>existing</u> subordinate financing for both 95% and 85% LTVs.	Standard CLTV on <u>new</u> subordinate financing, i.e., combined amount of first and second mortgages does not exceed applicable LTV ratio and the maximum mortgage limit for the area. Unlimited CLTV for re-subordination or modification of <u>existing</u> subordinate financing.
Max Mtg Amount	In addition to standard rate and term, the maximum mortgage calculation may include arrearages incurred because of interest rate reset or occurrence of extenuating circumstance.	Standard cash-out maximum mortgage calculation up to 95%.	Standard rate and term maximum mortgage calculation.
Value	Current appraised value is used in determining maximum loan amount.	Current appraised value is used in determining maximum loan amount.	Current appraised value is used in determining maximum loan amount.

Underwriting the Mortgage/Qualifying the Borrower

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

1. Determine that the borrower has the capacity to make future mortgage payments as well as pay all other obligations. The payment-to-income and debt-to-income ratios are 31 percent and 43 percent, respectively, and may be exceeded provided there is a strong compensating factor(s) (see handbook HUD 4155.1 REV-5, ¶ 2-13).

For borrowers limited to 90% LTV due to their mortgage payment history, the payment-to-income and debt-to-income ratios *may not* be exceeded even when compensating factors are present.

2. Analyze the borrower's overall credit history, especially payments on the existing mortgage. If the mortgage being refinanced is delinquent, the underwriter must determine that:
 - a. The borrower's mortgage payment history during the 6 months prior to the interest rate reset or occurrence of an extenuating circumstance showed no instances of making mortgage payments outside the month due; *OR*
 - b. In the 12 months prior to the reset or extenuating circumstance, the borrower's payment history shows no more than one 60-day late payment or two 30-day late payments. Borrowers with less than a full 12 months payment history (i.e., 7-11 months payment history) must show that they have made their monthly mortgage payments within the month due during the 6 months prior to rate reset or extenuating circumstance; *OR*
 - c. If the borrower is unable to meet the payment history requirements specified above, the loan-to-value ratio on the new FHA-insured mortgage must not exceed 90 percent *and* the borrower has no more than one 90-day late or no more than three 30-day late payments over the 12 month period prior to the rate reset or extenuating circumstance.
 - d. Borrowers with interest-only or payment option ARMs must show that they have made their monthly mortgage payments within the month due during the 6 months prior to the rate reset.

If the borrower was offered partial forbearance, the underwriter must determine that he/she has made payments under the forbearance agreement in a timely manner.

For those borrowers current on their non-FHA mortgage, underwriters should not automatically penalize borrowers who made their mortgage payment their first priority at the expense of meeting other recurring obligations in a timely manner. If the credit report indicates satisfactory credit prior to the reset or extenuating circumstance, and any derogatory credit subsequent to that date can be related to the effects of the rate reset or extenuating circumstance, FHA will consider for its underwriting standards that the borrower is a satisfactory credit risk.

3. Provide comments in the "remarks" section of the mortgage credit analysis worksheet (or loan underwriting and transmittal summary) that he or she has determined that the cause of the borrower's inability to make payments was directly related to the rate reset or extenuating circumstance and not due to a disregard for recurring obligations.

Misuse of FHA Secure

Lenders are also reminded that the *FHA Secure* initiative is *not* to be used to solicit borrowers to cease making timely mortgage payments. FHA reserves the right to reject for

insurance, those mortgage applications where it appears that a loan officer or other mortgagee employee suggested that the borrowers could stop making their payments, refinance into a FHA insured mortgage, and keep, as cash, the amount of payments not made on time.

II. Clarification on Cash-out Refinance Transactions

In Mortgagee Letter 2005-43, FHA revised its policies regarding refinance transactions and introduced a cash-out refinance of up to 95 percent of the appraiser's estimate of value. Given the popularity of this refinance option, FHA is taking this opportunity to reiterate and clarify the eligibility conditions that must be met in order to take advantage of the increased LTV that is permitted. And, as noted in ML 2008-09, if a borrower is pursuing a cash-out refinance and the loan balance exclusive of FHA's upfront mortgage insurance premium will exceed \$417,000, the loan-to-value may not exceed 85 percent of the appraiser's estimate of value.

- Borrowers who are delinquent or in arrears under the terms and condition of their mortgage *are not* eligible for a cash-out refinance.
- The subject property must have been owned by the borrower as his or her principal residence for at least 12 months preceding the date of the loan application. If the borrower has not owned the property for a minimum of 12 months, the FHA-insured new mortgage is capped at 85 percent LTV. In such cases, the mortgage amount must be calculated using the lesser of the appraised value or the original sales price of the property multiplied by 85 percent.
- If said property is encumbered by a mortgage, the borrower must have made all of his/her mortgage payments within the month due for the previous 12 payments, i.e., no payment may have been more than 30 days late and is current for the month due. For those borrowers who have owned their property for 12 months but do not have a full 12 months payment history, lenders may create an aggregate 12-month payment history from a previous mortgage the borrower held on the subject property. If a lender is unable to establish a 12 months payment history, the FHA-insured new mortgage is capped at 85 percent LTV.
- The property that is security for the refinanced mortgage must be a 1- or 2-unit dwelling.
- Existing subordinate financing may remain in place, but subordinate to the FHA-insured first mortgage, regardless of the total indebtedness or combined loan-to-value ratio, provided the borrower qualifies for making scheduled payments on all liens. FHA understands that many subordinate lien holders have been requesting modifications to the terms of the lien (typically a reduction in the amount of the lien) in exchange for remaining in a subordinate position. Modifying the subordinate lien in this manner often results in re-executing it at closing, which is an acceptable practice to FHA and therefore, we would not consider it a new subordinate lien. This policy regarding CLTV ratios is also applicable to cash-out refinance transactions limited to 85 percent of the appraiser's estimate of value (or sales price if the property was purchased less than one

year preceding loan application, whichever is less), thus superseding current policies in Handbook 4155.1 REV-5, paragraph 1-11 B, addressing CLTV ratios in 85 percent cash-out refinance transactions.

- Any co-borrower or co-signer being added to the note must be an occupant of the property securing the new FHA-insured mortgage. Non-occupant co-borrowers or co-signers may *not* be added in order to meet FHA's credit underwriting guidelines for the mortgage.

Attached to this Mortgagee Letter is an FHA Refinance Programs Comparison Matrix to use as a quick reference guide. If you should have any questions concerning this Mortgagee Letter, call 1-800-CALLFHA.

Sincerely,

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