



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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

MORTGAGEE LETTER 2005-50

December 29, 2005

**TO: ALL APPROVED MORTGAGEES
ALL APPROVED APPRAISERS**

SUBJECT: Enhancements to “Streamlined (k)” Limited Repair Program

Mortgagee Letter 2005-19 (ML 05-19) announced the Streamlined (k) Limited Repair Program to augment FHA’s existing Section 203(k) rehabilitation program for less extensive repairs and improvement. This Mortgagee Letter replaces in its entirety ML 05-19 and is designed to make the program more reflective of the desire of many homebuyers and existing homeowners to improve their homes including making them more energy efficient.

This Mortgagee Letter contains important changes to the Streamlined (k) program described in Mortgagee Letter 2005-19, including:

- Additional eligible work items, including lead-based paint stabilization.
- Increased maximum mortgage amount for repair or rehabilitation costs from \$15,000 to \$35,000.
- Elimination of minimum repair cost threshold.

Like the regular Section 203(k) rehabilitation loan program, Streamlined (k) is available for use in conjunction with other Departmental programs and activities. This Mortgagee Letter introduces some procedural requirements applicable only to Streamlined (k) – including:

- The availability of Streamlined (k) to pay for lead-based paint stabilization costs above and beyond that paid for by HUD when it sells real estate owned (REO).
- The option (rather than a requirement) for the mortgagee to establish a contingency reserve of rehabilitation loan proceeds.

In addition, like the regular Section 203(k) program, Streamlined (k) is available:

- To augment an FHA Energy Efficient Mortgage (EEM),
- To insure the mortgage on a single-family housing unit sold from the HUD’s REO inventory
- To insure a mortgage that covers both repairs costs and the refinance of an existing mortgage.

What improvements are eligible under the new Streamlined (k) program?

The Streamlined (k) program is intended to facilitate uncomplicated rehabilitation and/or improvements to a home for which plans, consultants, engineers and/or architects are not required. The Streamlined (k) program includes the discretionary improvements and/or repairs shown below:

- Repair/Replacement of roofs, gutters and downspouts
- Repair/Replacement/upgrade of existing HVAC systems
- Repair/Replacement/upgrade of plumbing and electrical systems
- Repair/Replacement of flooring
- Minor remodeling, such as kitchens, which does not involve structural repairs
- Painting, both exterior and interior
- Weatherization, including storm windows and doors, insulation, weather stripping, etc.
- Purchase and installation of appliances, including free-standing ranges, refrigerators, washers/dryers, dishwashers and microwave ovens
- Accessibility improvements for persons with disabilities
- Lead-based paint stabilization or abatement of lead-based paint hazards
- Repair/replace/add exterior decks, patios, porches
- Basement finishing and remodeling, which does not involve structural repairs
- Basement waterproofing
- Window and door replacements and exterior wall re-siding
- Septic system and/or well repair or replacement

What are the minimum and maximum amounts for repair costs under this program?

Given the need for homeowners to make minor repairs without exhausting personal savings, and in consideration of the increasing cost of materials, the minimum repair cost of \$5,000 is eliminated and the ceiling is now raised to \$35,000. This revised maximum repair/rehabilitation amount recognizes the cost of making older homes more energy efficient. Note that as described below, when the repairs exceed \$15,000, the mortgagee must perform or obtain an inspection to determine that all listed repairs were completed.

Can this program be used for repairs and improvements on purchases of HUD Homes?

Like the regular Section 203(k) program, Streamlined (k) may be used for single-family housing sold by HUD. REO properties that have been designated by FHA's Management and Marketing contractor (M&M) as "insurable" with repair escrow (\$5,000 or less in required repairs) or "uninsurable" (with more than \$5,000 but no more than \$35,000 in required repairs) are eligible for the Streamlined (k) program provided that the repairs qualify as eligible work items outlined in this Mortgagee Letter.

In addition, mortgagees are reminded that nonprofit purchasers of multiple HUD Homes using the Streamlined (k) program must comply with the approval and financing requirements described in Mortgagee Letter 00-8.

What if the REO property requires lead-based paint stabilization?

The Streamlined (k) program may be used for the financing of REO purchases where a pre-1978 property has been determined to contain lead-based paint and the M&M Contractor has completed a stabilization plan and cost estimate to stabilize (mitigate) the deteriorated paint. The purchaser must sign a 203(k) rehabilitation financing lead agreement requiring that a clearance examination and report be included in the work write-up and conducted before release of the final construction disbursement and before occupancy. The credit from HUD, received at sales closing by the purchaser, associated with the lead-based paint stabilization plan is not included in the \$35,000 Streamlined (k) limit. The Streamlined (k) program may be used for all eligible repair items as shown above, including the cost of lead-based paint stabilization *not* paid for by HUD when it sells a property requiring lead-based paint stabilization. A state- or Environmental Protection Agency (EPA) certified lead-based paint inspector, certified risk assessor or sampling technician, must perform the clearance examination.

When the Department sells a single-family REO property, the M&M Contractor determines whether repairs are necessary to stabilize any lead-based paint. HUD's regulations for pre-1978 housing require the stabilization of paint except for paint determined not to be lead-based paint. HUD may reduce the sales price by the amount of a *credit* equal to the Department's contribution toward the cost of lead-based paint stabilization. Any lead-based paint stabilization costs in excess of this credit become the responsibility of the purchaser.

Can the Streamlined (k) program be used for refinancing the mortgage?

The Streamlined (k) program is also available for mortgage refinance transactions including those where the property is owned free-and clear. Only credit-qualifying "no cash out" refinance transactions with an appraisal are eligible for the Streamlined (k) program. The form HUD-92700 provides instructions for calculating the maximum mortgage permitted for Streamlined (k) loans for purchase and refinance transactions.

If the borrower has owned the property for less than a year, the acquisition cost must be used to determine the maximum mortgage amount. The requirement to use the *lowest sales price* within the last year does not apply to the Streamlined (k) program.

What are the appraisal requirements under the Streamlined (k) program?

The Streamlined (k) program may be used for discretionary repairs and/or improvements that may not have been identified in the course of a pre-purchase inspection or appraisal. The mortgagee must provide the appraiser with information regarding the proposed rehabilitation or improvements and all cost estimates so that an after-improved value can be estimated. A

description of the proposed repairs and/or improvement must be included in the appraisal report as well as the contractor's cost estimate. The appraiser is to indicate in the reconciliation section of the appraisal report an after-improved value subject to completion of the proposed repairs and/or improvements.

What are the mortgagee's requirements for examining the contractor bids? For paying the contractor prior to beginning construction? For inspections of the work?

- Contractor bids: While mortgagees are not contractors, participation in this program requires that they examine the contractor's bid(s) and determine that they fall within the usual and customary range for similar work. Mortgagees must also ensure that the selected contractor(s) meet all jurisdictional licensing and bonding requirements.
- Payments in advance of construction: The mortgagee—at its discretion—may provide the contractor with up to 50 percent of the estimated cost of any work item prior to beginning construction. Such payments should only be made where the mortgagee is satisfied with the reputation of the contractor(s) and 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.
- Payments for Inspections:
 - For repair costs *not* exceeding \$15,000, the mortgagee is not required to perform, or have others perform, inspections of the completed work. However, the mortgagee may choose to obtain or perform inspections if it believes such actions are necessary for program compliance and/or risk mitigation. Mortgagees may also ensure that the repairs and/or improvements have been completed by obtaining contractor's receipts or by a signed Mortgagor's Letter of Completion. If the mortgagee determines that an inspection(s) 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 each contractor.
 - For repairs in excess of \$15,000, the mortgagee must perform or obtain an inspection of the completed work by a third party.

What are the mortgagor's requirements for selecting the contractor? And what are the mortgagee's requirements for review of the contractor and the rehabilitation proposal?

The mortgagor must use one or more contractors to complete the repairs. "Self-help" arrangements, in which the mortgagor performs the work, are not to be approved unless the mortgagor can sufficiently demonstrate that he or she has the necessary expertise and experience to perform the work competently (e.g., mortgagor is an electrician and will perform electrical repairs/upgrades to the property).

The mortgagor will select the contractor(s) who will provide estimates for work to be done. The mortgagee reviews the mortgagor's proposed work plan and cost estimates to ensure the planned work meets all program and repair recommendations as noted on the appraisal report. The mortgagor must provide the mortgagee with a written cost estimate(s) and references from a duly licensed and bonded contractor(s) for each specialized repair or improvement. If "self-help" arrangements are utilized, the mortgagor must provide written estimates from the suppliers of the materials. Those repairs and improvements must meet any local codes and ordinances and the mortgagor and/or contractor must obtain all required permits prior to the commencement of work.

The cost estimate(s) must clearly state the nature and type of repair and the cost for completion of the work item and must be made even if the mortgagor is performing some or all of the work under a self-help arrangement. The mortgagee must review the contractor's credentials, work experience and client references and may require the mortgagor to provide additional cost estimates if necessary. After review, the selected contractor(s) must agree in writing to complete the work for the amount of the cost estimate and within the allotted time frame. A copy of the contractor's cost estimate(s) and the Homeowner/Contractor Agreement(s) must be placed in the insuring binder. The contractor must finish the work in accordance with the written estimate and Homeowner/Contractor Agreement and any approved change order. As in the regular 203(k) program, the Rehabilitation Construction Period begins when the mortgage loan is closed.

What are the mortgagee's requirements for paying contractors?

No more than two payments may be made to each contractor, or to the mortgagor if the mortgagor is performing the work under a self-help arrangement. The first payment is intended to defray material costs and shall not be more than 50% of the estimated costs of all repairs/improvements. When permits are required, those fees may be reimbursed to the contractor at closing. The final payment to the contractor will be made following completion of all work and 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. When necessary, the mortgagee may arrange a payment schedule, not to exceed two (2) releases, per specialized contractor (an initial release plus a final release.) Mortgagees are to issue payments solely to the contractor, except if the mortgagor is performing the work under a self-help arrangement, in which case the mortgagor may be reimbursed for materials purchased in accordance with the previously obtained estimates; the mortgagor may not be compensated for his or her labor.

To eliminate the need and cost for an inspection of the completed repair(s) or improvement(s) when not exceeding \$15,000, the mortgagee may accept receipts or proof of completion of the work to the homeowner's satisfaction from the contractor. Before a final release is made, the mortgagor must sign a statement acknowledging that the work has been completed in a professional and satisfactory manner.

May the mortgagee establish a Contingency Reserve?

The Streamlined (k) program does not mandate a contingency reserve be established. However, at the mortgagee's discretion a contingency reserve account may be set up for administering the loan. Funds held back in contingency reserve must be used solely to pay for the proposed repairs or improvements and any unforeseen items related to these repair items. Any unspent funds remaining after the final work item payment(s) is made, must be applied to the mortgage principal.

Is there a maximum mortgage amount worksheet that must be used?

Form HUD-92700, 203(k) Maximum Mortgage Worksheet must be used to calculate the mortgage amount. Also, the appraiser must provide an after-improved value since 110% of that amount is used in calculating the maximum mortgage. Architectural and consultant fees, line items 6 and 7 of Section B of the worksheet are not applicable to the Streamlined (k) program. For Item 3 of Section D, please refer to handbook HUD-4155.1 REV-5, paragraph 1-7 which provides the various maximum loan-to-value ratios.

Expenses that may be included in the total amount of the improvements, not to exceed the \$35,000 limit, are inspection fees, building and other permits, the supplemental origination fee, title update costs and the amount of any contingency reserve required by the mortgagee.

Can we combine the Streamlined (k) with an Energy Efficient Mortgage (EEM)?

The EEM program, as described in ML 05-21, may be used in conjunction with the Streamlined (k) program. The amounts permissible under the EEM program—as well as the qualifying requirements—are in addition to those available under the Streamlined (k) program and, thus, combined may exceed the \$35,000 Streamlined (k) repair cost limit. Both the cost of EEM improvements as well as weatherization items (not to exceed \$2,000) may be added to the total FHA loan amount.

What are the “closeout requirements” under the Streamlined (k) program?

The mortgagee electronically certifies the closeout via the FHA Connection and is not required to forward the closeout documents to FHA. As with all FHA case binders, the originator must retain the file, either in hard copy or electronic format, for two years following endorsement of the mortgage. Proper close-out means that the mortgagee has certified that it has reviewed and verified for accuracy of the following without limitations: mortgagor's acknowledgement of satisfactory completion, evidence of release of lien(s), mortgagee's inspection report(s), change orders, mortgagee accounting of the escrow funds, and record of disbursements.

Are there specific data entry requirements under the Streamlined (k) program?

The mortgagee must enter “203KS” in the 203(k) Consultant ID field in the Case Number Assignment Screen (and the Insurance Application Screen) to identify the Streamlined (k) product and enter the amount of the repairs in the Repair Escrow Amount field in the Insurance Application Screen. In the event that the mortgagee had originally begun processing the case as a purchase mortgage without repairs, the mortgagee should 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.

If the Streamlined (k) mortgage is for a refinance transaction, please enter “substantial rehabilitation” in the drop down screen labeled “Construction Code” and “Not Streamlined” (the refinance type) in the drop down screen labeled “All Refinances” in the Case Number Assignment Screen in FHA Connection.

What items remain ineligible for the Streamlined (k) program?

Properties that require the following work items are not eligible for financing under the Streamlined (k):

- Major rehabilitation or major remodeling, such as the relocation of a load-bearing wall;
- New construction (including room additions);
- Repair of structural damage;
- Repairs requiring detailed drawings or architectural exhibits;
- Landscaping or similar site amenity improvements;
- Any repair or improvement requiring a work schedule longer than six (6) months; or
- Rehabilitation activities that require more than two (2) payments per specialized contractor.

Mortgagors may not use the Streamlined (k) program to finance any required repairs arising from the appraisal that do not appear on the list of Streamlined (k) Eligible Work Items or that would:

- Necessitate a “consultant” to develop a “Specification of Repairs/Work Write-Up”;
- Require plans or architectural exhibits;
- Require a plan reviewer;
- Require more than six months to complete;
- Result in work not starting within 30 days after loan closing; or
- Cause the mortgagor to be displaced from the property for more than 30 days during the time the rehabilitation work is being conducted. (FHA anticipates that, in a typical case, the mortgagor would be able to occupy the property after mortgage loan closing).

If you have any questions regarding this Mortgagee Letter, please contact your local Homeownership Center (HOC) in Atlanta (888) 696-4687, Denver (800) 543-9378, Philadelphia (800) 440-8647, or Santa Ana (888) 827-5605.

Sincerely,

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

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