

203(k) Rehabilitation Mortgage Insurance

Helps prospective and current borrowers improve their homes

BACKGROUND AND PURPOSE

The 203(k) Rehabilitation Mortgage Insurance program is FHA's primary tool to enable the rehabilitation and repair of single-family properties and has been in existence since 1978. The program enables lenders to offer homebuyers, current homeowners, and nonprofit organizations a single, long-term, fixed-, or adjustable-rate loan that covers the acquisition, refinance, and rehabilitation of a property. Often when buying a house that needs repairs, homebuyers have to find multiple sources of financing, and improvement loans often carry high interest rates and short repayment terms.

Section 203(k) insured loans help the borrower access affordable financing and protect lenders by allowing them to have the loan insured before the final condition and value of the property may offer adequate security.

There are two versions of the program, Standard and Limited, which are used to finance different levels and types of repairs. The Standard 203(k) program may be used for remodeling and extensive, structural repairs. There is a minimum repair cost of \$5,000 and the use of a 203(k) Consultant is required. 203(k) consultants are professionals certified by HUD who ensure that all FHA minimum standards are met during the 203(k) loan process and are listed in the HUD 203(k) consultant roster. Their duties include visiting the property, completing the work write-up/cost estimate and architectural exhibits, and performing draw request inspections. The Limited 203(k) program was created in 2005 to finance minor remodeling and non-structural repairs. Eligible projects must not exceed \$35,000 and there is no minimum repair amount. Any

PROGRAM NAME	203(k) Rehabilitation Mortgage Insurance
AGENCY	Federal Housing Administration
EXPIRATION DATE	Not Applicable
APPLICATIONS	To participate, lenders must be FHA-approved for the Title II loan program. Lenders may access FHA's Lender Requirements and the online lender application at: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/lender/lendappr
WEB LINK	http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/203k/203k--df
CONTACT INFORMATION	Telephone: (800) CALL-FHA (225-5342) Email: answers@hud.gov . Lenders that want to apply for FHA approval should include the words "New Applicant" in the email subject line and include a contact person and phone number in the email body so that a Lender Approval representative may contact you.
APPLICATION PERIOD	Continuous
GEOGRAPHIC SCOPE	National

FHA-approved lender may originate a Limited 203(k) loan, while the Standard 203(k) loan requires special expertise. In both the Standard and Limited versions of the program, a portion of the loan is used to pay the seller or, if it is a refinance, to pay off the existing mortgage. The remaining funds are placed in an escrow account and released as the repairs are completed.

Types of improvements that borrowers may make using Section 203(k) financing include:

- Structural alternations and reconstruction;
- Modernization and improvements to the home's function;
- Elimination of health and safety hazards;
- Changes that improve appearance and eliminate obsolescence;
- Reconditioning or replacing plumbing; installing a well and/or septic system;
- Adding or replacing roofing, gutters, and downspouts;
- Adding or replacing floors and/or floor treatments;
- Major landscape work and site improvements;
- Enhancing accessibility for a disabled person; and
- Making energy conservation improvements.

BORROWER CRITERIA

Income limits: There is no income limit to participate in the program.

Credit: Credit scores above 580 are eligible for maximum financing of 96.5 percent. Credit scores between 500 and 579 are limited to a maximum 90 percent loan to value. Credit scores of less than 500 are not eligible for FHA insured financing. Borrowers with non-traditional or insufficient credit histories are eligible for maximum financing, but must be underwritten using the procedures in manual underwriting.

First-time homebuyers: The program is open to all interested borrowers and can be used by first-time homebuyers. The program can also be used to refinance a property.

Occupancy and ownership of other properties: Only owner-occupants, not investors, may use the program. Local governments and nonprofits that obtain approval through FHA's Homeownership Centers can also use the program. The original construction of the property must have been complete for at least a year. This is to ensure the 203(k) loan insurance is not used to construct a new property, but only to repair an existing one. The 203(k) program can also be used with the Section 203(h) Mortgage Insurance for Disaster Victims program.

Damaged residences are eligible for 203(k) mortgage insurance regardless of the age of the property and for properties that must be razed

POTENTIAL BENEFITS

To minimize the risk to the lender, the mortgage loan is eligible for endorsement by HUD as soon as the mortgage proceeds are disbursed and a rehabilitation escrow account is established. At this point, the lender has a fully insured mortgage loan even though the improvements have not been completed.

The 203(k) program allows lenders to offer a product to a market segment of new and existing homeowners who wish to improve their property.

POTENTIAL CHALLENGES

This program has many unique requirements and forms with which lenders must be familiar, such as escrows and reserves, administration of draws, and pricing of rehabilitation work.

Lenders must partner with FHA-approved 203(k) Consultants and ensure they are in good standing.

Lenders must partner with appraisers who are familiar with the unique appraisal requirements of this program. Appraisers must be certified by the state in which they are located or by a nationally recognized professional organization.

in order for the construction to proceed, but retain the original complete foundation. Property types that are eligible for Section 203(k) insurance include one- to four-unit single-family structures; interior repairs only on individual condominium units in an FHA-approved condominium project; ground-only or “site” condominium units; manufactured housing where the rehabilitation does not affect the structural components; a mixed-use property with one to four units, provided that over half of the property’s square footage is for residential use; or HUD real estate owned (REO) property.

LOAN CRITERIA

Loan limits: FHA mortgage limits vary by the number of units and by the county or Metropolitan Statistical Area in which the property resides. HUD issues a Mortgagee Letter announcing the new mortgage limits every year.

Loan-to-value limits: For purchase transactions, the maximum mortgage amount that FHA will insure on a 203(k) loan is the lesser of:

1. The appropriate LTV ratio multiplied by the lesser of:
 - a. the “As-Is Value,” plus:
 - financeable repair and improvement costs;
 - financeable mortgage fees;
 - financeable contingency reserves; and
 - financeable mortgage payment reserves, (for Standard 203(k) only); or
 - b. 110 percent of the after improved value (100 percent for condominiums); or
2. The nationwide mortgage limits.

Down payment sources: As with other FHA programs, the minimum down payment for purchase loans is 3.5 percent of the loan amount. FHA allows for various acceptable sources of funds to cover down payment costs. The acceptable sources fall into six categories, including cash and savings/checking account funds; investment funds; gifts; funds resulting from the sale of personal or real property; loans and grants; and employer assistance.

Homeownership counseling: Not required.

Mortgage insurance: For all mortgages, the up-front mortgage insurance premium is 175 basis points (1.75 percent) of the base loan amount. Lenders also pay

an annual mortgage insurance premium on a monthly basis to HUD. These are typically passed on to the borrower at the lender’s discretion. The rates are the same as the Section 203(b) program and vary based on the loan to value, mortgage terms, and mortgage amount. FHA uses the “After Improved Value” to determine the LTV for the purpose of calculating the MIP.

Debt-to-income ratio: HUD requires lenders to calculate two ratios to determine if a borrower can reasonably meet the expected expenses. First, the Mortgage Payment Expense to Effective Income ratio (or front-end DTI) should not exceed 31 percent.

Second, the Total Fixed Payment to Effective Income ratio (or back-end DTI) should not exceed 43 percent. Ratios that exceed 31 percent or 43 percent may be acceptable if the lender documents qualified “significant compensating factors.” In the event the borrower has student loan debt, regardless of the payment status, FHA’s policy is to include either the actual documented payment, provided the payment will fully amortize the loan over its term or the greater of 1 percent of the total student loan balance or the monthly payment reported on the borrower’s credit report in the debt-to-income calculation.

Refinance: The program can be used to refinance and rehabilitate an existing property. A Section 203(k) rehabilitation mortgage may be refinanced into a Section 203(b) mortgage once the rehabilitation work is complete.

Origination fee: The lender 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 fees described below, as well as a portion of the borrower-paid discount points not to exceed an amount equal to the discount point percentage multiplied by the total of the fees described below:

- 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 reasonable.

Potential Benefits

- To minimize the risk to the lender, the mortgage loan is eligible for endorsement by HUD as soon as the mortgage proceeds are disbursed and a rehabilitation escrow account is established. At this point, the lender has a fully insured mortgage loan even though the improvements have not been completed.
- The 203(k) program allows lenders to offer a product to a market segment of new and existing homeowners who wish to improve their property.
- The 203(k) program allows lenders to offer this product at terms that are competitive compared to the conventional market. Loans originated under this program may receive favorable consideration under the CRA, depending on the geography or income of the participating borrowers.

Potential Challenges

- This program has many unique requirements and forms with which lenders must be familiar, such as escrows and reserves, administration of draws, and pricing of rehabilitation work.
- Lenders must partner with FHA-approved 203(k) Consultants and ensure they are in good standing.
- Lenders must partner with appraisers who are familiar with the unique appraisal requirements of this program. Appraisers must be certified by the state in which they are located or by a nationally recognized professional organization.

SIMILAR PROGRAMS

- Fannie Mae HomeStyle® Renovation Mortgage
- Freddie Mac Construction Conversion and Renovation Mortgage
- USDA Single Family Housing Repair Loans and Grants

RESOURCES

Direct access to the following web links can be found at <https://www.fdic.gov/mortgagelending>.

203(k) Consultant Roster List Map

<https://batchgeo.com/map/549720000a2265d825be379c0537302a>

FHA mortgage limits

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

HUD Handbook 4000.1

<https://www.hud.gov/sites/documents/40001HSGH.PDF>

- Refer to section II.A.8.a. for program requirements
- Refer to Appendix 1.0 for mortgage insurance premium requirements