



# Property Engineers LLC

## FHA 203(k) Information Package

### Program Overview:

The Federal Housing Administration (FHA), which is part of the Department of Housing and Urban Development (HUD), administers various single family mortgage insurance programs. These programs operate through FHA-approved lending institutions which submit applications to have the property appraised and have the buyer's credit approved. These lenders fund the mortgage loans which the Department insures. HUD does not make direct loans to help people buy homes.

The FHA 203k loan program is the Department's primary program for the rehabilitation and repair of single family properties. Basically a home improvement loan. As such, it is an important tool for community and neighborhood revitalization and for expanding homeownership opportunities. Since these are the primary goals of HUD, the Department believes that FHA 203k loan is an important program and they intend to continue to strongly support the program and the lenders that participate in it.

Lenders have successfully used the FHA 203k loan program in partnership with state and local housing agencies and nonprofit organizations to rehabilitate properties. These lenders, along with state and local government agencies, have found ways to combine the FHA 203k loan with other financial resources, such as HUD's HOME, HOPE, and Community Development Block Grant Programs, to assist borrowers. Several state housing finance agencies have designed programs, specifically for use with FHA 203k loan and some lenders have also used the expertise of local housing agencies and nonprofit organizations to help manage the rehabilitation processing. HUD also believes that the FHA 203k loan program is an excellent means for lenders to demonstrate their commitment to lending in lower income communities and to help meet their responsibilities under the Community Reinvestment Act (CRA). HUD is committed to increasing homeownership opportunities for families in these communities and Section 203(k) is an excellent product for use with CRA-type lending programs.

### How the Program Can Be Used:

This program can be used to accomplish rehabilitation and/or improvement of an existing one-tofour unit dwelling in one of three ways:

- To purchase a dwelling and the land on which the dwelling is located and rehabilitate it.
- To purchase a dwelling on another site, move it onto a new foundation on the mortgaged property and rehabilitate it.
- To refinance existing indebtedness and rehabilitate a dwelling;

To purchase a dwelling and the land on which the dwelling is located and rehabilitate it, and to refinance existing indebtedness and rehabilitate such a dwelling, the mortgage must be a first lien on the property and the loan proceeds (other than rehabilitation funds) must be available before the rehabilitation begins.

To purchase a dwelling on another site, move it onto a new foundation and rehabilitate it, the mortgage must be a first lien on the property; however, loan proceeds for the moving of the house cannot be made available until the unit is attached to the new foundation.

To be eligible for the FHA 203k mortgage loan, the property must be a one- to four-family dwelling that has been completed for at least one year. The number of units on the site must be acceptable according to local zoning requirements. All newly constructed units must be attached to the existing dwelling. Cooperative units are not eligible.

Homes that have been demolished, or will be razed as part of the rehabilitation work, are eligible provided some of the existing foundation system remains in place.



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In addition to typical home improvement loan projects, the FHA 203-k mortgage loan program can be used to convert a one-family dwelling to a two-, three-, or four-family dwelling. An existing multi-unit dwelling could be decreased to a one- to four-family unit.

An existing house (or modular unit) on another site can be moved onto the mortgaged property; however, release of loan proceeds for the existing structure on the non-mortgaged property is not allowed until the new foundation has been properly inspected and the dwelling has been properly placed and secured to the new foundation.

A 203-k mortgage loan may be originated on a "mixed use" residential property provided: (1) The property has no greater than 25 percent (for a one story building); 33 percent (for a three story building); and 49 percent (for a two story building) of its floor area used for commercial (storefront) purposes; (2) the commercial use will not affect the health and safety of the occupants of the residential property; and (3) the rehabilitation funds will only be used for the residential functions of the dwelling and areas used to access the residential part of the property.

## QUESTIONS AND ANSWERS:

### What is the minimum amount of repairs required on a FHA 203k home improvement loan?

There is a minimum \$5,000 requirement of eligible home improvement loan projects on the existing structure of the property. Minor or cosmetic repairs may be included after meeting the first \$5,000 worth of repairs.

### What are some of the repairs that qualify for the first \$5,000?

- **Structural alterations and reconstruction:** (Repair or replacement of structural damage, chimney repair, additions to the structure, installation of additional bath(s), skylights, finished attics and/or basements, repair of termite damage and the treatment against termites)

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- **Elimination of health and safety hazards.**

- **Changes for aesthetic appeal:**

(New siding, adding a dormer, covered porch, attached garage).

- **Air Conditioning or replacement:** (plumbing, heating, air conditioning and electrical systems).

- **Installation of well, septic system or connection to public utilities.**

- **Roofing, Gutter Downspouts, Flooring, Tiling and carpeting.**

- **Major landscape and site improvement.**

- **Improvements to improve accessibility and functions for the disabled.**

### What are the qualifications to be able to obtain a FHA 203-k loan?

The qualifications requirements are the same as a typical FHA mortgage loan. The only additional item that the borrower needs is either enough cash reserved to pay for materials and labor until they are reimbursed through a draw, or a credit card with an adequate available balance. If there is to be a contractor involved, the contractor may choose to cover these costs.

The interest rate on a typical FHA 203k mortgage loan is a little higher than a standard FHA or conventional 30/15-year fixed-rate loan. The cash requirements are the same as an FHA loan, 3 percent to 5 percent, which is less than a typical conventional loan. There are a couple of additional fees which pertain to the construction aspects of the FHA 203k loan.

### Can I pick my own contractor to do the work?

You may decide on your own contractor, and they should be brought into the process



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in the beginning stage of the loan process. Check out the credentials of the contractor thoroughly, making sure he is knowledgeable in all aspects of rehabilitation work.

The home improvements or repairs need not be made before moving into the property, depending on how extensive the repairs are and whether the house is habitable while the repairs are being made. The home improvement loan provides the ability to include up to 6 months of mortgage payments in the improvement escrow, should you not be able to occupy the property and have to pay rent during rehabilitation.

### **Is the FHA 203k mortgage loan program restricted to single-family dwellings?**

No. The FHA 203-k mortgage program can be used for one-to-four unit dwellings. Maximum mortgage limitations are the same as for properties under Section 203(b).

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### **Can the FHA 203k loan be used to improve a condominium unit?**

Yes, however, condominium rehabilitation is subject to the following conditions:

- a) Owner/occupant and qualified non-profit borrowers only;
- b) Rehabilitation is limited only to the interior of the unit. Mortgage proceeds are not to be used for the rehabilitation of exteriors or other areas which are the responsibility of the condominium association, except for the installation of firewalls in the attic for the unit;
- c) Only the lesser of five units per condominium association, or 25 percent of the total number of units, can be undergoing rehabilitation at any one time;
- d) The maximum mortgage amount cannot exceed 100 percent of after-improved value. After rehabilitation is complete, the individual buildings within the condominium must not contain more than four units. By law, FHA 203k loans can only be used to rehabilitate units in one-to-four unit structures. However, this does not mean that the condominium project, as a whole, can only have four units or that all individual structures must be detached. Example: A project might consist of six buildings each containing four units, for a total of 24 units in the project and, thus, be eligible for an FHA 203k loan. Likewise, a project could contain a row of more than four attached townhouses and be eligible for a FHA 203k loan because HUD considers each townhouse as one structure, provided each unit is separated by a 1 1/2 hour firewall (from foundation up to the roof). Similar to a project with a condominium unit with a mortgage insured under Section 234(c) of the National Housing Act, the condominium project must be approved by HUD prior to the closing of any individual mortgages on the condominium units.

### **Can a FHA 203k loan be used to convert a one family dwelling to a two-, three-, or fourfamily dwelling (or vice versa)?**

Yes.

### **Can a FHA 203k loan be used to move an existing house onto another site?**

Yes, however, release of loan proceeds for the existing structure on the nonmortgaged property is not allowed until the new foundation has been properly inspected and the dwelling has been properly placed and secured to the new foundation. At closing, funds would be released to purchase the site and the rest of the mortgage proceeds would be placed in the Rehabilitation Escrow Account. The borrower would have the site prepared to accept the dwelling. The first release



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would be based on the improvements made to the site, including the installation of the existing structure on the new foundation.

## **What eligible home improvements are acceptable under the \$5,000 minimum requirement?**

a) Structural alterations and reconstruction (e.g., repair or replacement of structural damage, chimney repair, additions to the structure, installation of an additional

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bath(s), skylights, finished attics and/or basements, repair of termite damage and the treatment against termites or other insect infestation, etc.).

b) Changes for improved functions and modernization (e.g., remodeled bathrooms and kitchens, including permanently installed appliances, i.e., built-in range and/or oven, range hood, microwave, dishwasher).

c) Elimination of health and safety hazards (including the resolution of defective paint surfaces or lead-based paint problems on homes built prior to 1978).

d) Changes for aesthetic appeal and elimination of obsolescence (e.g., new exterior siding, adding a second story to the home, covered porch, stair railings, attached carport).

e) Reconditioning or replacement of plumbing (including connecting to public water and/or sewer system), heating, air conditioning and electrical systems. Installation of new plumbing fixtures is acceptable, including interior whirlpool bathtubs.

f) Installation of well and/or septic system. The well or septic system must be installed or repaired prior to beginning any other repairs to the property. A property less than 1/2 acre with a separate well or septic system is not acceptable; also, a property less than 1 acre with both a well and a septic system is unacceptable. Lots smaller than these sizes, usually have problems in the future; however, the local HUD Field Office can approve smaller lot size requirements where the local health authority can justify smaller lots. The installation of a new well or the repair of an existing well (used for the primary water source to the property) can be allowed provided there is adequate documentation to show there is reason to believe the well will produce a sufficient amount of potable water for the occupants. (A well log of surrounding properties from the local health authority is acceptable documentation.)

g) Roofing, gutters and downspouts.

h) Flooring, tiling and carpeting.

i) Energy conservation improvements (e.g., new double pane windows, steel insulated exterior doors, insulation, solar domestic hot water systems, caulking and weather stripping, etc.).

k) Major landscape work and site improvement (e.g., patios, decks and terraces that improve the value of the property equal to the dollar amount spent on the improvements or required to preserve the property from erosion). The correction of grading and drainage problems is also acceptable. Tree removal is acceptable if the tree is a safety hazard to the property. Repair of existing walks and driveway is acceptable if it may affect the safety of the property. (Fencing, new walks and driveways, and general landscape work (i.e., trees, shrubs, seeding or sodding) cannot be in the first \$5000 requirement.)

l) Improvements for accessibility to a disabled person (e.g., remodeling kitchens and baths for wheelchair access, lowering kitchen cabinets, installing wider doors



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and exterior ramps, etc.). Related fixtures such as new cooking ranges,

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refrigerators, and other appurtenances, as well as general painting are also eligible; however, it must be in addition to the \$5,000 requirement.

### **Can a detached garage or another dwelling be placed on the mortgaged property?**

Yes, however, a new unit must be attached to the existing dwelling, and must comply with HUD's Minimum Property Standards in 24 CFR 200.926d and all local codes and ordinances.

### **Is there a time period on the rehabilitation construction period?**

Yes, the Rehabilitation Loan Agreement contains three provisions concerning the timeliness of the work. The work must begin within 30 days of execution of the Agreement. The work must not cease prior to completion for more than 30 consecutive days. The work is to be completed within the time period shown in the Agreement (not to exceed six months); the lender should not allow a time period longer than that required to complete the work.

### **What happens if the borrower fails to perform under the terms of the Agreement?**

The lender may refuse to make further releases from the Rehabilitation Escrow Account. The funds remaining in the Account can be applied to reduce the mortgage principal. Also, the lender has the option to call the mortgage loan due and payable.

### **Does the rehabilitation construction have to comply with HUD's Minimum Property Standards?**

Yes. The improvements must comply with HUD's Minimum Property Standards and all local codes and ordinances.

### **Does HUD always require a contingency reserve to cover unexpected cost increases?**

Typically, yes. On properties older than 30 years and over \$7,500 in rehabilitation costs, the cost estimate must include a contingency reserve. The reserve must be a minimum of ten (10) percent of the cost of rehabilitation; however, the contingency reserve may not exceed twenty (20) percent where major remodeling is contemplated. If utilities were not turned on for inspection, a minimum fifteen (15) percent is required.

### **How many draw releases can be scheduled during the rehabilitation period?**

As many as five releases (four plus a final) can be scheduled. The number of releases is normally dictated by the cash-flow requirements of the contractor. An inspection is always required with a scheduled release; however, inspections may be scheduled more often than releases if necessary to ensure compliance with the architectural exhibits, HUD's Minimum Property Standards and all local codes and ordinances. If the cost of rehabilitation exceeds \$ 10,000, then additional draw inspections may be authorized under certain circumstances.

### **Can the architectural exhibits, including the cost estimate, be modified after the mortgage loan is closed?**

Yes. The changes must be approved by HUD or a DE lender prior to beginning the work. If the change affects the health, safety or necessity of the dwelling, the contingency reserve can be used to pay for the change. However, if the health, safety or necessity of the dwelling is not affected and an increase in cost occurs, the borrower must apply monies into the contingency reserve fund to pay for the change. Should the change result in a reduced cost of rehabilitation, the difference will be placed in the contingency reserve fund; if unused, it will be applied as a



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mortgage prepayment after completion of construction.

**What happens if the cost of the rehabilitation increases during the rehabilitation period?**

Can the 203(k) mortgage amount be increased to cover the additional expenses?

No. This emphasizes the importance of carefully selecting a contractor who will accurately estimate the cost of the improvements and satisfactorily complete the rehabilitation at or below the estimate.

**How long will it take after the sales contract is signed to go to closing?**

If the cost estimates are completed within two weeks of signing the sales contract, the loan should close within 60 to 90 days, assuming there are no title problems and, of course, your borrower is qualified.

**Can a FHA 203k loan be an Adjustable Rate Mortgage?**

Yes. An Adjustable Rate Mortgage is available to an owner-occupant only. Investors and non-profits are not eligible for an ARM.

**Can an investor use the FHA 203k loan program?**

No. In October, 1996, the Department placed a moratorium on investor participation in the FHA 203k mortgage loan Rehabilitation Mortgage Program.

**Can a local government agency or a nonprofit organization use the FHA 203k loan program?**

Yes. The same qualification requirements will be used as for an owner-occupant of the property

**Can mortgage payments (PITI) be included in the mortgage?**

Yes. Up to six months of payments may be included in the mortgage if the property is not occupied during the rehabilitation period.

**Can a six (or more) unit building be done using the FHA 203k loan program?**

No. However, the building could be renovated and reduced to a four unit building.

**Can a dwelling be converted to provide access for a disabled person?**

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Yes. A dwelling can be remodeled to improve the kitchen and bath to accommodate a wheelchair access. Wider doors and handicap ramps can also be included in the cost of rehabilitation.

**Is a contractor required to do the work?**

No. However, if the borrower wants to do any work or be the general contractor, they must be qualified to do the work, and do it in a timely and workmanlike manner. It is very important that the work be done in a time frame that will assure the completion of the work that will be agreed upon in the Rehabilitation Loan Agreement (signed at closing). A borrower doing their own work can only be paid for the cost of the materials. Monies saved can be allocated to cost overruns or additional improvements.

**If the borrower does the work, how is the cost for work estimated?**

The cost estimate must be the same as if a contractor is doing the work, in case the borrower cannot (for some reason) complete the work.

**Can cost savings on the rehabilitation be given back to the borrower?**

No. However, the savings can be transferred to cost overruns in other work items or can be used to make additional improvements to the property. If the cost savings are not used, the money must be applied to the mortgage principal, but the mortgage payments will remain the same, because the loan has already closed. To use the cost savings, it will be necessary for a Change Order to be completed and



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approved by the lender.

**Can any rehabilitation money be paid upfront to offset the startup costs for the contractor?**

No. However, an exception can be allowed for kitchen and bath cabinetry, or floor covering, where a contract is established with the supplier and an order is placed with the manufacturer for delivery at a later date.

**Is there anyone available who can prepare the Work Write-up and cost estimates?**

Yes. HUD has designated fee consultants to work with the borrower. This is a time saver, because it can be completed in about two weeks. After this step is completed, closing should occur within 60 to 90 days.

**Can the borrower do their own work write up and cost estimate?**

Yes. However, it can greatly slow down the process and will save only about \$200, Hiring an independent fee consultant specifically trained in the process can be money well spent. If you do not utilize a fee consultant, then a plan reviewer is required to visit the site. FHA has a list of approved consultants.

**What is the definition of a First-Time Homebuyer?**

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A single person or an individual and his or her spouse who have not owned a home (as a tenant in common or as a joint tenant by the entirety) during the three years immediately preceding the date of application for the FHA 203k loan. Any individual who is legally separated or divorced cannot be excluded from consideration, because the three-year waiting period does not apply, provided the individual no longer has an interest in the home.

**Is there a limitation on how many properties a person or organization can have in any area of the community?**

Yes. A borrower can have not more than seven (7) units within a two block radius of the property they want to purchase. However, if the property is in a local community area that has been designated for redevelopment or revitalization, then this seven unit limitation does not apply.

**Can nonresidential (storefront) property be eligible for a FHA 203k mortgage loan?**

Yes. Mixed-use residential property is acceptable provided the property has no greater than 25% (for a one story building); 33% (for a three story building); and 49% (for a two story building) of its floor area used for commercial (storefront) purposes. The rehab funds can only be used for the residential functions of the dwelling and areas used to access the residential part of the property.

**Is only one appraisal required to establish the "after-rehab" value of the property?**

Yes. The appraisal would be subject to completion of the specified work. On a HUD-owned property, the lender can use HUD's appraisal for the after-rehab value.

**Can HUD-owned properties be purchased using a FHA 203k mortgage loan?**

Yes. However, the property must be advertised that it is eligible for financing with a FHA 203k loan. If the HUD-owned property is purchased with other funds, a FHA 203k loan can be made after the property is in the buyers name. In this case, cash back will be allowed to the borrower for a period of six months from purchasing the HUD-owned property

**Is the borrower required to enter into a contractual agreement with the general contractor who will do the work on the property?**

No. However, it is strongly suggested that a contractual agreement be entered.



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## Can an Energy Efficient Mortgage (EEM) be allowed using the FHA 203k program?

Yes. A borrower can finance into the mortgage 100 percent of the cost of eligible energy efficient improvements, subject to certain dollar limitations, without an appraisal of the energy improvements and without further credit qualification of the borrower.

## What fees should I expect to pay for a consultant?

FHA provides a not to exceed fee schedule. All inspection fees are based on renovation cost:

All inspection fees are typically paid at the time of inspection:

\$ 400.00: \$ 5,000 To \$ 7,500 Plus 48.5 per mile over 30 miles-round trip

\$ 500.00: \$ 7,501 To \$ 15,000 Plus 48.5 per mile over 30 miles-round trip

\$ 600.00: \$ 15,001 To \$ 30,000 Plus 48.5 per mile over 30 miles-round trip

\$ 700.00: \$ 30,001 To \$ 50,000 Plus 48.5 per mile over 30 miles round trip

\$ 800.00: \$ 50,001 To \$ 75,000 Plus 48.5 per mile over 30 miles round trip

\$ 900.00: \$ 75,001 To \$ 100,000 Plus 48.5 per mile over 30 miles round trip

Feasibility Study: \$ 100.00

Multi family, consisting of up to 4 units, adds \$ 25.00 per unit for consulting

Multi family, consisting of up to 4 units, adds \$ 25.00 per unit doing Review.

Consultant preparation consists of the following:

1. Consultant agreement Package
2. Specification of all renovations.
3. Complete narrative description of renovations.
4. Contractors bid sheets.
5. Complete draw request form HUD 9746-A
- 6 Change Order form HUD 92577

What is required from a consultant?

The improvements must comply with HUD's Minimum Property Standards (24 CFR 200.926d and/or HUD Handbook 4905.1) and all local codes and ordinances. The homebuyer may decide to employ an architect or a consultant to prepare the proposal. The homebuyer must provide the lender with the appropriate architectural exhibits that clearly show the scope of work to be accomplished. The following list of exhibits are recommended, but may be modified by the local HUD Field Office as required.

**A. A Plot Plan of the Site** is required only if a new addition is being made to the existing structure. Show the location of the structure(s), walks, drives, streets, and other relevant details. Include finished grade elevations at the property corners and building corners. Show the required flood elevation.

**B. Proposed Interior Plan of the Dwelling.** Show where structural or planning changes are contemplated, including an addition to the dwelling. (An existing plan is not required.)

**C. Work Write-up and Cost Estimate.** Any format may be used for these documents, however, quantity and the cost of each item must be shown. Also include a complete description of the work for each item (where necessary). The Rehabilitation Checklist in Appendix 1 of Handbook 4240.4 REV-2 should be used to ensure all work items are considered. Transfer the costs to the Draw Request (form HUD-9746-A).

Cost estimates must include labor and materials sufficient to complete the work by a contractor. Homebuyers doing their own work cannot eliminate the cost estimate for labor, because if they cannot complete the work there must be sufficient money in the



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