Escrow Technical Memorandum 104-2009
Distribution: All Direct Operations

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To: Cost Center Managers/Escrow Managers

From: Lisa Tyler, National Escrow Administrator

Subject: **FHA Loan Requirements - Origination and Payoff Rules**

PLEASE DUPLICATE THIS MEMORANDUM AND DISTRIBUTE TO ALL APPROPRIATE EMPLOYEES IMMEDIATELY

Make a copy of this Memorandum and place it in your Escrow Tech Manual for future reference. It may also be accessed via the Company's Internet at home.fnf.com.

Current economic conditions have prompted the revival of FHA loans. As market conditions change so have FHA guidelines and requirements. This memorandum will describe the procedures which should be followed and understood when closing a transaction wherein the borrower is getting a new FHA loan or a FHA loan is being paid off.

New FHA Loans

HUD has revised their policy regarding what fees can and what fees cannot be paid by the borrower. **MORTGAGEE LETTER 2006-04 issued by HUD states:**
"Mortgagees may charge and collect from mortgagors those customary and reasonable costs necessary to close the mortgage. Except for discount points, these fees may also be used to meet the homebuyer's minimum investment requirement. Due to existing requirements, mortgagors may not pay a tax service fee, and may not be charged an origination fee greater than one percent on forward mortgages"

According to **HUD Handbook 4000.2 REV-3** the borrower can pay *"customary and reasonable fees and charges to meet the minimum investment requirement for purchases and added to the existing indebtedness for refinances. The cost for any item charged to the borrower must not exceed the cost paid by the lender or charged to the lender by the service provider."*

Additionally, sellers on an FHA loan may contribute up to 6% of the sale price towards the buyer's non-recurring closing costs. In response to the **RESPA Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs** HUD issued **MORTGAGEE LETTER 2009-53** which reads as follows:

> *"On the HUD-1, the charge will be displayed in the borrower's column on the HUD-1 and a credit to offset charges will be listed in Section J, Summary of Borrower's Transaction on lines 204-209 with a reduction to the seller's proceeds in Section K, Summary of Seller's Transaction on lines 506-509. When the seller contributes to*

more than one expense, the seller credit shown on the HUD-1 must reflect the lump sum payment."

Lump sum credit on page 1 of HUD-1 –

200. Amounts Paid By Or In Behalf Of Borrower		500. Reductions In Amount Due To Seller	
201. Deposit or earnest money		501. Excess deposit (see instructions)	
202. Principal amount of new loan(s)	225,000.00	502. Settlement charges to seller (line 1400)	
203. Existing loan(s) taken subject to		503. Existing loan(s) taken subject to	
204.		504. Payoff of first mortgage loan	
205.		505. Payoff of second mortgage loan	
206.		506.	
207. Closing Costs pd. by seller	13,500.00	507. Closing Costs pd. by Seller	13,500.00

Settlement agents must ensure the terms of the lenders closing instructions match up with the terms of the purchase and sales agreement. One solution is for the settlement agent to provide a supplemental escrow instruction or an itemization to the principals in the transaction detailing the costs paid by the seller to clear up any confusion. The instruction could simply say:

Per the purchase and sale agreement dated_________ seller has agreed to pay up to $_______________ in non-recurring closing costs. Said costs are made up of the following charges found on the closing statement or HUD-1:

Loan Origination Fee	$2,250
Appraisal Fee	$ 300
Credit Report	$ 45
One-half Escrow Fee	$ 250
Loan Tie in Fee	$ 150
Lender's Title Premium	$ 450
Etc…	

TOTAL = Amount per contract and maximum allowed per loan instructions

Most purchase and sale agreements don't define non-recurring closing costs. An instruction provides the settlement agent with mutual written acceptance of the charges credited to the buyer. For example, it is not customary for the settlement agent to be asked to include proration as a non-recurring closing credit to the buyer/borrower therefore an instruction would provide the clarification needed.

<u>Excluded Parties List System</u>

The U.S. Government maintains a database of individuals and contractors who for one reason or another have been banned from doing business with any governmental agency. This list is called the Excluded Parties List System. Companies or individuals who appear on this list have already gone through an investigation and received notice of their banned status. The URL for the website is https://www.epls.gov/epls/search.do.

Anytime a person or entity is going to provide goods or services to a governmental entity the person approving or responsible for the purchase has to go in and check the list to ensure the person or company does not appear on the list. Goods and services include settlement agent services or title insurance. This means any person and company involved in a real estate transaction which involves FHA or VA financing, HUD REO's or even low income housing projects has to be checked to ensure they do not appear on the Excluded Parties List System.

In the case of a new FHA loan, the lender is responsible for ensuring the appraiser, home inspector, title company, settlement agent, escrow officer and title officer are not on the list.

If after the initial search any of these companies or individuals results in a potential match the lender is required to ask for more information. The website recommends the lender search using the potential match's social security number.

FNF, Inc. does not require settlement agents to provide the lender with personal, non-public information. It is a personal choice. Some lenders do not require a social security number. Instead they may accept a middle name, copy of a driver's license or some other personal information to clear the individual. Anyone notified they may be a potential match should discuss these options with the lender. Settlement agents who chose not to provide the lender with their personal, non-public information can ask their manager to have the file transferred to someone else.

Down Payment Assistance and FHA loans
HUD also eliminated certain types of down payment assistance on FHA loans. Section 2113(C) of the Housing and Economic Recovery Act of 2008 says:

> *PROHIBITED SOURCES.—In no case shall the funds required by subparagraph (A) consist, in whole or in part, of funds provided by any of the following parties before, during, or after closing of the property sale:*
>
> > *''(i) the seller or any other person or entity that financially benefits from the transaction.*
> > *''(ii) any third party or entity that is reimbursed, directly or indirectly, by anyof the parties described in clause (i)''.*

This change went into effect on October 1, 2008. For more information on this refer to **Tech Memo 95-2008 Down Payment Assistance Programs on FHA Loans.**

FHA Loans and Flips
It is equally important for settlement agents to understand FHA's anti-flip requirements. **Section 203.37a(b)(2)** of the FHA regulations states a mortgage for a property will not be insured by FHA if the contract of sale is executed within 90 days of the acquisition of the property by the seller. However, there are some exceptions to this regulation.

One of several exceptions to this 90-day prohibition is contained in **203.37a(c)(6),** which allows mortgage insurance for properties sold by state-and federally-chartered financial institutions and government-sponsored enterprises (e.g., Fannie Mae and Freddie Mac). The properties sold by these entities are usually obtained by foreclosure.

Since foreclosures have increased it has become more difficult for new funding lenders to determine if a transfer in the chain of title is exempt. The two major concerns are:

1) Determining which mortgagees and/or servicing lenders have sold properties acquired through foreclosure are state-or federally chartered; and

2) Discovering many of the mortgagees covered by the existing exemption transfer property titles to subsidiaries or asset managers for the purpose of selling the properties. The subsidiaries or asset managers are not currently covered by the exemption.

On June 8, 2008 FHA issued a temporary waiver to this rule to exempt properties foreclosed on by mortgagees, their subsidiaries, as well as vendors hired by exempt entities to sell their Real Estate Owned properties (REO's). It is not the responsibility of the settlement agent to determine if the title holder is exempt from this rule. It is the responsibility of the settlement agent to ensure the new funding lender is aware of any transfers of title which have occurred within the last 90 days.

Paying off FHA Loans

There are two significant dates' borrowers and settlement agents must be aware of when paying off a FHA insured loan. Those dates are:

1. August 2, 1985
2. January 21, 2015

These dates refer to the date the loan was closed or consummated. The borrower's ability and requirements to prepay or payoff a FHA insured loan differ depending on the time in which the loan was closed or consummated.

If the borrower's loan was insured prior to August 2, 1985 the borrower must provide 30 days written notice to their lender of their intent to pay their loan in full. The prepayment terms on notes insured prior to that time said:

> *"You may prepay your mortgage at any time without penalty. However, you are required to provide a written 30-day advance notice of prepayment. In order to avoid the accrual of interest on the principal amount after the date of prepayment, you must arrange for the prepayment to reach your mortgagee on or before the first day of the month."*

Settlement agents who have a transaction wherein the Deed of Trust or Mortgage was required prior to August 2, 1985 should be sure the borrower gives the lender 30 days' notice of their intent to prepay their loan.

For FHA insured loans closed after August 2, 1985 but before January 21, 2015 the borrower may prepay their loan in full provided the payment is received by the loan servicer on the first day of the month. The BORROWER'S RIGHT TO PREPAY provision states:

> *"Borrower has the right to pay the debt evidenced by this Note, in whole or in part, without charge or penalty, on the first day of any month. Lender shall accept prepayment on other days provided that Borrower pays interest on the amount prepaid for the remainder of the month to the extent required by Lender and permitted by regulations of the Secretary. If Borrower makes a partial prepayment, there will be no changes in the due date or in the amount of the monthly payment unless Lender agrees in writing to those changes."*

Simply sending the payoff on the first day of the month is not sufficient. It must be received by the lender no later than the first. If receipt of the payoff is delayed for any reason, the lender will most likely charge another months' interest.

Settlement agents should have sellers or borrowers whose FHA loan will be paid off as a part of their transaction execute the attached **FHA Payoff Instructions and Authorization.** Said instruction gives the settlement agent authority to hold an extra months' interest until verification that the payoff was received and processed on time with no additional interest due.

In response to the Ability-to Repay and Qualified Mortgage Standards under the Trust in Lending Act (Regulation Z) final rule issued by the Consumer Financial Protection Bureau (CFPB) the Department of Housing and Urban Development updated their prepayment rules on FHA insured loan closed or consummated on or after January 21, 2015 to ensure compliance with the CFPB's rule. This amendment removed any requirement for the borrower to provide the loan servicer with written notice or pay interest past the date the prepayment is received.

For loan consummated after January 21, 2015 the interest must be calculated on the actual unpaid principal balance of the loan and as of the date the prepayment is received by the loan servicer. Servicers may no longer collect a full month's interest from the borrower if the loan is prepaid before the installment due date which was the first day of the month.

It is important to understand this change only applies to FHA insured loans which were closed or consummated on or after January 21, 2015 and not just any FHA insured loan simply being paid off after that date.

Streamline Refinance of FHA Loans

FHA has underwriting guidelines in place which allow borrowers to refinance their existing FHA loan as long as it is current when it results in a lowering of the borrower's monthly principal and interest payments. It is referred to as a "streamline" refinance because the underwriting guidelines and required documentation is minimized compared to a traditional loan or refinance.

Borrowers participating in a streamline refinance can pay the closing costs incurred in cash or include them in the new mortgage amount as long as there is sufficient equity in the property. No additional advances or cash can be taken out on a streamline refinance. This is where the settlement agent comes in.

In most if not all cases a FHA loan requires the borrower's loan to include an impound account for the payment of the property taxes and hazard insurance premiums. Historically, some loan servicers would allow the settlement agent to deduct the balance of the impound account from the total payoff in conjunction with a streamline refinance and simply transfer the impound account to the new loan. In recent years some loan servicers have changed their position on this and include language in their payoff demand prohibiting this. Settlement agents who are asked to deduct the impound account balance from the total payoff can only do so if allowed by the payoff lender/servicer. It is the responsibility of the settlement agent to determine the payoff lender's policy regarding this.

FHA Pre-foreclosure Program

HUD also has a pre-foreclosure program available to homeowners in default. The Pre-foreclosure Sale (PFS) Program allows the mortgagor in default to sell his/her home and use the net sale proceeds to satisfy the mortgage debt even though these proceeds are less than the amount owed, aka a short sale. If the homeowner participates in this program and sells their home within 90 days HUD insures the lender for any balance unpaid.

Under this program the borrower receives incentives for selling their home within a certain time frame. **Mortgagee Letter 2008-43** states: *"…up to $2,500 to be used for the discharge of junior liens if closing occurs within 90 days. The first $1,000 represents the mortgagor's consideration and the additional $1,500 represents FHA's consideration for a total of $2,500. If settlement occurs after 90 days, the first $750 represents FHA's consideration for a total of $2,250."*

In other words, if the seller has a second lien on the property and the first loan is FHA insured only $2,500 may be paid towards the second lien if the property sells within the first 90 days of default or $2,250 if sold after 90 days. If the seller does not have any junior liens on the property the seller is entitled to $1,000 in proceeds if sold within the first 90 days or $750 if sold after that.

Mortgagee Letter 2008-43 also gives guidance on the use of a real estate agent with this program. It says: *"The broker/agent selected should have no conflict of interest with the mortgagor, the mortgagee, the appraiser or the purchaser associated with the PFS transaction. Any conflict of interest, appearance of a conflict, or self-dealing by any of the parties to the transaction is strictly prohibited. A broker/agent shall never be permitted to claim a sales commission on a PFS of his or her own property or that of an immediate family member (e.g., spouse, sibling, parent, or child)."* It goes on further to state: *"Mortgagors and mortgagees must adhere to ethical standards of conduct in their dealings with all parties involved in a Pre-foreclosure Sale transaction. The Pre-foreclosure must between* *two unrelated parties and be characterized by a selling price and other conditions that would prevail in a typical real estate sales transaction."*

What is the settlement agent's obligation?
Follow the terms of the short sale approval. In these instances most FHA insured lenders will require HUD-1 approval. Ensure the lender sees both sides of the HUD and include the disclosures required. Settlement agents who know or become aware of a non-arms length transaction in these instances should contact their manager, National Escrow Administration or underwriter for further direction.

Home Equity Conversion Mortgages (HECM)
FHA also has a reverse mortgage program. For details on closing reverse mortgages please refer to Tech Memo 58-2006.

Remember
One other pertinent reminder about FHA loans, in this day and age where creative financing options are being used remember a FHA loan can NEVER be wrapped. A Settlement agent who does wrap around an existing FHA loan could lose their right to close a FHA loan - forever.

Should you have any questions and/or comments regarding the contents of this memorandum, do not hesitate to contact your Escrow Administrators at settlement@fnf.com or by phone at (949)622-4425.

[enter office address, city, state, zip phone and fax number]

FHA Payoff Instructions and Authorization

Notice: This applies to an existing FHA Insured Loan that is to be paid off.

Date:
Re: Escrow No.:
Title No.:

Pursuant to the terms of the note your FHA loan being paid off through this file may accrue interest past the date of receipt of full prepayment received by your lender.. These terms can be found within the body of your Note under the heading BORROWER'S RIGHT TO PREPAY which says:

> *"Borrower has the right to pay the debt evidenced by this Note, in whole or in part, without charge or penalty, on the first day of any month. Lender shall accept prepayment on other days provided that Borrower pays interest on the amount prepaid for the remainder of the month to the extent required by Lender and permitted by regulations of the Secretary…"*

As a result, if the payoff is not received by the lender no later than the first day of the month (i.e., payoffs received on the second day of the month require interest paid to the end of that month) an amount equal to 30 days of interest charges will be due.

To avoid paying an additional 30 days of interest the following process must be strictly followed:

1. All loan and closing funds must be deposited into our trust account in the form of good funds and unconditionally collected by the last working day of the month. Wiring your closing funds is the most effective way to comply with this requirement. Our wiring instructions are attached.
2. You authorize transmittal of your payoff to your existing lender by wire transfer or overnight express service of the title company's choice at a cost to be paid by you.

Note: Holidays or weekends must be allowed for and the working days adjusted to ensure that the lender receives the payoff as outlined above.

Note: If receipt of the payoff to your lender within the above-referenced time constraints is questionable, [insert Company] has the right to hold a month's interest until payment in full is confirmed.

I/We have read this statement and fully understand the process involving payoff of the FHA loan and agree(s) to pay all existing loan charges including all interest required by [insert Company] to fully payoff my/our loan with ___________________________________.

I/We further agree and authorize [insert Company] to collect and hold an additional month's interest in escrow post closing pending my lender's timely receipt of the payoff and confirmation my loan is marked as paid in full. If the lender requires an additional months' interest [insert Company] is hereby authorized to remit the amount held to my lender.

In the event [Insert Company] does not withhold an extra month's interest and the payoff does not arrive in the time frame required by the existing lender, the Seller(s) agree(s) to deposit any additional funds necessary to [insert company] with lender's instructions immediately upon notice

Seller(s)/Borrower(s) Signature:

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