

APPENDIX 12

QUESTIONS AND ANSWERS  
Section 203(k) Rehabilitation  
Mortgage Insurance

1. Is there a secondary mortgage market for Section 203(k) mortgage loans?

Yes. The Government National Mortgage Association (GNMA) permits the Section 203(k) mortgage to be placed in both GNMA I and II pools with Section 203(b) mortgages. GNMA accepts the 203(k) mortgage after the loan is insured by HUD. The Federal National Mortgage Association (FNMA) will purchase a Section 203(k) first mortgage only when all the work has been completed and all funds have been disbursed from the rehabilitation escrow account. FNMA will not purchase Section 203(k) second mortgages.

2. Can a Section 203(k) mortgage have the graduated payment feature?

Yes. A Section 203(k) mortgage may be amortized according to any one of the five graduated payment mortgage plans available under Section 245(a).

3. Is the Section 203(k) program restricted to single-family dwellings?

No. The program can be used for one- to four unit dwellings. Maximum mortgage limitations are the same as for properties under Section 203(b). The number of units on a property can be no more than what the local zoning ordinances allow.

4. Can Section 203(k) be used to improve a condominium unit?

No.

5. Can Section 203(k) be used to move an existing house onto another site?

Yes. 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.

At closing, funds would be released to purchase the site; 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 would be based on the improvements made to the site, including the installation of the existing structure on the new foundation.

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6. What is the minimum amount of rehabilitation required for a Section 203(k) mortgage?

There is a minimum \$5,000 requirement for the eligible improvements on the existing structure on the property. Minor or cosmetic repairs by themselves are unacceptable; however, they may be added to the minimum requirement.

7. Can a detached garage or another detached dwelling be placed on the mortgaged property?

Yes. However, the \$5,000 requirement must be applied to the existing dwelling prior to adding additional structures to the site. The new structures must comply with HUD's Minimum Property Standards in 24 CFR 200.926d and all local codes and ordinances.

8. Is there a time limit 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 six (6) months following the execution of the Agreement; however, the lender should not allow a time period longer than that required to complete the work.

9. 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 if the work is not started within 30 days of closing or if work ceases for more than 30 consecutive days.

10. Does the rehabilitation construction have to comply with HUD's Minimum Property Standards?

Yes. 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.

11. Can Section 203(k) be processed under the Direct Endorsement program?

Yes, however, Direct Endorsement Lenders are required to attend special training prior to processing 203(k) loans and they must submit test cases as determined by the local office.

12. 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 ten (10) percent of the cost of rehabilitation, however, the contingency reserve may not exceed twenty (20) percent where major remodeling is contemplated. The reserve cannot be used to make additional improvements to the dwelling that are considered luxury items; however, it may be used to pay for added construction costs caused by deficiencies (health, safety or necessity) discovered during rehabilitation.

13. What eligible improvements are acceptable under the \$5,000 minimum requirement?

- A. Structural alterations and reconstruction (e.g., additions to the structure, finished attics, repair of termite damage and the treatment against termite infestation, etc.)
- B. Changes for improved functions and modernization (e.g., remodeled kitchens and bathrooms).
- C. Elimination of health and safety hazards (including the resolution of defective paint surfaces and/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).
- E. Reconditioning or replacement of plumbing (including connecting to public water and/or sewer system), heating, air conditioning and electrical systems.
- F. Roofing, gutters and downspouts.
- G. Flooring, tiling and carpeting.
- H. Energy conservation improvements (e.g., new double pane windows, insulation, solar domestic hot water systems, etc.).
- I. Major landscape work and site improvement, patios 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.
- J. Improvements for accessibility to the Handicapped.

Related fixtures such as new cooking ranges, refrigerators and other appurtenances, as well as general painting are also eligible, however, it must be in addition to the \$5,000 requirement.

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14. How many draw releases can be scheduled during the rehabilitation period?

As many as five (5) releases (four plus a final) can be scheduled. If the cost of rehabilitation exceeds \$10,000, then additional draw inspections are authorized provided the lender and the borrower agree in writing. 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.

15. 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 mortgage prepayment after completion of construction.

16. 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 that will accurately estimate the cost of the improvements and satisfactorily complete the rehabilitation at or below the estimate.