

## **FUNDS TO CLOSE for FHA**

With DAPS (Down payment Assistance Programs like Nehemiah) going away and the increased requirement of 3.5% buyer contribution (date pending upon the mortgagee letter), I wanted to share with you the FHA guidelines of FUNDS TO CLOSE. Please be aware that some of these FHA guidelines may have additional investor and industry restrictions so it is vital that verification is made up front prior to any action taken.

**All funds for the borrower's investment in the property must be verified and documented. Acceptable sources of these funds include the following:**

**Earnest Money Deposit.** If the amount of the earnest money deposit exceeds 2 percent of the sales price *or* appears excessive based on the borrower's history of accumulating savings, the lender must verify with documentation the deposit amount and the source of funds. Satisfactory documentation includes a copy of the borrower's cancelled check. A certification from the deposit-holder acknowledging receipt of funds and separate evidence of the source of funds is also acceptable. Evidence of source of funds includes a verification of deposit or bank statement showing that at the time the deposit was made the average balance was sufficient to cover the amount of the earnest money deposit.

**Savings and Checking Accounts.** A verification of deposit (VOD), along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

**Seller Contribution.** While FHA permits seller and other parties to make contributions of up to six percent of the sales price of a property toward a buyer's actual closing costs and financing concessions, this policy applies exclusively to the provision of mortgage financing. Other expenses paid on behalf of the borrower must result in a dollar-for-dollar reduction to the sales price (i.e., carpet allowance, etc). When someone other than a family member has paid off debts, the funds used to pay off the debt must be treated as an inducement to purchase and the sales price must be reduced by a dollar-for-dollar amount in calculating the maximum insurable mortgage. FHA deems the payment of consumer debt by third parties to be an inducement to purchase. Buyer must still have their required contribution (i.e., 3.5%) into the mortgage.

**Collateralized Loans.** Funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property. Such assets may include stocks, bonds, real estate (other than the property being purchased), etc. We can also use funds that have been borrowed against collateralized assets such as a car, boat, etc.

In addition, certain types of loans secured against deposited funds, such as signature loans, the cash value of life insurance policies, loans secured by 401(k)s, etc., in which repayment may be obtained through extinguishing the asset; do not require consideration of a repayment for qualifying purposes. However, in such circumstances, the asset securing the loan may not be included as assets to close or otherwise considered as available to the borrower.

An independent third party must provide the borrowed funds. The seller, real estate agent or broker, lender, or other interested third party may not provide such funds. **Unacceptable borrowed funds include signature loans, cash advances on credit cards, borrowing against household goods and furniture and other similar unsecured financing.**

**Sales Proceeds.** The net proceeds from an arms-length sale of a currently owned property may be used for the cash investment on a new house. A fully executed HUD-1 Settlement Statement must be provided as satisfactory evidence of the cash sales proceeds accruing to the borrower. If the property has not sold by the time of underwriting, loan approval must be conditioned upon verifying the actual proceeds received by the borrower. The lender must document both the actual sale and the sufficiency of the net proceeds required for settlement.

**Sale of Personal Property.** If the borrower intends to sell personal property items (cars, recreational vehicles, stamps, coins, baseball card collections, etc.) to obtain funds required for closing, **the borrower must provide a satisfactory estimate of their worth, in addition to conclusive evidence the items have been sold. The estimated worth of the items being sold may be in the form of**

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published value estimates, such as those issued by automobile dealers, philatelic or numismatic associations, or a separate written appraisal by a qualified appraiser with no financial interest in the loan transaction. Only the lesser of this estimate of value or the actual sales price is considered as assets to close.

**Gift Funds.** An outright gift of the cash investment is acceptable if the donor is the borrower's relative, the borrower's employer or labor union, a charitable organization, a governmental agency or public entity that has a program to provide homeownership assistance to low- and moderate-income families or first-time homebuyers, or a close friend with a clearly defined and documented interest in the borrower. The gift donor may not be a person or entity with an interest in the sale of the property, such as the seller, real estate agent or broker, builder, or any entity associated with them. Gifts from these sources are considered inducements to purchase and must be subtracted from the sales price. No repayment of the gift may be expected or implied. (As a rule, we are not concerned with how the donor obtains the gift funds provided they are not derived in any manner from a party to the sales transaction. Donors may borrow gift funds from any other acceptable source provided the mortgage borrowers are not obligors to any note to secure money borrowed to give the gift.) This rule also applies to properties of which the seller is a government agency selling foreclosed properties, such as the Veterans Administration or Rural Housing Services. Only family members may provide equity credit as a gift on a property being sold to other family members.

**Documentation Requirements.** The lender must document the gift funds by obtaining a gift letter, signed by the donor and borrower, that specifies the dollar amount of the gift, states that no repayment is required, shows the donor's name, address, telephone number and states the nature of the donor's relationship to the borrower. In addition, the lender must document the transfer of funds from the donor to the borrower, as follows:

1. If the gift funds are in the homebuyer's bank account, the lender must document the transfer of the funds from the donor to the homebuyer by obtaining a copy of the canceled check or other withdrawal document showing that the withdrawal is from the donor's account. The homebuyer's deposit slip and bank statement that shows the deposit is also required.
2. If the gift funds are to be provided at closing:
  - a. If the transfer of the gift funds is by certified check made on the donor's account, the lender must obtain a bank statement showing the withdrawal from the donor's account, as well as a copy of the certified check.
  - b. If the donor purchased a cashier's check, money order, official check, or any other type of bank check as a means of transferring the gift funds, the donor must provide a withdrawal document or canceled check for the amount of the gift, showing that the funds came from the donor's personal account. If the donor borrowed the gift funds and cannot provide documentation from the bank or other savings account, the donor must provide written evidence that those funds were borrowed from an acceptable source, i.e., not from a party to the transaction, including the lender. "Cash on hand" is not an acceptable source of the donor's gift funds.

Regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

**Trade Equity.** The borrower may agree to trade his or her real property to the seller as part of the cash investment. The amount of the borrower's equity contribution is determined by subtracting all liens against the property being traded (along with any real estate commission) from the lesser of that property's appraised value or sales/trade price.

Value must be determined by a residential appraisal no more than six months old. Evidence of ownership also is required. Additionally, if the property being traded has an FHA-insured mortgage, assumption processing requirements and restrictions apply. **Please be aware that there are additional industry restrictions to this provision- contact us for more information!**

**Employer's Guarantee Plans.** If the borrower's employer guarantees to purchase the borrower's previous residence as the result of relocation, the borrower must submit evidence of the agreement and the net proceeds must be guaranteed.

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**Employer Assistance Plans.** If the employer, to attract or retain valuable employees, pays the employee's closing costs, mortgage insurance premium, or any portion of the cash investment, this payment is considered employee compensation and no adjustment to the maximum mortgage amount is required. If the employer provides this benefit after loan settlement, the borrower must provide evidence of sufficient cash for closing. *A salary advance, however, cannot be considered as assets to close since it represents an unsecured loan.*

**Savings Bonds, Etc.** Government issued bonds are counted at original purchase price, unless eligibility for redemption and redemption value are confirmed. Actual receipt of funds at redemption must be verified.

**IRAs, Thrift Savings Plans, 401(k)s & Keogh Accounts.** Assets such as IRAs, thrift savings plans, and 401(k)s, etc., may be included in the underwriting analysis up to only *60 percent* of value unless the borrower provides conclusive evidence that a higher percentage may be withdrawn after subtracting any federal income tax and any withdrawal penalties. Evidence of redemption is required.

**Stocks and Bonds.** The monthly or quarterly statement provided by the stockbroker or financial institution managing the portfolio may be used to verify the value of these securities. Actual receipt of funds must be verified and documented.

**Cash Saved At Home.** Borrowers who have saved cash at home and are able to demonstrate adequately the ability to do so are permitted to have this money included as an acceptable source of funds to close the mortgage. To include such funds in assessing the homebuyer's cash assets for closing, the money must be verified—whether deposited in a financial institution or held by the escrow/title company—and the borrower must provide satisfactory evidence of the ability to accumulate such savings.

The asset verification process requires the borrower to explain in writing how such funds were accumulated and the amount of time taken to do so. The lender must determine the reasonableness of the accumulation of the funds based on the borrower's income stream, the time period during which the funds were saved, the borrower's spending habits, documented expenses and the borrower's history of using financial institutions. (All other factors being equal, individuals with checking and/or savings accounts are less likely to save money at home than an individual with no history of such accounts.) **Please be aware that there are additional industry restrictions to this provision- contact us for more information!**

**Rent Credit.** The cumulative amount of the rental payments that exceed the appraiser's estimate of fair market rent may be considered accumulation of the borrower's cash investment. Both the rent-with-option-to-purchase agreement and the appraiser's estimate of market rent must be included in the endorsement package.

Conversely, if the sales agreement reveals that the renter has been living in the property (or one owned by the seller) rent-free, or that an agreement was made allowing the renter to occupy at a rental amount considerably below fair market value in anticipation of eventual purchase of the property, this situation must be treated as an inducement to purchase with an appropriate reduction to the mortgage. Exceptions may be granted in situations, such as when a builder fails to deliver a property at an agreed-to time and then permits the borrower to occupy that or another unit for less-than-market rent temporarily until construction is complete.

**Sweat Equity.** Labor performed or materials furnished by the borrower before closing, on the property being purchased, may be considered as the equivalent of a cash investment, **to the extent of the estimated cost of the work or materials.** (Sweat equity may be "gifted" subject to the gift requirements and additional requirements shown below.) **Additionally, the following apply to sweat equity:**

1. On existing construction, **only the repairs or improvements listed on the appraisal are eligible for sweat equity. Any work completed or materials provided before the appraisal is made are not eligible.** On proposed construction, the sales contract must indicate the tasks to be performed by the homebuyer during construction.
2. The borrower's labor may be considered as the equivalent of cash, if the borrower can demonstrate his or her ability to complete the work in a satisfactory manner. The lender must document the contributory value of the labor through either the appraiser's estimate or a cost estimating service.
3. **Delayed work (on-site escrow), clean up, debris removal, and other general maintenance cannot be included as sweat equity.**
4. There can be no cash back to the borrower in these transactions.

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5. Sweat equity on a property other than the property being purchased is not acceptable. Compensation for work performed on other properties must be in cash and be properly documented.

6. Evidence of the source of funds used to purchase and the market value of the materials must be provided if the borrower furnishes these.

**Please be aware that there are additional industry restrictions to this provision- contact us for more information!**

**Commission from Sale.** If the borrower is a licensed real estate agent entitled to a real estate commission from the sale of the property being purchased, that amount may be used for the cash investment with no adjustment to the maximum mortgage required. A family member entitled to the commission also may provide gift funds to the homebuyer.

**Disaster Relief Grants and Loans.** Grants or loans from state and federal agencies [e.g., Federal Emergency Management Agency (FEMA)] that provide immediate housing assistance to individuals displaced due to natural disaster may be used for the borrower's cash investment. Secured or unsecured disaster relief loans administered by the Small Business Administration (SBA) also may be used. However, if the SBA loan will be secured against the property being purchased, it must be clearly subordinate to the FHA-insured mortgage. Any monthly payment arising from such a loan must be included in the qualifying ratios.

**Cash Accumulated with Private Savings Clubs.** Some borrowers may choose to use non-traditional methods of saving money by making deposits into private savings club. Often, these private savings clubs pool resources for use among the membership.

If a homebuyer claims that the cash to close an FHA-insured mortgage is from savings held with a private savings club, the borrower must be able to adequately document the accumulation of those assets with the club. While such clubs are not supervised banking institutions, the clubs must –at a minimum– have account ledgers, receipts from the club, verification from the club treasurer, and identification of the club so that the lender can reverify the information provided. The underwriter must be able to determine that it was reasonable for the borrower to have saved the money claimed and that there is no evidence these funds were borrowed with an expectation of repayment.

## **Second Liens Allowed (Whether soft or hard seconds)**

Any financing (other than the FHA-insured first mortgage) that creates a lien against the property is considered secondary financing and not a gift, even if it is a “soft” or “silent” second (i.e., has no monthly repayment provisions) or has other features forgiving the debt.

**Family Member Lending.** Family members (defined below) may help with the costs of acquiring a home in the form of a gift or a loan. All such gifts must also meet the requirements of paragraph 2-10(C). FHA permits family member to lend on a secured or unsecured basis, up to 100 percent of the homebuyer's required cash investment. This lending may include the downpayment, closing costs, prepaid expenses and discount points. If the money lent by the family member is secured against the subject property, whether borrowed from an acceptable source or from the family member's own savings, only the family member provider(s) may be the note holder. FHA will not approve any form of securitization of the note that results in any entity other than the family member being the note holder, whether at loan settlement or at any time during the mortgage life cycle.

Further, if the funds that are lent by the family member are borrowed from an acceptable source, the homebuyer may not be a co-obligor on that note (e.g., the son and daughter-in-law may not be co-obligors on the note used to secure money borrowed by the parents that in turn was lent for the down payment).

The following financing terms and conditions also apply:

- The maximum insurable mortgage is not affected by gifts or loans from family members.
- The combined amount of financing may not exceed 100 percent of the lesser of the property's value or sales price, plus normal closing costs, prepaid expenses, and discount points. While the family member may lend 100 percent of the cash investment requirements, cash back to the homebuyer (beyond refund of any earnest money deposit) at closing is not acceptable.
- If periodic payments of the secondary financing are required, the combined payments may not exceed the borrower's reasonable ability to pay. The secondary financing payments are to be included in the total debt-payment-to-income ratio (i.e., the "back-end" ratio) for qualifying purposes.
- The second lien may not provide for a balloon payment within five years from the date of execution.
- If the family member providing the secondary financing borrows those funds, the source may not be any entity with an identity-of-interest in the sale of the property, including the seller, builder, loan officer, real estate agent, etc. Mortgage companies that have retail banking affiliates may have that entity make a loan to the family member, providing the secondary

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financing for the home purchase. However, the lending institution may not make such financing available under terms and conditions more favorable than to other borrowers (i.e., there may not be any special considerations provided in connection between making the mortgage and lending funds to family members to be used as secondary financing for the purchase of the home).

- An executed copy of the document outlining the terms of the secondary financing must be maintained in the lender's file. An executed copy of this agreement also must be provided in the endorsement binder.
- For the purposes of this paragraph, a "family member" is defined as a child, parent, or grandparent of the borrower or borrower's spouse. Included in this definition are legally adopted sons or daughters (and a child who is a member of an individual's household, if placed with such individual by an authorized agency for legal adoption by that individual), and foster children. The term "child" means a son, stepson, daughter, or stepdaughter.

**Government Agencies.** Federal, state, and local government agencies, as well as nonprofit agencies considered instrumentalities of government (see B, below), may provide secondary financing *for the borrower's entire cash investment*. The second lien itself must be made or held by the eligible governmental body or instrumentality. Neither governmental units nor their established nonprofit instrumentalities may use "agents," including other nonprofits or for-profit enterprises to make the second lien regardless of the source of those funds. In other words, even if the funds used for the secondary financing were *derived* from an acceptable source such as HUD HOME funds or from a unit of government or the eligible nonprofit instrumentality, the subordinate lien must be in the name of the eligible entity, i.e., the state, county, city or eligible nonprofit instrumentality must be the lien holder. This authority cannot be delegated to another party that is not itself permitted to provide this level of secondary financing. These other entities, however, may be used to *service* the subordinate lien if regularly scheduled payments are to be made by the mortgagor.

**Other Organizations and Private Individuals.** Other organizations and private individuals may provide secondary financing under the following conditions:

The combined amount of the first and second mortgages do *not* exceed the applicable LTV ratio and the maximum mortgage limit for the area.

The repayment terms of the second mortgage must not provide for a balloon payment before ten years (or other such term acceptable to FHA), unless the property is sold or refinanced, and must permit prepayment by the borrower, without penalty, after giving the lender 30 days advance notice.

The required monthly payment under both the insured mortgage and the second mortgage or lien, plus other housing expenses and all recurring charges, cannot exceed the borrower's reasonable ability to pay. Any periodic payments due on the second mortgage are due monthly and are essentially the same in dollar amount.

**Borrowers 60 Years of Age or Older.** Borrowers 60 years of age or older may borrow the required cash investment for purchasing a principal residence, provided:

The donor or lender is a relative of the borrower, a close friend with clearly defined interest in the borrower, the borrower's employer, or an institution established for humanitarian or welfare purposes.

The donor or lender's interest is not solely in the sale of the property, such as a builder or seller, or any person or organization associated with builders or sellers.

The principal amount of the insured mortgage loan, plus the note or other evidence of indebtedness in connection with the property, may not exceed 100 percent of the value, plus prepaid expenses.

The note or other evidence of indebtedness may not bear an interest rate exceeding the interest rate of the insured mortgage.

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**We ARE the FHA Experts..... As we have said before (and will continue to say), don't let others practice on your buyers..... Let us be your FHA/VA and USDA Lender of Choice! Simply call us and let our expertise make it happen for your buyers!**