U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

October 1, 2008 **MORTGAGEE LETTER 2008 - 29**

TO: ALL APPROVED MORTGAGEES
ALL APPROVED APPRAISERS

SUBJECT: HOPE for Homeowners Origination Guidance

The Housing and Economic Recovery Act of 2008 amends the National Housing Act to authorize a new temporary FHA mortgage insurance program called the HOPE for Homeowners (H4H) Program. Under this Program, certain borrowers facing difficulty in paying their mortgages will be eligible to refinance into affordable FHA-insured mortgages. The H4H Program is effective for endorsements on or after October 1, 2008 through September 30, 2011.

While underwriting mortgages for the H4H Program presents unique challenges for the industry, FHA has confidence in its approved mortgagees to exercise their ingenuity in meeting these challenges, while adhering fully to this mortgagee letter, without compromising their ability to make and support sound underwriting decisions. The information, directions, and guidance provided in this mortgagee letter reflect statutory requirements as well as the standards, policies and regulations adopted by the Board of Directors (Board) for the H4H Program.

I. Determining Eligibility

Borrower Eligibility

- Borrowers who are current or delinquent[1] on their mortgage at the time of the refinance are eligible for this Program, if they:
  - Have not intentionally defaulted on their mortgage or any other debt (Intentionally defaulted means the borrower had available funds that could pay the mortgage and other debts without hardship. Debts subject to a documented bona fide dispute may be excluded.) **AND**
  - Have made a minimum of six (6) full payments during the life of the existing senior mortgage (full payment is defined as what was acceptable to the lender for meeting the monthly payment obligation under the terms and conditions of the mortgage).
- Borrowers must reside in the property securing the loan being refinanced, and may not have an ownership interest in other residential real estate, including second homes and/or rental properties.

[1] Borrowers in bankruptcy are not precluded by FHA requirements from participating in the H4H Program.

- Borrowers cannot have been convicted of fraud under state and Federal laws in the last 10 years.

    - Similar to its validation tool for social security numbers, FHA will use an automated tool at the time of case number assignment that will check the borrower's name against several databases for convictions of fraud and an ownership interest in other residential properties. In the event that the lender receives a warning at case number assignment and believes it is in error, it must provide evidence to the appropriate Homeownership Center documenting that the borrower has not been convicted of fraud or does not have an ownership interest in other residential properties. Once the Homeownership Center evaluates the documentation, it will determine whether to lift the warning.

- Borrowers must certify that they did not knowingly or willfully provide material false information to obtain the existing mortgages being refinanced under the H4H Program.

- As of March 1, 2008, the borrower's aggregate total monthly mortgage payment debt-to-income ratio (DTI) on all existing mortgages must be greater than 31 percent of the borrower's gross monthly income. The total monthly mortgage payment is defined as the fully-indexed and fully-amortized Principal, Interest, Taxes and Insurance (PITI) payment (this includes principal and interest, taxes and insurances, homeowners' association fees, ground rents, special assessments and all subordinate liens).

  FHA recognizes that reconstructing the borrower's prior total monthly mortgage payment DTI as of March 1, 2008 may be difficult, especially as the H4H Program nears its sunset date. To comply with this eligibility requirement, lenders must obtain:

    1. From the borrower, evidence that the prior mortgage DTI was more than 31 percent on March 1, 2008, such as pay stubs for March 2008, *or* a signed and dated copy of the individual 2008 Federal tax return, when available, to determine gross monthly income for that month (earnings divided by 12), or W-2s, financial records, or verification of employment from the borrower's employer.

       Lenders may also rely on the borrower's signed and dated 2007 Federal tax return if the lender has no reason to believe that the borrower's income in March 2008 was materially different than the income reported on the 2007 Federal tax return.

        - To determine March 2008 income for self-employed borrowers, obtain a copy of the quarterly tax return that contains income stream information for March 2008 *or* a signed and dated Profit and Loss Statement and balance sheet that contains income stream information for March 2008 *or* a signed and dated copy of the individual 2008 Federal tax return, when available, (earnings divided by 12).

    2. From the servicer of the mortgage, the borrower's total monthly mortgage payment due for March 2008, including any amounts due on subordinate liens.

- For mortgages without escrow accounts, the lender should obtain tax and insurance information from the borrower. If the borrower does not provide insurance information, then the servicer of the mortgage should estimate the monthly cost of hazard insurance (and flood insurance, if applicable) based on the property's location and the rates in effect for 2008. If the borrower does not provide real estate tax information, the lender should obtain it from public records.

Mortgage Eligibility

- The mortgage being refinanced must have been originated on or before January 1, 2008;

- Each holder of an existing senior mortgage being refinanced must:

    1. Waive all prepayment penalties and late payment fees (including insufficient funds fees) on the mortgage. Prepayment penalties are defined in the Federal Reserve Board's Regulation Z (Truth in Lending), 12 CFR 226.32(d)(6);

    2. Agree to accept the proceeds of the new H4H mortgage as payment in full, *and*

    3. Release their outstanding mortgage liens.

- Each holder of an existing subordinate mortgage must:

    1. Waive all prepayment penalties and late payment fees (including insufficient funds fees) on the mortgage. Prepayment penalties are defined in the Federal Reserve Board's Regulation Z (Truth in Lending), 12 CFR 226.32(d)(6); *and*

    2. Release their outstanding mortgage liens.

- Any type of mortgage is eligible for refinancing under the H4H Program, including conventional (prime, Alt-A, subprime) or government-backed (FHA, VA, or Rural Development), fixed-rate or an adjustable rate mortgage; and

- The mortgage being refinanced may have a variety of payment characteristics, including interest only, payment option, negative amortization and/or any other exotic features.

Property Eligibility

- The property must be the borrower's primary and only residence in which they have an ownership interest (if there are non-occupant co-borrowers, they will need to quit claim their interest in the property prior to the occupying co-borrowers applying for the H4H Program);

- Only 1 unit properties are eligible, including condominium units, cooperative units and manufactured housing permanently affixed to realty.

II. Consumer Protections and Disclosures

Although counseling is not required as a condition of insurance endorsement, borrowers should be strongly encouraged to contact and work with a housing counseling agency. The lender must provide to the borrower(s) the HOPE for Homeowners Consumer Disclosure and Certification Form at the time of initial loan application for the Program. This disclosure form must be signed and dated by the borrower at least one day prior to execution of the initial Universal Residential Loan Application (URLA) and HUD/VA Addendum to the URLA [see Exhibit A].

Typically, borrowers execute a final URLA and a final Addendum to the URLA at the time of closing. Borrowers will also need to sign and date the HOPE for Homeowners Consumer Disclosure and Certification Form at the time of closing.

III. Appraisals

The appraisal for the H4H mortgage must be performed by an appraiser on the FHA Appraiser Roster and conducted using FHA guidelines, which can be found in the Resources box at hud.gov/groups/appraisers.cfm.

However, the appraisal must have been specifically ordered for the H4H transaction and *the appraisal should be no more than 3 months old* at the time of loan closing. If an appraisal is more than 3 months old because of transactional delays, the appraisal may be acceptable with an explanation that addresses how the appraisal meets existing FHA standards and the requirement for "current" appraised value. The lender may require a new appraisal, if the appraisal and written explanation are insufficient.

Prevailing Appraised Value

If an appraisal is ordered by the current lender or servicer and a new appraisal is ordered by a different lender that will originate the new loan under this Program, the value provided in the appraisal ordered by the new lender will prevail as the appraisal accepted for obtaining FHA insurance.

Appraisal Practices in Declining Markets

It is expected that many of the properties financed under this Program will be located in declining market areas. Therefore, the following guidance is provided to assist lenders in ensuring that appraisers are providing accurate property valuations. A declining market could be as small as a neighborhood or as large as an entire state, and no standard definition exists, other than a market in which home prices are falling.

Appraiser Responsibilities

The purpose of the appraisal is to provide the lender/client with an accurate, and adequately supported, opinion of market value. It is the appraiser's responsibility in performing the appraisal to determine whether a property is located in a declining market.

The neighborhood section of each property specific appraisal form contains a subsection on housing trends where the appraiser must mark a box indicating whether property values are increasing, stable or declining. Whichever box is selected, the appraiser is certifying that he or she has performed an objective analysis of quantifiable data supporting the observations made.

The appraiser must provide an explanation in the "Market Conditions" section of the appraisal report that includes relevant information in support of the conclusions about appraised value relating to trends in property values, demand/supply and marketing time. The appraiser must also provide a description of the prevalence and impact of sales and financing concessions and/or down payment assistance in the subject's market area. Other areas of discussion may include days on market, list-to-sale price ratios, and/or financing availability.

Appraisers and lenders are reminded that a comparable sale should not be more than six months old and should represent a closed sale. The appraiser may utilize comparables that are more than six months old but only with a clear explanation and justification. The lender may require a new appraisal, if the appraisal and written explanation are insufficient. The appraiser is not permitted to use a comparable greater than 12 months old (see Comparable Selection, page D-6 of Valuation Protocol).

<u>Lender Responsibilities</u>

The lender's responsibility is to properly review the appraisal and determine that the appraised value used to support the loan amount of the new FHA-insured mortgage is accurate and adequately supported. Lenders may determine, through services such as the S&P/Case-Schiller Index, Office of Federal Housing Enterprise Oversight (OFHEO) House Price Index or any index developed by its successor, the Federal Housing Finance Agency, or National Association of Realtors (NAR) statistics, that the appraised value is supportable.

Lenders are reminded that, if the appraiser they select provides a poor or fraudulent appraisal that leads FHA to insure a mortgage at an inflated amount, the lender is held equally responsible with the appraiser for the violation if the lender knew or should have known of the defects or the fraud in the appraisal. FHA will pursue appropriate enforcement actions against both or either party. Lenders accept responsibility, equally with appraisers for the integrity, accuracy and thoroughness of the appraisal submitted to FHA for mortgage insurance purposes.

Lenders should inform appraisers that the purpose of the appraisal is for the H4H Program, advising them that a copy will be shared with subordinate lien holders and must be provided to the borrower.

Pressure on Appraisers and Conflicts of Interest

Lenders and appraisers must avoid conflicts of interest which affect, either in reality or in appearance, the credibility of the appraisal. A lender may not choose an appraiser that has any interest, direct or indirect, in the property being appraised. Instances of undue pressure or influence on an appraiser reported to FHA will result in appropriate sanctions against the lender involved. See also Mortgagee Letter 2005-06, Lender Accountability for Appraisals.

IV. Term and Interest Rate on the H4H Mortgage

Only 30-year term, fixed-rate mortgages may be offered under this Program. While the interest rate on the new mortgage is to be negotiated between the borrower and the lender, lenders should offer rates that are commensurate with interest rates on similar types of loans, if any (not considering the annual premium in that comparison).

V. Mortgage Insurance Premiums

The Upfront Mortgage Insurance Premium (UFMIP) is 3.00 percent of the base loan amount (loan amount excluding UFMIP) regardless of the loan-to-value (LTV) ratio. The Annual premium (collected monthly) is 1.50 percent of the base loan amount.

VI. Calculating the Maximum Mortgage Amount

The amount of the H4H mortgage may not exceed a *nationwide* maximum mortgage limit of $550,440. The LTV of the H4H mortgage is limited to 90 percent of current appraised value of the property, including the UFMIP. The proceeds from the new H4H mortgage will be applied to the existing senior mortgage, and extinguish all mortgage-related debts under all existing mortgages including:

- Advances by existing lenders/servicers for taxes, hazard insurance and/or mortgage insurance; and

- Out of pocket third party legal expenses of the existing lenders/servicers associated with foreclosures and preservation and protection (See Mortgagee Letters 2007-03 and 2005-30)

Closing Costs and Prepaid Items

Standard FHA policy regarding closing costs (outlined in Mortgagee Letter 2006-4) is applicable, including the 1 percent cap on origination fees. The origination fee compensates the lender for administrative costs in originating and closing the loan. The origination fee covers administrative costs for taking the loan application, evaluating, preparing and submitting a proposed mortgage loan. The origination fee cannot be supplemented by other fees to cover these administrative costs, such as “application or processing” fees or broker fees. The origination fee cannot exceed the greater of $20 or one percent of the original principal amount of the mortgage (excluding any one-time mortgage insurance premium)

FHA does not require that closing costs and prepaid items come from the borrower’s own assets, giving lenders and borrowers the flexibility to determine which of the following options (or combination of options) should be used to pay these costs:

- Borrowers pay closing costs and prepaid items from their own assets;

- The closing costs and prepaid items may be financed into the mortgage provided the LTV does not exceed 90 percent, including UFMIP;

- The servicing lender, originating lender and/or a third party (e.g., a Federal, state or local Program) may pay the closing costs and prepaid items; and/or

- The originating lender may pay the borrower's closing costs and prepaid items through premium pricing. (see handbook HUD 4155.1 REV-5, paragraph 1-9 J)

VII. Underwriting the Mortgage and Qualifying the Borrower

For analytical purposes, FHA requires all approved lenders to use FHA's TOTAL Mortgage Scorecard (TOTAL). Regardless of the risk classification obtained from TOTAL for each mortgage originated under the H4H Program, the underwriter must:

1. Determine that the borrower's total monthly mortgage payment on the new H4H loan *is less than* the borrower's aggregate total monthly mortgage payment on his or her existing (non-H4H) mortgage(s), including any subordinate mortgage liens, based on a fully-indexed, fully-amortizing PITI payment.

2. Determine that the payment-to-income and debt-to-income ratios are at, or below, 31 percent and 43 percent, respectively, which may not exceed 38 percent and 50 percent, respectively, provided there is a minimum three consecutive month 'trial modification' period prior to loan application for the new H4H mortgage. Through the 'trial modification' period borrowers have the opportunity to demonstrate their capacity and willingness to make a mortgage payment at the estimated H4H monthly payment amount (including PITI) that does not exceed the 38/50 cap. Non-occupant *co-signers* (i.e., borrowers who do not hold ownership interest in the property) may be added in order to meet these underwriting guidelines for the new H4H mortgage.

   When using a trial modification, the lender must include documentation in the file that demonstrates the borrower, using his or her existing gross income, made full and timely mortgage payments on the existing senior mortgage pursuant to the terms of the trial modification for the three consecutive months preceding application for the H4H loan, *and* in an amount that is at least 90 percent of the estimated total monthly mortgage payment on the new H4H mortgage payment.

3. In addition to standard FHA policies regarding documentation and verification of employment and income, the underwriter must also review income as reported on the transcript of the borrower's income tax returns or a copy of the borrower's income tax returns obtained directly from the IRS for the previous **two years**.

Consistent with the requirements above, for those borrowers current on their mortgage, underwriters should not automatically reject them for making their mortgage payment their first priority at the expense of meeting other recurring obligations in a timely manner. If the borrower was offered partial forbearance, the underwriter must determine that he or she has made payments under the forbearance agreement in a timely manner.

Lender and Underwriter Certifications

In addition to the certifications made by the lender and the underwriter of the loan on the HUD/VA Addendum to the URLA, both the lender and underwriter must also execute the HOPE For Homeowners Lender and Underwriter General Certification [see Exhibit B].

VIII. Documentation Requirements

In addition to the standard documentation requirements found in handbook HUD 4155.1 REV-5, Chapter 3, the following additional documentation for H4H loans must be included in the case binder on the right hand side. This additional documentation will also become a part of the pre-endorsement review conducted by FHA staff (Direct Endorsement Program) or the lender (Lender Insurance Program). Exhibit C is a suggested pre-endorsement review checklist for FHA staff and lenders to use. For lenders that submit electronic case binders, this information must be a new index labeled H4H.

- **Prior Mortgage Origination Date:** Evidence the mortgage(s) being refinanced was originated on/before January 1, 2008, such as a HUD-1 Settlement Statement or the mortgage payment history from the servicer.

- **Payment History:** If delinquent at the time of the refinance, evidence that the borrower made 6 full payments during the life of the first mortgage loan being refinanced, such as the mortgage payment history from the servicer.

- **Prior Total Mortgage Payment:** Evidence that the prior aggregate mortgage DTI was more than 31 percent on March 1, 2008, such as pay stubs for March 2008, *or* a signed and dated copy of the individual 2008 Federal tax return, when available, to determine gross monthly income for that month (earnings divided by 12), or W-2s, financial records, or verification of employment from the borrower's employer.

  Lenders may also rely on the borrower's signed and dated 2007 Federal tax return if the lender has no reason to believe that the borrower's income in March 2008 was materially different than the income reported on the 2007 Federal tax return.

  - To determine March 2008 income for self-employed borrowers, obtain a copy of the quarterly tax return that contains income stream information for March 2008 *or* a signed and dated Profit and Loss Statement and balance sheet that contains income stream information for March 2008 *or* a signed and dated copy of the individual 2008 Federal tax return, when available, (earnings divided by 12).

  From the servicer, evidence of what the borrower's total mortgage payment was for March 2008, including any subordinate liens. For mortgages without escrow accounts, evidence regarding the amount of taxes and the cost of hazard insurance and flood insurance (if applicable). If the lender must estimate the cost of all insurance, it must document how it arrived at that estimate based on the property's location and the rates in effect for 2008. If the borrower does not provide information on real estate taxes, the lender must also include public record information.

- **Primary Residence:** Evidence that the property is the borrower's primary residence, such as a Federal or state tax return, driver's license and/or voter registration card.

- **HOPE for Homeowners Consumer Disclosure and Certifications:** The initial and final HOPE for Homeowners Consumer Disclosure and Certifications, signed and dated by the borrower(s), along with the initial and final URLA and Addendum to the URLA.

- **Conviction of Fraud:** In instances where a warning is received that the borrower was convicted of fraud and the lender believes it is an error, the lender must document that the borrower has not been convicted of fraud under Federal or state law in last 10 years.

- **Tax Returns:** Copies of the previous two years Federal tax returns or transcripts of the borrower's income tax returns obtained directly from IRS.

- **Trial Modification:** If a 'trial modification' period was used to exceed the 31/43 DTI ratios, the lender must document that the borrower, using his or her existing gross income, made timely mortgage payments on the existing senior mortgage pursuant to the terms of the trial modification for the three consecutive months preceding application for the H4H loan, *and* in an amount that is at least 90 percent of the estimated total monthly mortgage payment on the new H4H mortgage payment.

- **First Payment Made:** Evidence that the first payment on the new mortgage was made by the borrower and not by any interested party to the transaction, from the loan proceeds or escrowed at closing.

- **Lender Certifications:** The HOPE for Homeowners Lender and Underwriter General Certifications, signed by an officer of the lending institution and the Direct Endorsement Underwriter.

IX. Prohibition Against Subordinate Financing

Under the H4H Program, borrowers are prohibited from taking out new subordinate liens for the first 5 years of the mortgage except when necessary to ensure maintenance of property standards. Therefore, during the first 5 years of the mortgage, FHA will permit a subordinate mortgage lien only if the proceeds are essential to preserve and protect the property, and:

- The condition to be repaired represents a health and safety hazard and/or the failure to make the repair will cause the property condition to deteriorate;

- The cost of the proposed repair is reasonable for the geographic market area as determined by HUD's residential property management contractor;

- The repairs are not primarily cosmetic and do not represent routine maintenance;

- The financing is a closed-end loan under Federal Reserve Board's Regulation Z;

- The financing does not reduce the amount of the government's equity share in the property;[2] and

- The new total debt does not exceed 95 percent of the property's new appraised value.

HUD will not subordinate equity or appreciation sharing notes to any subordinate financing – either within the first 5 years or thereafter – except liens as described above or for FHA loss mitigation actions (mortgage modifications and partial claims).

X. Equity and Appreciation Sharing

Shared Equity Mortgage

As a condition of the H4H mortgage, the borrower must share with HUD a portion of the initial equity, which is defined as the difference between the appraised value at the time of H4H loan origination[3] and the original principal balance on the H4H mortgage. The originating lender will prepare a Shared Equity note and mortgage (SEM) using the format attached as Exhibit D. A dollar amount equaling the initial equity will be inserted in the SEM. The SEM will be executed by the borrower and recorded with all other loan documents in second lien position.

> **Example:** Appraised value is $200,000. Maximum loan to value on a H4H mortgage is 90%, or $180,000. The equity amount that would be stated in the SEM is $20,000.

Shared Appreciation

As a condition of the H4H mortgage, the borrower must share with HUD 50 percent of any future property appreciation upon sale or disposition of the property. Future appreciation is the difference between the gross proceeds from the sale or disposition of the property and the appraised value of the property at origination of the H4H mortgage, less allowable closing costs incurred in connection with the sale or disposition and a percentage of the value of any capital improvements to the home that increases the value of the property.

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[2] That is, the sum of the unpaid principal balance and accrued interest on the H4H mortgage and the original principal balance of the new mortgage debt is less than the sum of (i) the appraised value of the property after completion of the proposed repair and (ii) HUD's share of the new equity created upon origination of the H4H mortgage as if a sale of the property occurred on date of origination of the new mortgage debt.

[3] The Act provides that, in the event of refinance, sale or other disposition, HUD receive the following percentage of initial equity:

During Year 1	100% of equity is paid to FHA
During Year 2	90% of equity is paid to FHA
During Year 3	80% of equity is paid to FHA
During Year 4	70% of equity is paid to FHA
During Year 5	60% of equity is paid to FHA
After Year 5	50% of equity is paid to FHA

The originating lender will prepare a Shared Appreciation note and mortgage (SAM) using the format attached as Exhibit E. The SAM will be executed by the borrower and recorded in third lien position. The originating lender is responsible for ensuring that a SAM (and a SEM) complies with state law.

Originating SEM and SAM liens

In addition to other origination actions, the originating lender of a H4H mortgage will complete actions necessary to determine and document a borrower's commitment to share equity and future appreciation with HUD as required under section 257 of the National Housing Act, as well as the commitment of existing lien holders to waive all rights to collect existing debt and to release the lien. The originating lender will:

- Identify all existing lien holders through review of the borrower's loan application and by obtaining a preliminary title report,
- Request that all existing lien holders provide a payoff statement itemizing unpaid principal, unpaid accrued interest, daily interest calculation, and allowable costs advanced on behalf of the borrower (e.g., taxes, insurance, legal fees, etc.),
- Refer the borrower to the HOPE for Homeowners Consumer Disclosure and Certifications he or she signed at the time of initial loan application (Exhibit A), and
- Provide the borrower copies of all payoff statements for review, requesting that the borrower notify the originating lender within 5 business days of receipt of any discrepancies noted on the payoff statements.

Absent any challenge from the borrower regarding a payoff amount, the originating lender will:

- Determine the dollar amount of borrower's initial equity as described in the example above,
- Using the Appreciation Worksheet provided in Exhibit F, calculate the maximum dollar amount that each subordinate mortgage lien holder could receive from HUD's share of future appreciation, if any, using the formula and charts contained herein,
- Provide each subordinate lien holder with the Appreciation Worksheet, describing appreciation sharing and stating the maximum amount the lien holder may be entitled to receive,
- Obtain the lien holder's signature on the Appreciation Worksheet, acknowledging it has read and accepts the terms of the Appreciation Worksheet and is prepared to execute a full release of its lien in exchange for a future appreciation share,
- Prepare and cause the borrower to execute SEM and SAM for the H4H mortgage,
- Record the SEM and SAM with other loan documents,

- Register the H4H security instruments in the Mortgage Electronic Registration System (MERS) as MERS Original Mortgages, and

- Deliver the original SEM and SAM notes and recorded mortgages to HUD's servicing contractor at the address below and retain copies in the servicing file.

Document Delivery

Following funding of the H4H mortgage, the originating lender will record the SEM and SAM mortgage documents in the public records of the county in which the property is located and will deliver the original SEM and SAM notes and original recorded mortgage documents to HUD at the address listed below no later than 15 business days from the date of endorsement. Time extensions may be granted by the National Servicing Center in the event document delivery is delayed by events beyond the control of the lender.

U.S. Department of HUD
c/o C&L Service Corporation / Morris-Griffin Corporation
2488 East 81st Street, Suite 700
Tulsa, Oklahoma 74137

Other documentation requirements include a copy of the HUD-1 settlement statement, and a copy of the appraisal that was completed in order to establish the amount of the H4H mortgage. HUD accepts certified copies of the recorded mortgage when the original recorded documents are not available. The SEM and SAM notes and mortgages will be serviced by HUD through its special servicing contractor.

XI. <u>Extinguishment of Subordinate Liens</u>

All existing mortgage lien holders must waive all rights to collect existing debt. To facilitate this agreement among lien holders, HUD may offer subordinate lien holders a share in future appreciation. Consistent with requirements and standards adopted by the Board, HUD may also take such actions as may be necessary and appropriate to facilitate coordination and agreement between the holders of the existing senior mortgage and any existing subordinate mortgages, taking into consideration the subordinate lien status of such subordinate mortgages. Subordinate lien holders whose write off is less than $2,500 will not receive the opportunity to share in future appreciation.

Qualifying existing subordinate mortgage lien holders may receive a share of HUD's interest in future appreciation in exchange for full release of their lien(s). The originating lender will prepare a SAM using the format attached as Exhibit E. In the event a subordinate lien holder accepts the future appreciation, the subordinate lien holder shall ensure it is a MERS member as MERS will be used to track lien holders with an interest in future appreciation of the property. The SAM will be executed by the borrower and recorded in third lien position. The originating lender is responsible for ensuring that a SAM (and a SEM) complies with state law. Instructions for calculating future appreciation sharing payments are in Exhibit F.

XII. Monitoring and Program Compliance

Monitoring

Current monitoring practices (such as the Post Endorsement Technical Reviews, Appraiser Watch, and Lender Monitoring Reviews), will be used to monitor lenders and appraisers participating in the H4H Program as well as loan performance. If a serious violation of H4H or existing FHA Program requirements is discovered, FHA's standard indemnification procedures and claim payment procedures apply, i.e., holders of FHA insurance benefits who were not a party to the violation will be paid a claim and the deficiency or loss to FHA will be pursued under the indemnification agreement with the lender responsible for the violation.

H4H mortgages will not be included in HUD's performance analysis of a lender's compare ratio with respect to the CreditWatch Termination Initiative. However, FHA will develop a separate module in Neighborhood Watch to display a lender's performance compare ratio for H4H loans.

Fraud Convictions

As part of its Lender Monitoring Reviews, FHA will perform an independent background check to determine whether the borrower has been convicted of fraud in the last 10 years. Regarding this aspect of the Program, the lender's liability is limited to what it knew or should have known. That is, during loan processing information was available to the lender indicating a fraud conviction or at the time of case number assignment the lender received a warning for a fraud conviction.

First Payment Default

Under the statute for the H4H Program, HUD is prohibited from paying insurance benefits to any lender in any case in which the borrower fails to make the first payment on the new H4H mortgage. For purposes of this Program, lenders will have a maximum of 120 days to submit a complete case binder, including evidence that the mortgage is current. FHA will not pay a claim on any mortgage under the H4H Program if the first payment was not made within 120 days. Lenders are reminded that in order to ensure compliance with this statutory requirement, FHA prohibits them or any interested third party from making any payment on behalf of the borrower, escrowing of any payment or applying any payment from closing proceeds. Violation of this requirement will also result in a denial of claim benefits.

If you should have any questions concerning this Mortgagee Letter, call 1-800-CALLFHA.

Sincerely,

Brian D. Montgomery
Assistant Secretary for Housing-
Federal Housing Commissioner