MORTGAGE BANKERS ASSOCIATION

July 19, 2018

Brian Montgomery
FHA Commissioner and Assistant Secretary for Housing
U.S. Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Request for Additional Clarity and Guidance Related to the FHA Single Family Housing Policy Handbook

Dear Mr. Montgomery:

Pursuant to ongoing discussions with our members and other stakeholders in the mortgage finance sector, the Mortgage Bankers Association (MBA),[1] has compiled a list of loan production issues related to the requirements of the Federal Housing Administration (FHA) that we believe warrant additional clarification from the U.S. Department of Housing and Urban Development (HUD). While some of these issues are broadly addressed in the FHA Single Family Housing Policy Handbook (Handbook), lenders originating FHA-insured loans would benefit from enhanced guidance with respect to all of the issues that follow.

MBA has identified the following issues as priorities:

- **Third-Party Underwriting and Vendor Verification of Borrower Income, Employment, and Assets**
- **Student Loan Debt Calculation**
- **Rent Below Fair Market**
- **Minimum Decision Credit Scores**
- **Deferred Action for Childhood Arrivals and Employment Authorization Documents**
- **Contract for Deed**
- **Community Transfer Fees**

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,300 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

Below is a description of each topic, accompanied by the issues facing market participants, the Handbook guidance that is currently available, and MBA's recommendations.

<u>Third-Party Underwriting and Vendor Verification of Borrower Income, Employment, and Assets:</u> As technology continues to evolve, so has the process of verifying borrowers' income, employment, and assets. Many lenders are utilizing the services of third-party vendors as well as outsourced underwriting to reduce costs and improve efficiency within the loan approval process. Fannie Mae, Freddie Mac and the U.S. Department of Veterans Affairs (VA) have clearly stated that third-party verifications of income, employment, and assets are acceptable (provided the sources meet various well-defined standards).

> **<u>Issue:</u>** FHA has not affirmatively taken a stance as to whether it accepts third-party underwriting recommendations or third-party vendor systems used to verify borrowers' income, employment, and assets. As a result, lenders are hesitant to utilize such resources when originating FHA-insured loans.
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> **<u>Recommendation:</u> MBA recommends that HUD provide clear guidance accepting the use of third-party underwriting and vendor verification of borrowers' income, employment, and assets, as well as the requirements and standards that must be met by any third parties providing such services.**

<u>Student Loan Debt Calculation:</u> Deferred student loan debt without a monthly payment reported on a borrower's credit report and/or an approved income-based repayment plan that is not fully amortized by the end of the term are represented by 1 percent of the outstanding balance when calculating a borrower's debt-to-income (DTI) ratio.

> **<u>Issue:</u>** Existing FHA Handbook policies regarding student loan debt calculation may disqualify a large number of potential borrowers. The presumed 1 percent payment is oftentimes as much as double the actual payment that borrowers are required to pay once the debt comes out of deferment. The inflated estimate of the student loan debt may be eliminating a subset of the market that would otherwise be qualified for an FHA-insured mortgage if an alternative method was used to account for these obligations. Currently, Fannie Mae and Freddie Mac subscribe to the 1 percent calculation, but provide an alternative that allows for the borrower to provide the lender with a proposed payment that is fully amortized over the course of the loan. VA has also provided an alternative to the 1 percent calculation by taking 5 percent of the outstanding balance and dividing it by 12 to determine the monthly payment used in the DTI calculation. In regard to income-based repayment, Fannie Mae, Freddie Mac and VA all accept the reported monthly payment regardless of whether the debt is fully amortized.
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> **<u>FHA Handbook Guidance:</u>** "Student Loan refers to liabilities incurred for educational purposes. The Mortgagee must include all Student Loans in the Borrower's liabilities, regardless of the payment type or status of payments. If the payment used for the monthly obligation is: less than 1 percent of the outstanding balance reported on the Borrower's credit report; and less than the monthly payment reported on the

Borrower's credit report; the Mortgagee must obtain written documentation of the actual monthly payment, the payment status, and evidence of the outstanding balance and terms from the creditor. Regardless of the payment status, the Mortgagee must use either: the greater of 1 percent of the outstanding balance on the loan or the monthly payment reported on the Borrower's credit report; or the actual documented payment, provided the payment will fully amortize the loan over its term."

Recommendation: MBA recommends that HUD consider an alternative to using 1 percent of the outstanding student loan balance as a proposed payment on deferred, unreported, and income-based obligations. Adopting an alternative would better align FHA with common industry practice while allowing for reasonable consideration of student loan debt during the underwriting process.

Rent Below Fair Market: Property owners often sell rental properties to occupying tenants. However, if the tenant(s) pay rent that is below fair market value, the sales price and/or the financing must be induced in order to offset the disparity.

Issue: Many lenders are unclear as to how they should calculate the "induced amount" of the subject property. Some lenders are basing the calculation on the amount currently being paid against the current fair market rent. For tenancy spanning multiple years, some lenders are going back to the beginning of the tenant's occupancy, which becomes problematic if the tenancy spans a lengthy period of time. In those cases, lenders are unable to determine what the fair market rent was at the time to then calculate the inducement.

FHA Handbook Guidance: "Rent may be an inducement to purchase when the sales agreement reveals that the Borrower has been living in the Property rent-free or has an agreement to occupy the Property at a rental amount considerably below fair market rent. Rent below fair market is not considered an inducement to purchase when a builder fails to deliver a Property at an agreed-upon time, and permits the Borrower to occupy an existing or other unit for less than market rent until construction is complete."

Recommendation: MBA recommends that HUD provide guidance as to how the induced amount is calculated and clarify if the below market rate calculation is retroactive to the beginning of the tenancy for multi-year occupancies or based on the rental amount of the most recent/current lease.

Minimum Decision Credit Scores: During the underwriting process, FHA requires lenders to evaluate credit scores that are calculated using data from the three national credit reporting bureaus. In most cases, a score is provided through each bureau, generating three different scores. The lender is required by FHA to use the middle of the three scores for the purposes of determining the borrower's eligibility. In situations in which credit scores are only available from two bureaus, the lender is required by FHA to use the lower score for the purposes of determining the borrower's eligibility.

Issue: Lenders often call FHA Homeownership Centers (HOCs) to seek further clarity from a Customer Service Representative (CSR) on FHA's guidelines regarding a credit score issue. In some cases, lenders have received guidance from CSRs that has created confusion regarding the number of qualifying credit scores. Recently, for example, an CSR explained to a lender that a borrower with three credit scores, two of which were the same number, only featured two "differing" scores. For example, under this guidance, a borrower with credit scores of 650/650/619 would have only two "differing" scores of 650 and 619, which would necessitate use of the lower score of 619. However, the more reasonable interpretation of "differing" in such a scenario is the differing credit bureaus that provide scores, not the numbers associated with the various scores. In the numerical example above, this would allow use of the middle score of 650.

FHA Handbook Guidance: "The Minimum Decision Credit Score (MDCS) refers to the credit score reported on the Borrower's credit report when all reported scores are the same. Where three differing scores are reported, the middle score is the MDCS. Where two differing scores are reported, the MDCS is the lowest score. Where only one score is reported, that score is the MDCS."

Recommendation: MBA recommends that HUD provide further clarity on FHA's guidelines relating to the Handbook phrase "differing scores" to ensure lenders and CSRs understand that this requirement is referencing "scores from different providers." A numerical example in the Handbook would be another beneficial tool to provide such clarity.

Deferred Action for Childhood Arrivals and Employment Authorization Documents: In September 2017, the Deferred Action for Childhood Arrivals (DACA) policy was rescinded by President Trump, thus causing the delay of many DACA application renewals and work permits. Prior to the policy being rescinded, DACA participants applied for renewals every two years and would be granted deferred deportation status along with work permits if requirements were met.

Issue: Given the future uncertainty of the DACA program, lenders are particularly hesitant to offer mortgages to individuals with deferred status and expired renewals. Lenders are also frequently uncertain as to whether they are in compliance when originating FHA-insured loans to DACA applicants because clear guidance is not provided within the Handbook. For example, clarity is needed when it relates to individuals who are DACA beneficiaries whose Employment Authorization Document (EAD) expires in less than 12 months, but who have applied for renewal. It appears those individuals whose EAD expired prior to March 5, 2018 were able to apply for renewal on or before October 5, 2017 and those renewal applications will be processed, but lenders do not know if they will be approved, leaving these lenders to determine the likelihood of renewal. Lenders are not aware of any information from U.S. Citizenship and Immigration Services (USCIS) that would make them believe a renewal is likely. In addition, there is little clarity as to whether the EAD is the only document that can be relied upon to substantiate work status or if an Immigration

Visa that allows for the ability to work in the United States is acceptable. Many types of Immigration Visas give a borrower the ability to work without issuing an actual EAD.

FHA Handbook Guidance: "The EAD is required to substantiate work status. If the EAD will expire within one year and a prior history of residency status renewals exists, the Mortgagee may assume that continuation will be granted. If there are no prior renewals, the Mortgagee must determine the likelihood of renewal based on information from the USCIS."

Recommendation: Currently, the Handbook contains three categorizations of non-U.S. citizen residency status: lawful permanent resident aliens, non-permanent resident aliens, and non-U.S. citizens without lawful residency. MBA recommends that HUD provide clear guidance as to which category DACA participants should fall under or, alternatively, that HUD create a fourth category for these individuals.

MBA also recommends that HUD provide clear guidance specifically addressing whether or not an Immigration Visa that allows the borrower the ability to work in the United States, but which does not come with an accompanying EAD, is acceptable to meet FHA's requirements or if all borrowers must have a valid EAD in order to be eligible.

Lastly, MBA recommends that HUD provide further clarity related to the DACA program in the Handbook in order to ensure lenders understand the program requirements.

Contract for Deed: In some states, a contract for deed is used in seller financing and is accompanied by a mortgage note and a warranty deed that is held in escrow. In some cases, the real estate contract is used to convey partial ownership rights to the occupant borrower. Full ownership rights are only transferred to the occupant borrower from the seller once the balance of the mortgage is paid in full and the warranty deed is satisfied. Current FHA guidelines allow the borrower to refinance the property while under a contract for deed, but not to sell the property as the owner to a new potential FHA borrower until title has been held for 90 days.

Issue: In this scenario, the occupant borrower sells the property to an FHA borrower and uses the proceeds to pay off the seller-financed mortgage note, allowing for the conveyance of full ownership to the occupant borrower. Consequently, the new deed conveying ownership from the occupant borrower to the FHA borrower is also recorded. A number of lenders have reported that there has been inconsistency in the enforcement of whether such an arrangement violates FHA's 90-day "flip rule" when determining eligibility for FHA endorsement.

FHA Handbook Guidance: "The eligibility of a Property for a Mortgage insured by FHA is determined by the time that has elapsed between the date the seller has acquired title to the Property and the date of execution of the sales contract that will result in the FHA-insured Mortgage. FHA defines the seller's date of acquisition as the date the seller acquired legal ownership of that Property. FHA defines the resale date as the date of execution of the sales contract by all parties intending to finance the Property with an FHA-insured Mortgage. A Property that is being resold 90 Days or fewer following the seller's date of acquisition is not eligible for an FHA-insured Mortgage."

<u>Recommendation:</u> MBA recommends that HUD provide clear guidance specifically addressing transactions involving a contract for deed, including whether FHA will endorse mortgages for borrowers purchasing homes from sellers who acquired the subject property through a contract for deed.

<u>Community Transfer Fees:</u> In certain housing communities, borrowers make separate payments to private companies to pay for various amenities within the community. These payments are typically found in retirement populaces and can cover landscaping, recreation centers, and golf courses. Developments that do not specifically target older residents also assess fees that are used for schools, resident programs, or nature conservancy efforts in and around the community. However, in the event of a foreclosure by a lender or the transfer of title to another person, the new owner is then responsible for paying these fees. HUD can take ownership of the properties in these communities through the foreclosure process, which forces HUD to pay such fees, a situation that would violate FHA guidelines.

<u>Issue:</u> FHA guidelines with respect to community transfer fees have recently changed due to the passage of the *Housing Opportunity Through Modernization Act of 2016*. While the changes exempt condominiums in such situations, HUD has not yet provided guidance for single-family properties.

<u>Applicable Guidance:</u> "Legal restrictions on conveyance means any provision in any legal instrument, law or regulation applicable to the mortgagor or the mortgaged property, including but not limited to a lease, deed, sales contract, declaration of covenants, declaration of condominium, option, right of first refusal, will, or trust agreement, that attempts to cause a conveyance (including a lease) made by the mortgagor to: (v) Be subject to limits on the amount of sales proceeds retainable by the seller." (24 CFR § 203.41)

<u>Recommendation:</u> MBA recommends that HUD consider the adoption of the FHFA guidance associated with Private Transfer Fees for single-family residences (found in 12 CFR 1228), which allows endorsement/purchase of loans for properties with mandatory transfer fees as long as such fees provide a "direct benefit" to the property. Such guidance would be consistent with FHA's condominium guidance as mandated through the *Housing Opportunity Through Modernization Act of 2016*.

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MBA appreciates HUD's consideration of our comments. Should you have questions or wish to discuss these comments, please contact Julienne Joseph, Assistant Director of Government Programs, at jjoseph@mba.org or (202) 557-2782 and Andrea Oh, Policy Advisor, at aoh@mba.org or (202) 557-2922.

Sincerely,

Stephen A. O'Connor
Senior Vice President
Public Policy and Industry Relations

cc: Regulations Division, Office of the General Counsel