



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

WASHINGTON, DC 20410-1000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

Date: February 28, 2012
To: All Approved Mortgagees
Mortgagee Letter 2012-3

Subject Miscellaneous Underwriting Issues

Purpose The purpose of this Mortgagee Letter (ML) is to:

- Modify documentation requirements for self-employed borrowers,
- Provide new guidance on disputed accounts, and
- Expand the current definition of family members for identity of interest transactions.

Effective Date The effective date of the new guidance is stated in each section of the ML.

Affected Topics This ML affects topics found in HUD Handbook 4155.1 listed in the table below. Additionally, this ML affects the corresponding references to these requirements in Mortgagee Letter 05-15 TOTAL Mortgage Scorecard Update, relating to Tolerance Level and Documentation Relief, and the FHA TOTAL Mortgage Scorecard User Guide, Chapter 2, relating to Credit Issues and Disputed Accounts. HUD will integrate these changes into the relevant FHA Single Family On-Line Handbooks shortly.

HUD 4155.1, Mortgage Credit Analysis for Mortgage Insurance
2.B.2.a, Definition: Identity of Interest Transactions
2.B.2.b, Maximum LTV for Identity of Interest Transactions
4.D.4.f, TOTAL Scorecard Accept/Refer Requirements for Self-Employed Borrowers
4.C.2.e, Paying Off Collections and Judgments
9.1.f, Glossary of Handbook Terms, Definition of Family Member



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Mortgagee Letter 2012-3, Continued

Summary – Income Documentation Requirements for Self-Employed Borrowers – The new guidance in this section of the ML is effective for case numbers assigned on or after April 1, 2012, and will apply to all FHA insured loans except non-credit qualifying streamline refinance loans and Home Equity Conversion Mortgage loans.

Below is a matrix with old and new documentation requirements for self-employed borrowers.

REFERENCE AND DOCUMENT TYPE	IF FHA TOTAL MESSAGE IS	OLD GUIDANCE	NEW GUIDANCE
HUD 4155.1 4.D.4.f Year-to-Date Profit & Loss (P&L) and Balance Sheet	Accept	A P&L and Balance Sheet are not required <i>unless</i> income used to qualify the borrower exceeds the two-year average of the tax returns; then either an audited P&L statement or quarterly tax returns are required to support the greater income stream used to qualify.	P&L and Balance Sheet required if more than a calendar quarter has elapsed since date of most recent calendar or fiscal-year end tax return was filed by the borrower – with no exceptions. <i>Additionally, if income used to qualify the borrower exceeds the two year average of tax returns, an audited P&L or signed quarterly tax returns obtained from IRS are required.</i>
	Refer	A P&L and balance sheet, or income information directly from the IRS is required if both of the following conditions exist: <ul style="list-style-type: none"> more than seven months have elapsed since the business tax year's ending date, and income to the self-employed borrower from each individual business is greater than 5% of his/her stable monthly income. 	Same requirements as an "Accept".

When reviewing income documentation, lenders are still required to comply with requirements of HUD Handbook 4155.1 4.D.4.g, which states: To determine if the borrower's business is expected to generate sufficient income for his/her needs, the lender must carefully analyze the business financial strength, including the source of the business income and general economic outlook for similar businesses in the area.

Annual earnings that are stable or increasing are acceptable, while businesses that show a significant decline in income over the analysis period are not acceptable, even if the current income and debt ratios meet FHA guidelines.

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Mortgage Letter 2012-3, Continued

**Summary –
Handling of
Disputed
Accounts,
Public Records
FHA Total
User Guide
Chapter 2**

The new guidance in this section of the ML is effective for all case numbers assigned on or after July 1, 2012, and applies to all FHA insured loans except non-credit qualifying streamline refinances.

OLD GUIDANCE	NEW GUIDANCE
<p>If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a DE underwriter for review.</p>	<p>If the Automated Underwriting System using the TOTAL Mortgage Scorecard rates the mortgage loan application as an Accept, the mortgage application will no longer be referred to a DE underwriter for review due to disputed accounts, as long as these accounts meet both of the following conditions:</p> <ul style="list-style-type: none"> • The total outstanding balance of all disputed credit accounts or collections are less than \$1,000, and • Disputed credit accounts or collections are aged two years from date of last activity as indicated on the most recent credit report. <p>If the borrower has individual or multiple disputed credit accounts or collections with singular or cumulative balances equal to or greater than \$1,000, the accounts must be resolved (e.g. payment arrangements with a minimum three months of verified payments made as agreed) or paid in full, prior to, or at the time of closing. The lender must obtain documentation supporting the payment arrangements or that the debt has been paid off. The payments arranged for the accounts must be included in the calculation of the borrower’s debt-to-income ratios.</p> <p>Disputed credit accounts or collections resulting from identity theft, credit card theft, or unauthorized use, etc., will be excluded from the \$1,000 limit under the terms shown below. The mortgagee must provide in the case binder, a credit report or letter from the creditor, or other appropriate documentation, to support that the borrower filed an identity theft or police report to dispute the fraudulent charges. Mortgagees must provide documentation in the case binder to show all disputed or collection accounts are resolved, verified as not a debt to the borrower, arrangements made for payment, or paid in full.</p>

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Mortgage Letter 2012-3, Continued

Handling of Disputed Accounts/Public Records (continued)

<p>HUD 4155.1 4.C.2.e</p>	<p>FHA does <i>not</i> require that collection accounts be paid off as a condition of mortgage approval. However, court-ordered judgments <i>must</i> be paid off before the mortgage loan is eligible for FHA insurance endorsement.</p>	<p>If the total outstanding balance of all collection accounts is equal to or greater than \$1,000 the borrower must resolve the accounts (e.g. entered into payment arrangements with minimum three months verified payments- paid as agreed) or paid in full at the time of, or prior to closing. Mortgagees must document the case binder showing each account was resolved or paid in full.</p> <p>If the total outstanding balance of all collection accounts is less than \$1,000, the borrower is not required to pay off the collection accounts as a condition of mortgage approval.</p> <p>FHA continues to require judgments to be paid off before the mortgage loan is eligible for FHA insurance.*</p>
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*** Exception:** An exception to the payoff of a court-ordered judgment may be made if the borrower has an agreement with the creditor to make regular and timely payments, and provides documentation indicating that a minimum of three months payments have been made according to the agreement. The monthly payment must be included in the borrower’s debt-to-income ratio.

Examples of acceptable documentation to support the resolution of disputed accounts or the payoff of accounts would be a letter from the creditor outlining the terms of the payment arrangements, or verifying payoff of debt, cancelled check(s), or a supplement to the credit report verifying payoff or payment arrangements.

Note: *Paying “down” of balances on disputed accounts and collections to reduce the singular or cumulative balance to below \$1,000, is not an acceptable resolution of accounts.*

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Mortgage Letter 2012-3, Continued

Summary – Identity of Interest Transactions

The new guidance in this section of the ML is effective for all case numbers assigned on or after April 1, 2012, and applies to all FHA insured loans.

Old Guidance

For the purposes of Identity of Interest transactions, a family member is defined as a borrower's:

- child, parent, or grandparent
- spouse
- legally adopted son or daughter, including a child who is placed with the borrower by an authorized agency for legal adoption, and
- foster child.

Note: A child is defined as a son, stepson, daughter, or stepdaughter.

New Guidance

For the purpose of Identity of Interest transactions, the definition of family member includes:

- child, parent, or grandparent
- spouse
- legally adopted son or daughter, including a child who is placed with the borrower by an authorized agency for legal adoption
- foster child
- brother, stepbrother
- sister, stepsister
- uncle, and
- aunt

Note: A child is defined as a son, stepson, daughter, or stepdaughter. A parent or grandparent includes a step-parent/grandparent or foster parent/grandparent.

As stated in handbook HUD 4155.1 2.B.2.b, identity-of-interest transactions may result in a reduced maximum loan-to-value limitation.

Reference: For current definition of family members, see HUD 4155.1.9.1.f.

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Mortgagee Letter 2012-3, Continued

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Questions

If you have questions regarding this Mortgagee Letter, please call FHA's Resource Center at 1-800-CALLFHA (1-800-225-5342).

Persons with hearing or speech impairments may reach this number via TTY by calling the Federal Information Relay Service at 1-800-877-3339.

Signature

Carol J. Galante
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