



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

Date: March 13, 2012

To: All Approved Mortgagees

Mortgagee Letter 12 - 5

Subject FHA Refinance of Borrowers in Negative Equity Positions: Program Enhancements

Background On August 6, 2010, the Department of Housing and Urban Development (HUD) published Mortgagee Letter (ML) 2010-23 "FHA Refinance of Borrowers in Negative Equity Positions" which provided enhancements to the Federal Housing Administration (FHA) refinance program that allows responsible homeowners with negative equity an opportunity to refinance their homes. These enhancements were designed to maintain homeownership by providing borrowers with conventional loans, who owe more on their mortgage than the value of their home, opportunities to refinance into an affordable FHA loan. This opportunity allows only non-FHA insured loans to qualify for an FHA refinance loan provided that the lender or investor writes off the unpaid principal balance of the original first lien mortgage by at least 10 percent.

Purpose This ML amends ML 2010-23 and provides several enhancements to FHA's Refinance of Borrowers in Negative Equity Positions ("FHA Short Refinance"). These changes are effective for loans with case numbers issued on or after March 13, 2012, and which are closed on or before December 31, 2014. Aside from the program enhancements listed below, all other provisions of ML 2010-23 shall remain in effect.

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Program Enhancements - Summary

The program enhancements are:

- A Short Refinance Trial Payment Plan
 - First lien holders' option to extinguish 2nd lien debt
 - An increase of the allowable housing debt-to-income (DTI) ratio to 35% provided the back-end DTI ratio does not exceed 48%
 - An extension of the expiration date of the program to December 31, 2014.
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Program Enhancement No. 1 –Short Refinance Trial Payment Period

In addition to the mortgage statuses described in the section titled “Current Mortgage” of ML 2010-23, this ML allows borrowers who may have been delinquent on their existing loan, but who have successfully completed a trial payment plan that meets the following standards to be eligible for the program.

The trial payment plan must require a payment amount which is consistent with the amount the borrower would pay if they were to refinance the mortgage under the FHA Short Refinance. If the borrower can make three consecutive on-time monthly payments successfully, they are now eligible for a FHA Short Refinance loan.

- **Trial Payment Plan Success:** If the Mortgagor successfully makes three consecutive on-time monthly payments during the trial plan, the Mortgagor is eligible for a permanent loan under FHA's Short Refinance. The lender will then go through the standard origination process as per ML 2010-23.
 - **Trial Payment Plan Failure:** If the Mortgagor is not able to successfully make three consecutive on-time monthly payments during the trial plan, the Mortgagor remains ineligible for a FHA Short Refinance loan. These mortgage payments must not have been paid late. However, if the Mortgagor is able to successfully complete a new Trial Payment Plan, despite having been previously unsuccessful with such a plan, the borrower would be eligible to apply for a Short Refinance loan that is consistent with the terms of the successful Trial Payment Plan.
 - **Documentation of the Trial Payment Plan:** Lenders must document in the case binder the borrower's successful completion of the most recent Trial Payment Plan. Acceptable documentation includes, but is not limited to: servicing payment history reflecting the timely payments, Trial Payment Plan agreement, canceled checks, and/or bank statements reflecting electronic withdrawals for the payments.
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**Program
Enhancement
No. 1 –Short
Refinance
Trial Payment
Period
(continued)**

The monthly payment under the Trial Payment Plan must be calculated using the Short Refinance principal balance requirements, which include:

- A principal balance that is reduced a minimum of 10% and at a level that would make the loan-to-value (LTV) no greater than 97.75% and combined LTV no greater than 115%
- Amortized over 30 years at a current market rate for FHA fixed-rate loans

At the time the new FHA Short Refinance loan is originated, the new mortgage payment amount on the FHA Short Refinance Loan cannot increase by more than six percent over the trial payment amount on the existing loan.

**Program
Enhancement
No. 2 –First
Lien Holders’
Option to
Extinguish
Second Lien
Debt**

ML 2010-23, section “Calculating Mortgage,” states that “The new FHA mortgage may be used only to refinance the unpaid principal balance on the first lien, plus the interest charged by the servicing lender.”

This ML amends this provision to allow, at the discretion of the first lien holder, the new FHA mortgage to include the refinanced unpaid principal balance on the first lien after the required reduction of at least 10%, amounts used to pay down or pay off any existing second lien debt, plus the interest charged by the servicing lender, provided the new principal balance has a loan-to-value (LTV) no greater than 97.75% and combined LTV no greater than 115%. All other provisions regarding usage of the new FHA mortgage shall remain in effect.

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Program Enhancement No. 3 – Increase of the Allowable Housing Debt-to-Income Ratio to 35% provided the back-end DTI ratio does not exceed 48%

ML 2010-23, provides specific guidance for debt-to-income ratios for loans that receive a “refer” risk classification from TOTAL Mortgage Scorecard (TOTAL) and/or are manually underwritten. The homeowner’s total monthly mortgage payment, as defined above under Enhancement No. 1, cannot be greater than 31 percent of gross monthly income, and total debt, including all recurring debts, cannot be greater than 50 percent of gross monthly income.

This ML also allows loans that receive a “refer” risk classification from TOTAL Mortgage Scorecard (TOTAL) and/or are manually underwritten, to have a total monthly mortgage payment, including the first and any subordinate mortgage(s), of up to 35 percent of gross monthly income, provided the total debt, including all recurring debts, is not greater than 48 percent of gross monthly income.

Program Enhancement No. 4 – Extend the Expiration Date

This ML amends the initial program expiration date. The FHA Short Refinance will be available for an additional two years. All loans under the program must now close on or before December 31, 2014.

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Questions

If you have any questions regarding this Mortgagee Letter, please call the FHA 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
Acting Assistant Secretary for Housing-
Federal Housing Commissioner
