

Chapter 5. Borrower Funds to Close

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Section A. Settlement Requirements

Overview

In This Section This section contains the topics listed in the table below.

Topic	Topic Name	See Page
1	General Information on Settlement Requirements	5-A-2
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1. General Information on Settlement Requirements

Introduction This topic contains general information on settlement requirements, including

- lender responsibility for estimating settlement requirements, and
- determining the amount needed for closing.

Change Date May 10, 2009

**4155.1 5.A.1.a
Lender
Responsibility
for Estimating
Settlement
Requirements** For each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction.

In addition to the minimum down payment described in [HUD 4155.1 2.A.2.c](#), additional borrower expenses must be included in the total amount of cash that the borrower must provide at mortgage settlement. Such additional expenses include

- closing costs, such as those customary and reasonable costs necessary to close the mortgage loan
- prepaid items
- discount points
- non-realty or personal property
- up-front mortgage insurance premium (UFMIP) amounts
- repairs and improvements
- real estate broker fees
- mortgage broker fees
- premium pricing on the Federal Housing Administration (FHA) insured mortgages, and
- yield spread premiums.

Reference: For information on the expenses, see [HUD 4155.1 5.A.2](#).

**4155.1 5.A.1.b
Determining
the Amount
Needed for
Closing** The amount of cash needed by the borrower for closing a loan eligible for FHA mortgage insurance is the *difference* between

- the total cost to acquire the property, including the expenses listed in [HUD 4155.1 5.A.1.a](#), and
- the amount of the FHA-insured mortgage, excluding any UFMIP.

2. Settlement Requirements Needed to Close

Introduction This topic contains information on closing cost settlement requirements used for closing a mortgage transaction, including

- closing costs
 - types of prepaid items, including per diem interest
 - discount points
 - non-realty (chattel) or personal property
 - UFMIP amounts
 - repairs and improvements
 - real estate broker fees
 - mortgage broker fees
 - premium pricing on FHA-insured mortgages, and
 - yield spread premiums.
-

Change Date May 10, 2009

4155.1 5.A.2.a Closing Costs Lenders may charge and collect from borrowers those customary and reasonable costs necessary to close the mortgage loan.

Borrowers may not

- pay a tax service fee, and
 - be charged a loan origination fee greater than 1 percent, plus the supplemental origination fee for Section 203(k) mortgages.
-

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2. Settlement Requirements Needed to Close, Continued

-
- 4155.1 5.A.2.b** Prepaid items are collected at closing to cover
Types of
Prepaid Items
(Including Per
Diem Interest)
- accrued and unaccrued hazard insurance
 - mortgage insurance premiums
 - taxes
 - per diem interest, and
 - other similar fees and charges.

Per Diem Interest

The lender must use a minimum of 15 days of per diem interest when estimating prepaid items. To reduce the burden on borrowers whose loans were scheduled to close at the end of the month, but did not due to unforeseen circumstances, lenders and borrowers may agree to credit the per diem interest to the borrower and have the mortgage payments begin the first of the succeeding month.

- 4155.1 5.A.2.c** Discount points that are being paid by the borrower
Discount Points
- become part of the total cash required to close, and
 - are *not* eligible for meeting the minimum down payment requirement.
-

- 4155.1 5.A.2.d** Non realty (chattel) or personal property items that the borrower agrees to pay
Non Realty or
Personal
Property
- for separately, including the amount subtracted from the sales price when determining the maximum mortgage, are included in the total cash requirements for the loan.
-

- 4155.1 5.A.2.e** Any UFMIP amounts paid in cash are added to the total cash settlement
UFMIP
Amounts
- requirements. The UFMIP must be
- entirely financed into the mortgage, except any amount less than \$1.00, or
 - paid entirely in cash and all mortgage amounts rounded down to a multiple of \$1.00.
-

- 4155.1 5.A.2.f** Repairs and improvements, or any portion, paid by the borrower that cannot
Repairs and
Improvements
- be financed into the mortgage are part of the borrower's total cash requirements.
-

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2. Settlement Requirements Needed to Close, Continued

4155.1 5.A.2.g Real Estate Broker Fees

If a borrower is represented by a real estate buyer-broker and must pay any fee directly to the broker, that expense must

- be included in the total of the borrower's settlement requirements, and
- appear on the [HUD-1](#) Settlement Statement.

If the seller pays the buyer-broker fee as part of the sales commission, it is not considered an inducement to purchase, or part of the 6 percent seller contributions limitation, as long as the seller is paying only the normal sales commission for that market. Any additional seller-paid commission to the buyer-broker is considered an inducement to purchase.

To determine if the seller paid a buyer-broker fee in addition to the normal sales commission for the market, the lender must obtain a copy of the original listing agreement, and compare it with the [HUD-1](#) Settlement Statement.

References: For more information on

- seller contributions, see [HUD 4155.1 2.A.3](#), and
 - inducements to purchase, see [HUD 4155.1 2.A.4](#).
-

4155.1 5.A.2.h Mortgage Broker Fees

Include mortgage broker fees in the total of the borrower's cash settlement requirements and on the [HUD-1](#) Settlement Statement, if he/she pays a fee directly to a mortgage broker.

This requirement applies only in instances in which the borrower independently engages a mortgage broker exclusively to seek financing, and pays the broker directly. The mortgage broker cannot be the same as the originating lender.

Note: The payment may *not* come from the lending institution.

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2. Settlement Requirements Needed to Close, Continued

4155.1 5.A.2.i Premium Pricing on FHA-Insured Mortgages

Lenders may pay the borrower's closing costs, and/or prepaid items by "premium pricing." Closing costs paid in this manner do not need to be included as part of the 6 percent seller contribution limit. The funds derived from a premium priced mortgage

- may *never* be used to pay any portion of the borrower's down payment
- *must* be disclosed on the Good Faith Estimate (GFE) and the [HUD-1 Settlement Statement](#)
- *must* be used to reduce the principal balance if the premium pricing agreement establishes a specific dollar amount for closing cost and prepaid expenses, with any remaining funds in excess of actual costs reverting to the borrower, and
- may not be used for payment of
 - debts
 - collection accounts
 - escrow shortages or missed mortgage payments, or
 - judgments.

Note: The GFE and [HUD-1 Settlement Statement](#) must contain an itemized statement indicating which items are being paid on the borrower's behalf. It is unacceptable to disclose only a lump sum.

Reference: For more information on seller contributions, see [HUD 4155.1 2.A.3](#).

4155.1 5.A.2.j Yield Spread Premium

Yield spread premiums (YSP) are not part of the cash required to close, but *must* be disclosed to borrowers on the GFE and [HUD-1 Settlement Statement](#), in accordance with the Real Estate Settlement Procedures Act (RESPA).

Section B. Acceptable Sources of Borrower Funds

Overview

In This Section This section contains the topics listed in the table below.

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8	Employer Programs as Acceptable Sources of Funds	5-B-26

1. General Information on Acceptable Sources of Borrower Funds

Introduction This topic contains general information on acceptable sources of borrower funds that can be used for mortgage closing, including

- closing cost and minimum cash investment requirements, and
- types of acceptable sources of borrower funds.

Change Date May 10, 2009

4155.1 5.B.1.a Closing Cost and Minimum Cash Under most FHA programs, the borrower is required to make a minimum down payment into the transaction of at least 3.5 percent of the *lesser* of the appraised value of the property or the sales price.

Investment Requirements Additionally, the borrower must have sufficient funds to cover borrower-paid closing costs and fees at the time of settlement. Such funds used to cover the required minimum down payment, as well as closing costs and fees, must come from acceptable sources and must be verified and properly documented.

References: For more information on

- the required minimum down payment, see [HUD 4155.1 2.A.2.c](#)
- settlement requirements, see [HUD 4155.1 5.A](#), and
- acceptable sources of borrower funds, see [HUD 4155.1 5.B.1.b](#).

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1. General Information on Acceptable Sources of Borrower Funds, Continued

4155.1 5.B.1.b
Acceptable
Sources of
Borrower
Funds

The table below lists the acceptable sources of borrower funds and a reference for locating additional information on the various types of funds.

Acceptable Source of Funds	Reference
<ul style="list-style-type: none"> • Earnest money deposit • Savings and checking accounts • Cash saved at home • Cash Accumulated with private savings club 	See HUD 4155.1 5.B.2
<ul style="list-style-type: none"> • Savings bonds • IRAs • 401(k) and Keogh accounts • Stocks and Bonds • Thrift Savings Plans 	See HUD 4155.1 5.B.3
Gift Funds	See HUD 4155.1 5.B.4
<ul style="list-style-type: none"> • Sales proceeds • Sale of personal property • Commissions from sale • Trade Equity • Rent Credit • Sweat Equity 	See HUD 4155.1 5.B.6
<ul style="list-style-type: none"> • Collateralized loans • Disaster relief grants and loans 	See HUD 4155.1 5.B.7
<ul style="list-style-type: none"> • Employer’s Guarantee Plans • Employer Assistance Plans 	See HUD 4155.1 5.B.8

2. Cash and Savings/Checking Accounts as Acceptable Sources of Funds

Introduction This topic contains information on cash and savings/checking account funds as acceptable sources of borrower funds, including

- earnest money deposits
 - savings and checking accounts
 - cash saved at home
 - verifying cash saved at home
 - cash accumulated with private savings clubs, and
 - requirements for private savings clubs.
-

Change Date May 10, 2009

4155.1 5.B.2.a Earnest Money Deposit The lender must verify with documentation, the deposit amount and source of funds, 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.

Satisfactory documentation includes

- a copy of the borrower's cancelled check
- certification from the deposit-holder acknowledging receipt of funds, or
- separate evidence of the source of funds.

Separate evidence includes a verification of deposit (VOD) or bank statement showing that the average balance was sufficient to cover the amount of the earnest money deposit, at the time of the deposit.

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2. Cash and Savings/Checking Accounts as Acceptable Sources of Funds, Continued

4155.1 5.B.2.b Savings and Checking Accounts

A 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 recently opened, the lender must obtain from the borrower a credible explanation of the source of the funds.

TOTAL Scorecard Accept and Refer recommendations require that the lender

- obtain an explanation and documentation for recent large deposits in excess of 2 percent of the property sales price, and
- verify that any recent debts were not incurred to obtain part, or all, of the required cash investment on the property being purchased.

Reference: For additional information on TOTAL Scorecard, see [HUD 4155.1 6.A.1](#).

4155.1 5.B.2.c Cash Saved at Home

Borrowers who have saved cash at home, and are able to adequately demonstrate the ability to do so, are permitted to have this money included as an acceptable source of funds to close the mortgage.

To include cash saved at home when assessing the borrower's cash assets, the

- money must be verified, whether deposited in a financial institution, or held by the escrow/title company, and
- borrower must provide satisfactory evidence of the ability to accumulate such savings.

Reference: For information on verifying cash saved at home, see [HUD 4155.1 5.B.2.d](#).

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2. Cash and Savings/Checking Accounts as Acceptable Sources of Funds, Continued

4155.1 5.B.2.d Verifying Cash Saved at Home

Verifying the cash saved at home assets requires the borrower to explain in writing

- how the funds were accumulated, and
- the amount of time it took to accumulate the funds.

The lender must determine the reasonableness of the accumulation, based on the

- borrower's income stream
- time period during which the funds were saved
- borrower's spending habits, and
- documented expenses and the borrower's history of using financial institutions.

Note: Borrowers with checking and/or savings accounts are less likely to save money at home, than individuals with no history of such accounts.

4155.1 5.B.2.e Cash Accumulated With Private Savings Clubs

Some borrowers may choose to use non-traditional methods to save money by making deposits into private savings clubs. Often, these private savings clubs pool resources for use among the membership.

If a borrower claims that the cash to close an FHA-insured mortgage is from savings held with a private savings club, he/she *must* be able to adequately document the accumulation of the funds with the club.

Reference: For information on the requirements for private savings clubs, see [HUD 4155.1 5.B.2.f](#).

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2. Cash and Savings/Checking Accounts as Acceptable Sources of Funds, Continued

4155.1 5.B.2.f Requirements for Private Savings Clubs

While private savings 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.

The lender must reverify the information, and the underwriter must be able to determine that

- it was reasonable for the borrower to have saved the money claimed, and
 - there is no evidence that the funds were borrowed with an expectation of repayment.
-

3. Investments as an Acceptable Source of Funds

Introduction This topic includes information on investments as an acceptable source of funds, including

- IRAs, thrift savings plans, 401(k)s and Keogh accounts
 - stocks and bonds, and
 - savings bonds.
-

Change Date May 10, 2009

4155.1 5.B.3.a IRAs, Thrift Savings Plans, and 401(k)s and Keogh Accounts Up to 60 percent of the value of assets such as IRAs, thrift savings plans, 401(k) and Keogh accounts may be included in the underwriting analysis, unless the borrower provides conclusive evidence that a higher percentage may be withdrawn, after subtracting any

- Federal income tax, and
- withdrawal penalties.

Notes:

- Redemption evidence is required.
- The portion of the assets not used to meet closing requirements, after adjusting for taxes and penalties, may be counted as reserves.

TOTAL Scorecard Accept/Reject Recommendation

TOTAL Scorecard Accept or Reject recommendations require the lender to document the terms and conditions for withdrawal and/or borrowing, and that the borrower is eligible for these withdrawals.

Use only 60 percent of the amount in the account, unless the borrower presents documentation supporting a greater amount, after subtracting any taxes or penalties for early withdrawal.

Note: Liquidation evidence is not required.

Continued on next page

3. Investments as an Acceptable Source of Funds, Continued

**4155.1 5.B.3.b
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 stocks and bonds.

Total Scorecard Accept Recommendation

Evidence of liquidation is not required for the TOTAL Scorecard Accept recommendation.

Note: The actual receipt of funds must be verified and documented.

**4155.1 5.B.3.c
Savings Bonds**

Government issued bonds are counted at the original purchase price, unless eligibility for redemption and the redemption value are confirmed.

Note: The actual receipt of funds at redemption must be verified.

4. Gifts as an Acceptable Source of Funds

Introduction This topic contains information on using gift funds as acceptable sources of borrower funds, including

- a description of gift funds
 - who can provide a gift
 - who cannot provide a gift
 - lender responsibility for verifying the acceptability of gift fund sources
 - requirements regarding donor source of funds
 - equity credit
 - payment of consumer debt must result in a sales price reduction
 - using down payment assistance programs
 - gifts from charitable organizations when the organization loses or gives up its Federal tax-exempt status, and
 - lender responsibility for ensuring that entities are charitable organizations.
-

Change Date December 8, 2009

4155.1 5.B.4.a Description of Gift Funds In order for funds to be considered a gift there must be no expected or implied repayment of the funds to the donor by the borrower.

Note: The portion of the gift not used to meet closing requirements may be counted as reserves.

4155.1 5.B.4.b Who Can Provide a Gift An outright gift of the cash investment is acceptable if the donor is

- the borrower's relative
- a close friend with a clearly defined and documented interest in the borrower
- the borrower's employer or labor union
- a charitable organization
- a governmental agency or public entity that has a program providing home ownership assistance to
 - low- and moderate-income families, or
 - first-time homebuyers.

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4. Gifts as an Acceptable Source of Funds, Continued

4155.1 5.B.4.c Who Cannot Provide a Gift

The gift donor may *not* be a person or entity with an interest in the sale of the property, such as

- the seller
- the real estate agent or broker
- the builder, or
- an associated entity.

Gifts from these sources are considered inducements to purchase, and *must* be subtracted from the sales price.

Note: This applies to properties where the seller is a government agency selling foreclosed properties, such as the US Department of Veterans Affairs (VA) or Rural Housing Services.

4155.1 5.B.4.d Lender Responsibility for Verifying the Acceptability of Gift Fund Sources

Regardless of when gift funds are made available to a borrower, the lender *must* be able to determine that the gift funds were *not* provided by an unacceptable source, and were the donor's own funds.

When the transfer occurs at closing, the lender is responsible for verifying that the closing agent received the funds from the donor for the amount of the gift, and that the funds were from an acceptable source.

Reference: For the requirements regarding the documentation of this transfer at closing, see [HUD 4155.1 5.B.5.b](#).

4155.1 5.B.4.e Requirements Regarding Donor Source of Funds

As a general rule, FHA is not concerned with how a donor obtains gift funds, provided that the funds 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.

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4. Gifts as an Acceptable Source of Funds, Continued

4155.1 5.B.4.f Equity Credit

Only family members may provide equity credit as a gift on property being sold to other family members.

The restrictions on gifts previously discussed in this topic and the restriction on equity credit may be waived by the jurisdictional Homeownership Center (HOC), provided that the seller is contributing to or operating an acceptable affordable housing program.

4155.1 5.B.4.g Payment of Consumer Debt Must Result in Sales Price Reduction

FHA regards the payment of consumer debt by third parties to be an inducement to purchase.

While FHA permits sellers and other parties to make contributions of up to 6 percent of the sales price of a property toward a buyer's actual closing costs and financing concessions, this requirement applies *exclusively* to the mortgage financing provision.

When someone other than a family member has paid off debts or other expenses on behalf of the borrower

- the funds must be treated as an inducement to purchase, and
- there *must* be a dollar for dollar reduction to the sales price when calculating the maximum insurable mortgage.

Note: The dollar for dollar reduction to the sales price also applies to gift funds not meeting the requirement

- that the gift be for down payment assistance, and
 - that it be provided by an acceptable source.
-

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4. Gifts as an Acceptable Source of Funds, Continued

4155.1 5.B.4.h Using Down Payment Assistance Programs

FHA does not “approve” down payment assistance programs providing gifts administered by charitable organizations, such as nonprofits. FHA also does *not* allow nonprofit entities to provide gifts to pay off

- installment loans
- credit cards
- collections
- judgments, and
- similar debts.

Lenders *must* ensure that a gift provided by a charitable organization meets the appropriate FHA requirements, and that the transfer of funds is properly documented.

4155.1 5.B.4.i Gifts from Charitable Organizations That Lose or Give Up Their Federal Tax- Exempt Status

If a charitable organization makes a gift that is to be used for all, or part, of a borrower’s down payment, and the organization providing the gift loses or gives up its Federal tax exempt status, FHA will recognize the gift as an acceptable source of the down payment provided that

- the gift is made to the borrower
 - the gift is properly documented, and
 - the borrower has entered into a contract of sale (including any amendments to purchase price) *on, or before*, the date the IRS officially announces that the charitable organization’s tax exempt status is terminated.
-

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4. Gifts as an Acceptable Source of Funds, Continued

**4155.1 5.B.4.j
Lender
Responsibility
for Ensuring
That an Entity
Is a Charitable
Organization**

The lender is responsible for ensuring that an entity is a charitable organization as defined by Section 501(a) of the Internal Revenue Code (IRC) of 1986 pursuant to Section 501(c) (3) of the IRC.

One resource available to lenders for obtaining this information is the Internal Revenue Service (IRS) Publication 78, *Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986*, which contains a list of organizations eligible to receive tax-deductible charitable contributions.

The IRS has an online version of this list that can help lenders and others conduct a search of these organizations. The online version can be found at <http://apps.irs.gov/app/pub78> using the following instructions to obtain the latest update:

- enter search data and click “Search”
- click “Search for Charities” under the “Charities & Non-Profits Topics” heading on the left-hand side of the page
- click “Recent Revocations and Deletions from Cumulative List” under the “Additional Information” heading in the middle of the page, and
- click the name of the organization if the name appears on the list displayed.

In addition, FHA has developed a web page that provides a listing of down payment assistance providers whose nonprofit status has been revoked. This page can be found at <http://www.hud.gov/offices/hsg/sfh/np/irstatus.cfm>.

5. Gift Fund Required Documentation

Introduction This topic contains information on the required documentation for gift funds, including

- the requirement for a gift letter, and
- documenting the transfer of gift funds.

Change Date May 10, 2009

**4155.1 5.B.5.a
Gift Letter
Requirement** A lender must document any borrower gift funds through a gift letter, signed by the donor and borrower. The gift letter must

- show the donor's name, address, telephone number
- specify the dollar amount of the gift, and
- state
 - the nature of the donor's relationship to the borrower, and
 - that no repayment is required.

TOTAL Scorecard Accept/Refer Recommendation

For the TOTAL Scorecard Accept and Refer recommendation, the borrower must list the following:

- name, address, telephone number
- relationship to the home buyer, and
- the dollar amount of the gift on the loan application or in a gift letter for each cash gift received.

If sufficient funds required for closing are not already verified in the borrower's accounts, document the transfer of the gift funds to the borrower's accounts, in accordance with the instructions described in [HUD 4155.1 5.B.5.b](#).

Reference: For additional information on the TOTAL Scorecard, see [HUD 4155.1 6.A.1](#).

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5. Gift Fund Required Documentation, Continued

4155.1 5.B.5.b Documenting the Transfer of Gift Funds The lender must document the transfer of the gift funds from the donor to the borrower.

The table below describes the requirements for the transfer of gift funds.

If the gift funds ...	Then ...
are in the borrower's account	obtain <ul style="list-style-type: none"> • a copy of the withdrawal document showing that the withdrawal is from the donor's account, and • the borrower's deposit slip and bank statement showing the deposit.
<ul style="list-style-type: none"> • are to be provided at closing, and • are in the form of a certified check from the donor's account 	obtain a <ul style="list-style-type: none"> • bank statement showing the withdrawal from the donor's account, and • copy of the certified check.
<ul style="list-style-type: none"> • are to be provided at closing, and • are in the form of a cashier's check, money order, official check, or other type of bank check 	have the donor provide a withdrawal document or cancelled check for the amount of the gift, showing that the funds came from the donor's personal account.
<ul style="list-style-type: none"> • are to be provided at closing, and • are in the form of an electronic wire transfer to the closing agent 	have the donor provide documentation of the wire transfer. <p>Note: The lender must obtain and keep the documentation of the wire transfer in its mortgage loan application binder. While the document does not need to be provided in the insurance binder, it must be available for inspection by FHA's Quality Assurance Division (QAD) when that office conducts its onsite review of lenders.</p>

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5. Gift Fund Required Documentation, Continued

Documenting the Transfer of Gift Funds (continued)

If the gift funds ...	Then ...
<ul style="list-style-type: none"> • are being borrowed by the donor, and • documentation from the bank or other savings account is <i>not</i> available 	<p>have the donor provide written evidence that the funds were borrowed from an acceptable source, not from a party to the transaction, including the lender.</p> <p><i>IMPORTANT:</i> <i>Cash on hand</i> is not an acceptable source of donor gift funds.</p>

6. Property Related Acceptable Sources of Funds

Introduction This topic contains information on savings, investment, and agency program funds as acceptable sources of borrower funds, including

- types of personal property
 - sale of personal property documentation requirement
 - sales proceeds
 - commission from sale
 - trade equity
 - rent credit
 - sweat equity considered a cash equivalent, and
 - additional sweat equity requirements.
-

Change Date May 10, 2009

**4155.1 5.B.6.a
Types of
Personal
Property** In order to obtain cash for closing, a borrower may sell various personal property items. The types of personal property items that a borrower can sell include

- cars
 - recreational vehicles
 - stamps
 - coins, and
 - baseball card collections.
-

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6. Property Related Acceptable Sources of Funds, Continued

4155.1 5.B.6.b Sale of Personal Property Documentation Requirement

If a borrower plans to sell personal property items to obtain funds for closing, he/she must provide

- satisfactory estimate of the worth of the personal property items, and
- evidence that the items were sold.

The estimated worth of the items being sold may be in the form of

- published value estimates issued by organizations, such as
 - automobile dealers, or
 - 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 the estimated value or actual sales prices are considered as assets to close.

4155.1 5.B.6.c Net Sales Proceeds From a Property

The net proceeds from an arms-length sale of a currently owned property may be used for the cash investment on a new house. The borrower must provide a fully executed [HUD-1](#) Settlement Statement as satisfactory evidence of the accrued cash sales proceeds.

If the property has not sold by the time of underwriting, condition loan approval by verifying the actual proceeds received by the borrower. The lender must document the

- actual sale, and
- sufficiency of the net proceeds required for settlement.

Note: If the property has not sold by the time of the subject settlement, the existing mortgage must be included as a liability for qualifying purposes.

Continued on next page

6. Property Related Acceptable Sources of Funds, Continued

4155.1 5.B.6.d Commission From the Sale of the Property

If the borrower is a licensed real estate agent entitled to a real estate commission from the sale of the property being purchased, then he/she may use that amount for the cash investment, with no adjustment to the maximum mortgage required.

A family member entitled to the commission may also provide gift funds to the borrower.

Reference: For information on gift fund requirements, see [HUD 4155.1 5.B.4](#).

4155.1 5.B.6.e Trade Equity

The borrower may agree to trade his/her real property to the seller as part of the cash investment. The amount of the borrower's equity contribution is determined by

- using the *lesser* of the property's appraised value or sales price, and
- subtracting all liens against the property being traded, along with any real estate commission.

In order to establish the property value, the borrower must provide

- a residential appraisal no more than six months old to determine the property's value, and
- evidence of ownership.

Note: If the property being traded has an FHA-insured mortgage, assumption processing requirements and restrictions apply.

Reference: For more information on assumptions, see [HUD 4155.1 7](#).

Continued on next page

6. Property Related Acceptable Sources of Funds, Continued

4155.1 5.B.6.f Rent Credit

The cumulative amount of rental payments that exceed the appraiser's estimate of fair market rent may be considered accumulation of the borrower's cash investment.

The following *must* be included in the endorsement package:

- rent with option to purchase agreement, and
- appraiser's estimate of market rent.

Conversely, treat the rent as an inducement to purchase with an appropriate reduction to the mortgage, *if* the sales agreement reveals that the borrower

- has been living in the property rent-free, or
- has an agreement to occupy the property as a rental considerably below fair market value in anticipation of eventual purchase.

Exception: An exception may be granted when a builder

- fails to deliver a property at an agreed to time, and
 - permits the borrower to occupy an existing or other unit for less than market rent until construction is complete.
-

4155.1 5.B.6.g Sweat Equity Considered a Cash Equivalent

Labor performed, or materials furnished by the borrower before closing on the property being purchased (known as "sweat equity"), may be considered the equivalent of a cash investment, to the amount of the estimated cost of the work or materials.

Note: Sweat equity may also be "gifted," subject to

- the additional requirements in [HUD 4155.1 5.B.6.h](#), and
 - the gift fund requirements described in [HUD 4155.1 5.B.4](#).
-

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6. Property Related Acceptable Sources of Funds, Continued

4155.1 5.B.6.h Additional Sweat Equity Requirements

The table below describes additional requirements for applying sweat equity as a cash equivalent and as an acceptable source of borrower funds.

Sweat Equity Category	Requirement
Existing Construction	<p>Only repairs or improvements listed on the appraisal are eligible for sweat equity.</p> <p>Any work completed or materials provided before the appraisal are <i>not</i> eligible.</p>
Proposed Construction	The sales contract must indicate the tasks to be performed by the borrower during construction.
Borrower's Labor	<p>The borrower must demonstrate his/her ability to complete the work in a satisfactory manner.</p> <p>The lender must document the contributory value of the labor either through</p> <ul style="list-style-type: none"> • the appraiser's estimate, or • a cost-estimating service.
Delayed Work	<p>The following <i>cannot</i> be included as sweat equity:</p> <ul style="list-style-type: none"> • delayed work (on-site escrow) • clean up • debris removal, and • other general maintenance.

Continued on next page

6. Property Related Acceptable Sources of Funds, Continued

Additional Sweat Equity Requirements (continued)

Sweat Equity Category	Requirement
Cash Back	Cash back to the borrower in sweat equity transactions is <i>not</i> permitted.
Sweat Equity on Property Not Being Purchased	<p>Sweat equity is <i>not</i> acceptable on property other than the property being purchased.</p> <p>Compensation for work performed on other properties must be</p> <ul style="list-style-type: none"> • in cash, and • properly documented.
Source of Funds Evidence	<p>Evidence of the following must be provided if the borrower furnishes funds and materials:</p> <ul style="list-style-type: none"> • source of the funds, and • market value of the materials.

7. Loans and Grants as Acceptable Sources of Funds

Introduction This topic contains information on loans and grants as acceptable sources of funds, including

- collateralized loans
 - who can provide collateralized loans, and
 - disaster relief grants and loans.
-

Change Date May 10, 2009

**4155.1 5.B.7.a
Collateralized
Loans**

Funds may 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. These assets may include stocks, bonds, and real estate other than the property being purchased.

Certain types of loans secured against deposited funds, where repayment may be obtained through extinguishing the asset, do not require consideration of a repayment for qualifying purposes. The asset securing the loan may *not* be included as assets to close, or otherwise considered as available to the borrower. The types of deposited funds that can secure the loan include

- signature loans
 - the cash value of life insurance policies, or
 - loans secured by 401(k) accounts.
-

Continued on next page

7. Loans and Grants as Acceptable Sources of Funds, Continued

4155.1 5.B.7.b Who Can Provide Collateralized Loans

An independent third party must provide the borrowed funds for collateralized loans.

The seller, real estate agent or broker, lender, or other interested party *may not* provide such funds.

Unacceptable borrowed funds include

- unsecured signature loans
- cash advances on credit cards
- borrowing against household goods and furniture, and
- other similar unsecured financing.

4155.1 5.B.7.c Disaster Relief Grants and Loans

Grants or loans from state and Federal agencies, such as the Federal Emergency Management Agency (FEMA), that provide immediate housing assistance to individuals displaced due to a natural disaster, may be used for the borrower's cash investment.

Secured or unsecured disaster relief loans administered by the Small Business Association (SBA) may also be used. If the SBA loan will be secured against the property being purchased, it must be clearly subordinate to the FHA-insured mortgage.

Note: Any monthly payment arising from this type of loan *must* be included in the qualifying ratios.

8. Employer Programs as Acceptable Sources of Funds

Introduction This topic contains information on employer programs that are acceptable sources of borrower funds, including

- employer's guarantee plans, and
 - employer assistance plans.
-

Change Date May 10, 2009

**4155.1 5.B.8.a
Employer's
Guarantee
Plans** If the borrower's employer guarantees to purchase the borrower's previous residence as a result of relocation, he/she must submit evidence of the agreement.

The net proceeds must also be guaranteed.

**4155.1 5.B.8.b
Employer
Assistance
Plans** If the employer pays the following to attract or retain valuable employees, the payment is considered employee compensation:

- employee's closing costs
- mortgage insurance premiums, or
- any portion of the cash investment.

An adjustment to the maximum mortgage amount is *not* required.

If the employer provides this benefit after loan settlement, the borrower must provide evidence of sufficient cash for closing.

Note: A salary advance *cannot* be considered as assets to close, since it represents an unsecured loan.

Section C. Borrower Secondary Financing

Overview

In This Section This section contains the topics listed in the table below.

Topic	Topic Name	See Page
1	General Information on Secondary Financing	5-C-2
2	Permissible Borrower Secondary Financing	5-C-3
3	Government Agency Secondary Financing	5-C-5
4	Nonprofit Agency Secondary Financing	5-C-7
5	Organizations and Private Individuals Providing Secondary Financing	5-C-9
6	Family Member Secondary Financing	5-C-11
7	Secondary Financing for Borrowers 60 Years of Age and Older	5-C-15

1. General Information on Secondary Financing

Introduction This topic contains general information on secondary financing, including

- what is secondary financing
 - secondary financing documentation requirements, and
 - permissible secondary financing arrangements.
-

Change Date May 10, 2009

4155.1 5.C.1.a
What Is
Secondary
Financing?

Any financing, other than an FHA-insured first mortgage, that creates a lien against the property is considered secondary financing. Such financing is *not* considered a gift, even if it is a “soft” or “silent” second or has other features forgiving the debt.

Note: A “soft” or “silent” second is secondary financing that has no monthly repayment provisions.

4155.1 5.C.1.b
Secondary
Financing
Documentation
Requirements

The lender must obtain from the provider of any secondary financing

- documentation showing the amount of funds provided to the borrower for each transaction, and
- copies of the loan instruments for the endorsement binder.

Notes:

- FHA reserves the right to reject any secondary financing
 - that does not serve the needs of the intended borrower, or
 - where the costs to participants outweighs the benefits derived by the borrower.
 - Costs incurred for participating in a down payment assistance secondary financing program may only be included in the amount of the second lien.
-

2. Permissible Borrower Secondary Financing

Introduction This topic contains information on permissible borrower secondary financing, including

- secondary financing from
 - government agencies
 - nonprofit organizations
 - private individuals or other organizations, and
 - family members, and
 - the FHA policy on borrowing when the borrower is 60 years of age and older.
-

Change Date May 10, 2009

**4155.1 5.C.2.a
Financing
From
Government
Agencies**

FHA will insure a first mortgage loan on a property that has a second mortgage or lien by a Federal, State, or local government agency.

The monthly payments under the insured mortgage and second lien, plus housing expense and other recurring charges, cannot exceed the borrowers' ability to pay.

Reference: For more information on secondary financing by government agencies, see [HUD 4155.1 5.C.3](#).

**4155.1 5.C.2.b
Financing
From Nonprofit
Organizations**

With advance approval, FHA will insure a first mortgage loan on a property that has a second mortgage held by an approved nonprofit agency.

The monthly payments under the insured mortgage and second lien, plus housing expense and other recurring charges, cannot exceed the borrowers' ability to pay.

Reference: For more information on secondary financing by nonprofit organizations, see [HUD 4155.1 5.C.4](#).

Continued on next page

2. Permissible Borrower Secondary Financing, Continued

4155.1 5.C.2.c Financing From Private Individuals or Other Organizations

With advance approval, FHA will insure a first mortgage loan on a property that has a second mortgage or lien held by an individual or company, provided that

- the secondary financing is disclosed at the time of application
- the required minimum cash investment is *not* financed
- the first and second mortgage together do *not* exceed FHA mortgage limits
- the borrower can afford the total amount of the payments
- any periodic payments are level and monthly
- there is no balloon payment during the first ten years, and
- there is no prepayment penalty.

Reference: For more information on secondary financing by private individuals or other organizations, see [HUD 4155.1 5.C.5](#).

4155.1 5.C.2.d Financing From Family Members

FHA permits family member lending on a secured or unsecured basis, up to 100 percent of the borrower's required funds to close. This lending may include the down payment, 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.

Reference: For more information on secondary financing by family members, see [HUD 4155.1 5.C.6](#).

4155.1 5.C.2.e Borrowing Policy for Borrowers 60 Years of Age and Older

With advance approval, borrowers 60 years of age and older may borrow the required funds to close for purchasing a principal residence under certain circumstances.

Reference: For more information on secondary financing for borrowers 60 years of age and older, see [HUD 4155.1 5.C.7](#).

3. Government Agency Secondary Financing

Introduction This topic contains information on using government agencies for secondary financing, including

- government agencies that can provide secondary financing
 - who can hold a secondary lien, and
 - policies for loans secured by secondary liens.
-

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**4155.1 5.C.3.a
Government
Agencies That
Can Provide
Secondary
Financing**

Federal, state, local government, and nonprofit agencies considered instrumentalities of government may provide secondary financing for the borrower's entire amount of required funds to close.

Reference: For information on acceptable government instrumentalities, see [HUD 4155.1 4.A.6.](#)

**4155.1 5.C.3.b
Who Can Hold
a Secondary
Lien**

When secondary financing is provided by a government agency, the secondary lien must be made or held by the eligible government body or instrumentality. Government units *cannot* use agents including nonprofit or for-profit enterprises to make the second lien, regardless of the source of funds. They can, however, be used to service the subordinate lien if regularly scheduled payments are made by the borrower.

Example: Even if funds used for secondary financing funds are from an acceptable source, such as HUD HOME, a government unit, or an eligible nonprofit instrumentality, the subordinate lien *must* be in the name of the eligible entity, such as the

- state
 - county
 - city, or
 - eligible nonprofit instrumentality.
-

Continued on next page

3. Government Agency Secondary Financing, Continued

4155.1 5.C.3.c
Policies for
Loans Secured
by Secondary
Liens

Listed below are the policies for loans secured by secondary liens.

Financing Terms and Conditions

- The FHA-insured first mortgage, when combined with any second mortgage or other junior lien from government agencies and nonprofit agencies considered instrumentalities of government, may *not* result in cash back to the borrower.
- The FHA-insured first mortgage *cannot* exceed the FHA statutory limit for the area where the property is located. However, the combined indebtedness of the mortgages *may* exceed the FHA statutory limit.
- The sum of all liens cannot exceed 100 percent of the cost to acquire the property. (*Note:* The cost to acquire the property is the sales price plus borrower-paid closing costs, discount points, repairs and rehabilitation expenses and prepaid expenses.)
- The cost to acquire may exceed the appraised value of the property under these types of government assistance programs.

Required Monthly Payments

The required monthly payments, under both the FHA-insured first mortgage and the second mortgage or lien, plus other housing expenses and all recurring charges, *cannot* exceed the borrower's reasonable ability to pay.

Mortgage Application Disclosures

The source, amount, and repayment terms must be disclosed in the mortgage application, and the borrower must acknowledge that he/she understands and agrees to the terms.

4. Nonprofit Agency Secondary Financing

Introduction This topic contains information on using nonprofit agencies for secondary financing, including

- secondary financing by a nonprofit agency considered an instrumentality of the government
- FHA requirement for government unit that established the non-profit agency
- HOC responsibilities for nonprofit agency approval, and
- secondary financing by an agency not considered an instrumentality of the government.

Change Date May 10, 2009

**4155.1 5.C.4.a
Secondary
Financing by a
Nonprofit
Agency
Considered an
Instrumentality
of the
Government** Nonprofit agencies may provide secondary financing under the terms outlined in [HUD 4155.1 5.C.2.b](#) provided that they

- meet the criteria described in [HUD 4155.1 4.A.6](#), and
- are considered instrumentalities of the government.

Note: To be considered an instrumentality of the government, the nonprofit entity must be “established by a governmental body or with governmental approval or under special law to serve a particular public purpose or designated by law (statute or court opinion).”

**4155.1 5.C.4.b
FHA
Requirement
for
Government
Unit That
Established the
Nonprofit
Entity** FHA requires that the unit of government that established the nonprofit must exercise either organizational control, operational control, or financial control of

- the nonprofit agency in its entirety, or
- at a minimum, the specific borrower assistance program that is using FHA’s credit enhancement.

Continued on next page

4. Nonprofit Agency Secondary Financing, Continued

4155.1 5.C.4.c HOC Responsibilities for Nonprofit Agency Approval

The appropriate HOC is responsible, based on information submitted by the nonprofit, for

- approving the nonprofit agency
- determining if the agency can be considered an instrumentality of government, and
- reviewing applications from nonprofits that purport to be instrumentalities of government.

Note: The HOC is also responsible for approving nonprofit agencies that are *not* considered instrumentalities of government.

References: For information on

- approval of nonprofit agencies that are *not* instrumentalities of government, see [HUD 4155.1 5.C.4.d](#), and
 - acceptable nonprofit government instrumentalities, see [HUD 4155.1 4.A.6](#).
-

4155.1 5.C.4.d Secondary Financing by a Nonprofit Agency Not Considered an Instrumentality of the Government

Nonprofit agencies that are *not* considered instrumentalities of government may provide secondary financing under the same conditions described in [HUD 4155.1 5.C.2.b](#) provided that

- the agency meets the conditions described in [HUD 4155.1 4.A.6](#)
- the borrower makes a down payment of at least 3.5 percent of the lesser of the appraised value or the sales price of the property
- the combined amount of the first and second mortgages does not exceed the statutory loan limit for the area where the property is located, and
- the FHA-insured first mortgage, when combined with any second mortgage or junior lien from the nonprofit agency, may not result in cash back to the borrower.

Note: The jurisdictional HOC is responsible for approving these agencies.

5. Organizations and Private Individuals Providing Secondary Financing

Introduction This topic contains information on the conditions for secondary financing from organizations and private individuals, including the

- applicable LTV ratio and mortgage limit
 - repayment terms for secondary mortgages, and
 - required monthly payment for secondary loans.
-

Change Date May 10, 2009

**4155.1 5.C.5.a
Applicable
LTV Ratio and
Mortgage
Limits** Other organizations or individuals may provide secondary financing when the combined amount of the first and second mortgages *do not* exceed the

- applicable LTV ratio, and
 - maximum mortgage limit for the area.
-

**4155.1 5.C.5.b
Repayment
Terms for
Secondary
Mortgages** Repayment terms for the second mortgage when borrowing from other organizations or private individuals must

- *not* include a balloon payment before ten years (or other such term acceptable to FHA), unless the property is sold or refinanced, and
 - permit repayment by the borrower, without penalty, after giving the lender 30 days advance notice.
-

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5. Organizations and Private Individuals Providing Secondary Financing, Continued

4155.1 5.C.5.c
Required
Monthly
Payment for
Secondary
Loans

The required monthly payment, under both the FHA-insured first 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 must be calculated as an equal monthly payment.

6. Family Member Secondary Financing

Introduction This topic contains information on secondary financing provided by a family member, including

- the definition of the term ‘family member’
 - how a family member can help with a property purchase
 - the amount permitted on a family member loan
 - restriction on a borrower being a co-obligor on the Note securing a borrowed down payment, and
 - additional policies regarding financing terms and conditions.
-

Change Date May 10, 2009

4155.1 5.C.6.a For a definition of the term *family member*, see [HUD 4155.1 9](#).
Definition:
Family
Member

Continued on next page

6. Family Member Secondary Financing, Continued

4155.1 5.C.6.b How a Family Member Can Help With Property Purchase

Family members may assist with the costs of acquiring a new home in the form of a loan.

Only the family member provider(s) may be the Note holder if the money lent is secured against the subject property.

FHA will *not* approve any form of securitization of the Note that results in any entity other than the family member being the noteholder, whether at loan settlement, or any time during the mortgage life cycle.

4155.1 5.C.6.c Amount Permitted on a Family Member Loan

FHA permits a family member to lend, on a secured or unsecured basis, a maximum of 100 percent of the borrower's required funds to close, including

- down payment
 - closing costs
 - prepaid expenses, and
 - discount points.
-

4155.1 5.C.6.d Restriction on a Borrower Being a Co-Obligor on the Note Securing a Borrowed Down Payment

When the funds loaned by the family member are borrowed from an acceptable source, the borrower may *not* be a co-obligor on the Note.

Example: A son or daughter in law may not be co-obligors on the Note used to secure the money borrowed by the parents that, in turn, was loaned to the borrower for the down payment on the property.

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6. Family Member Secondary Financing, Continued

4155.1 5.C.6.e The table below describes additional policies regarding the various financing terms and conditions for loans secured with family member secondary financing.

Additional Policies Regarding Financing Terms and Conditions

Financing Category	Policy Description
Maximum insurable mortgage	The maximum insurable mortgage amount is <i>not</i> affected by loans from family members.
Combined financing amount	<p>The combined amount of financing may not exceed 100 percent of</p> <ul style="list-style-type: none"> • the <i>lesser</i> of the property’s <ul style="list-style-type: none"> – appraised value, or – sales price, plus • the normal closing costs, prepaid expenses, and discount points.
Borrower cash back	While a family member may lend 100 percent of the borrower funds to close requirement, cash back to the borrower at closing (beyond the refund of any earnest money deposit) is <i>not</i> permitted.
Secondary financing payments	<p>If periodic payments of the secondary financing are required, the combined payments may not exceed the borrower’s reasonable ability to pay.</p> <p>Note: The secondary financing payments must be included in the total debt to income ratio (that is, the “back end” ratio) for qualifying purposes.</p>
Second lien balloon payments	The second lien may <i>not</i> provide for a balloon payment within five years from the date of execution.

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6. Family Member Secondary Financing, Continued

4155.1 5.C.6.e Additional Polices Regarding Financing Terms and Conditions (continued)

Financing Category	Policy Description
Family member supplying borrowed funds	<p>If the family member providing the secondary financing borrows the funds, the lending source may <i>not</i> be an entity with an identity-of-interest in the sale of the property, such as</p> <ul style="list-style-type: none"> • the seller • a builder • the loan officer, or • the real estate agent. <p>Mortgage companies that have retail banking affiliates may have that entity loan the funds to the family member. However, the terms and conditions for the loan that will be used for the secondary mortgage cannot be more favorable than it would be for other borrowers.</p> <p>Example: There may <i>not</i> be any special consideration given between</p> <ul style="list-style-type: none"> • the making of the mortgage, and • the lending of funds to family members to be used for secondary financing for the purchase of the home.
Secondary financing document retention	<p>An executed copy of the document describing the terms of the secondary financing must be maintained in the lender's file. An executed copy must also be provided in the endorsement binder.</p>

7. Secondary Financing for Borrowers 60 Years of Age and Older

Introduction	<p>This topic contains information on secondary financing for borrowers 60 years of age and older, including</p> <ul style="list-style-type: none">• the circumstances in which an older borrower may borrow the cash investment, and• the Note interest rate for older borrowers.
Change Date	<p>May 10, 2009</p>
4155.1 5.C.7.a Circumstances in Which an Older Borrower May Borrow the Cash Investment	<p>Borrowers 60 years of age or older may borrow the required funds to close to purchase a principal residence when</p> <ul style="list-style-type: none">• the provider of secondary financing is<ul style="list-style-type: none">– a relative– a close friend with a clearly defined interest in the borrower– the borrower’s employer, or– an institution established for humanitarian or welfare purposes• the provider of the secondary financing may not have an identity-of-interest in the sale of the property, such as with<ul style="list-style-type: none">– a builder or seller, or– any person/organization associated with the builder or seller, and• the principal amount of the insured mortgage loan, plus the Note or other evidence of indebtedness in connection with the property, does <i>not</i> exceed 100 percent of the value, plus prepaid expenses.
4155.1 5.C.7.b Note Interest Rate for Older Borrowers	<p>The Note or other evidence of indebtedness may not bear an interest rate exceeding the interest rate of the insured mortgage.</p>
