



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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

July 9, 2013

Mortgagee Letter 2013-23

To All FHA-Approved Mortgagees Servicing Single Family Mortgages

Subject Updated Pre-Foreclosure Sale (PFS) and Deed in Lieu (DIL) of Foreclosure Requirements

Purpose This Mortgagee Letter establishes updated Federal Housing Administration (FHA) Pre-Foreclosure Sale (PFS) and Deed in Lieu (DIL) of foreclosure requirements. Specifically, this Mortgagee Letter describes:

- Documentation requirements for verifying assets, income, and expenses;
- Use of the Deficit Income Test (DIT);
- The elimination of the financial hardship/deficit income PFS requirement for a servicemember who has received Permanent Change of Station (PCS) Orders; and
- Validation requirements for appraisals.

Effective Date Mortgagees must implement the requirements in this Mortgagee Letter for approved PFS transactions no later than October 1, 2013.

Affected Policy The policies set forth in this Mortgagee Letter supersede, where in conflict, Mortgagee Letters 2008-43, 2002-13, and 2000-05. All other requirements of Mortgagee Letters 2008-43, 2002-13, and 2000-05 remain in effect.

Deficit Income Test Documentation Requirement for Standard PFS Transactions The priority order of FHA's Loss Mitigation non-home retention options requires that a mortgagor in default or at imminent risk of default be evaluated for a PFS transaction before being evaluated for a DIL transaction. Therefore, the mortgagee must determine a mortgagor's eligibility for a PFS or DIL.

For a standard PFS¹, a mortgagee must determine whether a mortgagor is experiencing a hardship by using a Deficit Income Test (DIT), which is calculated by subtracting total monthly expenses from total monthly net income. The DIT is used to determine if a mortgagor can sustain his/her

¹ A standard PFS is a PFS transaction that does not meet the requirements of one of the two types of Streamlined PFS stipulated in this Mortgagee Letter and is only available to owner-occupants.

mortgage or if a mortgagor is experiencing a hardship that may qualify the mortgagor for a standard PFS. A DIT yielding a negative amount would indicate that the mortgagor's expenses exceed his/her income each month and, thus a PFS may be an appropriate loss mitigation tool for the mortgagor if a loss mitigation home retention option is not viable.

The DIT is not required for mortgagors that meet the Streamlined PFS requirements.

Supporting Documentation for the DIT

For standard PFS transactions, to determine a mortgagor's income and expenses for the DIT, the mortgagee must:

- Verify the mortgagor's monthly net income by obtaining one of the following:
 - at least two of the mortgagor's most recent pay stubs or, if self-employed, the most recent quarterly or year-to-date profit and loss statement, compiled by a Certified Public Accountant (CPA);
 - Social Security Income (SSI) statements and/or disability payment statements, if applicable;
 - the most recent Form W-2, Form 1099, or Federal Tax Return.
 - Verify the mortgagor's monthly expenses by ensuring that all expenses on the mortgagor's credit report are factored into the DIT along with any other expenses that are supported by bills, payment receipts, and/or the standard payment amounts (e.g., for utilities) under an IRS Index (such as the IRS Collection Financial Standards). *(For large past-due balances or for accounts included in bankruptcy proceedings, mortgagees should refer to the minimum monthly payment required prior to the delinquency when using the DIT.)*
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Calculating Cash Reserve Contributions for Standard PFS Transactions

Prior to approving a mortgagor to participate in a standard PFS transaction, the mortgagee must calculate and disclose to the mortgagor the amount of the mortgagor's cash reserve contribution to be applied toward the standard PFS transaction. To determine the cash reserve contribution, the mortgagee must obtain the:

- mortgagor's three most recent monthly bank statement(s),
- three most recent months of brokerage statement(s), and
- mortgagor's most recent Federal Tax Return at the time the mortgagor requests an approval for a standard PFS.

The mortgagee must calculate the total cash reserves using the highest ending balance of each cash reserve asset.

Cash reserves include all non-retirement liquid assets available for withdrawal or liquidation from all financial institutions. Such accounts include but, are not limited to the following: brokerage, mutual funds, checking, savings, money market or certificate of deposits, other depository accounts, and stocks. Cash reserves also include other equity instruments such as marketable debt of federal, state, or local governments; government sponsored enterprises, corporations and other businesses; and other securities and commodities (including futures, traded on an exchange or marketplace generally available to the public) for which values can be readily verified. Existence of these assets must be verified using Schedules B (Interest & Dividends), D (Capital Gains & Losses) and E (Supplemental Income & Loss) of the mortgagor's most recent Federal Tax Return.

A mortgagor with cash reserves greater than \$5,000 will be required to contribute 20 percent (20%) of the total amount exceeding \$5,000 (not to exceed the difference between the unpaid principal balance and the appraised value of the property) towards the principal balance of the mortgage, in order for the mortgagee to approve the mortgagor to close a standard PFS transaction.² (Please see Attachment A for an example of the Cash Reserve Contribution Calculation).

Since mortgagors meeting the Streamlined PFS requirements are not required to contribute cash reserves, mortgagees do not need to collect financial information for this purpose.

**Imminent
Default for
Standard PFS
Transactions
Only**

Owner-occupant mortgagors may be considered for a standard PFS if they are current or less than 30 days past due on the mortgage obligation and can clearly demonstrate that they are at risk of imminent default due to one or more of the following hardships:

- A loss of or reduction in income that was supporting the mortgage loan;
- A change in household financial circumstances;
- Death of a co-mortgagor;
- Long-term/permanent illness or disability of a mortgagor or dependent family member;
- Divorce or legal separation of a mortgagor; or
- Distant employment transfer/relocation greater than 50 miles one-way from the mortgagor's current primary residence to be closer to employment.

When approving a mortgagor for a standard PFS based on the mortgagor's imminent default, the mortgagee's servicing file must include the following:

- evidence of the mortgagor's imminent default hardship(s); and
- evidence that the DIT results in a negative value.

² A negative value indicates that the mortgagor is not required to make a principal reduction payment towards the closing of the PFS transaction.

**Streamlined
Eligibility
Requirements
for PFS and
DIL**

Mortgagees may approve a mortgagor for a Streamlined PFS or DIL without verifying hardship or obtaining a complete mortgagor workout packet³ if each of the conditions below exists:

For Non-Owner-Occupants:

- Mortgagor(s) are 90 days or more delinquent on their FHA-insured loan as of the date of the mortgagee's review; and
- Each mortgagor has a credit score of 620 or below.

For Owner-Occupants:

- Mortgagor(s) are 90 days or more delinquent on their FHA-insured loan as of the date of the mortgagee's review;
 - Each mortgagor has a credit score of 620 or below; and
 - Except for servicemembers with PCS orders that meet the requirements for a Streamlined PFS, owner-occupant mortgagors must have been reviewed for loss mitigation home retention options. Mortgagees may only offer a Streamlined PFS or DIL to owner-occupant mortgagors when one or more of the following conditions have also been met:
 - The mortgagor has defaulted on a Trial Payment Plan within the last six months;
 - The mortgagor has defaulted on an FHA-HAMP or standard (rate-and-term) modification within the last two years;
 - The mortgagor has been deemed ineligible for a permanent home-retention option (Standard Modification, FHA-HAMP, or Formal Forbearance) or Special Forbearance, pursuant to ML 2012-22;
 - The mortgagor received a Special Forbearance but, did not otherwise qualify for a permanent home-retention option by the end of the forbearance period;
 - The mortgagor has been deemed eligible for and offered a loss mitigation home retention option. However, the mortgagor has a credit score below 580 and provides written documentation that he/she chooses not to accept the loss mitigation home retention option offered by the mortgagee.
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³ A mortgagor workout packet is comprised of the consolidated information a mortgagee must obtain from a mortgagor in order for the mortgagee to conduct the financial analysis required in Section D of Mortgagee Letter 2008-43.

Streamlined PFS and DIL Eligibility Requirements for Servicemembers with PCS Orders

Mortgagees may also approve a servicemember for a Streamlined PFS or DIL without verifying hardship or obtaining a complete mortgagor workout packet if the following conditions exist:

- The servicemember has PCS Orders to relocate to a duty station at least 50 miles away from his/her existing residence and provides the mortgagee with a copy of such orders; and
 - The servicemember submits an affidavit certifying that:
 - the property securing the FHA-insured mortgage is or was his/her principal residence when the PCS orders were issued; and
 - new permanent housing has been or will be obtained as a result of the orders.
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Eligible Properties for Streamlined PFS and DIL

Principal residences, second homes, and investment properties are eligible for disposition under the Streamlined PFS and DIL processes, provided that all mortgagors meet all program requirements. Such properties may be vacant, but cannot be condemned.

Appraisal Validation Requirements for PFS Transactions

After its review of an FHA Roster appraisal, a mortgagee must submit a Request for a Variance through the Extensions and Variances Automated Requests System (EVARS) to approve a PFS transaction if one of the following conditions exists:

- The current appraised value of the property is less than the Unpaid Principal Balance (UPB) by an amount of \$75,000 or greater; *or*
- The appraised value is less than 50 percent of the UPB.

If neither of these conditions exists, a PFS appraisal (prepared by a FHA Roster Appraiser) will be considered acceptable if the “as is” value of the property is affirmed using a Broker’s Price Opinion (BPO) or Automated Valuation Model⁴ (AVM) that is within 10 percent (10%) of the value assessed by the appraiser. The cost of an AVM and/or BPO is reimbursable. Upon determining and documenting that the appraised value is within the relevant range, the mortgagee may authorize the marketing of the property in accordance with Mortgagee Letter 2008-43.

However, if the appraisal is deemed unacceptable because it does not meet the aforementioned criteria for acceptability, the mortgagee must:

- submit a variance through EVARS; and
 - obtain approval prior to authorizing the marketing of the property.
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⁴ An acceptable AVM is one that is utilized by the mortgagee in its existing standard business processes.

**Owner-Occupant
Mortgagor
Incentive for
Successful PFS
Sale**

Owner-occupant mortgagors, acting in good faith, who successfully sell their properties using this option are relieved of their mortgage obligation and are entitled to a consideration of up to \$3,000. The owner-occupant mortgagor may elect to apply the entire amount of the \$3,000 consideration or a portion of it to resolve junior liens and to offset the sales transaction costs not paid by HUD (including a home warranty plan fee, costs of optional repairs, and buyer's closing expenses). Only those mortgagors who are not required to make minimum cash reserve contributions are permitted at closing to receive the remaining amount from the aforementioned \$3,000 consideration. This remaining amount may only be used for transition or relocation assistance.

The mortgagee must instruct the closing agent to pay the HUD relocation or transition assistance from sales proceeds and itemize it and any assistance received from other entities separately on the HUD-1 Settlement Statement to the extent that the mortgagee is aware of other relocation or transition assistance being paid as part of the PFS transaction.

**Disclosure
Requirements
for all PFS and
DIL
Transactions**

Before being approved for a PFS or DIL, the mortgagor must be notified in writing of the following:

- The mortgage must be in default on the date the PFS transaction closes, pursuant to Section 204 of the National Housing Act (12 U.S.C. 1710 (1)D);
 - PFS and DIL transactions are generally reported to credit bureaus, and will likely affect the mortgagor's ability to obtain another mortgage and other types of credit;
 - If the mortgagor is a servicemember, it is recommended that the mortgagor obtain guidance from his/her employer regarding the PFS or DIL's impact on his/her security clearance and employment; and
 - PFS and DIL transactions are generally reported to the Credit Alert Interactive Voice Response System (CAIVRS) which may result in his/her inability to obtain government financing or affect other government benefits for a certain period of time.
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**Addendum for
all PFS
Transactions**

Mortgagees must provide the mortgagor and his/her real estate agent with a “Pre-Foreclosure Sale Addendum” (Please see Attachment B for sample language) in conjunction with an approval letter for a PFS. In addition, the mortgagee is required to provide the closing agent/settlement company with the PFS Addendum that is signed by all parties except for the closing agent upon receipt of an acceptable sales contract. Unless explicitly prohibited by state statute, the closing agent must sign the addendum on or before the date the PFS transaction closes.

No later than three business days after the PFS transaction closes, the mortgagee’s servicing file must include a copy of the addendum containing the signatures of all parties, including the closing agent (if permitted by state statute).

**Reporting to
Credit Bureaus**

Mortgagees must not report PFS or DIL transactions to credit bureaus as foreclosures.

**Anti-Fraud
Requirements
for PFS
Transactions**

A mortgagee must not approve a mortgagor for a PFS if the mortgagee knows or has reason to know of a mortgagor’s fraud or misrepresentation of information. All parties involved in a PFS transaction must sign and date a PFS Addendum as a contingency for a PFS transaction to close.

Except for real estate commissions, third-party fees (incurred by the mortgagee or mortgagor to negotiate a PFS) cannot be included on the HUD-1 Settlement Statement unless explicitly permitted by state law. Also, the mortgagee, its agents, or any outsourcing firm it employs must not charge any fee for participation in the PFS transaction.

**PFS
Participation
Requirements**

The following arms-length requirements apply to parties involved in PFS transactions:

- Any PFS proposed by the mortgagor or his agent, and approved by the mortgagee, must be an arm’s length transaction between the mortgagor and “would-be” purchaser;
- HUD defines an “arm’s length” transaction as a PFS between two unrelated parties that is characterized by a selling price and other conditions that would prevail in an open market environment. Also, no hidden terms or special understandings can exist between any of the parties (e.g., buyer, seller, appraiser, sales agent, closing agent, and mortgagee) involved in the transaction;
- No party that is a signatory on the sales contract, including addenda, can

serve in more than one capacity. To meet the PFS Addendum requirements, brokers and their agents may only represent the buyer or the seller, but not both parties;

- The broker hired to sell the property may not share a business interest with the mortgagee (if a shared interest exists between appraiser and sales agent and is known to the mortgagee, it must be noted in the servicing file); and
- All doubts will be resolved in a manner to avoid a conflict of interest, the appearance of conflict, or self-dealing by any of the parties (e.g., a real estate agent shall never be permitted to claim a sales commission on the sale of his own property, or that of an immediate family member [spouse, sibling, parent, or child], under the PFS procedure).

**Previously
Initiated
Foreclosures**

A foreclosure sale that has already been scheduled should not be cancelled to initiate a PFS marketing period for a property of a mortgagor meeting the streamlined PFS eligibility requirements. Scheduled foreclosure sales should only be cancelled if the mortgagee has received an acceptable purchase contract that meets the requirements of Mortgagee Letter 2008-43.

**Liquidation
Requirements**

Mortgagees must follow applicable liquidation requirements for PFS transactions that are in secondary marketing instruments.

**Information
Collection
Requirements**

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0584. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB Control Number.

Questions

Any questions regarding this Mortgagee Letter may be directed to the HUD National Servicing Center at (877) 622-8525. Persons with hearing or speech impairments may reach this number by calling the Federal Information Relay Service at (800) 877-8339. For additional information on this Mortgagee Letter, please visit www.hud.gov/answers.

Signature

Carol J. Galante
Assistant Secretary for Housing-Federal Housing Commissioner

Attachment A

Example of the Calculation of the Cash Reserve Contribution Required from Mortgagors for Standard PFS Transactions

On April 18th, Mr. Jones is one month delinquent and has requested a standard PFS transaction for his owner-occupied property. A review of Mr. Jones' monthly income and expenses indicates that he has a deficit monthly income of \$700. The following reflects the balances in Mr. Jones' brokerage account for the months of January, February, and March:

	Brokerage Account			Bank Account		
	January	February	March	January	February	March
Cash	\$100	\$80	\$70	\$1,000	\$1,600	\$800
Mutual Funds	\$15,000	\$10,000	\$500			
Stocks	\$500	\$400	\$375			
Bonds	\$300	\$250	\$200			
CDs			\$1,245	\$5,000	\$6,000	\$3,000
401K	\$100,000	\$100,000	\$100,000			
Total	\$115,900	\$110,730	\$102,390	\$6,000	\$7,600	\$3,800

Mr. Jones has an unpaid principal balance of \$185,000 and the non-distressed appraised value as determined by an FHA Roster Appraiser is \$115,000. The maximum cash contribution based on these values is \$70,000 (\$185,000 - \$115,000).

Mr. Jones' cash reserves for purposes of a standard PFS transaction are \$24,745 (\$100 + \$15,000 + \$500 + \$300 + \$1,245 + \$1,600 + \$6,000).

Since Mr. Jones has cash reserves in excess of \$5,000, **the minimum principal amount that he is required to pay to reduce his mortgage's unpaid principal balance is \$3,949** [(\$24,745 - \$5,000) x 20%].

Attachment B

SAMPLE PRE-FORECLOSURE SALE ADDENDUM

Mortgagee:

Mortgagee Loan Number:

Address of Property:

Date of Purchase Contract:

___/___/___

Seller:

Buyer:

Seller:

Buyer:

Seller's Agent/Listing Agent:

Buyer's Agent:

Escrow Closing Agent:

Transaction Facilitator/Negotiator (if applicable)

This Pre-Foreclosure Sale Addendum ("Addendum") is given by the Seller(s), Buyer(s), Agent(s), and Facilitator/Negotiator to the Mortgagee of the mortgage loan secured by the Property ("Mortgage") in consideration for the mutual and respective benefits to be derived from the pre-foreclosure sale of the Property.

NOW, THEREFORE, the Seller(s), Buyer(s), Agent(s), and Facilitator/Negotiator do hereby represent, warrant and agree under the pains and penalties of perjury, to the best of each signatory's knowledge and belief, as follows:

(a) The sale of the Property is an "arm's length" transaction, between Seller(s) and Buyer(s) who are unrelated and unaffiliated by family, marriage, or commercial enterprise. Additionally, the transaction is characterized by a selling price and other conditions that would prevail in an open market environment and there are no hidden terms or special understandings that exist between any of the parties involved in the transaction including, but not limited to the buyer, seller, appraiser, broker, sales agent (including, but not limited to the listing agent and seller's agent), closing agent and mortgagee;

(b) Any relationship or affiliation by family, marriage, or commercial enterprise to the Seller(s) or Buyer(s) by other parties involved in the sale of the Property has been disclosed to the Mortgagee;

- (c) There are no agreements, understandings or contracts between the Seller(s) and Buyer(s) that the Seller(s) will remain in the Property as tenants or later obtain title or ownership of the Property, except that the Sellers(s) are permitted to remain as tenants in the Property for a short term, as is common and customary in the market but no longer than ninety (90) days, in order to facilitate relocation;
- (d) Neither the Sellers(s) nor the Buyer(s) will receive any funds or commissions from the sale of the Property except that the Seller(s) may receive a payment if it is offered by the Mortgagee, and, if the payment is made at closing of the sale of the Property, reflected on the HUD-1 Settlement Statement;
- (e) There are no agreements, understandings, current or pending higher offers, or contracts relating to the current sale or subsequent sale of the Property that have not been disclosed to the Mortgagee;
- (f) The current sale transaction is a market real estate transaction, and the buyer is making an outright purchase of real property;
- (g) The current sale transaction will be recorded;
- (h) All amounts to be paid to any person or entity, including holders of other liens on the Property, in connection with the pre-foreclosure sale have been disclosed to and approved by the Mortgagee and will be reflected on the HUD-1 Settlement Statement;
- (i) Each signatory understands, agrees and intends that the Mortgagee is relying upon the statements made in this Addendum as consideration for the reduction of the payoff amount of the Mortgage and agreement to the sale of the Property;
- (j) A signatory who makes a negligent or intentional misrepresentation agrees to indemnify the Mortgagee for any and all loss resulting from the misrepresentation including, but not limited to, repayment of the amount of the reduced payoff of the Mortgage;
- (k) This Addendum and all representations, warranties and statements made herein will survive the closing of the pre-foreclosure sale transaction; and
- (l) The signatories to this agreement can only serve in one capacity in order to meet the conflicts of interest and arms-length policies of HUD.
- (m) Each signatory certifies that all the information stated herein, as well as any information provided in the accompaniment herewith, is true and accurate. HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties.
(18 U.S.C. 1001. 1010. 1012; 31 U.S.C. 3729. 3802)

IN WITNESS WHEREOF, I have subscribed my name this ____ day of _____, 20____.

(Seller's Signature) By: _____

(Seller's Signature) By: _____

IN WITNESS WHEREOF, I have subscribed my name this ____ day of _____, 20____.

(Seller's Agent/Listing Agent's Signature) By: _____

IN WITNESS WHEREOF, I have subscribed my name this ____ day of _____, 20____.

(Buyer's Signature) By: _____

(Buyer's Signature) By: _____

IN WITNESS WHEREOF, I have subscribed my name this ____ day of _____, 20____.

(Buyer's Agent's Signature) By: _____

IN WITNESS WHEREOF, I have subscribed my name this ____ day of _____, 20____.

(Escrow Closing Agent's Signature) By: _____

IN WITNESS WHEREOF, I have subscribed my name this ____ day of _____, 20____.

(Transaction Facilitator's Signature (if applicable)) By: _____