

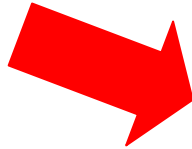
A perspective view of a suspension bridge with wooden planks and metal cables, stretching over a dense green forest. The bridge leads towards a central tower in the distance under a cloudy sky.

# **IT'S A JUNGLE OUT THERE**

## **203k GUIDE BUILDING THE BRIDGE TO HOME OWNERSHIP**

With Brian Short, CMC<sup>®</sup>, CRMS<sup>®</sup>, GMA<sup>®</sup>  
Nationally Certified, State Licensed,  
“Dream Maker & Problem Solver!”

# How do you turn a fixer upper into your dream home?



The Solution – **the FHA 203(k) Loan!**

The purchase of a house that needs repair is often a catch-22 situation, because the bank won't lend the money to buy the house until the repairs are complete, and the repairs can't be done until the house has been purchased.

HUD's 203(k) program can help you with the purchase or refinance of a property by allowing you to roll-in the costs of repairs and improvements up to 110% of the after improved value of the home with a minimum 3.5% down payment.

We hope you find this 203(k) guide helpful. If you have more questions or would like to speak with a 203(k) specialist about a loan, my contact info is below. Happy House Hunting!

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Federal Housing Administration (FHA), which is part of the Department of Housing and Urban Development (HUD), administers various single family mortgage insurance programs. The Section 203(k) program is HUD's primary program for the rehabilitation and repair of single family properties. As such, it is an important tool for community and neighborhood revitalization and for expanding homeownership opportunities.

## 203(k) - How Is It Different?

Most mortgage financing plans provide only permanent financing. That is, the lender will not usually close the loan unless the condition and value of the property provide adequate loan security. When rehabilitation is involved, this means that a lender typically requires the improvements to be finished before a long-term mortgage is made.



When a homebuyer wants to purchase a house in need of repair or modernization, the homebuyer usually has to obtain financing first to purchase the dwelling; additional financing to do the rehabilitation construction; and a permanent mortgage when the work is completed to pay off the interim loans with a permanent mortgage. Often the interim financing (the acquisition and construction loans) involves relatively high interest rates and short amortization periods. The Section 203(k) program was designed to address this situation. The

borrower can get just one mortgage loan, at a long-term fixed (or adjustable) rate, to finance both the acquisition and the rehabilitation of the property. To provide funds for the rehabilitation, the mortgage amount is based on the projected value of the property with the work completed, taking into account the cost of the work.

## There are two Different 203(k) Loans Available

Choosing which loan suits you best will depend on the amount of improvement your property needs.

**Streamlined:** The 203(k) Streamline is an all-in-one loan used for homes that need minor repairs. It allows borrowers to finance the purchase of an existing home and make improvements or upgrades up to \$35,000 before move-in. There are no minimum repair costs and the borrower must occupy the property.

**Standard:** The Standard 203(k) is an all-in-one loan used when homes need major rehabilitation, or when repairs are structural, involves landscaping, or when the renovation costs exceed \$35,000. There must be a minimum of \$5,000 worth of repairs, and again, the borrower must occupy the property. FHA loan limits are based on property type and location of the property being financed. A portion of the loan proceeds are used to pay the seller, or, if a refinance, to pay off the existing mortgage, and the remaining funds are placed in an escrow account and released as rehabilitation is completed. You may also roll in up to six months of mortgage payments if the HUD consultant determines you need to be displaced from the home during the repairs.

We will discuss both of these loans in detail but first let's discuss the 203(k) process from start to finish.

## Here is What You Can Expect:

### 1. Find a Property and Make the Offer

A potential homebuyer locates a fixer-upper and executes a purchase agreement or sales contract after doing a feasibility analysis of the property with their real estate agent.

### 2. Find a FHA approved Lender and Meet with a 203(k) Specialist

The homebuyer then selects an FHA-approved 203(k) lender and arranges for a detailed proposal from licensed contractors showing the scope of the work to be done, including a detailed cost estimate on each repair or improvement of the project.

### 3. Appraise the Property

The appraisal is performed to determine the value of the property after renovation. The appraiser will also determine if there are any additional repairs necessary for the property to meet minimum FHA property guidelines. Any health or safety issues would be addressed at this time.



### 4. Loan is Approved and Closed

The borrower, property and requested improvements are approved and the loan closes for an amount that will cover the purchase or refinance cost of the property, along with the improvement costs. The amount of the loan will also include a contingency reserve of 10% to 20% of the total renovation costs and is used to cover any overages resulting from extra work required to complete the work proposed. At closing, the seller of the property is paid off and the remaining funds are put in an escrow account to pay for the repairs and improvements during the rehabilitation period.

### 5. Work Begins on the Property

The mortgage payments and renovation begin after the loan closes. The borrower can decide to have up to six mortgage payments (PITI) put into the cost of rehabilitation if the property is not going to be occupied during construction, but it cannot exceed the length of time it is estimated to complete the rehab.

### 6. Disbursements & Payment (Draws)

Escrowed funds are released to the contractor during construction through a series of draw requests for completed work. To ensure completion of the job, 10% of each draw is held back; this money is paid after the lender determines there will be no liens on the property. The borrower will always approve the release of funds to the contractor.

## Eligible Properties

To be eligible, the property must be a one- to four-family dwelling that has been completed for at least one year. In addition to typical home rehabilitation projects, this program can be used to convert a one-family dwelling to a two-, three-, or four-family dwelling. An existing multi-unit dwelling could be decreased to a one- to four-family unit.

A 203(k) mortgage may be originated on a "mixed use" residential property provided:

- (1) The property has no greater than 25 percent (for a one story building); 33 percent (for a three story building); and 49 percent (for a two story building) of its floor area used for commercial (storefront) purposes;
- (2) The commercial use will not affect the health and safety of the occupants of the residential property; and
- (3) The rehabilitation funds will only be used for the residential functions of the dwelling and areas used to access the residential part of the property.



A 203(k) mortgage may be originated on a condominium provided:

- (1) The condominium project has been approved by FHA
- (2) Must be owner occupied (no investors)
- (3) Rehab is limited only to the interior of the property
- (4) The lesser of 5 units in the project or 25% of the total number of units can be undergoing rehabilitation at the same time
- (5) The maximum amount of the loan cannot exceed 100% of the after improved value
- (6) No more than four condo units per building

## How the Program Can Be Used

This program can be used to accomplish rehabilitation and/or improvement of an existing one-to-four unit dwelling in one of three ways:

- (1) To purchase a home and rehabilitate it.
- (2) To purchase a dwelling on another site, move it onto a new foundation and rehabilitate it.
- (3) To refinance an existing mortgage and rehabilitate the home.

## Features of the 203(k) Streamline

### Eligible and Ineligible Improvements for the 203(k) Streamline

#### Eligible Improvements include:

203(k) Streamlined loan is intended to facilitate uncomplicated rehabilitation and/or improvements to a home. Eligible improvements include:

- Repair/Replacement of roofs, gutters and downspouts
  - Repair/Replacement/upgrade of existing HVAC systems
  - Repair/Replacement/upgrade of plumbing and electrical systems
  - Repair/Replacement of flooring
  - Minor renovation, such as kitchens & baths, which do not involve structural repairs
  - Painting, both exterior and interior
  - Weatherization, including storms windows and doors, insulation, weather stripping, etc.
  - Purchase and installation of appliances, including free-standing ranges, refrigerators, washers/dryers, dishwashers and microwave ovens
  - Septic system and/or well repair or replacement
  - Accessibility improvements for persons with disabilities
  - Lead-based paint stabilization or abatement of lead-based paint hazards
  - Repair/replace/add exterior decks, patios, porches
  - Basement finishing and renovation with does not involve structural repairs
  - Basement waterproofing
  - Window and door replacements and exterior wall re-siding
- #### Ineligible Improvements include:
- Renovation involving structural changes, like moving a load-bearing wall, or new construction, like adding rooms
  - Landscaping or Fencing
  - Work that will not start within 30 days of loan closing or will cause the borrower to be displaced from the home for more than 30 days or renovations that will take more than 6 months to complete
  - Luxury items like swimming pools, hot tubs, tennis courts, etc.

## **Contractor Requirements**

Borrowers must use contractors to complete rehab unless borrower can provide documented proof that they can perform the work. *Example: Borrower is a licensed plumber or electrician, etc.*

## **Timelines and Disbursements for the 203(k) Streamline**

### **Timelines**

When the loan closes, the mortgage proceeds will be disbursed to pay off the seller of the existing property and the Rehabilitation Escrow Account will be established. Construction may begin. Depending on the type of improvements the homeowner has up to six (6) months for completion.

### **Disbursements & Payments (Draws)**

No more than two payments may be made to each contractor. The first payment is intended to defray material costs and shall not be more than 50% of the estimated costs of all repairs and improvements. The Lender will allow the first payment at closing to cover for, and not exceed, actual required contractor deposits, building permits, and/or the cost of building materials incurred prior to construction.



Before a final disbursement is made, the borrower must sign a statement acknowledging that the work has been completed in a workmanlike and satisfactory manner. A final inspection is required regardless of the improvement or repair, and must be done at completion before the final disbursement is released. Any leftover funds are applied to principal balance of the loan.

## **Features of the Standard 203(k)**

### **FHA Approved Consultants**

All Standard 203(k) loans must use a FHA Approved 203(k) consultant. The HUD consultant will be very helpful as they will assist you in determining the scope of repairs and the budget for the work to be done. Once the project has been determined the HUD consultant will give you a “specification of repairs” plan that will detail the work to be completed and the associated costs. The HUD consultant will also carry out the disbursement and final inspections needed to pay your contractors. Basically they are there to help you through the construction process and verify all work is completed satisfactorily and as stated and that the home meets HUD’s minimum property guidelines when repairs are completed.

## Eligible Improvements for the 203(k) Standard

Homeowners can use the 203(k) program to finance “desired” repairs or upgrades such items as painting, room additions, decks and other items even if the home does not need any other improvements.

Eligible improvements can range from relatively minor (though exceeding \$5,000 in cost) to virtual reconstruction: a home has been demolished or will be razed as part of rehabilitation is eligible, for example, provided that the existing foundation system remains in place.

The types of improvements that borrowers may make using Section 203(k) Standard loan financing include:

- All of the improvements listed in the eligible improvements for a streamlined 203(k)
- Structural alterations and reconstruction, like room additions, repair of termite damage, major remodeling of kitchens and bathrooms, finishing an attic or basement, adding a second story to a home, etc
- Major landscaping and site improvement including correction of grading and drainage problems, tree removal and repair of sidewalks and driveway, if they are a safety hazard to the property.



## Timelines, Disbursements and Inspections for the 203(k) Standard

### Timeline

When the loan closes, the mortgage proceeds will be disbursed to pay off the seller of the existing property and the Rehabilitation Escrow Account will be established.



Construction may begin. The homeowner has up to six (6) months to complete the work depending on the extent of work to be completed.

### Disbursements

As construction progresses, funds are released after the work is inspected by a HUD-approved inspector. A maximum of 5 draws are allowed. Draw amounts may vary and are based on the work performed. Disbursements are made as each phase of the project is completed based on the draw paperwork provided by the consultant. Inspections are required prior to each disbursement.



A ten (10) percent **holdback** is required on each disbursement released from the Rehabilitation Escrow Account. The Holdback/Contingency Fee is:

1. Used as an incentive to insure all work is completed and to cover health, safety and unplanned issues that arise during construction.
2. Required on FHA 203(k); recommended on Streamline
3. Required on properties older than 30 years and/or over \$7,500 in rehabilitation costs.
4. A minimum of 10% of the cost or rehabilitation and maximum of 20%.

If not used (after all construction is complete) the remaining amount will be applied to pay down the principal balance of the loan. The total of all holdbacks may be released only after a final inspection of the rehabilitation and issuance of the Final Release Notice.

## Maximum Mortgage Amount Calculation

### REFINANCE:

Based on the lesser of:

- 1) The existing mortgage balance before rehabilitation, plus the estimated cost of rehabilitation and allowable closing costs or
- 2) The lesser of the As-Is value plus rehabilitation costs or 110 percent of the After-Improved value multiplied by 97.75%.

### PURCHASE:

The maximum mortgage amount is based on the lesser of 1) or 2) of the below multiplied by 96.5%.

- 1) The As-is value or the purchase price of the property before rehabilitation, whichever is less, plus the estimated cost of rehabilitation or
- 2) 110 percent of the After-Improved value of the property.



**We hope you found this 203(k) guide to be helpful during the home buying process. The following pages contain additional information and resources to help build a smooth and straight path to your dream home.**

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# Potential Home Checklist

Print out a few copies of this checklist to use as you visit prospective homes.  
 Having a record of what each home offers can make your final decision much easier.

Date Seen \_\_\_\_\_  
 Address \_\_\_\_\_ Price \_\_\_\_\_ Property Taxes \_\_\_\_\_  
 Seller \_\_\_\_\_ Age of Home \_\_\_\_\_ Neighborhood \_\_\_\_\_

Style of home     Two Story     Ranch     Split Level     Traditional     Contemporary  
                           Cape cod     Townhouse     Condo

Type of construction     Wood     Brick     Stone     Stucco     Vinyl Siding     Aluminum Siding

### Exterior Features

Landscaping     Good     Fair     Poor  
 Fencing     Good     Fair     Poor     Nonexistent  
 Porch     Good     Fair     Poor     Nonexistent  
 Paint     Good     Fair     Poor  
 Patio     Good     Fair     Poor     Nonexistent  
 Deck     Good     Fair     Poor     Nonexistent  
 Garage     1 car     2 car     3 car     Detached  
                   Good     Fair     Poor  
 Roof Condition     Good     Fair     Poor  
 Sidewalks     Yes     No  
 Well-maintained neighborhood     Yes     No

### Interior Features

**Kitchen**    Size \_\_\_\_\_  
 Eat-in     Yes     No  
 Flooring     Ceramic     Vinyl     Wood     Carpet     Good     Fair     Poor  
 Appliances     Good     Fair     Poor     Nonexistent  
 Cabinets     Good     Fair     Poor  
 Windows     Good     Fair     Poor

**Dining room**    Size \_\_\_\_\_  
 Flooring     Carpet     Hardwood     Tile     Good     Fair     Poor  
 Lighting fixtures     Good     Fair     Poor     Nonexistent

**Living room**    Size \_\_\_\_\_  
 Flooring     Carpet     Hardwood     Tile     Good     Fair     Poor  
 Lighting fixtures     Good     Fair     Poor     Nonexistent  
 Fireplace     Good     Fair     Poor     Nonexistent

**Den**    Size \_\_\_\_\_  
 Flooring     Carpet     Hardwood     Tile     Good     Fair     Poor  
 Lighting fixtures     Good     Fair     Poor     Nonexistent  
 Fireplace     Good     Fair     Poor     Nonexistent

**Hallway**    Flooring     Carpet     Hardwood     Tile     Good     Fair     Poor  
 Linen closet     Good     Fair     Poor     Nonexistent

Total bedrooms \_\_\_\_\_

Bedroom 1 Size \_\_\_\_\_  
Flooring  Carpet  Hardwood  Tile  Good  Fair  Poor  
Closet  Good  Fair  Poor  Nonexistent

Bedroom 2 Size \_\_\_\_\_  
Flooring  Carpet  Hardwood  Tile  Good  Fair  Poor  
Closet  Good  Fair  Poor  Nonexistent

Bedroom 3 Size \_\_\_\_\_  
Flooring  Carpet  Hardwood  Tile  Good  Fair  Poor  
Closet  Good  Fair  Poor  Nonexistent

Total Bathrooms \_\_\_\_\_

Master Bath Size \_\_\_\_\_  
Flooring  Ceramic  Vinyl  Wood  Carpet  Good  Fair  Poor  
Tub  Good  Fair  Poor  
Fixtures  Good  Fair  Poor

Guest Bath Size \_\_\_\_\_  
Flooring  Ceramic  Vinyl  Wood  Carpet  Good  Fair  Poor  
Tub  Good  Fair  Poor  
Fixtures  Good  Fair  Poor

Laundry room Location \_\_\_\_\_  
Washer  Good  Fair  Poor  Nonexistent  
Dryer  Good  Fair  Poor  Nonexistent

Good closet space  Yes  No

Basement  Yes  No  Finished  Carpet  Hardwood  Tile

Utilities

Type of heating  Hot water  Gas  Electric  Oil  
Insulation  Fiberglass  Cellulose  Foam  Nonexistent  
Central Air  Yes  No  
Plumbing Condition  Good  Fair  Poor  
Sump pump/drainage system  Yes  No  
Connected to sewer system  Yes  No  
Age of heating system \_\_\_\_\_  
Age/capacity of water heater \_\_\_\_\_  
Age of electrical wiring \_\_\_\_\_

Easy proximity to:

Work  Schools  Shopping  Airport Area  Industry  Highways  
 Houses of worship  Train station  Public transportation  Doctors/dentists

Recent sales in neighborhood:

Address \_\_\_\_\_ Size \_\_\_\_\_ Price \_\_\_\_\_  
Address \_\_\_\_\_ Size \_\_\_\_\_ Price \_\_\_\_\_  
Address \_\_\_\_\_ Size \_\_\_\_\_ Price \_\_\_\_\_  
Address \_\_\_\_\_ Size \_\_\_\_\_ Price \_\_\_\_\_

