

203(b) Mortgage Insurance Program

Affordable low down payment lending traditionally for first-time homebuyers and underserved communities

BACKGROUND AND PURPOSE

The 203(b) mortgage insurance program, or the Basic Home Mortgage Loan, is the centerpiece of all FHA mortgage insurance programs for one- to four-unit residential properties, including individual condominium units or manufactured homes on real estate. The purpose of the Section 203(b) program is to provide approved lenders with mortgage insurance to protect them against the risk of default on mortgages that are made to qualified buyers who may not otherwise qualify for conventional loans or who live in underserved areas. Insured mortgages can be used to finance the purchase of new or existing one- to four-unit structures and can be used to refinance both FHA and non-FHA mortgages.

Down payments may be lower than conventional mortgages because the federally backed insurance allows lenders to finance up to 96.5 percent of the value of the home. This results in down payments as low as 3.5

percent. Out-of-pocket costs to borrowers in some cases can be lowered through a variety of sources including loans, grants, and employer assistance.

FHA sets the limits on the maximum mortgage amount that may be insured through the program and can vary by geographic location.

BORROWER CRITERIA

Income limits: There is no income limit to participate in the program. Lenders must analyze the income of each borrower who is obligated for the mortgage debt to determine whether the borrower’s income level can be reasonably expected to continue through at least the first three years of the mortgage loan. This includes salaries and wages, as well as income from other non-employment sources, such as disability benefits,

PROGRAM NAME	203(b) Mortgage Insurance Program including Special Feature Programs (251, 203(n), 203(h), 247, and 248)
AGENCY	Federal Housing Administration
EXPIRATION DATE	Not Applicable
APPLICATIONS	To participate, lenders must be FHA-approved for the Title II loan program. Lenders may access FHA’s Lender Requirements and the online lender application at: https://www.hud.gov/program_offices/housing/sfh/lender/lendappr
WEB LINK	https://www.hud.gov/program_offices/housing/sfh/ins/203b--df
CONTACT INFORMATION	Lenders that want to apply for FHA approval may contact the FHA Resource Center at answers@hud.gov or (800) 225-5342. Include the words “New Applicant” in the subject line, include a contact person, and phone number in the email body so that a Lender Approval representative may contact you.
APPLICATION PERIOD	Continuous
GEOGRAPHIC SCOPE	National

alimony, or pension benefits, all of which may be considered if properly verified and documented by the lender.

Credit: FHA uses a borrower's credit score to help determine the maximum amount of financing the borrower is eligible to receive. If the credit score is less than 500, then the borrower is not eligible for FHA-insured financing. If the borrower's credit score is at or above 580, then the borrower is eligible for maximum financing with a loan-to-value ratio (LTV) of 96.5 percent. If the credit score is between 500 and 579, then the borrower is limited to a maximum LTV of 90 percent.

First-time homebuyers: The program is often used to assist first-time homebuyers but is not restricted to this population; there are no additional or special terms for first-time homebuyers.

Occupancy and ownership of other properties: The program is limited to owner-occupied primary residences. The program can be used to finance the purchase of proposed, under construction, or existing one- to four-unit family dwellings, manufactured homes, or to refinance indebtedness on existing housing. In general, the program does not allow borrowers to have a secondary residence. If they do, the borrower may have only one secondary residence at any time to be eligible for the 203(b) program and it is only permitted in one circumstance.

A secondary residence is only permitted if the Homeownership Center assisting the borrower determines that undue hardship exists, meaning that there is no affordable rental housing for lease that meets the needs of the family within a reasonable commuting distance of work; and if the maximum loan amount is 85 percent of the lesser of the appraised value or sales price.

Special populations: This program does not provide special benefits for members of certain populations.

Property criteria: The home must meet HUD's minimum property standards, such as durability and safety and soundness, which are frequently more stringent than local building codes because of the importance of having standardized collateral backing the loan. Sellers are expected to correct any safety and soundness deficiencies as a condition of accepting the loan. All repairs must be completed before closing. If the seller refuses, the buyer may create an escrow account for repairs and finance it into the loan through FHA's Limited Section 203(k) program (no minimum amount, non-structural repairs not exceeding \$35,000) or Standard Section 203(k) program (repairs of at least \$5,000, which may include structural repairs and additions).

POTENTIAL BENEFITS

The Section 203(b) Mortgage Insurance Program may help community banks access the secondary market, providing greater liquidity to enhance their lending volume.

Special feature programs are responsive to different mortgage types (e.g., adjustable-rate mortgages) and populations (e.g., disaster victims, Native Americans, Native Hawaiians).

The Section 203(b) Mortgage Insurance Program may allow community banks to expand their customer base in low- and moderate-income communities and to a broader range of borrowers.

Loans originated through the Section 203(b) Mortgage Insurance Program may receive favorable consideration under the CRA, depending on the geography or income of the participating borrowers.

POTENTIAL CHALLENGES

Lenders must have a way to access the program, whether through direct sales or a correspondent arrangement, as discussed in the introduction to this section. Depending on the arrangement, community banks may need to acquire or develop new expertise and infrastructure in order to participate.

LOAN CRITERIA

Loan limits: FHA mortgage limits vary by the number of units and by the county or Metropolitan Statistical Area in which the property resides. HUD issues a Mortgagee Letter announcing the new mortgage limits every year.

Loan-to-value limits: For purchases of existing properties, the maximum LTV is 96.5 percent and for refinance transactions (no cash-out), the maximum LTV is 97.75 percent. There are special requirements for maximum LTV for properties that do not yet exist or are under construction. The maximum LTV ratio for a property depends upon the stage of construction (proposed, under construction, or existing), the appraised value and sales price (for a purchase), and the borrower's credit score.

Adjustable-rate mortgages: Adjustable-rate mortgages are allowed through the sub-program Section 251 Mortgage Insurance for Adjustable-Rate Mortgages, described in more detail later in this summary. FHA permits either one-year Treasury Constant Maturities Index or one-year London Interbank Offered Rate (LIBOR) to determine interest rate changes. The annual and lifetime interest rate changes permitted vary based upon the initial fixed period of the mortgage.² In addition, borrowers must be informed at least 25 days in advance of any adjustment to the monthly payment. In most other respects, Section 251 loans are similar to basic FHA-insured single-family loans.

Down payment sources: FHA allows for various acceptable sources of funds to cover down payment costs. The acceptable sources fall into six categories, including cash and savings/checking account funds; investment funds; gifts; funds resulting from the sale of personal or real property; loans and grants; and employer assistance.

Homeownership counseling: Counseling is not required, but it is encouraged that borrowers contact a HUD-approved housing counseling agency to learn more about the program.

Mortgage insurance: Mortgage insurance premiums (MIP) are used to protect lenders against loss in the event of a foreclosure. Under Section 203(b), premiums are paid up front and monthly. For all mortgages, the upfront mortgage insurance premium (UFMIP) is 175 basis points (1.75 percent) of the base loan amount

and is due within 10 calendar days of the mortgage closing or disbursement date, whichever is later.

Lenders also collect from the borrower and remit an annual mortgage insurance premium monthly to HUD. The MIP rates vary based on the LTV and mortgage term and mortgage amount. For 30-year mortgages greater than 95 percent LTV with a loan amount less than or equal to \$625,500, the annual premium is 85 basis points.

Debt-to-income ratio: HUD utilizes two ratios to determine if a borrower can reasonably meet the expected expenses. First, the mortgage payment expense-to-effective income ratio (or front-end DTI) should not exceed 31 percent.

Second, the total fixed payment-to-effective income ratio (or back-end DTI) should not exceed 43 percent. Manually underwritten loans with ratios that exceed 31 percent or 43 percent may be acceptable only if the lender documents qualified significant compensating factors. Loans receiving an "accept" scoring recommendation from the TOTAL Mortgage Scorecard are not subject to these restrictions. In the event the borrower has student loan debt, regardless of the payment status, FHA's policy is to include either the actual documented payment, provided the payment will fully amortize the loan over its term or the greater of 1 percent of the total student loan balance or the monthly payment reported on the borrower's credit report in the debt-to-income calculation.

Temporary interest rate buy downs: A third party may contribute up to 6 percent of either the lesser of the property's sales price or the appraised value toward closing costs. Any payment for permanent or temporary interest rate buy downs must be included in the 6 percent. Any temporary interest rate buy down is prohibited on all FHA-insured ARM products.

² A 1- and 3-year ARM may increase by one percentage point annually after the initial fixed interest rate period, and five percentage points over the life of the mortgage. A 5-year ARM may either allow for increases of one percentage point annually, and five percentage points over the life of the mortgage; or increases of two percentage points annually, and six points over the life of the mortgage. A 7- and 10-year ARM may only increase by two percentage points annually after the initial fixed interest rate period, and six percentage points over the life of the mortgage.

Refinance: Refinance is an allowed use of this product.

SPECIAL FEATURE PROGRAMS

FHA operates a number of programs that have the same basic requirements as the 203(b) program, but include certain special features.

251 Adjustable-Rate Mortgage (ARM): The program provides lenders with insurance on ARMs that have built-in safeguards for borrowers and lenders that minimize the effect of a rapid rise in interest rates.

- Lenders must use either the one-year Treasury Constant Maturities Index or the one-year London Interbank Offered Rate (LIBOR) to calculate interest rates and annual adjustments. The rate must be constant for the initial period (1, 3, 5, 7, or 10 years) and then can change annually. ARMs with initial periods longer than one year are called "Hybrid ARMs." The annual and lifetime interest rate changes permitted vary based upon the initial fixed period of the mortgage.
- The annual mortgage insurance premium is based on the initial interest rate.
- The loan term must fully amortize over a period of not more than 30 years.
- Owner-occupants may refinance any loan to an FHA ARM.
- Properties must be one- to four-unit dwellings or condominium units.

FHA sets a cap on the total number of ARMs it will insure each fiscal year and notifies lenders when it is close to reaching the cap. The cap is set at 30 percent of the total number of mortgages insured in the prior fiscal year.

203(h) Mortgage Insurance for Disaster Victims:

The program insures lenders for loans to finance the purchase or reconstruction of a one-family, primary residence where the borrower is a victim of a Presidentially Declared Major Disaster Area. The one difference from the 203(b) program is that borrowers are not required to make a down payment. Borrowers must still have a minimum credit score of 500 to be eligible and are responsible for closing costs and prepaid expenses. The borrower's previous residence must have been located in the disaster area and either

destroyed or damaged in such a way that the borrower requires a new property or total reconstruction.

247 Insured Mortgages on Hawaiian Home Lands:

The FHA provides lenders with insurance to make mortgage loans to Native Hawaiians. Eligible borrowers must purchase a one- to four-unit property located on Hawaiian homeland and use it as their primary residence. The lender must certify that the property is located on eligible land through the Department of Hawaiian Home Lands. The program operates with the same parameters as the 203(b) program, except that the typical minimum credit score requirement of 500 does not apply and only an upfront mortgage insurance premium is required and not the annual premium. Loans are eligible for refinancing under the Section 247 program.

248 Insured Mortgages on Indian Land: The program is very similar to the Section 247 special feature, except insurable loans must be made to Native Americans to buy, build, or rehabilitate a one- to four-unit property on Indian land that they intend to use as a primary residence. The minimum credit score requirement of the 203(b) program does not apply to Section 248 loans, and instead of an upfront mortgage insurance premium, the program only requires monthly MIP payments.

Potential Benefits

- The Section 203(b) Mortgage Insurance Program may help community banks access the secondary market, providing greater liquidity to enhance their lending volume.
- Special feature programs are responsive to different mortgage types (e.g., adjustable-rate mortgages) and populations (e.g., disaster victims, Native Americans, Native Hawaiians).
- The Section 203(b) Mortgage Insurance Program may allow community banks to expand their customer base in low- and moderate-income communities and to a broader range of borrowers.
- The Section 203(b) Mortgage Insurance Program offers competitive pricing and terms.
- Loans originated through the Section 203(b) Mortgage Insurance Program may receive favorable consideration under the CRA, depending on the geography or income of the participating borrowers.

Potential Challenges

- Lenders must have a way to access the program, whether through direct sales or a correspondent arrangement, as discussed in the introduction to this section. Depending on the arrangement, community banks may need to acquire or develop new expertise and infrastructure in order to participate.

SIMILAR PROGRAMS

- Fannie Mae HomeReady™
- Freddie Mac HomePossible®
- Freddie Mac HomeOneSM
- VA Home Purchase Loan Program
- USDA Single Family Housing Guaranteed Loan Program

RESOURCES

Direct access to the following web links can be found at <https://www.fdic.gov/mortgagelending>.

General information

http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/ins/203b--df

Applications

http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/lender/lendappr

FHA mortgage limits

<https://entp.hud.gov/idapp/html/hicostlook.cfm>

HUD Handbook 4000.1 (contains all 203(b) program requirements; sections of particular importance are identified below)

<https://www.hud.gov/sites/documents/40001HSGH.PDF>

- See section I.A.3 for lender application and approval requirements
- See section II.A.5.c.viii. for Approvable Ratio Requirements for manual underwriting
- See section II.A.8.f. for Section 251 Adjustable-Rate Mortgage program requirements
- See section II.A.8.b. for Section 203(h) Mortgage Insurance for Disaster Victims program requirements
- See section II.A.8.h. for Section 247 Single Family Mortgage Insurance on Hawaiian Home Lands program requirements
- See section II.A.8.g. for Section 248 Mortgages on Indian Land program requirements
- See Appendix 1.0 for Mortgage Insurance Premiums

Mortgage insurance premium rate calculation procedures

http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/comp/premiums/sfpcalc

HUD-approved housing counseling agencies

<http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm>

HUD's minimum property standards

https://www.hud.gov/program_offices/administration/hudclips/handbooks/hsg/4910.1