

New "Buy and Bail" law makes new home purchase financing difficult, house swapping is at rescue.

With the passing of the "buy and bail" law taking affect October 1, 2008, any homeowners with unsold homes now have to qualify for any new FHA financing with both mortgages. It used to be that the homeowners had an option of renting their unsold residence and use the large portion of the rent income derived against their total liabilities--not anymore. House swapping now makes even more sense because it eliminates the need to rent the unsold home in the first place, since homeowner is swapping their primary residence for another and the original mortgage on the primary residence is paid off during the simultaneous closing. You can read the notes on this new law below.

September 19, 2008

MORTGAGEE LETTER 2008-25

TO: ALL
APPROVED MORTGAGEES

SUBJECT: Converting Existing Homes to
Rentals Underwriting Instructions

Through this Mortgagee Letter, the Federal Housing Administration (FHA) takes steps to immediately respond to an unscrupulous practice arising in the housing mortgage market that poses a risk to FHA, FHA-approved lenders, and consequently to FHA's ability to help new homeowners.

Recently, FHA and others in the mortgage industry have observed an increasing number of homeowners who have chosen to vacate their existing principal residence and purchase a new residence. This has been occurring as some homeowners, given the rising price of fuel, are relocating to homes nearer their employment, or are taking advantage of other home buying opportunities arising in the marketplace.

Due to FHA's concern that some homebuyers in these transactions may attempt to provide misleading information regarding the rental income of the property being vacated to qualify for the new mortgage, FHA is instituting underwriting guidance designed to assure that the homebuyer can make payments on the full debt service of both mortgages. Consequently, beginning with case number assignments on or after the date of this Mortgagee Letter and until further notice, the underwriting analysis may not consider any rental income from the property being vacated except under circumstances described in this Mortgagee Letter. The exclusion of rental income from property being vacated is being instituted on a temporary basis while FHA further analyzes this situation to determine whether permanent measures may need to be taken. This will assure that a homeowner either has sufficient income to make both mortgage payments without any rental income or has an equity position not likely to result in defaulting on the mortgage on the property being vacated. In either case, this guidance is directed to preventing the practice known as "buy and bail" where the homebuyer purchases, for example, a more affordable dwelling with the intention to cease making payments on the previous mortgage. Although the property being vacated will

not have a mortgage insured by FHA, surrounding properties may and, thus, FHA may be indirectly negatively affected should that property result in a foreclosure.

Exceptions:

Rental
income on the property being vacated, reduced by the appropriate vacancy factor as determined by the jurisdictional FHA Homeownership Center (see <http://www.hud.gov/offices/hsg/sfh/ref/sfh2-21u.cfm>) may be considered in the underwriting analysis under the following circumstances:

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Relocations: The homebuyer is relocating with a new employer, or being transferred by the current employer to an area not within reasonable and locally recognized commuting distance. A properly executed lease agreement (i.e., a lease signed by the homebuyer and the lessee) of at least one year's duration after the loan is closed is required. FHA recommends that underwriters also obtain evidence of the security deposit and/or evidence the first month's rent was paid to the homeowner.

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Sufficient Equity in Vacated Property: The homebuyer has a loan-to-value ratio of 75 percent or less, as determined by either a current (no more than six months old) residential appraisal or by comparing the unpaid principal balance to the original sales price of the property. The appraisal, in addition to using forms Fannie Mae1004/Freddie Mac 70, may be an exterior-only appraisal using form Fannie Mae/Freddie Mac 2055, and for condominium units, form Fannie Mae1075/Freddie Mac 466.

The guidance in this Mortgagee Letter applies solely to a principal residence being vacated in favor of another principal residence. This Mortgagee Letter is not applicable to existing rental properties disclosed on the loan application and confirmed by tax returns (Schedule E of form IRS 1040).

It is important to note that if the property being vacated had a mortgage insured by FHA, eligibility for a second FHA insured mortgage can only occur under the exemptions described in handbook HUD-4155.1 REV-5, paragraph 1-2.

If you have any questions regarding this Mortgagee Letter, call 1-800-CALLFHA.

Sincerely,

D. Montgomery Brian
Secretary for Housing- Assistant

Federal Housing Commissioner