New FHA Rule on Mortgagee Net-Worth Requirements and Loan Correspondent Approval

On April 20, 2010, the U.S. Department of Housing and Urban Development (“HUD”) issued a final rule that will limit the ability of smaller originators to participate directly in the Federal Housing Administration’s (“FHA”) insured loan programs. The rule will amend HUD’s regulations at 24 CFR Part 202, but are currently available at 75 Fed. Reg. 20718, and on the HUD website at http://portal.hud.gov/portal/page/portal/HUD/federal_housing_administration/5356F-02RiskMgmtFinalRuleforWebPosting.pdf. The changes are meant to respond to concerns about FHA’s financial standing after the forecast that FHA’s capital reserves will drop below its two-percent required minimum. This Client Alert will outline the new FHA requirements and their effective dates.

FHA Net-Worth Requirements

The current net-worth requirement for an FHA-approved mortgagee is $250,000. Beginning May 20, 2010, a currently-approved mortgagee classified as a ‘small business’ under Small Business Administration (‘SBA’) rules (currently $7 million or less in average annual revenue – please see 13 CFR §121.201) must have a minimum net-worth of $500,000 in assets acceptable to HUD, with at least 20% in cash or cash equivalents. A currently-approved mortgagee not classified as an SBA ‘small business’ must have a minimum net-worth of $1 million, again in assets acceptable to HUD and with at least 20% in cash or cash equivalents. Beginning May 20, 2013, FHA-approved mortgagees must have, in addition to the minimum $1 million net-worth, additional assets equal to one percent (1%) of the total dollar volume of FHA mortgages originated during its prior fiscal year in excess of $25 million, to a maximum net-worth requirement for FHA purposes of $2.5 million.

Loan Correspondent Approval

FHA will no longer approve loan correspondents as of May 20, 2010, and all existing approvals will expire on December 31, 2010. Under the new FHA rule, each mortgagee can do FHA business with any originator (called a ‘third-party originator’ or ‘TPO’) without getting HUD’s authorization to do so. The tradeoff, though, is that the FHA-approved mortgagee may only originate the loan in its own name, and is entirely responsible to HUD for the actions of the TPO, whether or not it had any knowledge of them. HUD recommends, but does not require, that each FHA-approved mortgagee implement its own approval requirements for TPOs, including licensure verification, loan-level quality control audit processes, ongoing renewal requirements, and financial standards. The FHA-approved mortgagee must also enter into FHA’s records the name and federal tax ID number for a TPO involved in an FHA loan that the mortgagee closes.
FHA Principal/Authorized Agent Transactions

Beginning May 20, 2010, FHA will allow two FHA Direct Endorsement ("DE") underwriters to act as principal and agent in an FHA transaction, and would also allow either to close the loan in its own name, although the designated principal must originate the loan and the designated agent must underwrite it. Current regulations permit the agent to be an FHA-approved mortgagee, instead of a DE underwriter, require the designated principal to close the loan in its name, and permit either lender to originate and underwrite the loan. Since the new rule requires both lenders to have DE underwriting approval, it will no longer be possible for a newly-approved FHA mortgagee to become the agent of a DE underwriter principal while its own DE approval is pending with HUD.

Effect on Smaller FHA Lenders

Current FHA correspondent lenders that cannot meet the new financial requirements to become or remain an FHA-approved mortgagee will have to become a TPO in order to continue originating FHA loans. Since the new HUD rule will not allow the TPO to close FHA loans in its own name, even if table-funded by the FHA-approved mortgagee, the TPO will have to act as the broker in each transaction, and will face new requirements for state mortgage broker licensing and borrower disclosures. FHA-approved mortgagees will likely implement new approval requirements and restrictions in their wholesale process for TPOs originating FHA loans. Since HUD’s rule leaves the content of those requirements and restrictions open to the discretion of each mortgagee, they may vary greatly, and can also change at any time. Finally, to add insult to injury, TPOs will not have direct access to their FHA loan originations through the FHA Connection website.

Conclusion

While HUD may have successfully addressed concerns about its financial stability with this new rule, it has done so at the cost of substantially raising the financial bar for approved mortgagees in the FHA program, and by making those approved mortgagees completely responsible for the actions of non-approved originators. HUD’s new rule will also force many small and medium-sized FHA originators out of a direct mortgagee relationship with HUD, and into a broker/wholesale relationship with one or more approved mortgagees that may in turn require a radical change in how they run their FHA lending operations.

If you have any questions or comments concerning this Client Alert, please do not hesitate to contact:

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