Section C. Borrower Secondary Financing

Overview

In This Section This section contains the topics listed in the table below.

1. General Information on Secondary Financing

Introduction

This topic contains general information on secondary financing, including

- a definition of secondary financing
- secondary financing documentation requirements, and
- references for permissible sources of secondary financing.

Change Date

November 19, 2010

4155.1 5.C.1.a Definition of Secondary Financing

Any financing other than the first mortgage that creates a lien against the property is considered secondary financing. Such financing is *not* considered a gift, even if it is a "soft" or "silent" second, or has other features forgiving the debt.

Note: A "soft" or "silent" second is secondary financing with no monthly repayment provisions.

4155.1 5.C.1.b Secondary Financing Documentation Requirements

The lender must obtain from the provider of any secondary financing, and include in the endorsement binder

- documentation showing the amount of funds provided to the borrower for each transaction, and
- copies of the loan instruments.

Notes:
- FHA reserves the right to reject any secondary financing
  - that does not serve the needs of the intended borrower, or
  - where the costs to the participant outweigh the benefits derived by the borrower.
- Costs incurred for participating in a downpayment assistance secondary financing program may only be included in the amount of the second lien.

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1. General Information on Secondary Financing, Continued

4155.1 5.C.1.c Permissible Sources of Secondary Financing (Reference)

For more information on

- secondary financing from government agencies, see HUD 4155.1 5.C.2
- secondary financing from nonprofit organizations, see HUD 4155.1 5.C.3
- secondary financing from private individuals or other organizations, see HUD 41551. 5.C.4
- secondary financing from family members, see HUD 4155.1 5.C.5, and
- special arrangements for borrowers 60 years of age or older, see HUD 4155.1 5.C.6.

2. Government Agency Secondary Financing

Introduction

This topic contains information on government agency secondary financing, including

- secondary financing from government agencies
- government agencies that can provide secondary financing
- government agencies holding or servicing second liens, and
- terms of secondary financing provided by government agencies for purchases.

Change Date

November 19, 2010

4155.1 5.C.2.a Secondary Financing From Government Agencies

FHA will insure a first mortgage loan on a property that has a second mortgage or lien held by a federal, state, or local government agency.

The monthly payments under the insured mortgage and second lien, plus housing expense and other recurring charges, cannot exceed the borrower's ability to repay.

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2. Government Agency Secondary Financing, Continued

4155.1 5.C.2.b Government Agencies That Can Provide Secondary Financing

Federal, state, local government, and nonprofit agencies considered instrumentalities of government may provide secondary financing for the borrower's entire amount of required funds to close on a purchase.

References: For more information on

- acceptable government instrumentalities, see HUD 4155.1 4.A.6
- refinancing loans with outstanding subordinate liens, see HUD 4155.1 3.B.1.c
- cash out refinances with subordinate liens, see HUD 4155.1 3.B.2.e
- streamline refinances with appraisals and subordinate liens, see HUD 4155.1 3.C.3.b, and
- streamline refinances without appraisals and with subordinate liens, see HUD 4155.1 3.C.2.f.

4155.1 5.C.2.c Government Agencies Holding or Servicing Second Liens

When secondary financing is provided by a government agency, the secondary lien must be made or held by the eligible government body or instrumentality. Government units *cannot* use agents, including nonprofit or for-profit enterprises, to make the second lien, regardless of the source of funds. They can, however, be used to service the subordinate lien if regularly scheduled payments are made by the borrower.

Example : Even if funds used for secondary financing are from an acceptable source, such as HUD HOME, a government unit, or an eligible nonprofit instrumentality, the subordinate lien *must* be in the name of the eligible entity, such as the

- state
- county
- city, or
- eligible nonprofit instrumentality.

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2. Government Agency Secondary Financing, Continued

4155.1 5.C.2.d Terms of Secondary Financing Provided by Government Agencies for Purchases

Listed below are the policies for loans secured by secondary liens.

Terms and Conditions

- The FHA-insured first mortgage, when combined with any second mortgage or other junior lien from a government agency or nonprofit agency considered an instrumentality of government, may *not* result in cash back to the borrower.
- The FHA-insured first mortgage *cannot* exceed the FHA statutory limit for the area where the property is located. The combined indebtedness of the mortgages *may*, however, exceed the FHA statutory limit.
- The combined loan-to-value (LTV) ratio of all liens cannot exceed 100% of the cost to acquire the property. (***Note***: The cost to acquire the property is the sales price plus borrower-paid closing costs, discount points, repairs and rehabilitation expenses and prepaid expenses.)
- The cost to acquire may exceed the appraised value of the property under these types of government assistance programs.

Required Monthly Payments

The required monthly payments for both the FHA-insured first mortgage and the second mortgage or lien, plus other housing expenses and all recurring charges, *cannot* exceed the borrower's reasonable ability to repay.

Mortgage Application Disclosures

The source, amount, and repayment terms must be disclosed in the mortgage application, and the borrower must acknowledge that he/she understands and agrees to the terms.

3. Nonprofit Agency Secondary Financing

Introduction

This topic contains information on nonprofit agency secondary financing, including

- secondary financing from nonprofit organizations
- secondary financing by a nonprofit agency considered an instrumentality of the government
- requirement for government unit that established the nonprofit agency
- HOC responsibilities for nonprofit agency approval, and
- secondary financing by an agency not considered an instrumentality of the government.

Change Date

January 31, 2011

4155.1 5.C.3.a Secondary Financing From Nonprofit Organizations

With advance approval, FHA will insure a first mortgage loan on a property that has a second mortgage held by an approved nonprofit agency.

The monthly payments under the insured mortgage and second lien, plus housing expense and other recurring charges, cannot exceed the borrower's ability to repay.

4155.1 5.C.3.b Secondary Financing by a Nonprofit Agency Considered an Instrumentality of the Government

Nonprofit agencies may provide secondary financing under the terms outlined in HUD 4155.1 5.C.3.a provided that they

- meet the criteria described in HUD 4155.1 4.A.6, and
- are considered instrumentalities of the government.

Note: To be considered an instrumentality of the government, the nonprofit entity must be "established by a governmental body or with governmental approval or under special law to serve a particular public purpose or designated by law (statute or court opinion)."

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3. Nonprofit Agency Secondary Financing, Continued

4155.1 5.C.3.c Requirement for Government Unit That Established the Nonprofit Agency

FHA requires that the unit of government that established the nonprofit must exercise either organizational control, operational control, or financial control of

- the nonprofit agency in its entirety, or
- at a minimum, the specific borrower assistance program that is using FHA's credit enhancement.

4155.1 5.C.3.d HOC Responsibilities for Nonprofit Agency Approval

The appropriate Homeownership Center (HOC) is responsible, based on information submitted by the nonprofit, for

- approving the nonprofit agency
- determining if the agency can be considered an instrumentality of government, and
- reviewing applications from nonprofits that purport to be instrumentalities of government.

Note: The HOC is also responsible for approving nonprofit agencies that are *not* considered instrumentalities of government.

References: For information on
- approval of nonprofit agencies that are *not* instrumentalities of government, see HUD 4155.1 5.C.3.e, and
- acceptable nonprofit government instrumentalities, see HUD 4155.1 4.A.6.

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3. Nonprofit Agency Secondary Financing, Continued

4155.1 5.C.3.e Secondary Financing by a Nonprofit Agency not Considered an Instrumentality of the Government

Nonprofit agencies that are not considered instrumentalities of government may provide secondary financing under the conditions described in HUD 4155.1 5.C.3.a provided that the

- agency meets the conditions described in HUD 4155.1 4.A.6
- borrower makes a downpayment of at least 3.5% of the lesser of the appraised value or the sales price of the property
- amount of the insured first mortgage does not exceed the statutory loan limit for the area where the property is located
- the combined loan-to-value (CLTV) ratio of the first and subordinate liens does not exceed the applicable FHA maximum loan-to-value (LTV) limit for the area where the property is located, and
- FHA-insured first mortgage, when combined with any second mortgage or junior lien from the nonprofit agency, may not result in cash back to the borrower.

Note: The jurisdictional HOC is responsible for approving these agencies.

4. Organizations and Private Individuals Providing Secondary Financing

Introduction

This topic contains information on organizations and private individuals providing secondary financing, including

- secondary financing from private individuals or other organizations
- repayment terms for secondary mortgages from other organizations or private individuals, and
- repayment terms for secondary financing from other organizations or private individuals.

Change Date

November 19, 2010

4155.1 5.C.4.a Secondary Financing From Private Individuals or Other Organizations

With advance approval, FHA will insure a first mortgage loan on a property that has a second mortgage or lien held by an individual or a company, provided that

- the secondary financing is disclosed at the time of application
- the required minimum cash investment is *not* financed
- the insured first mortgage does *not* exceed FHA mortgage limits
- the combined loan-to-value (CLTV) ratio of the first and subordinate liens does not exceed the applicable FHA loan-to-value (LTV) limit
- the borrower can afford the total amount of the payments
- any periodic payments are level and monthly
- there is no balloon payment during the first ten years, and
- there is no prepayment penalty.

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4. Organizations and Private Individuals Providing Secondary Financing, Continued

4155.1 5.C.4.b Repayment Terms for Secondary Financing From Other Organizations or Private Individuals

Repayment terms for a second mortgage from an organization or a private individual must

- *not* include a balloon payment before ten years (or other such term acceptable to FHA), unless the property is sold or refinanced, and
- permit repayment by the borrower, without penalty, after giving the lender 30 days advance notice.

4155.1 5.C.4.c Required Monthly Payment for Secondary Loans

The required monthly payment on both the FHA-insured first mortgage and the second mortgage or lien plus other housing expenses and all recurring charges *cannot* exceed the borrower's reasonable ability to repay.

Any periodic payments due on the second mortgage must be calculated as an equal monthly payment.

5. Family Member Secondary Financing

Introduction

This topic contains information on secondary financing provided by a family member, including

- secondary financing from family members for purchase transactions
- assistance from family members on a property purchase
- borrower as co-obligor on a note securing a borrowed downpayment, and
- terms and conditions for secondary financing provided by family members.

Change Date

November 19, 2010

4155.1 5.C.5.a Secondary Financing From Family Members for Purchase Transactions

FHA permits lending from family members on a secured or unsecured basis, up to 100% of the borrower's required funds to close. This may include the downpayment, closing costs, prepaid expenses, and discount points.

If the loan from the family member, whether borrowed from an acceptable source or the family member's own savings, is secured by the subject property, only the family member provider may be the noteholder.

FHA will *not* approve any form of securitization of the note that results in any entity *other* than the family member being the noteholder, whether at loan settlement or at any time during the mortgage life cycle.

Reference: For a definition of the term ***family member***, see HUD 4155.1 9.2.f.

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5. Family Member Secondary Financing, Continued

4155.1 5.C.5.b Assistance From Family Members on a Property Purchase

Family members may assist with the costs of acquiring a new home by providing the borrower with a loan.

Only the family member provider(s) may be the noteholder if the money lent is secured against the subject property.

FHA will *not* approve any form of securitization of a note that results in an entity other than the family member being the noteholder, whether at settlement, or any time during the mortgage life cycle.

4155.1 5.C.5.c Borrower as Co-Obligor on a Note Securing a Borrowed Downpayment

When the funds loaned by the family member are borrowed from an acceptable source, the borrower may *not* be a co-obligor on the note.

Example: A son may not be the co-obligor on the note used to secure the money borrowed by his parents which, in turn, was loaned to the son for the downpayment on the property.

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5. Family Member Secondary Financing, Continued

4155.1 5.C.5.d Terms and Conditions for Secondary Financing Provided by Family Members for Purchases

The table below describes additional policies regarding the terms and conditions for FHA-insured loans with secondary financing provided by family members.

Category	Policy Description
Maximum insurable mortgage	The maximum insurable mortgage amount is *not* affected by loans from family members.
Combined loan-to-value (CLTV) limit on financing	The combined loan-to-value (CLTV) limit on financing may not exceed 100% of the • *lesser* of the property's – appraised value, or – sales price, plus • normal closing costs, prepaid expenses, and discount points.
Borrower cash back	A family member may lend 100% of the borrower's required funds to close, but cash back to the borrower at closing (beyond the refund of any earnest money deposit) is *not* permitted.
Secondary financing payments	If periodic payments of the secondary financing are required, the combined payments may not exceed the borrower's reasonable ability to repay. ***Note***: The secondary financing payments must be included in the total debt to income ratio (i.e. the "back end" ratio) for qualifying purposes.
Second lien balloon payments	The second lien may *not* provide for a balloon payment within five years from the date of execution.

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5. Family Member Secondary Financing, Continued

4155.1 5.C. 5.d Terms and Conditions for Secondary Financing Provided by Family Members for Purchases (continued)

Category	Policy Description
Family member supplying borrowed funds	If the family member providing the secondary financing borrows the funds, the lending source may *not* be an entity with an identity-of-interest in the sale of the property, such as the • seller • builder • loan officer, or • real estate agent. Mortgage companies with retail banking affiliates may have the affiliate loan the funds to the family member. However, the terms and conditions of the loan to the family member cannot be more favorable than they would be for any other borrowers. ***Example***: There may *not* be any special consideration given between the • making of the mortgage, and • lending of funds to family members to be used for secondary financing for the purchase of the home.
Secondary financing documentation	An executed copy of the document(s) describing the terms of the secondary financing must be maintained in the lender's file, and another executed copy provided in the endorsement binder.

6. Secondary Financing for Borrowers 60 Years of Age or Older

Change Date November 19, 2010

4155.1 5.C.6.a Borrowers 60 Years or Older Obtaining Secondary Financing for Purchases

With advance approval, a borrower 60 years of age or older may borrow the required funds to close for the purchase of a principal residence, under the following circumstances:

- the provider of secondary financing is
  – a relative
  – a close friend with a clearly defined interest in the borrower
  – the borrower's employer, or
  – an institution established for humanitarian or welfare purposes
- the provider of the secondary financing does not have an identity-of-interest in the sale of the property, such as with
  – a builder or seller, or
  – any person/organization associated with the builder or seller
- the principal amount of the insured mortgage loan, plus the note or other evidence of indebtedness in connection with the property, does *not* exceed 100% of the value, plus prepaid expenses, and
- the note or other evidence of indebtedness for the secondary financing does not bear an interest rate exceeding the interest rate of the insured mortgage.