HomeStyle® Renovation Mortgage

Finances purchase and renovation in a single mortgage

BACKGROUND AND PURPOSE

A healthy housing market includes homes at various levels of quality, including less expensive "starter homes" that help low- and moderate-income households become homeowners and start building equity. Frequently, starter homes are older and have deferred maintenance that drives down the price. Access to affordable credit that covers not just the purchase price but also the cost of renovations is essential for the continued viability of starter homes as a strategy to promote homeownership.

The HomeStyle® Renovation (HSR) Mortgage permits borrowers to include financing for home improvements in a purchase or refinance transaction on existing homes. The HSR Mortgage provides a convenient way for borrowers to make renovations, repairs, or improvements totaling up to 75 percent of the as-completed appraised value of the property with a first mortgage, rather than a second mortgage, home equity line of credit, or other more costly financing method. Eligible borrowers include individual homebuyers, investors, nonprofit organizations, and local government agencies.

BORROWER CRITERIA

Income limits: This program has no income limits.

Credit: The borrower's credit score influences the loan parameters. The minimum credit score is 620. Fannie Mae uses trended data in its credit risk assessment including those loans submitted through Desktop Underwriter®. Trended credit data provides expanded information on a borrower's revolving account credit history including whether the borrower pays off the balance each month or makes the minimum payment due, and whether the borrower exceeds the credit limit.

PROGRAM NAME	HomeStyle® Renovation Mortgage
AGENCY	Fannie Mae
EXPIRATION DATE	Not Applicable
APPLICATIONS	https://www.fanniemae.com/content/guide_form/1000a.pdf
WEB LINK	https://www.fanniemae.com/content/guide/selling/b5/3.2/02.html
CONTACT INFORMATION	Sellerservicer_application@fanniemae.com (ask for a call-back in your email)
APPLICATION PERIOD	Continuous
GEOGRAPHIC SCOPE	National

First-time homebuyers: First-time homeowner status confers no benefit.

Occupancy and ownership of other properties: A borrower may be financing no more than four properties, including a primary residence. This program may be used for a primary residence, second home, or investment property.

Special populations: Nonprofits, for-profits, and government agencies are eligible borrowers. Nonprofits must provide information on their track records with this type of work.

Special assistance for persons with disabilities: Funds may be used to outfit a home for use by a person with a disability.

Property type: The property may be a one- to four-unit primary residence, a one-unit second home, or a one-unit investment property with each having separate loan-to-value (LTV) limits. Fee simple ownership, co-ops, condominiums, and planned unit developments are allowed. Manufactured housing is allowed, but the repairs, renovations, or improvements are capped at 50 percent of the as-completed appraised value. When the security property is a unit in a condominium or co-op project, the project must be one for which the proposed renovation work is permissible under the bylaws of the homeowners' association or co-op corporation or one for which the homeowners' association or co-op corporation has given written approval for the renovation work. The renovation work for a condominium or co-op unit must be limited to the interior of the unit.

Renovation or repair requirements: Any type of renovation or repair is eligible, as long as it is permanently affixed to the property and adds value. Renovations should be completed within 12 months from the date that the mortgage loan is delivered.

LOAN CRITERIA

Loan limits: FHFA publishes Fannie Mae's conforming loan limits annually. See Resources for a link to the current limits.

Loan-to-value limits: The maximum allowable LTV is 97 percent for a one-unit primary residence unless combined with HomeReady. A combined LTV of up to 105 percent is allowed with a Community Seconds®[18] mortgage for purchase transactions. For properties underwritten manually, the LTV is determined by credit score and other factors. Cost of renovations is limited to 75 percent of the as-completed value of the property; manufactured housing is limited to 50 percent of the as-completed value. The borrower may not receive cash back at closing in any amount.

[18] A Community Seconds® mortgage is a subordinate mortgage that is used in connection with a first mortgage delivered to Fannie Mae. Fannie Mae does not purchase Community Seconds, but it does provide eligibility requirements for the subordinate Community Seconds product. See fact sheet at https://www.fanniemae.com/content/fact_sheet/community-seconds-fact-sheet.pdf.

POTENTIAL BENEFITS

The HomeStyle® Renovation Mortgage program attracts new and existing homeowners who want to invest in and improve their property in a way that may lead to an appreciation in value. Improvements benefit com munity banks because of the associated economic stability or growth in the areas they serve.

Compared to the HomeStyle® Renovation Mortgage program, conventional improvement loans may have higher interest rates with shorter repayment terms. The competitive terms of this program help lenders do more volume in improvement loans and attract borrowers who are interested in this product.

POTENTIAL CHALLENGES

Special approval is required to deliver HomeStyle® Renovation loans to Fannie Mae. 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 exper tise and infrastructure in order to participate.

Lenders may not sell or transfer servicing until the renovation work is complete.

ALLOWABLE RENOVATION/REPAIRS COSTS:

Renovations must be permanently affixed and add value to the property. Sweat equity is not an allowable cost. Allowable costs include the following:

- Contract labor and materials.
- Property inspection, title update, and permit fees.
- Architectural, engineering, and other consultant fees.
- Other documented charges, such as fees for energy reports, appraisals, review of renovation plans, and fees charged for processing renovation draws.

LENDER RENOVATION OVERSIGHT:

- The lender may not sell or transfer servicing until renovation work is complete.
- The lender must review the contractor hired by the borrower to determine if he or she is adequately qualified and experienced for the work being performed. The Contractor Profile Report (Form 1202) can be used to assist the lender in making this determination.
- Borrowers must have a construction contract with their contractor. Fannie Mae has a model Construction Contract (Form 3734) that may be used to document the construction contract between the borrower and the contractor.
- Plans and specifications must be prepared by a registered, licensed, or certified general contractor, renovation consultant, or architect. The plans and specifications should fully describe all work to be done and provide an indication of when various jobs or stages of completion will be scheduled (including both the start and job completion dates).
- For one-unit owner-occupied homes, borrowers may perform repairs themselves, but financing of these repairs may not exceed 10 percent of the as-completed value.
- Inspections are required for all work items that cost more than $5,000.
- The reimbursement is limited to the cost of materials or the cost of properly documented contract labor (sweat equity may not be reimbursed).

Adjustable-rate mortgages: ARMs are allowed, but they must conform to Fannie Mae's ARM requirements (see Resources).

Homeownership counseling: Homeownership counseling is not required.

Loan-level price adjustments: Loan-level price adjustments (LLPAs) are risk-based pricing adjustments that apply at the time of delivery only. The standard Fannie Mae LLPAs apply. When the mortgage is used to finance energy-related improvements, the lender may be eligible for an LLPA credit of $250.

Mortgage insurance: The borrower must have hazard insurance in place to cover the estimated as-completed value of the home after renovation. Mortgage insurance, if required based on LTV, must be in place before closing, and coverage is based on the estimated value of the home after renovation.

Debt-to-income ratio: The debt-to-income (DTI) ratio cannot exceed 45 percent. In the event that the borrower has student loan debt, if the payment amount is provided on the credit report, that amount can be used for qualifying purposes. If the credit report does not identify a payment amount, the lender can use either 1 percent of the outstanding student loan balance, or a calculated payment that will fully amortize the loan based on documented loan repayment terms.

Refinance: Limited cash-out refinance is a valid use of this product, but cash may only be used to perform renovations; no cash may be disbursed to the borrower, unlike other Fannie Mae limited cash-out refinances. The lender must disburse all remaining funds to the borrower through one of two methods:

1. reduce the principal balance, or
2. make additional permanent, value-adding changes to the property.

Reserves: Up to 12 months of reserves are required depending on transaction type, credit score, LTV, and number of units in the property.

ADDITIONAL INFORMATION

Approval: Special approval is required to deliver HomeStyle® Renovation Mortgage loans to Fannie Mae. Lenders must already be approved by Fannie Mae.

The lender must have two years of direct experience originating and servicing renovation mortgages within the last five years. The lender must also have strong operational controls and sufficient financial capacity to cover the lender's recourse obligations during renovation. Fannie Mae provides a Contractor Profile Report (see resources) to ensure that the lender has sufficient information to determine that a contractor is qualified. The lender must set up and hold an interest-bearing custodial renovation fund account. An as-completed appraisal must be obtained. Renovation work must be completed no later than 12 months from the date the mortgage loan is delivered. The lender is responsible for monitoring the completion of the renovation work and managing disbursement of the funds.

Training: Fannie Mae offers a 30-minute online course on underwriting, servicing, and delivering HomeStyle® Renovation Mortgages.

Workflow: Lenders must review plans and manage renovation work throughout the process. In the preparatory phase, the borrower works with the contractor to submit work plans and specifications to the lender. The appraiser reviews the plans and specifications, and determines the as-completed value after improvements. The lender then uses the Maximum Mortgage Worksheet to determine the mortgage amount (see Resources).

In the renovation phase, the loan is first closed and sold to Fannie Mae. Funds for renovation are placed in a custodial account. The contractor begins work and requests funding. The lender performs inspections to confirm that the work is completed, and gets lien waivers and title endorsements if required. The lender funds draw requests with two-party checks or direct funding.

Once construction is complete, the lender orders a final appraisal inspection, updates the title policy, and obtains a signed completion certificate, which the lender gives to Fannie Mae to have the recourse removed.

Potential Benefits

- The HomeStyle® Renovation Mortgage program attracts new and existing homeowners who want to invest in and improve their property in a way that may lead to an appreciation in value. Improvements benefit community banks because of the associated economic stability or growth in the areas they serve.
- Compared to the HomeStyle® Renovation Mortgage program, conventional improvement loans may have higher interest rates with shorter repayment terms. The competitive terms of this program help lenders do more volume in improvement loans and attract borrowers who are interested in this product.
- A lender may deliver a HomeStyle® Renovation Mortgage as soon as it is closed; the renovation, repair, or rehabilitation does not need to have been completed when the mortgage is delivered. This eliminates the costs of holding the mortgage in a portfolio until the renovation is completed.
- A single closing mortgage (as opposed to one mortgage for the home's current value and one for the renovation improvements) saves work for lenders.
- The HomeStyle® Renovation program may allow community banks to expand their customer base in low- and moderate-income communities.
- Loans originated through the HomeStyle® Renovation Mortgage program may receive favorable consideration under the CRA, depending on the geography or income of the participating borrowers.

Potential Challenges

- Special approval is required to deliver HomeStyle® Renovation loans to Fannie Mae. 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.

- Lenders may not sell or transfer servicing until the renovation work is complete.

- Fannie Mae has full recourse to the lender throughout the renovation process. Fannie Mae may require the lender to re-purchase the loan if the borrower defaults before the work is completed, or if the lender's actions affect Fannie Mae's ability to obtain clear title to the property. Therefore, lenders retain substantial risk until the renovation is complete.

- Lenders must monitor the renovation progress, which requires expertise in areas such as construction draws and contractor management. The lender must maintain a copy of all the documentation that supports the renovation work, plans, and specifications, as-completed appraisal, renovation contract, renovation loan agreement, certificate of completion, title insurance endorsements or updates, and so on, in the individual mortgage file.

Similar Programs

- FHA 203(k) Rehabilitation Mortgage Insurance

- Freddie Mac Construction Conversion and Renovation Mortgage

RESOURCES

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

Loan-to-value ratios

https://www.fanniemae.com/content/guide/selling/b5/3.2/02.html#LTV.20Ratios

Loan-level price adjustment

https://www.fanniemae.com/content/pricing/llpa-matrix.pdf

FHFA Conforming loan limits

http://www.fhfa.gov/DataTools/Downloads/Pages/Conforming-Loan-Limits.aspx

Mortgage insurance pricing

https://www.fanniemae.com/content/guide/selling/b7/1/02.html

HomeStyle® Renovation Mortgage: Lender Eligibility (Selling Guide B5-3.2-01)

https://www.fanniemae.com/content/guide/selling/b5/3.2/01.html

Model construction contract (Form 3734)

https://www.fanniemae.com/content/legal_form/3734w.doc

Maximum Mortgage Worksheet (Form 1035)

https://www.fanniemae.com/content/guide_form/1035.pdf

Eligibility Matrix

https://www.fanniemae.com/content/eligibility_information/eligibility-matrix.pdf

Appraisal update and/or Completion Report (Form 1004D)

https://www.fanniemae.com/content/guide_form/1004d.pdf

HomeStyle® Renovation Mortgages fact sheet

https://www.fanniemae.com/content/fact_sheet/homestyle-renovation-overview.pdf

Fannie Mae adjustable-rate mortgage requirements

https://www.fanniemae.com/content/guide/selling/b2/1.3/02.html

Community Seconds®

https://www.fanniemae.com/content/fact_sheet/community-seconds-fact-sheet.pdf