

# Community Developments

## FACT SHEET

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### FHA's 203(b) Basic Home Mortgage Guarantee Program

*Community Developments Fact Sheets* are designed to share information about programs and initiatives of bankers and community development practitioners. These fact sheets differ from OCC bulletins and regulations in that they do not reflect agency policy and should not be considered regulatory or supervisory guidance. Some of the information used in the preparation of this fact sheet was obtained from publicly available sources. These sources are considered reliable and current, as of September 2022, but the use of this information does not constitute an endorsement of its accuracy by the OCC.

This *Community Developments Fact Sheet* explains the Federal Housing Administration's (FHA) 203(b) basic home mortgage guarantee program for national banks and federal savings associations (collectively, banks). While 203(b) loans may be used for purchase or refinance, this fact sheet focuses on purchase money mortgages rather than refinance transactions.

#### Overview

The 203(b) program is the FHA's flagship program to support the availability of low-cost housing finance assistance to borrowers. The 203(b) program is one of several loan programs to promote affordable homeownership. FHA loan programs allow borrowers to buy homes with lower down payments and because of less restrictive underwriting criteria than might be the case with conventional loans.

FHA 203(b) mortgages may finance a home purchase of new and existing one- to four-family housing. Loans must be for purchasing primary residences. A borrower

may purchase a property with up to four units if the buyer intends to reside in one of the units.

#### How Can Banks Use the FHA 203(b) Program?

The FHA 203(b) program provides mortgage insurance to protect banks and other lenders against the risk of default on mortgages to qualified buyers. Banks originate the mortgages, and the FHA provides the mortgage insurance. If a borrower defaults and after the bank completes foreclosure, the bank may file a claim with the FHA for payment of the remaining principal balance on the mortgage and certain other expenses.

#### What Are the Benefits to Banks That Offer FHA 203(b) Loans?

The FHA 203(b) program can expand a bank's customer base by offering mortgages to market segments that may not qualify for conventional lending. In addition to origination income, FHA 203(b) loans

generate a servicing premium of 44 basis points (bps), which is slightly higher than the servicing premium for conventional loans. Additionally, FHA 203(b) loans are eligible to be placed in Ginnie Mae mortgage pools, thus potentially providing liquidity and secondary market fee income to banks.

The FHA 203(b) program provides mortgage insurance against loan default, and the guarantee is backed by the full faith and credit of the federal government.

Borrowers who obtain FHA mortgages pay an upfront mortgage insurance premium and an annual mortgage insurance premium. At the time of this fact sheet's issuance, the FHA 203(b) upfront mortgage insurance premium was 1.75 percent of the base loan amount and is collected at closing.<sup>1</sup> The upfront mortgage insurance premium may be financed in the mortgage amount, but the loan-to-value (LTV) ratio may not exceed 96.5 percent if the borrower's credit score is above 580, or 90 percent if the credit score is between 500-579. The annual mortgage insurance premium is paid monthly as part of the borrower's mortgage payment. The annual mortgage insurance premium amount is between 45 and 85 bps of the original mortgage amount and is based on the loan type, loan term, and LTV ratio.<sup>2</sup>

### **How Does the FHA 203(b) Program Work?**

Banks can participate in the FHA 203(b) program in two ways. The first way is to

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<sup>1</sup> The maximum amounts that the FHA is allowed to charge for the annual and the upfront premiums are established by statute. Since these are maximum amounts, however, the FHA has the discretion to set the premiums at lower levels.

<sup>2</sup> Refer to Appendix 1.0 of Handbook 4000.1, FHA Single-Family Housing Policy Handbook.

become a direct endorsement lender by obtaining approval from FHA's Office of Lender Activities and Program Compliance.<sup>3</sup> Direct endorsement lenders may originate, underwrite, fund, service, or portfolio FHA-insured loans. Banks seeking to become direct endorsement lenders must meet capital, management, experience, and other requirements and have a dedicated FHA-approved underwriter on staff.

Banks that do not meet the FHA's approval criteria for direct endorsement lenders or do not have sufficient loan volume to justify the costs of being direct endorsement lenders may originate FHA 203(b) loans as sponsored third-party originators. In this scenario, an approved direct endorsement lender agrees to act as a sponsor that underwrites and approves the loan on the sponsor's behalf.

### **How Do Banks Participate in the 203(b) Program?**

The FHA requires all purchase money loan applications, except transactions involving loan applicants without credit scores, to be submitted through an automated underwriting system using the FHA's TOTAL<sup>4</sup> Mortgage Scorecard. TOTAL evaluates an applicant's credit history and application information.

The TOTAL Mortgage Scorecard classifies the application as either "accept" or "refer." An accept classification indicates that the FHA will insure the loan without manual underwriting. If the loan receives a refer

<sup>3</sup> Banks seeking FHA approval must submit applications and demonstrate eligibility for approval as provided in section I.A.3 of the Single-Family Housing Policy Handbook.

<sup>4</sup> TOTAL stands for Technology Open to Approved Lenders.

classification, the bank is required to manually underwrite the loan. FHA policy states that no borrower is to be denied an FHA-insured mortgage based solely on the classification generated by the TOTAL Mortgage Scorecard.

### ***Manually Underwritten Loans***

Handbook 4000.1, FHA Single-Family Housing Policy Handbook, provides guidelines for manually underwriting mortgage applications. The guidelines are intended to assist banks in objectively quantifying a borrower's risk. The guidelines establish borrower reserve requirements for all manually underwritten borrowers, set qualifying ratios based on a borrower's credit score and compensating factors, and provide a list of compensating factors that can be used to qualify borrowers who exceed the FHA's standard housing payment and debt-to-income ratios.

The maximum mortgage payment to income ratio and maximum debt-to-income ratio for borrowers with no compensating factors are 31 percent and 43 percent, respectively.

### ***FHA Underwriting Flexibility***

#### ***Previous Bankruptcy***

The FHA's underwriting requirements generally are different from underwriting requirements for conventional mortgages for borrowers who have filed for bankruptcy.

According to the FHA Single-Family Housing Policy Handbook, a Chapter 7 bankruptcy (liquidation) does not disqualify a borrower from obtaining an FHA-insured mortgage if at least two years have elapsed since the date of the bankruptcy discharge. The borrower must have reestablished good

credit or chosen not to incur new credit obligations.

An elapsed period of less than two years, but not less than 12 months, may be acceptable, if the borrower

- can show that the bankruptcy was caused by extenuating circumstances beyond the borrower's control, and
- has since exhibited a documented ability to manage his or her financial affairs in a responsible manner.

The bank must document that the events that led to the borrower's bankruptcy are unlikely to recur.

According to the FHA Single-Family Housing Policy Handbook, a Chapter 13 bankruptcy (reorganization) does not automatically disqualify a borrower from an FHA-insured mortgage, if the bank documents that one year of the payout period under the bankruptcy has elapsed. The bank must determine that the borrower's payment performance has been satisfactory, that all required payments have been made on time, and that the borrower has received written permission from the bankruptcy court to enter into the mortgage transaction.

#### ***Previous Foreclosure***

Borrowers who have gone through a foreclosure on their primary residence are generally ineligible for an FHA-insured mortgage for three years from the date of foreclosure. This policy also applies to former borrowers who have completed a deed in lieu of foreclosure or a short sale, which is when a bank approves the sale for less than the amount owed. A bank is permitted to grant an exception to the three-year requirement if the foreclosure was the

result of documented extenuating circumstances that were beyond the borrower's control, such as a serious illness or death of a wage earner, and the borrower has reestablished a good credit history.

The FHA recognizes that some applicants may not have established a traditional credit history. In these situations, the bank must obtain a nontraditional mortgage credit report obtained from a credit reporting company or independently develop a credit history from such sources as utility payment records, rental payments, and automobile insurance payments.

A nontraditional mortgage credit report is designed to access the credit history of a borrower who does not have the types of trade references that appear on a traditional credit report and is used either as a

- substitute for a traditional credit report, or
- supplement to a traditional credit report that has an insufficient number of trade items reported.

### **Borrower Benefits**

When underwriting an FHA 203(b) loan, the bank evaluates standard credit risk factors, such as debt-to-income and loan-to-value ratios and the borrower's credit history. An advantage of the FHA 203(b) program is that in some situations, the FHA underwriting criteria regarding the borrower's credit history can be less restrictive than conventional underwriting requirements. Additional benefits include the following:

- Financial gifts for down payment assistance are permitted and can come from an approved source, such as an employer, a relative, or a nonprofit organization or government agency that offers down payment assistance. Any party with an interest in the sale, such as the seller, may not provide a gift to the borrower.
- The seller or another interested party can elect to contribute up to 6 percent of the purchase price toward the closing costs associated with the loan. Exceeding the 6 percent contribution limit may trigger a reduction in the maximum loan amount.<sup>5</sup>

### **Loan Limits**

FHA 203(b) program loan limits vary by geography and are adjusted annually by FHA. As of January 1, 2022, the nationwide loan limit for a single-family unit is \$420,680 or \$970,800 in high-cost areas. The [loan limits](#) page on the U.S. Department of Housing and Urban Development's website allows users to look up the loan limits for a particular geographic region, such as a state, county, or metropolitan statistical area.

### **Down Payment Requirements**

FHA 203(b) loans make it possible for borrowers to make down payments with as little as 3.5 percent of either the lesser of the sales price or the appraised value of the property. FHA insurance is available to finance up to 96.5 percent of the value of the home.

Borrowers with a credit score of 580 or higher must make a 3.5 percent down

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<sup>5</sup> Interested party contributions may be applied toward loan discount points, prepaid items, items paid outside of closing, and other closing costs. Refer

to Single-Family Housing Policy Handbook, section II.A.4.d.iii.(G).

payment. Borrowers with a credit score between 500 and 579 must make a 10 percent down payment. Borrowers with credit scores below 500 are ineligible for FHA financing.

## **Operational Considerations for Administering the Program**

### ***Regulatory Capital Requirements***

Under the bank regulatory agencies' current risk-based capital requirements, the portion of loans guaranteed by the federal government through the FHA is risk-weighted at 20 percent as the bank must meet FHA servicing guidelines for guaranteed loans.<sup>6</sup>

### ***Appraisal Requirements***

The FHA 203(b) appraisal encompasses a detailed property analysis report and a thorough property inspection component similar in nature to that of a home inspection. The 203(b) inspection is more involved than the conventional single-family property inspection completed during the site visit. The FHA maintains a registry of appraisers who are eligible to perform FHA single-family appraisals. To conduct an appraisal for FHA insurance endorsement, the appraiser must be on the FHA registry.<sup>7</sup>

### ***Qualified Mortgage***

Regulation Z requires creditors to make a reasonable and good faith determination that the consumer will have a reasonable ability to repay a covered transaction at or before consummation.<sup>8</sup> FHA loans are generally considered "qualified mortgages" under Regulation Z and have a safe harbor or

presumption of compliance with the repayment ability requirement.

## **Federal Home Loan Bank Mortgage-Backed Security Program**

The Federal Home Loan Bank of Chicago issues securities backed by government-insured mortgages, including FHA 203(b) loans, originated by Federal Home Loan Bank member financial institutions. The secondary market conduit product, Mortgage Partnership Finance Government Mortgage-Backed Securities, can provide banks, particularly small banks that lack direct access to the secondary mortgage market, with a source of liquidity.

## **For More Information**

### ***OCC Resources***

- [Community Affairs Contacts](#)
- [Bank Supervision Policy](#)

### ***Other Resources***

- Handbook 4000.1, [FHA Single-Family Housing Policy Handbook](#)
- [U.S. Housing and Urban Development Mortgagee Letters](#)

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<sup>6</sup> Refer to 12 CFR 3.32(a)(1)(ii).

<sup>7</sup> Refer to the [FHA's appraiser registry](#).

<sup>8</sup> Refer to 12 CFR 1026.43.