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To: Clients and Friends

From: David F. Dulock

Subject: FHA Extends Property Flipping Exemption to December 31, 2011

In today's issue of the *Federal Register* (76 FR 6149), the FHA published notice that it is extending its temporary waiver of its property flipping regulations (*see* 24 CFR §203.37a) until December 31, 2011. Pertinent parts of the notice are reprinted below:

Waiver

This notice announces that FHA is extending the availability of the temporary waiver of its regulation that prohibits the use of FHA financing to purchase single family properties that are being resold within 90 days of the previous acquisition, until December 31, 2011. This waiver, which was issued in January 2010, took effect for all sales contracts executed on or after February 1, 2010, and is set to expire on February 1, 2011. Prior to the waiver, a mortgage was not eligible for FHA insurance if the contract of sale for the purchase of the property that is the subject of the mortgage is executed within 90 days of the prior acquisition by the seller and the seller does not come under any of the exemptions to this 90-day period that are specified in the regulation. ... [T]he waiver is applicable to all single family properties being resold within the 90-day period after prior acquisition, ... [a]dditionally, the waiver is subject to certain conditions, and eligible mortgages must meet these conditions to take advantage of the waiver. ... Although no changes are made to the conditions to which the waiver is subject, this notice also includes guidance on the waiver conditions in response to questions that have arisen from time to time during the first year in which the waiver was made available.

Waiver Conditions

To be eligible for the waiver of the Property Flipping Rule, an FHA approved mortgagee must meet the following conditions:

1. All transactions must be arms length, with no identity of interest between the buyer and seller or other parties participating in the sale transaction. Some ways that the lender can ensure that there is no inappropriate collusion or agreement between parties, [*sic*] are to assess and determine the following:

- a. The seller holds title to the property;
- b. Limited liability companies, corporations, or trusts that are serving as sellers were established and are operated in accordance with applicable State and Federal law;
- c. No pattern of previous flipping activity exists for the subject property as evidenced by multiple title transfers within a 12 month time frame (chain of title information for the subject property can be found in the appraisal report);
- d. The property was marketed openly and fairly, through a multiple listing service (MLS), auction, for sale by owner offering, or developer marketing (any sales contracts that refer to an "assignment of contract of sale," which represents a special arrangement between seller and buyer may be a red flag).

2. In cases in which the sale of the property is greater than 20 percent above the seller's acquisition cost, an FHA-approved mortgagee is eligible for the waiver only if the mortgagee:

- a. Justifies the increase in value by retaining in the loan file supporting documentation and/or a second appraisal, which verifies that the seller has completed sufficient legitimate renovation, repair, and rehabilitation work on the subject property to substantiate the increase in value or, in cases where no such work is performed, the appraiser provides appropriate explanation of the increase in property value since the prior title transfer; and

b. Orders a property inspection and provides the inspection report to the purchaser before closing. The mortgagee may charge the borrower for this inspection. The use of FHA-approved inspectors or 203(k) consultants is not required. The inspector must have no interest in the property or relationship with the seller, and must not receive compensation for the inspection for [sic] any party other than the mortgagee. Additionally, the inspector may not: Compensate anyone for the referral of the inspection; receive any compensation for referring or recommending contractors to perform any repairs recommended by the inspection; or be involved with performing any repairs recommended by the inspection. At a minimum, the inspection must include:

- i. The property structure, including the foundation, floor, ceiling, walls and roof;
 - ii. The exterior, including siding, doors, windows, appurtenant structures such as decks and balconies, walkways and driveways;
 - iii. The roofing, plumbing systems, electrical systems, heating and air conditioning systems;
 - iv. All interiors; and
 - v. All insulation and ventilation systems, as well as fireplaces and solid fuel-burning appliances.
3. Only forward mortgages are eligible for the waiver. Mortgages insured under HUD's HECM program are ineligible for the waiver.

Guidance on the Conditions for Waiver Eligibility

A. Seller's Acquisition Cost

The seller's acquisition cost is the purchase price which [sic] the seller paid for the property, and the following costs (if paid by the seller):

- Closing costs, plus
- Prepaid costs, including commissions.

The seller's acquisition cost does not include the cost of repairs that the seller makes to the property.

B. Justification and Documentation of Increase in Value

If the resale price of the property is greater than 20 percent above the seller's acquisition cost, the property will be eligible for an FHA-insured mortgage only if the Mortgagee justifies the increase in value. The Mortgagee must verify that the seller has completed sufficient legitimate renovation, repair, or rehabilitation work on the subject property to substantiate the increase in value by retaining supporting documentation in the loan file or by providing a second appraisal.

- If the Mortgagee uses a second appraisal:
 - An FHA roster appraiser must perform the appraisal in compliance with all FHA appraisal reporting requirements.
 - The Mortgagee may not use an appraisal done for a conventional loan even if it was completed by an FHA roster appraiser.
 - The Mortgagee may not charge the cost of the second appraisal to the homebuyer.

If the Mortgagee has ordered a second appraisal to document the increase in value, the Mortgagee must not use this appraisal for case processing and must not enter it into FHA Connection.

C. Property Inspection Report

If the resale price of the property is greater than 20 percent above the seller's acquisition cost, the property will be eligible for an FHA-insured mortgage only if the Mortgagee obtains a property inspection and provides the inspection report to the buyer before closing. The borrower, lender, or mortgage broker (if one is involved in the transaction) may order the property inspection. The lender or mortgage broker may charge the borrower for this inspection.

D. Repairs

If the inspection report notes that repairs are required because of structural or “health and safety” issues, those repairs must be completed prior to closing. After completion of repairs to address structural or “health and safety” issues, the inspector must conduct a final inspection to determine if the repairs have been completed satisfactorily and eliminated the structural or “health and safety” issues. The borrower, lender, or mortgage broker may order the final inspection.

This memorandum is for informational purposes and is a redaction of the notice. We advise you to read the complete notice published by the FHA, which is found at the following website: <http://www.gpo.gov/fdsys/pkg/FR-2011-02-03/pdf/2011-2434.pdf>.

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