

# Getting FHA/HUD approval: The who, what and why

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**W**hen looking for ways to grow their businesses, many small and medium-sized mortgage companies ignore Federal Housing Administration (FHA) and U.S. Department of Housing and Urban Development (HUD) loans. The reason: the mystery of the approval process, not the loan programs themselves. In turn, these companies leave the FHA/HUD market for larger outfits and competitors.

The FHA mortgage market, however, is a lucrative field, and the first step to solving the mystery behind FHA/HUD approval is to understand its requirements. Once your company is positioned for approval, obtaining it and capitalizing on the market's opportunities — including originating FHA reverse mortgages — are only one step away.

## Who needs FHA/HUD approval?

All mortgage companies must secure approval as HUD Loan Correspondent Mortgagees (for brokers) or Non-Supervised Mortgagees (for lenders) to originate or fund FHA-insured mortgage loans.

If your company is not HUD-approved, you must turn away FHA leads or refer potential borrowers to approved mortgagees. It is illegal to pay

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or receive referral fees under the Real Estate Settlement Procedures Act. According to the HUD Office of Lender Approval and Recertification, these restrictions also apply to the origination of FHA reverse mortgages.

### Business-type requirements

Only corporations, limited liability companies (LLCs) and limited partnerships are eligible for HUD approval. Sole proprietorships and individual brokers cannot obtain approval. LLCs also must have at least two members and an operating agreement that meets HUD requirements for their duration of existence, replacement of withdrawing members and transfer of FHA loans upon termination or dissolution of the LLC.

Finally, partnerships also must have a general partner that is a corporation or an LLC. If the general partner is an LLC, the LLC must meet the same requirements noted above. Partnerships also must have a partnership agreement that meets the same requirements as for LLC agreements.

There is no time requirement for a corporation, LLC or partnership; new entities can obtain HUD approval.

### Staff requirements

The mortgage company must have a vice president or higher-level officer with at least three years of mortgage-origination experience, though no FHA-origination experience is required. The mortgage company also must have a minimum of two full-time employees. Officers, members or limited partners who are actively involved in the company's day-to-day operations count toward the requirement.

All company employees must be employed exclusively by that company. Employees of a third-party agency are not counted under this rule. There are two exceptions, though. Use of a shared receptionist is permitted but does not count toward the two-employee requirement. An officer of the approval-seeking company also can serve as another corporate entity's officer if:

- **There is a clear and effective separation of the two entities**, and borrowers know at all times with which entity they are doing business.
- **There is a duly constituted senior corporate officer (i.e., a vice president or higher level) who conducts the business' affairs during normal business hours.** The designated senior corporate officer must have three years of mortgage-origination experience.

### State-licensing requirements

A mortgage company may obtain initial HUD approval for any of its offices. The company, however, must be licensed in each office's home state or exempt from licensing.

Upon obtaining HUD approval, the mortgage company will be able to originate in HUD-approved areas, which cover the region surrounding the HUD-approved office. For offices in smaller states, the area may encompass all or part of several states; in larger states, such as California and Texas, the approved area will cover part of the state. State-licensing rules do apply for each state in a company's approved area.

On a limited basis, additional approved areas may be granted. This can

include a neighboring approved region. Generally, though, it is necessary to open an office in the additional area and obtain a HUD branch-office approval.

## Facilities requirements

The office for a HUD-approved company must be located in a commercial-office space and must:

- Be “separate and apart” from any other entity
- Be in a location conducive to mortgage lending
- Be clearly identified to the public. This can include signs or the company’s name being listed on a building directory.
- Have standard office equipment, such as desks, computers, phones, a fax machine and a copy machine.

Operating more than one business out of the same office space is prohibited under the “separate and apart” rule. Use of a shared reception area is permissible. The actual company office, though, must be physically separated from any other business. HUD prefers separation by full walls with a separate entrance. Half walls or other physical barriers can be sufficient.

The rule of thumb is that there must be a clear and effective separation, so borrowers know at all times with which business entity they are communicating. An office in a suite of offices generally will meet this requirement.

## Quality requirements

All applicants must implement and practice from a quality-control plan to receive and maintain FHA/ HUD approval. Plan requirements are in Chapter 6 of the *Mortgagee Approval Handbook* as amended in November 2003. A copy of the plan must accompany an approval application.

The most-efficient and cost-effective method of obtaining an approvable plan is to purchase one from an FHA-licensing consultant or an FHA-compliance company, rather than attempting to draft your own. Plans from these sources can cost \$400 to \$1,000.

## Credit and sanctions requirements

The mortgage company as well as its principals — officers and those who own 25 percent or more of the company — must have acceptable credit histories. A business-credit report must be submitted with the approval application even if the company has no credit history. The principals must submit tri-bureau credit reports, which include a public-records search. No minimum credit score is required, but outstanding past-due accounts, collections, judgments and tax liens can lead to rejection.

Explanation and documentation can smooth over similar past or paid derogatory items. Bankruptcies, however, must have been discharged one to two years prior to application, depending on the type of bankruptcy.

Neither the company nor the principals may have incurred license restrictions, suspensions, disbarments or similar sanctions. HUD will conduct a background search in the Mortgage Asset Resource Institute system to verify possible sanctions.

## Sponsoring-lender requirements (loan correspondent only)

While the previous requirements cover loan correspondents and non-supervised mortgagees, only loan-correspondent applicants must have a sponsoring lender. The lender must be a HUD Approved Mortgagee with direct-endorsement underwriting authority. The sponsoring lender must provide a letter stating that it will fund all FHA mortgages originated by the company.

Generally, the sponsoring lender will review the HUD application package before it is sent for approval. After the application package passes review, the sponsoring lender will add the sponsorship/funding letter to the package and file it with HUD.

## Net-worth requirements

Each loan-correspondent applicant must have an adjusted net worth

of at least \$63,000, plus \$25,000 for each HUD-approved branch office. The maximum of required net worth is \$250,000.

Nonsupervised mortgagees must have an adjusted net worth of at least \$250,000, and there is no additional required net worth for branches.

For loan-correspondent and non-supervised-mortgagee applicants, 20 percent of adjusted net worth, to a maximum of \$100,000, must consist of liquid assets. These can include cash, cash equivalents or readily convertible instruments.

Applicants must prove their net worth by submitting audited financial statements prepared by a CPA who is licensed in their state. Requirements for initial approval only include standard, audited financial statements prepared according to Generally Accepted Accounting Principles and supplemented with a HUD Computation of Adjusted Net Worth page. A HUD audit/yellow-book audit only is required for annual recertification.

These net-worth requirements apply to the company and not to any individual owner of the company. Personal assets can be transferred to the company to meet the requirements; this does not include personal residences or vehicles.

For certain assets, audited financial statements must also include documentation substantiating that the company’s assets are legitimate. Stocks and bonds require inclusion of a brokerage statement indicating that the brokerage account is in the company’s name. For property, a copy of the deed with the company’s name is required. For company vehicles, a copy of the title and registration must be provided.

## Other requirements

Nonsupervised-mortgagee applicants must secure a \$300,000 fidelity bond and a \$300,000 errors-and-omissions insurance policy. They also must have a warehouse line of no less

than \$1 million, and it must be sufficient to fund the mortgagee's average 60-day origination-production pipeline. There are no bond, insurance or warehouse-line requirements for loan correspondents.

Lenders who obtain HUD approval as nonsupervised mortgagees cannot underwrite and fund FHA mortgages. They also cannot submit FHA mortgages directly to the FHA to be insured. Instead, newly approved mortgagees first must obtain direct-endorsement authority. To do so, the mortgagee must employ an underwriter who works exclusively for the mortgagee and who has at least three years' credit-evaluation experience and three years of appraisal experience. FHA underwriting experience is highly recommended, though not required.

After mortgagees sign up for the endorsement program with the proper HUD Home Ownership Center, they must go through a test-case phase. Here, the mortgagee's nominated underwriter must underwrite 15 FHA

test mortgages and submit those loan files to the center's underwriting department. After the department grades each test case, the center will grant the mortgagee direct-endorsement authority.

If mortgagees do not have a qualified underwriter at the approval stage, they may contract with another nonsupervised mortgagee with endorsement authority. This mortgagee may act as an authorized agent to underwrite FHA mortgages until a qualified underwriter is secured.


If a nonsupervised mortgagee is positioned to fund a large volume of FHA mortgages, it may underwrite the 15 test cases and submit the loan files to the Home Ownership Center's underwriting department. The department will review the files and use an authorized agent to underwrite the excess FHA mortgages.



Knowing if your company meets FHA/HUD-approval requirements is essential, especially considering the

enigma that is the application itself. It is important to understand all the implications, as the market can be lucrative for companies of any size.

*Author's note: None of the information contained in this article should be construed as legal advice or a legal opinion. All information should be verified by researching applicable state or federal regulations or by contacting the applicable state or federal regulatory agency.*

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