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U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

December 19, 2005

MORTGAGEE LETTER 2005-ML-48

TO: ALL APPROVED MORTGAGEES
ALL APPROVED APPRAISERS

SUBJECT: FHA Repair and Inspection Requirements for existing
properties and revisions to FHA Appraisal Protocol

In September 2005, the Federal Housing Administration (FHA) issued Mortgagee Letter 2005-34, which announced the adoption of four of Fannie Mae's revised appraisal reporting forms as well as the release of Revised Appendix D of Handbook 4150.2, CHG-1. This Mortgagee Letter provides additional guidance regarding FHA's repair and inspection requirements for existing properties and the use of the Fannie Mae appraisal reporting forms. All appraisal guidance for new construction that serves as security for FHA-insured mortgages remains unchanged beyond the clarification in the Revised Appendix D that the appraiser may appraise a home that is under construction and that is 90% or more complete without benefit of plans and specifications.

In a continuing effort to reform and standardize its appraisal requirements, FHA has shifted from its historical emphasis on the repair of minor property deficiencies and now only requires repairs for those property conditions that rise above the level of cosmetic defects, minor defects or normal wear and tear. FHA Roster Appraisers are reminded to report all readily observable property deficiencies, as well as any adverse conditions discovered performing the research involved in completing the appraisal, within the appraisal reporting form. Lenders should use professional judgment and rely upon prudent underwriting practices in determining when a property condition poses a threat to the safety of an occupant and/or jeopardizes the soundness and structural integrity of the property, such that additional inspections and/or repairs are necessary.

Revisions to the appraisal reporting guidance contained in Chapters 2 and 3 of Handbook 4150.2, CHG-1 are limited to those described in this Mortgagee Letter and Mortgagee Letter 2005-34 and Revised Appendix D. The specific areas of guidance that are rescinded by this Mortgagee Letter are delineated below. FHA intends to retire and replace Handbook 4150.2, CHG-1 in the near future.

Repair Requirements

As stated in Revised Appendix D, FHA now permits an "as-is" appraisal for existing properties that serve as security for FHA-insured mortgages when minor property deficiencies, which generally result from deferred maintenance and normal wear and tear, do not affect the safety of the occupants or the security and soundness of the property. FHA no longer requires repairs for

these types of minor cosmetic deficiencies to bring a property into compliance with FHA Minimum Property Requirements. Specifically, the guidance provided in Handbook 4150.2, CHG-1, Chapter 3, Paragraph 3-6, A-7 referencing all-weather road surfaces; Paragraph 3-6, A-8 referencing poor workmanship; Paragraph 3-6, A-11 referencing debris and trash in crawl space; Paragraph 3-6, A-16 referencing steps without a handrail; Paragraph 3-6, C referencing bare floors, badly soiled carpeting and cracked plaster and sheetrock is no longer applicable. Additionally, the guidance provided in Handbook 4905.1, REV-1, Chapter 2, Paragraph 2-7, A-2 referencing all weather road surfaces; Paragraph 2-8 referencing poor workmanship and Paragraph 2-14, C referencing crawl spaces with debris and trash is no longer applicable. Any reference to the Valuation Condition form (form HUD-92564-VC) and protocol for its completion contained in Handbook 4150.2 is no longer applicable as well. Examples of minor property conditions that no longer require automatic repair for existing properties include, but are not limited to:

- * Missing handrails
- * Cracked or damaged exit doors that are otherwise operable
- * Cracked window glass
- * Defective paint surfaces in homes constructed post 1978
- * Minor plumbing leaks (such as leaky faucets)
- * Defective floor finish or covering (worn through the finish, badly soiled carpeting)
- * Evidence of previous (non-active) Wood Destroying Insect/Organism damage where there is no evidence of unrepaired structural damage
- * Rotten or worn out counter tops
- * Damaged plaster, sheetrock or other wall and ceiling materials in homes constructed post- 1978
- * Poor workmanship
- * Trip hazards (cracked or partially heaving sidewalks, poorly installed carpeting)
- * Crawl space with debris and trash
- * * Lack of an all weather driveway surface

Examples of property conditions that may represent a risk to the health and safety of the occupants or the soundness of the property for which FHA will continue to require automatic repair for existing properties include, but are not limited to:

- * Inadequate access/egress from bedrooms to exterior of home
- * Leaking or worn out roofs (if 3 or more layers of shingles on leaking or worn out roof, all existing shingles must be removed before re-roofing)
- * Evidence of structural problems (such as foundation damage caused by excessive settlement)
- * Defective paint surfaces in homes constructed pre-1978
- * Defective exterior paint surfaces in home constructed post-1978 where the finish is otherwise unprotected.

Lenders must review the appraisal to determine whether the appraiser has reported any property conditions that will affect the health and safety of the occupants or the security and the soundness of the property and must require immediate repair where the property condition poses a threat to these criteria.

Inspection Requirements

FHA no longer mandates automatic inspections for the following items and/or conditions in existing properties:

- * Wood Destroying Insects/Organisms: inspection required only if evidence of active infestation, mandated by the state or local jurisdiction, if customary to area, or at lender's discretion
- * Well (individual water system): test or inspection required if mandated by state or local jurisdiction; if there is knowledge that well water may be

contaminated; when the water supply relies upon a water purification system due to presence of contaminants; or when there is evidence of:

Corrosion of pipes (plumbing)

Areas of intensive agriculture within 1/4 mile

Coal mining or gas drilling operations within 1/4 mile

Dump, junkyard, landfill, factory, gas station, or dry cleaning operation within 1/4 mile

Unusually objectionable taste, smell or appearance of well water

(superceding the guidance in Mortgagee Letter 95-34 that requires well water testing in the absence of local or state regulations)

* Septic: test or inspection required only if evidence of system failure, if mandated by state or local jurisdiction, if customary to the area, or at lender's discretion

* Flat and/or unobservable roof

Consequently, the guidance provided in Handbook 4150.2, Chapter 3, Paragraph 3-6, A-6 referencing mandatory termite inspections for any structure that is ground level and for any structure where wood touches the ground; Paragraph 3-6, A-5 referencing mandatory well and septic tests; and Paragraph 3-6, A-12 referencing mandatory inspections for a flat roof is no longer applicable. Additionally, the guidance provided in Handbook 4905.1, REV-1, Chapter 2, Paragraph 2-5, B-1 referencing mandatory well water tests is no longer applicable. In cases where well tests are necessary, as described above, FHA's existing testing standards outlined in Chapter 3, Paragraph 3-6, A-5a. of Handbook 4150.2 remain in effect and supercede Mortgagee Letter 95-34. If the appraiser reports a potential property deficiency that may pose a threat to the safety of the occupants or the security and soundness of the property, the lender will require an inspection of the condition to determine whether repairs are necessary to mitigate or resolve the problem. Examples of conditions that will continue to require automatic inspections include, but are not limited to:

- * Standing water against the foundation and/or excessively damp basements
- * Hazardous materials on the site or within the improvements
- * Faulty or defective mechanical systems (electrical, plumbing, or heating)
- * Evidence of possible structural failure (e.g., settlement or bulging foundation wall)

Additional Changes to Appendix D, Valuation Protocol

As a result of these changes in FHA's repair and inspection requirements for existing properties, Revised Appendix D of Handbook 4150.2, CHG-1 has been updated. The following pages in Revised Appendix D have been updated to reflect these changes: 2, 4, 19, 23, 27, 50, 55, 60, 85, 92, 112, 116 and 120. Revised Appendix D is attached to this Mortgagee Letter and will be available online at:

<http://www.hudclips.org/cgi/index.cgi>

Conditional Commitment Form

Mortgagee Letter 2005-34 instructed the mortgagee to provide a copy of the completed form HUD-92800.5B (Conditional Commitment Direct Endorsement Statement of Appraised Value) to the mortgagor at least five business days prior to loan closing. The five-business day delivery date prior to loan closing of the Conditional Commitment form is hereby rescinded and lenders are instructed to ensure that the mortgagor receives either a completed copy of HUD 92800.5B, or a copy of the completed appraisal report, at or before loan closing.

This Mortgagee Letter is effective for all appraisals performed on or after January 1, 2006.

If you have any questions regarding this Mortgagee Letter, please contact your local Homeownership Center (HOC) in Atlanta (888) 696-4687, Denver

(800) 543-9378, Philadelphia (800) 440-8647, or Santa Ana (888) 827-5605.

Sincerely,

Brian D. Montgomery
Assistant Secretary for Housing-
Federal Housing Commissioner

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