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The FHA 203(k) Mortgage

The **FHA 203(k) mortgage**, often referred to as an **FHA Rehab Loan**, is a government-backed loan designed to assist buyers in purchasing a home that requires repairs or renovations. This loan allows the cost of these improvements to be bundled into a single mortgage, rather than requiring a separate home loan and renovation loan. This streamlined approach makes homeownership more accessible for properties that might not qualify for conventional financing.

The Most Common FHA 203(k): The Limited 203(k)

The **Limited FHA 203(k)** is the most commonly used renovation mortgage program and allows up to **$35,000 in repairs and improvements**.

Eligible repairs may include:

- Kitchen and bath updates
- Flooring, paint, and cosmetic improvements
- Roofing repairs or replacement
- HVAC systems
- Water heaters
- Safety and health-related repairs
- Certain structural and code-related corrections

- The entire **$35,000** is not reserved strictly for repairs. The repair budget may also include:
- 203(k) inspection fees
- Contingency reserves (up to 20% of repair costs)
- Certain allowable renovation-related expenses

These items are included within the overall **$35,000** limitation.

Your Most Important Job: Choose the Right Loan Officer

The success of a 203(k) transaction often depends on selecting a loan officer who is experienced and hands-on throughout the process.

A major advantage is having your loan officer visit the property with you before the transaction begins. Together, you can establish the two numbers that drive every FHA 203(k) loan decision.

Number #1: The "As-Is Value"

The **As-Is Value** represents the property's value before repairs are completed.

Ultimately, this value will be determined by an FHA appraiser, but the Realtor and loan officer should work together to estimate a conservative number early in the process.

For FHA 203(k) purposes, the As-Is Value is defined as the lesser of:

- The contract sales price (after subtracting seller concessions or inducements to purchase), or
- The appraiser's As-Is Value

Understanding this number early helps determine whether the project is feasible.

Number #2: The “After Completion Value”

The **After Completion Value** is the projected value after all repairs and improvements are completed.

The FHA appraiser determines this value after reviewing:

- Contractor bids
- Repair plans

· Specifications and scope of work

One unique benefit of FHA 203(k) financing is that FHA may allow financing up to approximately **110% of the completed value**, providing some flexibility when structuring renovation costs.

Understanding the relationship between the As-Is Value and the After Completion Value is critical when evaluating whether a project makes financial sense.

Contractor Management: A Key Realtor Responsibility

One of the most important Realtor contributions is helping gather proper contractor documentation.

Contractors should be:

- Properly licensed
- Properly insured
- Bonded when required
- Experienced and reputable

“Fly-by-night” contractors can create significant underwriting and approval issues.

You should also help ensure contractor bids are:

- Detailed
- Accurate
- Properly structured
- Submitted on the correct forms

Your loan officer should provide guidance regarding required documentation and bid formats.

Underwriters may also request:

- Contractor references
- Evidence of prior work
- Verification of experience

The more organized the contractor package, the smoother the transaction.

Preparing Your Buyer

Buyers should understand upfront that renovation financing generally costs more than a traditional FHA loan.

Typical expectations include:

- Interest rates that may be up to approximately 0.50% higher
- Additional lender and renovation administration fees
- Several thousand dollars in additional transaction costs

Some eligible renovation-related expenses may be financed into the mortgage.

Proper expectation setting early in the process helps prevent surprises later.

Timing Expectations

While a Limited 203(k) can close quickly when all parties are organized, realistic expectations are important.

Limited 203(k)

- Ideal closing timeline: 30 days
- Recommended contract timeline: 45-60 days when multiple contractors are involved
- Repairs must generally be completed within 9 months

Standard FHA 203(k)

The **Standard FHA 203(k)** is designed for larger renovation projects.

Unlike the Limited 203(k), there is no fixed $35,000 repair cap.

Instead, the maximum financing is largely determined by:

- The As-Is Value
- The After Completion Value
- FHA lending guidelines

Standard 203(k) projects may include:

- Structural modifications
- Room additions
- Major renovations
- Converting a single-family residence into a multi-family property (when permitted)

Additional differences include:

FHA Consultant Required

- A HUD-approved FHA Consultant is mandatory on all Standard 203(k) transactions.

Mortgage Payments May Be Financed

- Unlike the Limited 203(k), the Standard program may allow certain mortgage payments during construction to be **included in the financing**.

Completion Timeline

- Repairs must generally be completed within 12 months.

Final Thoughts

The FHA 203(k) program can be an excellent solution when significant repairs are needed. However, it should not always be the first solution considered.

Before pursuing a renovation mortgage, Realtors should explore all available alternatives for buyers and sellers to accomplish the same goal through simpler means.

Depending on the situation, repairs may sometimes be negotiated between the parties in ways that avoid the additional documentation, time, cost, and complexity associated with renovation financing.

A knowledgeable loan officer should review all available options and help determine the path that creates the smoothest transaction with the least amount of stress for both buyer and seller.

<u>Remember</u>:

The Realtor's role is not to be the 203(k) expert.

Your role is to:

1. **Identify Opportunities**
   Properties needing repairs may be FHA 203(k) candidates.
2. **Assemble the Right Team**
   Partner with an experienced loan officer and qualified contractors.
3. **Determine Value**
   Establish realistic As-Is and After-Completion values.
4. **Gather Documentation**
   Collect contractor bids, licensing, insurance, and supporting documents.
5. **Manage Expectations**
   Prepare buyers for timelines, inspections, and renovation requirements.

When the pieces come together, FHA 203(k) financing can become a powerful tool for helping buyers purchase homes that otherwise may not qualify for traditional financing.

NOT A COMMITMENT TO LEND. ALL LOANS SUBJECT TO CREDIT APPROVAL

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