

FHA 203K INFORMATION GUIDE

INFORMATION GUIDE FOR BORROWERS AND THEIR CONTRACTORS

ABOUT THIS INFORMATION GUIDE

The Information Guide details the FHA 203K Renovation loan program for Borrowers and their Contractors. This guide will provide an overview of the necessary steps to close a renovation loan and explain how the renovation funding process works after the loan is closed. For purposes of this guide, "Lender" refers to On Q Financial.

LENDER'S ROLE IN THE RENOVATION PROCESS

The Lender's primary responsibility is to protect its legal, physical and financial interest and does not warrant that the project will be completed within the budget or to the standards and expectations of the Borrower. The Lender will perform a review of the Contractor for eligibility. The Lender has contracted with the Construction Loan Management Company, Land Gorilla, to assist with the renovation related elements of the 203K program.

LAND GORILLA'S ROLE IN THE PROCESS

Land Gorilla is an industry leader in Construction Loan Management and will assist the lender in pre-closing due diligence and post-closing loan management. Land Gorilla will review the renovation documents for program acceptance. After the loan closing, Land Gorilla will work on behalf of the Lender to make sure that the project is on schedule, manage draws disbursements and confirm the loan program requirements are being met. Land Gorilla will appoint a dedicated Construction Loan Administrator who be the point of contact for the Borrower, Contractor, Inspector, Title Company and Lender.

IMPORTANT NOTICE

The Lender, its employees and its Construction Loan Management Company, Land Gorilla, are not contractors, engineers, soil analysts, architects, etc., and do not warrant, certify or control the quality, scheduling, structural integrity, etc., of your project. The Borrower is always encouraged to seek competent advice from qualified persons or firms on all construction matters. The Borrower is solely responsible for selecting their Contractor(s) and performing appropriate due diligence. Always review the Contractor's references, licensing, and financial background.

Under most state laws, those who work on a property or provide materials but are not paid, have a right to enforce their claim for payment against the property. This claim is known as a Construction Lien or Mechanic's Lien. If the Contractor fails to pay subcontractors or material suppliers, or neglects to make other legally required payments to the people who are owed funds, these subcontractors and suppliers may look to the property for payment even if the Borrower or Lender have paid the Contractor in full. Borrowers and Contractors are responsible to collect copies of all Lien Waivers from the Contractor, subcontractors, and suppliers.

203K RENOVATION LOAN PROGRAM

The FHA 203K Loan Program fills a unique and important need for homebuyers. When buying a house that needs repair or modernization, homebuyers usually have to follow a complicated and costly process. The interim acquisition and improvement loans often have relatively high interest rates, short repayment terms and a balloon payment. However, this program offers a solution that helps borrowers covers both the acquisition and renovation of a property. The FHA 203K Loan Program saves borrowers time and money.

The FHA 203K Loan Program is for the renovation of a home that is at least a year old. A portion of the loan proceeds is used to pay the seller (purchase transaction), or pay off the existing mortgage (refinance transaction), and the remaining funds are placed in an escrow account and released as renovation is completed.

The FHA 203K Loan Program allows for the Borrower to incorporate the traditional renovation related soft costs into the loan, such as plans, specifications, permits, inspections, title updates, borrower's interest reserves, borrower's contingency and Lender's supplemental origination fees.

There are two different types of FHA 203K loans available and choosing will depend on the amount of improvements the property needs.

THE 203K STANDARD

The **203K Standard** formerly known as the "203K Full" is for homes that need major renovation and because of the size and complexity of the FHA 203K Standard loan, FHA requires the use of an FHA 203K HUD Consultant. You will find the FHA 203K HUD Consultant very helpful, as they will assist in determining the scope of repairs, the budget for the work to be done, and verify all work is completed satisfactorily and as stated by the contractor. See eligible improvements under the "Program Details" section of this document.

THE 203K LIMITED

The **203K Limited** formerly known as the "203K Streamline" the 203K Limited is used for homes that need minor repairs, remodeling or upgrades and has a cap of \$35,000 which will need to include all soft costs like inspections, borrower's contingency (at least 10%), title updates, and other related soft costs. See eligible improvements under the "Program Details" section of this document.

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HOW TO GET STARTED

GET PREQUALIFIED

First you need to get prequalified with the Lender so that you know your purchasing power. Work with your Lender and know your options before you start the home search.

FINDING YOUR PROPERTY

Next you want to search for a property. Make your offer subject to 203K financing and allow for extra time in the loan closing. Work with your Lender and real estate agent to set appropriate closing expectations.

If your offer is accepted it's time to get to work. You will want to create a timeline and schedule to keep your closing on track. Missing important milestones could delay your closing and cause you to lose the property.

REQUEST THE 203K HUD CONSULTANT

Your Lender will provide you contact information to your 203K HUD Consultant. The Consultant will require payment for their work on your project. If you are planning on using the 203K Limited program you will not need a 203K HUD Consultant.

CONTRACTOR SELECTION & ACCEPTANCE

If you don't have a Contractor in mind, it's time to find one. Look for a licensed, insured and reputable contractor that is familiar with the work you are looking to complete, due your research. Sites such as Angie's list, home advisor, and yelp are great resources. Gather the required documents from your Contractor (Contractor Package) and provide them to the Lender to get the Contractor accepted, this should be done as soon as you have settled on a Contractor(s). The Lender will review the Contractor's Package for acceptance.

FINALIZE THE SCOPE OF WORK

Once you have decided on your Contractor you will need to meet them and the 203K HUD Consultant at the property, preferably at the same time, to determine the renovation Scope of Work. Be prepared and have a list of your "must haves" and "wish list" items you want included in the renovation. The 203K HUD Consultant will also include items that must be included to meet HUD health & safety requirements. These are the items that HUD requires be completed under the program to be eligible. The 203K HUD Consultant will complete the Work Write-Up and your Contractor will complete their final bid.

APPRAISAL PROCESS

Once the Work Write Up and final bid by your Contractor is completed your Lender will order the Appraisal. The appraiser will use these items, along with the purchase contract to develop the appraisal report based on a value that is subject to the repairs being completed.

FINAL APPROVAL

Land Gorilla will review all the renovation related documents, reports, and forms for program acceptance. Separate from credit approval by the Underwriter Land Gorilla will work and help resolve any outstanding conditions related to the renovation.

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203K LIMITED PROGRAM DETAILS

The FHA 203K Limited is intended to provide homebuyers a means to complete uncomplicated renovation projects when plans, engineers or architects are not required. If your renovation is more extensive or contains work not allowable under the Limited program see the 203K Standard Program Details section of this document for more information.

REQUIREMENTS (203K LIMITED)

- Total cost of project must not to exceed \$35,000 (including all project soft costs)
- The home must be occupied within 30 days of closing
- The work must start within 30 days of closing
- The project can easily be completed in less than 180 days
- Work must not stop for a consecutive 30 days
- No structural changes are allowed

ELIGIBLE IMPROVEMENTS (203K LIMITED)

- Roofs, gutters and downspouts
- HVAC systems
- Plumbing and electrical systems
- Flooring
- Kitchens & baths
- Painting
- Weatherization (windows, doors, insulation, weather stripping, etc.)
- Appliances
- Accessibility improvements for persons with disabilities
- Lead-based paint stabilization or abatement of lead-based paint hazards
- Decks, patios, porches
- Basement finishing and remodeling (excludes structural repairs)
- Basement waterproofing
- Exterior Siding
- Septic systems and wells

INELIGIBLE IMPROVEMENTS (203K LIMITED)

- Major rehabilitation or major remodeling
- Structural changes
- No new construction such as room additions
- Repairs requiring detailed drawings or architectural exhibits;
- Landscaping or similar site amenity improvements;
- Any repair or improvement requiring a work schedule longer than six (6) months; or
- More than two (2) payments per contractor
- Swimming pools
- Barbecue pits
- Hot tubs & Saunas
- Tennis courts
- Gazebos
- Alterations to support commercial use
- Improvements that are not a permanent part of the real property

203K LIMITED PROGRAM DETAILS (cont.)

DRAW PROCESS (203K LIMITED)

After the loan closes Land Gorilla will assign a dedicated Construction Loan Administrator (CLA) to work with the Borrower and Contractor. The CLA will work on behalf of the Lender to manage the draw disbursements and various program requirements. The CLA will become the point of contact for the Borrower, Contractor, Inspector, Title Company, and Lender. All issues and questions should be routed to the CLA assigned to the loan.

The FHA 203K Limited allows for two disbursements. The Contractor may receive funds for the initial draw for permits, materials and some labor when the contractor is not able to defer receipt of payment until work is completed. The final payment will be issued when the project is completed and the final draw package is completed and accepted.

Upon completion of the project the Construction Loan Administrator will coordinate the final draw and prepare the necessary documents. The CLA will order a final inspection and title search. Property must be free of mechanics liens and the inspection report must demonstrate that the work is completed. Below is a list of documents that may be required to process the final draw disbursement.

- Draw Request (HUD Form 92577)
- Change Order if applicable (HUD Form 92577)
- Conditional Lien Waivers from all Contractor (State Specific Form)
- Permit Card from local agency
- Certificate of Occupancy if required by local jurisdictions
- Copy of all necessary inspection reports
- Copy of any State Required documents
- Borrower Letter of Completion
- Final Release Notice

The final draw will include the interest earned and remaining contingency holdback in the final payment on the renovation escrow account. However, if it is required to protect the priority of the security instrument, the Mortgagee may retain the holdback for a period not to exceed 35 Days (or the time period required by law to file a lien, whichever is longer), to ensure compliance with state mechanics lien laws or other state requirements

203K STANDARD PROGRAM DETAILS

FHA 203K Standard program ranges from relatively minor projects to more complex. For this reason FHA requires that a 203K HUD Consultant be used. In some renovations the home may not be habitable during the renovation and FHA allows the borrower to finance up to 6 months of mortgage payments into the loan.

REQUIREMENTS (203K STANDARD)

- No Cap or Maximum for project amount
- The work must start within 30 days of closing
- The project can easily be completed in less than 180 days
- Work must not stop for more than 30 consecutive days
- Contractor does not receive any upfront monies (exceptions for supplier deposits)
- 203K HUD Consultant must be used
- 10% holdback at each draw (retainage)

ELIGIBLE IMPROVEMENTS (203K STANDARD)

Eligible improvements include all eligible improvements of the FHA 203K(s) Limited as well as the following improvements:

- Structural alterations and reconstruction
- Remodeled bathrooms and kitchens
- Elimination of health and safety hazards
- Changes that improve appearance and eliminate obsolescence
- Connecting to a public water or sewer
- Installing a well and/or septic system
- Major landscape work and site improvements
- Correction of grading and draining problems
- Enhancing accessibility for a disabled person
- Energy conservation improvements

INELIGIBLE IMPROVEMENTS (203 STANDARD)

- Swimming pools
- Barbecue pits
- Hot tubs
- Saunas
- Tennis courts
- Gazebos

203K STANDARD PROGRAM DETAILS (cont.)

DRAW PROCESS (203K STANDARD)

After the loan closes, Land Gorilla will assign a dedicated Construction Loan Administrator (CLA) to work with the Borrower and Contractor. The CLA will work on behalf of the Lender to manage the draw disbursements and various program requirements. The CLA will become the point of contact for the Borrower, Contractor, Inspector, Title Company, and Lender. All issues and questions should be routed to the CLA assigned to the loan.

- The FHA 203K Standard allows for up to five (5) disbursements
- The Lender must hold back 10% of each draw (retainage) from the renovation
- The Contractor may receive funds for up to 50% of deposit items such as cabinets, doors, and windows when a contract can be verified
- The Contractor may receive funds at closing for permit fees (the permit must be obtained before work commences)
- The 203K HUD Consultant will inspect the property for the interim and final final draws
- The 203K HUD Consultant will coordinate the inspections and prepare the draw request, lien waivers, inspection report, and possible change order forms
- The CLA will review the consultants work, review title update, and documents to facilitate the draw disbursement

Upon completion of the project, the Construction Loan Administrator will coordinate the final draw and prepare the necessary documents. The CLA will review the final inspection by the 203K HUD Consultant and title search. Property must be free of mechanics liens and the 203K HUD Consultants inspection report must demonstrate that the work is completed. Below is the list of documents that may be required to process the final draw disbursement.

- Draw Request (HUD Form 92577)
- Change Order if applicable (HUD Form 92577)
- Conditional Lien Waivers from all Contractor (State Specific Form)
- Permit Card from local agency
- Certificate of Occupancy if required by local jurisdictions
- Copy of all necessary inspection reports
- Copy of any State Required documents
- Borrower Letter of Completion
- Final Release Notice

The final draw will include the interest earned, remaining contingency holdback, and unused interest reserves in the final payment from the renovation escrow account. However, if it is required to protect the priority of the security instrument, the Mortgagee may retain the holdback for a period not to exceed 35 Days (or the time period required by law to file a lien, whichever is longer), to ensure compliance with state mechanics lien laws or other state requirements.

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FREQUENTLY ASKED QUESTIONS

Frequently Asked Questions to help Borrowers and Contractors.

CAN LAND GORILLA MANAGE THE PROJECT?

No, Land Gorilla does not manage projects for Borrower's. If a Borrower is looking for a project manager to help assist in the renovation process they can contract with an industry professional such as a 203K HUD Consultant or Architect.

CAN THE CONTRACTOR RECEIVE MONEY UPFRONT TO GET STARTED?

This depends on if the program selected is the Limited or Standard version. The Limited allows for the Contractor to receive funds on the initial draw if the Contractor can not defer payment till the work is completed. The Standard version of the program does not allow the Contractor to receive funds in advance, however, it does allow for up to 50% deposits to be paid to supplier when a contract is established and confirmed by the Land Gorilla CLA.

WE WANT TO USE LOWE'S OR HOME DEPOT SERVICES. HOW DO I GET THEM ACCEPTED?

Land Gorilla has pre-approved both Lowe's and Home Depot and a copy of the contract should be provided with the Contractor Acceptance process. Both companies offer multiple program to engage with the home improvement store. It's important to pay attention to the contract and make sure that the contract is with Home Depot or Lowes and not with a recommended provider. Home Depot and Lowes must warranty and guarantee the work.

MY CONTRACTOR SAYS A LICENSE IS NOT REQUIRED IN THIS AREA? CAN THEY STILL GET APPROVED?

Yes, not all jurisdictions have licensing requirements. Have the contractor provide a letter of explanation in lieu of a license when providing the Contractor package.

WHY DO WE NEED A LEAD PAINT TEST COMPLETED ON HOMES PRIOR TO 1978?

FHA has special provisions for homes built prior to 1978. Not to be confused with seller requirements for Lead Based Paint statements. Renovations that are disturbing interior or exterior painted surfaces may require additional requirements such as inspections, statements, and/or testing.

HOW MANY DRAWS DOES MY CONTRACTOR RECEIVE?

How many draws the contractor receives depends on the program. See the program details of this document to learn more.

MY CONTRACTOR HAS NOT STARTED OR STOPPED SHOWING UP. WHAT SHOULD I DO?

The program requires that work must start within 30 days of the loan closing and that work must not stop for more than 30 days. If you believe that you will exceed either one of these requirements contact your Construction Loan Administrator immediately. HUD may require that the lender use the renovation funds to pay down your principal balance.

I WANT TO DO ADDITIONAL WORK THAT IS OUTSIDE THE SCOPE OF WORK ACCEPTED BY THE LENDER. IS IT POSSIBLE TO DO THIS AT THE SAME TIME?

Consult with your 203K HUD Consultant and Construction Loan Administrator. Some work may delay payments to your Contractor if work is not completed during your inspections.

IMPORTANT TERMS

Terms and terminology to help understand consumer construction lending and assist with understanding concepts and responsibilities.

CHANGE ORDER - A change order is a component of the change management process whereby changes in the Scope of Work agreed to by the Borrower, Contractor, and Lender are implemented. Change orders may change the work, costs, and/or time elements to a project. All change orders must be approved by Land Gorilla before the start of the work.

RETAINAGE - Retainage is a portion of the agreed upon contract price deliberately withheld until the work is complete to assure that contractor or subcontractor will satisfy its obligations and complete a project.

LIEN WAIVER - In the mechanics lien process, a lien waiver is a document from a contractor, subcontractor, materials supplier, or other party to the construction project stating they waive any future lien rights to the property for the amount paid. Waivers may be State specific and available in conditional formats that allow for the person to waive future lien rights based on conditions of "good payment".

LIEN RELEASE - In the mechanics lien process, a lien release is a document from a contractor, subcontractor, materials supplier, or other party to the construction project stating they release their lien rights to the property.

LIEN - A Construction Lien, also known as a mechanic's lien, is a claim made against a property by a contractor or other professional who has supplied labor or materials for work on that property. Construction liens are designed to protect professionals from the risk of not being paid for services rendered.

REHABILITATION LOAN AGREEMENT - The legal document that Lender uses to construct the terms between the Borrower and Lender to the renovation loan. Outlines the term of the renovation between the parties and establishes clear responsibilities to the Borrower's performance under the Agreement.

TITLE UPDATE - Title update is a general term to describe an update to the Title Policy. Title updates may be referred to as title endorsements, date down endorsement, bring downs, run downs, or title search. Title updates provide a tool to verify if the property is free of liens.

RENOVATION/REHABILITATION ESCROW ACCOUNT - For the 203K Loan Program the funds provided for renovation are placed in an interest-bearing escrow account Renovation Escrow Account (Rehabilitation Escrow Account).

HOMEOWNER CONTRACTOR AGREEMENT - Contractual document used to establish an agreement between the Borrower and Contractor.

PLANS & SPECIFICATIONS - A key part of the process of designing and renovating homes is having detailed plans & specifications. They are a means of communicating between parties, and of ensuring that the appropriate designs, materials, and construction techniques are used.

CONTRACTOR'S DEPOSITS - Contractors may require an upfront deposit to get the project started for obtaining permits, insurance or other direct construction related costs. These funds may be advanced at closing depending on Land Gorilla approval and program guidelines.

RENOVATION ACKNOWLEDGEMENT

The funds provided for renovation are placed in an interest-bearing escrow account (Renovation Escrow Account).

Land Gorilla will require that a contingency reserve be added to the loan to cover unforeseen repairs or deficiencies during the renovation. If funds remain after the renovation is complete, they can be applied to additional elective repairs/improvements or can be used to reduce the principal balance. If the Borrower deposits funds into the account, the funds deposited can be paid directly back to the Borrower at the completion of the project.

The Borrower is responsible for selection and review of contractors. When selecting a contractor, always review contractor references, licensing and financial backgrounds. A Contractor Questionnaire (Form 20001R) is used during the contractor vetting process. It's important to know that the review of the contractor by the Lender will be for the Lender's benefit only and should not be relied on by the Borrower or to replace the Borrower's responsibility in reviewing their contractor.

The Borrower and Contractor are responsible for negotiating any agreements or warranties. The Lender and Land Gorilla do not provide any warranty on the Contractor's work.

The Borrower is responsible for overseeing the renovation and ensuring that it is done as specified in the Homeowner Contractor Agreement with the Contractor. If work stops for an extended period of time, or there are problems with the work performed that may cause significant delays, the Borrower must contact Land Gorilla.

The Lender and Land Gorilla do not warrant or guarantee the condition of the property being purchased or the renovation.

The Borrower is responsible for making the mortgage payment each month, even if the renovation is not satisfactorily completed. The Borrower has the option to escrow mortgage payments into a mortgage payment reserve if the home will be deemed uninhabitable for a period longer than 30 days, not to exceed 6 months.

Funds are released to the Contractor after an inspection of the improved Work. Funds for incomplete Work or Work not in place are not allowed. The funds are provided in a check made payable jointly to the Borrower and the Contractor. Payments are requested via the draw process described in this guide.

Borrowers should not approve funds to be released to the Contractor if they are not happy with the work. Borrowers should not accept unsatisfactory work. Borrowers should not pay the contractor "up front" out of their own funds before the renovation is satisfactorily completed.

The Lender may withhold some of the funds from each Draw Request in the form of Retainage. These funds are paid to the Contractor when the work is completed. This helps to protect the Borrower from a Contractor failing to complete the renovation.

The loan and project are based on contract(s), specification, bids and/plans. NO changes can be made without first getting approval from Land Gorilla. If the Borrower and Contractor would like to revise the original approved renovation, they must submit a Change Order Request (HUD Form 92577) to Land Gorilla for approval, and deposit any additional required funds (including contingency reserve) in the Renovation Escrow Account.

Borrower(s) acknowledge that no other work with the Contractor or other contractors will be done until the completion of this project without receiving approval from the Construction Loan Administrator at Land Gorilla. Borrower(s) acknowledge that no other work has been agreed to outside of the bids and contacts presented to Lender before closing.

When the renovation is completed, the Lender should provide the Borrower an accounting for all distribution of funds in the Renovation Escrow Account.

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RENOVATION ACKNOWLEDGEMENT (cont.)

I/We acknowledge that I/We have read the FHA 203K Renovation Information Guide and the Renovation Acknowledgement and that I/We understand them.

BORROWER NAME

BY _____

DATE _____

CO-BORROWER NAME

BY _____

DATE _____