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Steer Clear of FHA Financing: Dealing with Investors Who Seek Quick Profits

In a recent article, top mortgage originator and national trainer Greg Frost noted that hyper-appreciation of property values in Albuquerque, NM had drawn attention from many out-of-state investors in the last year. The area saw an influx of savvy investors ready to bid on HUD Repos and other affordably priced single-family dwellings.

Frost warned mortgage originators and Realtors® to be wary of investors who try to represent themselves as owner occupants in this type of situation. They may seek to obtain 97% FHA financing, even though their real mission is to turn around and sell for a quick profit. Not only does the lender lose their investment due to the rapid pre-pay in this type of transaction -- The Government National Mortgage Association-backed security loses value as well!

This practice is called "flipping," which the United States Department of Housing and Urban Development (HUD) defines as "...a predatory lending practice whereby a property that was acquired is quickly resold for a considerable profit with an artificially inflated value, often abetted by a mortgagee's collusion with the property appraiser and others involved in the mortgage loan transaction."*

Flipping is not good for FHA, GINNIE MAE, or the affected lenders. Moreover, the negative effect dominoes to those earnest purchasers who end up bearing a harsh increase in interest rates as lenders seek to recoup their losses.

HUD established time restriction guidelines in 2003 in an effort to crack down and prohibit the use of FHA loans to support property flipping. The rule forbids a sale within 90 days of purchase, and requires increased documentation by the lender if an FHA-financed home is flipped within 180 days. However, HUD's Prohibition of Property Flipping in HUD's Single Family Mortgage Insurance Programs; Additional Exceptions to Time Restrictions on Sales; Interim Rule was published in December 2004 to broaden and clarify certain exceptions to the existing regulation.

The interim rule, which became effective on January 24, 2005, now permits federal agencies that acquire properties [i.e., HUD's Real Estate-Owned (REO) properties] as a result of a function of their programs, to quickly market and sell those acquired properties.

Additionally, the interim rule provides that time restrictions on sales do not apply to inherited property. The purpose of time restrictions is to curb fraudulent property flips, whereby a property is deliberately acquired for the purposes of reselling quickly and at an inflated value. While an Heir may turn a property quickly and at a profit, HUD now acknowledges that the sale of an inherited property falls outside the intended scope of the regulation.

The interim rule also establishes that time restrictions do not apply to the sale of properties acquired by an employer or relocation agency in connection with the relocation of an employee.

With the exception of an Heir selling a home or a person who is forced to relocate due to a job transfer, the HUD definition of flipping applies to all transactions by individuals (non-agencies) who purchase or refinance using FHA funds. Greg Frost advises that if you determine that a potential buyer is really an investor looking for a quick turnaround, steer away from FHA financing entirely and seek to place the buyer in a conventional loan.

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