MOBILITY

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# Revisiting the FHA Anti-flipping Rule

In recent discussions with lenders, one of the most apparent developments affecting the industry is a reinvigorated approach to ensure that their loans comply with all applicable underwriting guidelines. Secondary market investors typically reserve the right to sell back non-conforming loans, and in the current market climate it is more important than ever for lenders to ensure they will not be left holding problematic mortgages. On mobility transactions, this enhanced scrutiny is seen most often in objections relating to the FHA Anti-flipping Rule, a subject of much discussion in our industry in years past. Generally, the rule prohibits FHA financing in two circumstances: when the seller has not owned the property for a certain period, typically 90 days; and when the seller is someone other than the owner of record. Thanks to Worldwide ERC® lobbying efforts, mobility transactions are exempt from the time restrictions on resales, but there is no such exemption from the owner of record requirement.

From its adoption in 2003 to the latter months of 2008, the rule was not a common cause for objections to the sale of relocation property to FHA borrowers. While the two sales might objectively look like a flip, it was generally understood that there was little risk of fraud or inflated sale prices because of a relocation management company's (RMC) involvement in the transaction. However, as FHA loans became more popular and underwriting scrutiny increased, lenders began objecting to the use of a single deed based on the rule. Namely, if an RMC sells property to a resale purchaser when they are not in title, they are not the owner of record and FHA will not insure the borrower's loan. Therefore, two deeds are now almost universally required for an FHA lender to fund the loan. It may even be the case that a lender will require the first deed be recorded before resale closing, so that the RMC is the "owner of record" when underwriting decisions are being made on the borrower's loan. Attorney Burton S. Kliman of Kliman Law Offices, P.C., Newton, Massachusetts, who specializes in both relocation and investor transactions, adds, "When two deeds are used in a relocation transaction, instead of recording them simultaneously as is currently the practice, it may be better to split them up with the deed from the transferee to the RMC recorded first and then the deed from the RMC to the third-party buyer recorded at least 30 days later in conjunction with the purchase money closing. The splitting up of the process coupled with any supporting documents relating to the transfer may be enough to satisfy most lenders."

Although the rule explicitly exempts mobility transactions from the rule's time restrictions on resales, there are still instances where it can pose a problem. In an abundance of caution, certain lenders may still require a written approval from HUD stating that the transaction qualifies for the relocation exemption before they will fund the loan. Generally, this is only the practice of smaller, regional lenders that do not have the mobility expertise of national lenders. If they feel they are not in a position to determine whether the exemption applies, they will wait for HUD to explicitly approve the transaction, which may take from one to six weeks. This issue may be alleviated, at least temporarily, by HUD's recent one-year waiver of the time restrictions. Effective February 1, 2010, properties that have been owned for less than 90 days will be eligible for FHA insurance if the lender determines that the transaction is conducted at arms-length (no identity of interest between the parties to the transaction). While this provides further heft to the argument that the time restrictions should not apply, it remains to be seen whether lenders that required a written approval from HUD regarding the mobility exemption will do the same with regard to the arms-length requirement.

With FHA borrowers comprising a historically high percentage of the market, it is no small matter to plan for compliance with the Anti-flipping Rule. While the availability of FHA financing certainly has increased the potential liquidity of transferee property, it should be understood from the outset that FHA transactions may introduce new costs, complexities, and even delays to the homesale process. If one deed typically is used in the state, a second deed, and all its attendant costs, may be necessary to convey title to an FHA borrower. If a property is already in inventory, it may be necessary to restructure the conveyance once it becomes clear that a potential purchaser will be obtaining FHA financing. Various third-party titleholder arrangements—nominee services, trusts, and the like—may be called into question. If the lender will require a waiver from HUD, it may require copies of the sales contracts, an updated title commitment showing the RMC in title, and other evidence of the transaction. If HUD does not respond in a timely manner, closing may have to be delayed and additional carrying costs incurred.

Finally, while the Anti-flipping Rule is FHA-specific, it certainly is possible that the VA or even conventional lenders and investors may explicitly incorporate its key provisions into their underwriting guidelines, and we recently have seen indications that this may be on the horizon. One thing is certain: the FHA Anti-flipping Rule is not something to be overlooked as in times past, and planning accordingly will be key to a successful closing.

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