

MAR/APR
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Update

NPMA LIBRARY UPDATE

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HUD Shifts Policy on Wood Destroying Insect Inspections

Background

On December 19, 2005, the Department of Housing and Urban Development (HUD) issued Mortgagee Letter 2005-ML-48, which, among other things, affirmed HUD's policy of several years which requires appraisers to call attention to any defects including wood destroying insects. While this is not new, the Mortgagee Letter also aligns HUD's policy

for situations requiring WDI inspections to be consistent with Fannie Mae and other conventional mortgage tools. A Mortgagee Letter is essentially a policy notice to lenders. NPMA immediately sent electronic messages to members and posted information on the Web site (www.npmapestworld.org) to assist in understanding the policy. This *Library Update* provides additional information as well as details the HUD position after discussions with the department over the past few months since this has become effective.

In 2005-ML-48, the policy for wood destroying insects (WDI) is left to the underwriter of the loan, consistent with conventional practices. The letter states:

"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."



NPMA has heard from WDI inspectors, primarily in the northern parts of the country, that realtors and mortgage companies are misinterpreting the Mortgagee Letter to mean that no inspections are required under any circumstances. This is not prudent underwriting and it was not HUD's intent to eliminate inspections.

The Intent of the Mortgagee Letter

According to HUD, the agency insures only about 2% to 3% of the single family housing mortgages written nationwide. Ten years ago, the number was over 20% but due to newer products in the mortgage industry, market share for HUD has shrunk. Share is cyclical, so expect that those numbers may rise. In keeping with the administration philosophy, HUD is streamlining underwriting requirements to be consistent with conventional mortgages. Thus, the mortgagee letter, nearly 130 pages with attachments, is intended to make the HUD mortgage process more consistent with the conventional markets. Note that our industry is affected by only a few lines of 2005-ML-48.

Historically, HUD would set geographical areas where inspections are required. This was inconsistent with some conventional requirements. 2005-ML-48 essentially tries to make HUD policy consistent with the bulk of the market, the conventional mortgage industry. The concept was to not conflict with requirements of the conventional industry.



The Underwriters' Mistake

After the policy became effective on January 1, 2006, many conventional lenders viewed the policy as a shift. What was surprising to all is that the conventional lenders usually follow HUD's guidelines so when HUD made a policy change only for HUD insured loans, the conventional mortgage market followed suit. This is because many large lenders write both HUD and conventional loans, and in order to stay consistent, they commonly follow HUD guidelines, similar to the use of the NPMA-33 in most states. While only mandated for HUD loans, nearly all conventional lenders require the form.

As part of the new policy, conventional underwriters read the following:

"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."

Unfortunately, underwriters misinterpreted the above paragraph to mean that inspections are no longer required. They immediately shifted their underwriting policies for conventional loans as well, causing confusion.

Dissecting the Statement

HUD's intent was to make sure that there is "prudent underwriting." If there is an appraisal and the appraiser has concerns about something seen suggesting active infestation, then the underwriter must have an inspection if none was scheduled. If there is a state or local law or regulation, then an inspection must be performed. If it is customary to the area, meaning that if it was done in the past, then an inspection must be performed. Finally, if the lender has none of the previous requirements in hand, but wants an inspection, they can mandate it.

The key is that if the inspection is customary, then nothing should change, according to HUD. This is an important point and underwriters need to follow this provision.

NPMA's Response

In January, NPMA posted a summary of this

information online. Also, the map in this *Library Update* was posted. This is for the benefit of not only NPMA members but also for underwriters referred by HUD to view areas of potential infestation, although it is just for termites as the U.S. Forest Service does not have a beetle map. Many underwriters have accessed the site for the updated information. Inspectors can refer underwriters, realtors, customers, and staff to the website.

Go to the professional and members' only site, nmapestworld.org and click on the blue box on the right that is labeled "Mortgagees and HUD." The information will then open including the map. Click on the heading above the map for text regarding the policy.

A Few Common Questions

Q. Lenders or realtors in our area no longer require inspections. What can I do?

A. Refer them to the NPMA web site information noted above or provide them with a copy of this *Library Update*. Even HUD is referring underwriters to our web site for guidance. Note that the map is not an industry map - it was produced by the U.S. Forest Service.

Q. Why is HUD requiring appraisers to perform WDI inspections?

A. They are not requiring appraisers to perform inspections and they specifically do not want appraisers performing WDI inspections. That was never the intent nor does the Mortgagee Letter require this. Appraisers have also made it very clear that they are not qualified to perform inspections, even if asked. Finally, many states require that you have a pest control license or credential to perform inspections. The only role of the appraiser is to call attention to potential infestation and ask for an inspection by a pest management firm, as has been the practice since 1995 or before, primarily because the appraiser is one of the first professionals to evaluate a house in the mortgage process.

Q. We have seen realtors tell buyers that inspections are no longer required. What can we do to turn this around?

A. Talk to the realtor with the information in this publication. While we are not experts in liability, it is a common belief in the legal community that the realtor will have liability if they do not advise an inspection and later infestation is found by the buyer. Offer to visit the real estate office for a brief presentation on WDI and areas of potential infestation. Finally, you may wish to provide NPMA brochures "The Truth About Termites" and "Buying or Selling a Home" to buyers, lenders, and underwriters. Both brochures are available for sale through the Bug Store at NPMA.



Q. Can't we get HUD to force underwriters to get inspections?

A. This would be contrary to the Administration policy of making things consistent with conventional markets and would counter the Mortgagee Letter. HUD will not reverse their position, but they are getting the word out via conference calls to their field offices as to interpretation.

Q. Where can I get a copy of 2005-ML-48?

A. A copy of 2005-ML-48 may be accessed at www.hud.gov. Questions about this HUD policy may be directed to HUD at 202-708-2121.

Q. I still have some questions. Who can I contact at NPMA?

A. Members with questions may contact Greg Baumann at gbaumann@pestworld.org. If inspectors are noting that certain companies no longer require inspections, please email Greg Baumann as well. We will forward to HUD so that they know that there is still some concern.

The Future

We as an industry have been very successful in explaining this new policy to realtors, underwriters, inspectors, and customers. Many companies, which had initially lost market share, have gained it back through the NPMA web posting. NPMA expects that there will be some confusion for the next few months, but by following the recommendations listed above, the market share will not erode for members. ●

Probability of Subterranean Termite Infestation

Source: U.S. Forest Service (also incorporated into the International Residential Code)

Note: While Alaska and Hawaii are not listed by the U.S. Forest Service, Alaska is determined to be none to slight and Hawaii is very heavy

