



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

**Date: October 16, 2023**

**Mortgagee Letter 2023-17**

**To:** All FHA-Approved Mortgagees  
All Direct Endorsement Underwriters  
All Eligible Submission Sources for Condominium Project Approvals  
All FHA Roster Appraisers  
All FHA-Approved 203(k) Consultants  
All HUD-Certified Housing Counselors  
All HUD-Approved Nonprofit Organizations  
All Governmental Entity Participants  
All Real Estate Brokers  
All Closing Agents

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**Subject** Revisions to Rental Income Policies, Property Eligibility, and Appraisal Protocols for Accessory Dwelling Units

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**Purpose** This Mortgagee Letter (ML) establishes guidelines for consideration of rental income in underwriting forward mortgages and performing the financial assessment for Home Equity Conversion Mortgages (HECM) and protocols for the Appraiser's analysis and reporting of Accessory Dwelling Unit (ADU) market rent on appraisals.

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**Effective Date** The provisions of this ML are effective immediately.

All updates will be incorporated into a forthcoming update of the HUD Handbook 4000.1, *FHA Single Family Housing Policy Handbook* (Handbook 4000.1) and the HECM Financial Assessment and Property Charge Guide.

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**Public Feedback** HUD welcomes feedback from interested parties for a period of 30 calendar days from the date of issuance. To provide feedback on this policy document, please send feedback to the FHA Resource Center at [answers@hud.gov](mailto:answers@hud.gov) or call 1-800-CALLFHA (1-800-225-5342). HUD will consider the feedback in determining the need for future updates.

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**Affected Programs** The provisions of this ML apply to FHA Single Family Title II Forward and Home Equity Conversion Mortgage (HECM) programs.

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**Background** FHA programs currently allow for the purchase, rehabilitation, or refinance of Properties that include a single ADU. FHA does not, however, presently allow for the inclusion of income from the ADU in the Borrower’s Effective Income for purposes of qualifying for an FHA-insured Mortgage.

FHA recognizes that ADUs can serve to enhance the generational wealth-building potential of homeownership. Additionally, ADU rental income can contribute to Mortgage Payments and help Borrowers sustain long-term homeownership. To support the goals of increasing the stock of affordable housing and expanding opportunities for wealth building and homeowner stability, FHA is updating its appraisal protocols, underwriting requirements, and HECM financial assessment guidelines to permit the inclusion of income from an ADU in the Borrower’s Effective Income for purposes of qualifying for FHA-insured mortgage financing. FHA is also updating its property eligibility guidelines for the type of improvements eligible under the Standard 203(k) Rehabilitation Program and property types eligible for New Construction as it relates to ADUs.

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**Summary of Changes** This ML:

- updates the definition and standard in Property Types – Accessory Dwelling Unit (II.A.1.b.iv(B)(4));
- provides guidance on underwriting income in:
  - Underwriting the Borrower Using the TOTAL Mortgage Scorecard (TOTAL) – Rental Income (TOTAL) (II.A.4.c.xii(I));
  - Manual Underwriting of the Borrower – Rental Income (Manual) (II.A.5.b.xii(I)); and
  - 203(k) Rehabilitation Mortgage Insurance Program – Borrower Eligibility (II.A.8.a.ii);
- updates reserve requirements for Properties:
  - with ADUs in General Asset Requirements (TOTAL) – Reserves (TOTAL) (II.A.4.d.i(C)); and
  - with ADUs in General Asset Requirements (Manual) – Reserves (Manual) (II.A.5.c.i(C));
- updates types of improvements eligible for a Standard 203(k) transaction in Standard 203(k) Eligible Improvements – Types of Improvements (II.A.8.a.vi(A)(1));
- clarifies that rental income from an ADUs cannot be used as Effective Income for Cash-Out Refinances (II.A.8.d.v(A));

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- adds a Single Family property with an ADU as an eligible property type for new construction financing in New Construction – Eligible Property Types (II.A.8.i.ii);
- updates the table in Appraiser and Property Requirements for Title II Forward and Reverse Mortgages – Acceptable Appraisal Reporting Forms and Protocols (II.D.3);
- updates Characteristics of Property Improvements – Accessory Dwelling Unit (II.D.3.b.vii(E)); and
- adds guidance on rental income related to ADUs in 3.50, 3.51, 3.52, 3.53, and 3.54 of the HECM Financial Assessment and Property Charge Guide.

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**FHA Single  
Family Housing  
Policy  
Handbook  
4000.1**

The policy changes will be incorporated into Handbook 4000.1 as follows:

**Accessory Dwelling Unit (II.A.1.b.iv(B)(4))**

**(a) Definition**

**Origination  
Through Post-  
closing/  
Endorsement**

An Accessory Dwelling Unit (ADU) refers to a **single** habitable living unit with means of separate ingress and egress that meets the **minimum requirements for a living unit** (II.A.3.a.ii(F)). An ADU is a private space that is subordinate in size and can be added to, created within, or detached from a primary one-unit Single Family dwelling, which together constitute a single interest in real estate.

**(b) Standard**

A Single Family residential **one-unit** Property with a **single** ADU remains a one-unit Property. For any **Single Family residential** Property with two or more units, a separate additional Dwelling Unit must be considered as an additional unit.

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**Rental Income (TOTAL) (II.A.4.c.xii(I))**

**(1) Definition**

Rental Income refers to income received or to be received from the subject Property or other real estate holdings.

**(2) Rental Income Received from the Subject Property (TOTAL)**

**(a) Standard**

The Mortgagee may consider Rental Income from existing and prospective renters if documented in accordance with the following requirements.

Rental Income from the subject Property may be considered Effective Income when the Property is or will be a one-unit dwelling with an ADU, a two- to four-unit dwelling, or an acceptable one- to four-unit Investment Property.

No income from commercial space may be included in Rental Income calculations.

**(b) Required Documentation**

Documentation varies depending upon the length of time the Borrower has owned the Property and must meet one of the applicable documentation requirements below:

**(i) Limited or No History of Rental Income**

Where the Borrower does not have a history of Rental Income from the subject since the previous tax filing:

**Two- to Four-Units**

The Mortgagee must verify and document the proposed Rental Income by obtaining an appraisal showing fair market rent (use [Fannie Mae Form 1025/Freddie Mac Form 72](#), *Small Residential Income Property Appraisal Report*) and, if available, the prospective leases.

**One-Unit**

The Mortgagee must verify and document the proposed Rental Income by obtaining a [Fannie Mae Form 1004/Freddie Mac Form 70](#), *Uniform Residential Appraisal Report (URAR)*, and a [Fannie Mae Form 1007/Freddie Mac Form 1000](#), *Single Family Comparable Rent Schedule*, showing fair market rent and, if available, the prospective leases.

**One-Unit with an Accessory Dwelling Unit**

The Mortgagee must verify and document the proposed Rental Income from the ADU by obtaining a [Fannie Mae Form](#)

[1004/Freddie Mac Form 70, URAR](#), and a [Fannie Mae Form 1007/Freddie Mac Form 1000, Single Family Comparable Rent Schedule](#), showing fair market rent and, if available, the prospective leases.

**(ii) History of Rental Income**

Where the Borrower has a history of Rental Income from the subject **Property** since the previous tax filing, the Mortgagee must verify and document the existing Rental Income by obtaining the Borrower's most recent tax returns, including Schedule E, from the previous two years.

For Properties owned less than two years, the Mortgagee must document the date of acquisition by providing a copy of the deed, Closing Disclosure, or other legal document.

**(c) Calculation of Effective Income**

The Mortgagee must add the net subject property Rental Income to the Borrower's gross income to calculate Effective Income. The Mortgagee may not reduce the Borrower's total Mortgage Payment by the net subject property Rental Income.

**(i) Limited or No History of Rental Income**

To calculate the Effective Income from the subject Property where the Borrower does not have a history of Rental Income from the subject Property since the previous tax filing, the Mortgagee must use 75 percent of the lesser of:

- fair market rent reported by the Appraiser; or
- the rent reflected in the lease or other rental agreement.

**One-Unit with an Accessory Dwelling Unit**

The amount of the Rental Income from an ADU used as Effective Income must not exceed 30 percent of the total monthly Effective Income used to qualify the Borrower.

**(ii) History of Rental Income**

The Mortgagee must calculate the Rental Income by averaging the amount shown on Schedule E.

Depreciation, mortgage interest, taxes, insurance, and any HOA dues shown on Schedule E may be added back to the net income or loss.

If the Property has been owned for less than two years, the Mortgagee must annualize the Rental Income for the length of time the Property has been owned.

**(3) Rental Income from Other Real Estate Holdings (TOTAL)**

**(a) Standard**

Rental Income from other real estate holdings may be considered Effective Income if the documentation requirements listed below are met. If Rental Income is being derived from a Property being vacated by the Borrower, the Borrower must be relocating to an area more than 100 miles from the Borrower's current Principal Residence. The Mortgagee must obtain a lease agreement of at least one year's duration after the Mortgage is closed and evidence of the payment of the security deposit or first month's rent.

**(b) Required Documentation**

**(i) Limited or No History of Rental Income**

Where the Borrower does not have a history of Rental Income for the Property since the previous tax filing, including Property being vacated by the Borrower, the Mortgagee must obtain an appraisal evidencing market rent and that the Borrower has at least 25 percent equity in the Property. The appraisal is not required to be completed by an FHA Roster Appraiser.

**Two- to Four-Units**

The Mortgagee must verify and document the proposed Rental Income by obtaining an appraisal showing fair market rent (use [Fannie Mae Form 1025/Freddie Mac Form 72](#), *Small Residential Income Property Appraisal Report*) and, if available, the prospective leases.

**One-Unit or One-Unit with an Accessory Dwelling Unit**

The Mortgagee must verify and document the proposed Rental Income by obtaining a [Fannie Mae Form 1004/Freddie Mac Form 70](#), *Uniform Residential Appraisal Report (URAR)* and a [Fannie Mae Form 1007/Freddie Mac Form 1000](#), *Single Family Comparable Rent Schedule*, showing fair market rent and, if available, the prospective leases.

**(ii) History of Rental Income**

The Mortgagee must obtain the Borrower's last two years' tax returns with Schedule E.

**(c) Calculation of Effective Net Rental Income**

**(i) Limited or No History of Rental Income [Text was deleted in this section.]**

To calculate the effective net Rental Income from other real estate holdings where the Borrower does not have a history of Rental Income since the previous tax filing, the Mortgagee must deduct the Principal, Interest, Taxes, and Insurance (PITI) from 75 percent of the lesser of:

- fair market rent reported by the Appraiser; or
- the rent reflected in the lease or other rental agreement.

**(ii) History of Net Rental Income**

The Mortgagee must calculate the net Rental Income by averaging the amount shown on the Schedule E provided the Borrower continues to own all Properties included on the Schedule E.

Depreciation shown on Schedule E may be added back to the net income or loss.

Positive net Rental Income must be added to the Borrower's Effective Income. Negative net Rental Income must be included as a debt/liability.

If the Property has been owned for less than two years, the Mortgagee must:

- annualize the Rental Income for the length of time the Property has been owned; and
- document the date of acquisition by providing the deed, Closing Disclosure, or other legal document.

**(4) Borders of the Subject Property (TOTAL)**

**(a) Definition**

Boarder refers to an individual renting space inside the Borrower's Dwelling Unit. **A renter of an ADU is not a Boarder.**

**(b) Standard**

Rental Income from Boarders is only acceptable if the Borrower has a two-year history of receiving income from Boarders that is shown on the tax return and the Borrower is currently receiving Boarder income.

**(c) Required Documentation**

The Mortgagee must obtain two years of the Borrower's tax returns evidencing income from Boarders and the current lease.

For purchase transactions, the Mortgagee must obtain a copy of the executed written agreement documenting their intent to continue boarding with the Borrower.

**(d) Calculation of Effective Income**

The Mortgagee must calculate the Effective Income by using the lesser of the two-year average or the current lease.

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**General Asset Requirements (TOTAL) (II.A.4.d.i)**

**(C) Reserves (TOTAL)**

The Mortgagee must verify and document all assets submitted to the AUS.

Reserves refer to the sum of the Borrower's verified and documented liquid assets minus the total funds the Borrower is required to pay at closing.

Reserves do not include:

- the amount of cash taken at settlement in cash-out transactions;
- incidental cash received at settlement in other loan transactions;
- equity in another Property; or
- borrowed funds from any source.

**(1) Required Reserves for One-Unit with an Accessory Dwelling Unit Properties**

If Rental Income is being used as Effective Income to qualify the Borrower, the Mortgagee must verify and document Reserves equivalent to two months' PITI after closing for one-unit with an ADU Properties.

**(2) Required Reserves for Three- to Four-Unit Properties**

The Mortgagee must verify and document Reserves equivalent to three months' PITI after closing for three- to four-unit Properties.



## **Rental Income (Manual) (II.A.5.b.xii(I))**

### **(1) Definition**

Rental Income refers to income received or to be received from the subject Property or other real estate holdings.

### **(2) Rental Income Received from the Subject Property (Manual)**

#### **(a) Standard**

The Mortgagee may consider Rental Income from existing and prospective **renters** if documented in accordance with the following requirements.

Rental Income from the subject Property may be considered Effective Income when the Property is **or will be a one-unit dwelling with an ADU**, a two- to four-unit dwelling, or an acceptable one- to four-unit Investment Property.

No income from commercial space may be included in Rental Income calculations.

#### **(b) Required Documentation**

Required documentation varies depending upon the length of time the Borrower has owned the Property.

##### **(i) Limited or No History of Rental Income**

Where the Borrower does not have a history of Rental Income from the subject since the previous tax filing:

##### **Two-to Four-Units**

The Mortgagee must verify and document the proposed Rental Income by obtaining an appraisal showing fair market rent (use [Fannie Mae Form 1025/Freddie Mac Form 72](#), *Small Residential Income Property Appraisal Report*) and, **if available**, the prospective leases.

##### **One-Unit**

The Mortgagee must verify and document the proposed Rental Income by obtaining a [Fannie Mae Form 1004/Freddie Mac Form 70](#), *Uniform Residential Appraisal Report (URAR)*, **and a Fannie**

[Mae Form 1007](#)/Freddie Mac Form 1000, *Single Family Comparable Rent Schedule*, showing fair market rent and, if available, the prospective leases.

### **One-Unit with an Accessory Dwelling Unit**

The Mortgagee must verify and document the proposed Rental Income from the ADU by obtaining a [Fannie Mae Form 1004](#)/Freddie Mac Form 70, URAR, and a [Fannie Mae Form 1007](#)/Freddie Mac Form 1000, *Single Family Comparable Rent Schedule*, showing fair market rent and, if available, the prospective leases.

#### **(ii) History of Rental Income**

Where the Borrower has a history of Rental Income from the subject since the previous tax filing, the Mortgagee must verify and document the existing Rental Income by obtaining the existing lease, rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal or military renters, or property rehabilitation), and the Borrower's most recent tax returns, including Schedule E, from the previous two years.

For Properties owned less than two years, the Mortgagee must document the date of acquisition by providing the deed, Closing Disclosure, or other legal document.

#### **(c) Calculation of Effective Income**

The Mortgagee must add the net subject property Rental Income to the Borrower's gross income to calculate Effective Income. The Mortgagee may not reduce the Borrower's total Mortgage Payment by the net subject property Rental Income.

##### **(i) Limited or No History of Rental Income**

To calculate the Effective Income from the subject Property where the Borrower does not have a history of Rental Income from the subject Property since the previous tax filing, the Mortgagee must use 75 percent of the lesser of:

- fair market rent reported by the Appraiser; or
- the rent reflected in the lease or other rental agreement.

### **One-Unit with an Accessory Dwelling Unit**

The amount of the Rental Income from an ADU used as Effective Income must not exceed 30 percent of the total monthly Effective Income used to qualify the Borrower.

#### **(ii) History of Rental Income**

The Mortgagee must calculate the Rental Income by averaging the amount shown on the Schedule E.

Depreciation, mortgage interest, taxes, insurance, and any HOA dues shown on Schedule E may be added back to the net income or loss.

If the Property has been owned for less than two years, the Mortgagee must annualize the Rental Income for the length of time the Property has been owned.

### **(3) Rental Income from Other Real Estate Holdings (Manual)**

#### **(a) Standard**

Rental Income from other real estate holdings may be considered Effective Income if the documentation requirements listed below are met. If Rental Income is being derived from a Property being vacated by the Borrower, the Borrower must be relocating to an area more than 100 miles from the Borrower's current Principal Residence. The Mortgagee must obtain a lease agreement of at least one year's duration after the Mortgage is closed and evidence of the payment of the security deposit or first month's rent.

#### **(b) Required Documentation**

##### **(i) Limited or No History of Rental Income**

Where the Borrower does not have a history of Rental Income for the Property since the previous tax filing, including Property being vacated by the Borrower, the Mortgagee must obtain an appraisal evidencing market rent and that the Borrower has at least 25 percent equity in the Property. The appraisal is not required to be completed by an FHA Roster Appraiser.

#### **Two- to Four-Units**

The Mortgagee must verify and document the proposed Rental Income by obtaining an appraisal showing fair market rent (use [Fannie Mae Form 1025](#)/[Freddie Mac Form 72](#), *Small Residential*

*Income Property Appraisal Report*) and, if available, the prospective leases.

**One-Unit or One-Unit with an Accessory Dwelling Unit**

The Mortgagee must verify and document the proposed Rental Income by obtaining a [Fannie Mae Form 1004/Freddie Mac Form 70, Uniform Residential Appraisal Report \(URAR\)](#), and a [Fannie Mae Form 1007/Freddie Mac Form 1000, Single Family Comparable Rent Schedule](#), showing fair market rent and, if available, the prospective lease.

**(ii) History of Rental Income**

The Mortgagee must obtain the Borrower's last two years' tax returns with Schedule E.

**(c) Calculation of Effective Net Rental Income**

**(i) Limited or No History of Rental Income [Text was deleted in this section.]**

To calculate the effective net Rental Income from other real estate holdings where the Borrower does not have a history of Rental Income since the previous tax filing, the Mortgagee must deduct the PITI from 75 percent of the lesser of:

- fair market rent reported by the Appraiser; or
- the rent reflected in the lease or other rental agreement.

**(ii) History of Net Rental Income**

The Mortgagee must calculate the net Rental Income by averaging the amount shown on the Schedule E provided the Borrower continues to own all Properties included on the Schedule E.

Depreciation shown on Schedule E may be added back to the net income or loss.

Positive net Rental Income must be added to the Borrower's Effective Income. Negative net Rental Income must be included as a debt/liability.

If the Property has been owned for less than two years, the Mortgagee must:

- annualize the Rental Income for the length of time the Property has been owned; and

- document the date of acquisition by providing the deed, Closing Disclosure, or other legal document.

#### **(4) Borders of the Subject Property (Manual)**

##### **(a) Definition**

Boarder refers to an individual renting space inside the Borrower's Dwelling Unit. **A renter of an ADU is not a Boarder.**

##### **(b) Standard**

Rental Income from Boarders is only acceptable if the Borrower has a two-year history of receiving income from Boarders that is shown on the tax return and the Borrower is currently receiving Boarder income.

##### **(c) Required Documentation**

The Mortgagee must obtain two years of the Borrower's tax returns evidencing income from Boarders and the current lease.

For purchase transactions, the Mortgagee must obtain a copy of the executed written agreement documenting their intent to continue boarding with the Borrower.

##### **(d) Calculation of Effective Income**

The Mortgagee must calculate the Effective Income by using the lesser of the two-year average or the current lease.

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#### **General Asset Requirements (Manual) (II.A.5.c.i)**

##### **(C) Reserves (Manual)**

Reserves refer to the sum of the Borrower's verified and documented liquid assets minus the total funds the Borrower is required to pay at closing.

Reserves do not include:

- the amount of cash taken at settlement in cash-out transactions;
- incidental cash received at settlement in other loan transactions;
- gift funds;
- equity in another Property; or
- borrowed funds from any source.

**(1) Required Reserves for One-to Two-Unit Properties**

The Mortgagee must verify and document Reserves equivalent to one month's PITI after closing for one- to two-unit Properties.

**(2) Required Reserves for Three- to Four-Unit Properties**

The Mortgagee must verify and document Reserves equivalent to three months' PITI after closing for three- to four-unit Properties.

**(3) Required Reserves for One-Unit with an Accessory Dwelling Unit Properties**

If Rental Income is being used to qualify, the Mortgagee must verify and document Reserves equivalent to two months' PITI after closing for one-unit with an ADU Properties.

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**203(k) Rehabilitation Mortgage Insurance Program (II.A.8.a)**

**ii. Borrower Eligibility**

The Borrower must meet the eligibility requirements found in the [Borrower Eligibility](#) (II.A.1.b.ii) section, and the additional guidance provided here related to nonprofit agency Borrowers.

The Mortgagee must verify and document the nonprofit agency Borrower's caseload. The Mortgagee must review the Nonprofit List in FHA Connection ([FHAC](#)), and ensure the maximum 203(k) case load limitation is not exceeded for nonprofit Borrowers.

**(A) Rental Income Received from the Subject Property**

**One-Unit with an Accessory Dwelling Unit**

If the subject Property is a one-unit with an Accessory Dwelling Unit (ADU) and the Borrower does not have a history of Rental Income from the subject Property since the previous tax filing, to calculate the Effective Income the Mortgagee must use 50 percent of the lesser of:

- fair market rent reported by the Appraiser; or
- the rent reflected in the lease or other rental agreement.

Mortgagees must apply this requirement for both Mortgages underwritten through TOTAL Scorecard and manual underwriting.

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## Standard 203(k) Eligible Improvements (II.A.8.a.vi(A))

### (1) Types of Improvements

Types of eligible improvements include, but are not limited to:

- converting a one-family Structure to a one-family Structure with an ADU, two-, three-, or four-family Structure;
- adding an Accessory Dwelling Unit (ADU) that will be attached to an existing Structure;
- renovating an existing ADU that is attached or unattached to an existing Structure;
- decreasing an existing multi-unit Structure to a one- to four-family Structure;
- reconstructing a Structure that has been or will be demolished, provided the complete existing foundation system is not affected and will still be used;
- repairing, reconstructing, or elevating an existing foundation where the Structure will not be demolished;
- purchasing an existing Structure on another site, moving it onto a new foundation, and repairing/renovating it;
- making structural alterations such as the repair or replacement of structural damage, additions to the Structure, and finished attics and/or basements;
- rehabilitating, improving, or constructing a garage;
- eliminating health and safety hazards that would violate HUD's [Minimum Property Requirements](#) (MPR) (II.A.3.a.ii);
- installing or repairing wells and/or septic systems;
- connecting to public water and sewage systems;
- repairing/replacing plumbing, heating, AC, and electrical systems;
- making changes for improved functions and modernization;
- making changes for aesthetic appeal;
- repairing or adding roofing, gutters, and downspouts;
- making energy conservation improvements;
- creating accessibility for persons with disabilities;
- installing or repairing fences, walkways, and driveways;
- installing a new refrigerator, cooktop, oven, dishwasher, built-in microwave oven, and washer/dryer;
- repairing or removing an in-ground swimming pool;
- installing smoke detectors;
- making site improvements;
- landscaping;

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- installing or repairing exterior decks, patios, and porches;
- constructing a windstorm shelter; and
- covering lead-based paint stabilization costs, if the Structure was built before 1978, in accordance with the Single Family mortgage insurance lead-based paint rule ([24 CFR §§ 200.805 and 200.810\(c\)](#)) and the U.S. Environmental Protection Agency's (EPA) [Renovation, Repair and Painting Rule](#) (40 CFR [Part 745](#), especially subparts E and Q).

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### Cash-Out Refinances (II.A.8.d.v(A))

#### (A) Borrower Eligibility

Nonprofit agencies, state and local government agencies and Instrumentalities of Government are not eligible for cash-out refinances. Income from a non-occupant co-Borrower may not be used to qualify for a cash-out refinance.

If the subject Property is a one-unit with an Accessory Dwelling Unit (ADU), rental income from the ADU cannot be used as Effective Income to qualify for a cash-out refinance.

Mortgagees must apply this requirement for both Mortgages underwritten through TOTAL Scorecard and manual underwriting.

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### New Construction (II.A.8.i)

#### ii. Eligible Property Types [Updates to this section must be implemented for case numbers assigned on or after January 4, 2021]

The following property types are eligible for New Construction financing:

- Site Built Housing (one-unit, one-unit with an Accessory Dwelling Unit (ADU), or two- to four-units)
- Condominium units in Approved Projects or Legal Phases
- Manufactured Housing (one-unit or one-unit with an ADU)



**Acceptable Appraisal Reporting Forms and Protocols (II.D.3)**

<b>Property/Assignment Type</b>	<b>Acceptable Reporting Form</b>
Single Family, Detached, Attached or Semi-Detached Residential Property (One-Unit Property or a One-Unit Property with a Single Accessory Dwelling Unit (ADU))	<a href="#">Fannie Mae Form 1004/Freddie Mac Form 70</a> , <i>Uniform Residential Appraisal Report (URAR)</i> ; Mortgage Industry Standards Maintenance Organization (MISMO) 2.6 Government-Sponsored Enterprise (GSE) format
Single Family Comparable Market Rent Analysis	<a href="#">Fannie Mae Form 1007/Freddie Mac Form 1000</a> , <i>Single Family Comparable Rent Schedule</i>
Single Unit Condominium	<a href="#">Fannie Mae Form 1073/Freddie Mac Form 465</a> , <i>Individual Condominium Unit Appraisal Report</i> ; MISMO 2.6 GSE format
Manufactured (HUD Code) Housing (One-Unit Property or a One-Unit Property with a Single ADU)	<a href="#">Fannie Mae Form 1004C/Freddie Mac Form 70B</a> , <i>Manufactured Home Appraisal Report</i> ; MISMO 2.6 Errata 1 format
Small Residential Income Properties (Two- to Four-Units)	<a href="#">Fannie Mae Form 1025/Freddie Mac Form 72</a> , <i>Small Residential Income Property Appraisal Report</i> ; MISMO 2.6 Errata 1 format
Update of Appraisal (All Property Types)	Summary Appraisal Update Report Section of <a href="#">Fannie Mae Form 1004D/Freddie Mac Form 442</a> , <i>Appraisal Update and/or Completion Report</i> ; MISMO 2.6 Errata 1 format
Compliance or Final Inspection for New Construction or New Construction for Manufactured Housing	Form <a href="#">HUD-92051</a> , <i>Compliance Inspection Report</i> , in Portable Document Format (PDF)

Compliance or Final Inspection for Existing Property	Certification of Completion Section of <a href="#">Fannie Mae Form 1004D/Freddie Mac Form 442</a> , <i>Appraisal Update and/or Completion Report</i> ; MISMO 2.6 Errata 1 format
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**Characteristics of Property Improvements (II.D.3.b.vii)**

**(E) Accessory Dwelling Unit**

**(1) Identification of an Accessory Dwelling Unit**

An [Accessory Dwelling Unit](#) (ADU) is subordinate in size, location, and appearance to the primary Dwelling Unit and may or may not have separately metered utilities. The ADU must comport with zoning requirements, which may include a legal nonconforming use.

**(2) Required Analysis and Reporting Protocols**

As part of the highest and best use analysis, the Appraiser must make the determination to classify the Property as a Single Family dwelling with an ADU, or a two-family dwelling. The conclusion of the highest and best use analysis will then determine the classification of the Property and the **required** analysis reporting.

**(a) One-Unit Single Family Dwelling with an Accessory Dwelling Unit**

When the highest and best use analysis determines the Property to be a Single Family dwelling with an ADU, the Appraiser must:

- provide a description of the ADU characteristics;
- summarize the ADU’s market acceptance;
- report the [Gross Living Area](#) (II.D.3.c) of the ADU separate from the primary dwelling;
- state whether the ADU can be legally rented without restrictions; and
- report the current ADU occupancy and the relevant details of any known lease agreements.

**(b) Optional Accessory Dwelling Unit Market Rent Analysis**

The Mortgagee may request an opinion of the ADU market rent in the scope of work. The Appraiser may provide the ADU market rent only if:

- the highest and best use is determined to be a one-unit Single Family dwelling with an ADU;
- the ADU is legally rentable without restrictions; and
- the Appraiser determines that a non-transient (see [Restriction on Investment Properties for Hotel and Transient Use \(II.A.1.b.iv\(A\)\(4\)\)](#)) monthly market rent can be credibly developed.

The analysis of the rental data must include support for the ADU comparable rental selections, the adjustments applied, and the opinion of the ADU market rent. The Appraiser must include the ADU opinion of market rent on [Fannie Mae Form 1007/Freddie Mac Form 1000, Single Family Comparable Rent Schedule](#), as an attachment to the appraisal and include the following supplemental statement:

*“This form is completed to provide FHA an opinion of the market rent of the subject’s legally rentable Accessory Dwelling Unit (ADU). Sufficient competitive market data exists to develop credible results.”*

Appraisers completing the optional ADU market rent analysis must comply with FHA’s [Appraiser Competency Requirement \(I.B.1.e.ii\)](#).

The Appraiser must contact the Mortgagee if unable to fulfill a request for ADU market rent analysis.

### **(c) Comparable Selection for Optional Accessory Dwelling Unit Market Rent Analysis**

The Appraiser must include a sufficient number of comparable rents to produce a credible ADU market rent estimate. The comparables used to develop the ADU market rent must not include properties rented for hotel or transient purposes, or for periods less than 30 Days. The Appraiser must include at least one comparable rental that is a Single Family dwelling with a rented ADU. If a Single Family dwelling with a rented ADU is not available, the Appraiser must supplement with the most appropriate rental available and summarize the reason for the selection and how the marketability of the ADU was determined.

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The policy changes amend the HECM Financial Assessment and Property Charge Guide, as follows:

**HECM  
Financial  
Assessment and  
Property  
Charge Guide**

**Section 3.50, Rental Income from the Subject Property**

Rental income refers to income received **or to be received from** the subject property **or other real estate holdings**.

The mortgagee may consider rental income from existing and prospective **renters** if documented in accordance with the following requirements.

**Rental income from the subject property may be considered effective income when the property is a one-unit dwelling with an Accessory Dwelling Unit (ADU) or a two- to four-unit dwelling.**

**No income from commercial space may be included in rental income calculations.**

**Required documentation varies depending upon the length of time the borrower has owned the property.**

**Limited or No History of Rental Income**

Where the **borrower** does not have a history of rental income from the subject property since the previous tax filing:

**Two-to Four-Units**

**The mortgagee must verify and document the proposed rental income by obtaining an appraisal showing fair market rent (use [Fannie Mae Form 1025/Freddie Mac Form 72](#), *Small Residential Income Property Appraisal Report*) and, if available, the prospective leases.**

**One-Unit or One-Unit with an Accessory Dwelling Unit**

**The mortgagee must verify and document the proposed rental income by obtaining a [Fannie Mae Form 1004/Freddie Mac Form 70](#), *Uniform Residential Appraisal Report (URAR)*, and a [Fannie Mae Form 1007/](#), *Single Family Comparable Rent Schedule*, showing fair market rent and, if available, the prospective lease.**

**Calculation of Rental Income**

Where the **borrower** has a history of rental income from the subject property since the previous tax filing, the mortgagee must verify and document the existing rental income by obtaining the **existing** lease, rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal or military renters, or property rehabilitation), and the **borrower's** most recent tax returns, including Schedule E, from the previous two years.

For properties **owned less than two years**, the mortgagee must document the date of acquisition by providing the deed, closing disclosure, or other legal document.

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**Section 3.51, Calculating Rental Income from the Subject Property**

The mortgagee must add the net subject property rental income to the **borrower's** gross income **to calculate effective income**.

**Limited or No History of Rental Income**

To calculate the effective income from the subject property where the **borrower** does not have a history of rental income from the subject property since the previous tax filing, the mortgagee must use 75 percent of the lesser of:

- fair market rent reported by the appraiser; or
- the rent reflected in the lease or other rental agreement.

**The amount of the rental income from an ADU used as effective income must not exceed 30% of the total monthly effective income.**

**History of Rental Income**

The mortgagee must calculate the rental income by averaging the amount shown on the Schedule E.

Depreciation, mortgage interest, taxes, insurance, and any HOA dues shown on Schedule E may be added back to the net income or loss.

If the property has been owned for less than two years, the mortgagee must annualize the rental income for the length of time the property has been owned.

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**Section 3.52, Rental Income – Other Real Estate Holdings**

Rental income from other real estate holdings may be considered effective income if the documentation requirements listed below are met. If rental income is being derived from a property being vacated by the **borrower**, the **borrower** must be relocating to an area more than 100 miles from the **borrower's** current principal residence. The mortgagee must obtain a lease agreement of at least one year's duration after the mortgage is closed and evidence of the payment of the security deposit or first month's rent.

### Limited or No History of Rental Income

Where the borrower does not have a history of rental income for the property since the previous tax filing, including property being vacated by the borrower, the mortgagee must obtain an appraisal evidencing market rent and that the borrower has at least 25 percent equity in the property. The appraisal is not required to be completed by an FHA Roster appraiser.

- **Two- to Four-Units**

The mortgagee must verify and document the proposed rental income by obtaining an appraisal showing fair market rent (use [Fannie Mae Form 1025/Freddie Mac Form 72, Small Residential Income Property Appraisal Report](#)) and, if available, the prospective leases.

- **One-Unit or One-Unit with an Accessory Dwelling Unit**

The mortgagee must verify and document the proposed rental income by obtaining a [Fannie Mae Form 1004/Freddie Mac Form 70, Uniform Residential Appraisal Report](#), and a [Fannie Mae Form 1007/Freddie Mac Form 1000, Single Family Comparable Rent Schedule](#), showing fair market rent and, if available, the prospective lease.

### History of Rental Income

The mortgagee must obtain the borrower's last two years' tax returns with Schedule E.

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### Section 3.53, Calculating Rental Income from Other Real Estate Holdings

#### Limited or No History of Rental Income

To calculate the effective net rental income from other real estate holdings where the borrower does not have a history of rental income since the previous tax filing, the mortgagee must deduct the principal, interest, taxes, and insurance payment (PITI) from 75 percent of the lesser of:

- fair market rent reported by the appraiser; or
- the rent reflected in the lease or other rental agreement.

#### Calculation of Rental Income

The mortgagee must calculate the net rental income by averaging the amount shown on the Schedule E provided the borrower continues to own all properties included on the Schedule E.

Depreciation shown on Schedule E may be added back to the net income or loss.

If the property has been owned for less than two years, the mortgagee must:

- annualize the rental income for the length of time the property has been owned; and
- document the date of acquisition by providing the deed, closing disclosure, or other legal document.

Positive net rental income must be added to the borrower's effective income. Negative net rental income must be included as a debt/liability.

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### **Section 3.54, Income from Boarders of the Subject Property**

Boarder refers to an individual renting space inside the borrower's dwelling unit. **A renter of an ADU is not a boarder.**

Rental income from boarders is only acceptable if the borrower has a two-year history of receiving income from boarders that is shown on the tax return and the borrower is currently receiving boarder income.

The mortgagee must obtain two years of the borrower's tax returns evidencing income from boarders and the current lease.

For **HECM for Purchase** transactions, the mortgagee must obtain a copy of the executed written agreement documenting their intent to continue boarding with the borrower.

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### **Paperwork Reduction Act**

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501-3520) and assigned OMB control numbers 2502-0005; 2502-0059; 2502-0117; 2502-0189; 2502-0302; 2502-0306; 2502-0322; 2502-0358; 2502-0404; 2502-0414; 2502-0429; 2502-0494; 2502-0496; 2502-0524; 2502-0525; 2502-0527; 2502-0538; 2502-0540; 2502-0556; 2502-0561; 2502-0566; 2502-0570; 2502-0583; 2502-0584; 2502-0589; 2502-0595; 2502-0600; 2502-0610; and 2502-0611. In accordance with the PRA, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

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**Questions**

Any questions regarding this ML may be directed to the FHA Resource Center at 1-800-CALLFHA (1-800-255-5342), [answers@hud.gov](mailto:answers@hud.gov), or [www.hud.gov/answers](http://www.hud.gov/answers). The FHA Resource Center is prepared to accept calls from persons who are deaf or hard of hearing, as well as individuals with speech or communication disabilities. Information on how to make an accessible phone call is available at <https://www.fcc.gov/consumers/guides/telecommunications-relay-services>.

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**Signature**

/s/14/

Julia R. Gordon  
Assistant Secretary for Housing –  
FHA Commissioner

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