CHAPTER 4: BORROWER ELIGIBILTY

4.1 OVERVIEW

Ensuring that all applicants served are eligible and receive the correct amount of assistance is a significant responsibility of Loan Originators. A borrower must be income-eligible, demonstrate a credit history that indicates ability and willingness to repay a loan, and meet a variety of other program requirements. This chapter provides guidance for each of these areas.

- **Section 1: Evaluating Borrower Income** provides instructions for calculating annual, adjusted, and repayment income.
- **Section 2: Evaluating Borrower Assets** discusses Agency requirements for cash contributions to the purchase and methods for computing income from assets.
- **Section 3: Credit History** identifies indicators of acceptable and unacceptable credit, and provides instructions for reviewing an applicant's credit history.
- **Section 4: Other Eligibility Requirements** addresses a variety of other requirements applicants must meet to be eligible for the program.
- **Section 5: Processing the Certificate of Eligibility** provides policies and procedures for processing *Form FD 1944-59, Certificate of Eligibility*.

SECTION 1: EVALUATING BORROWER INCOME

4.2 OVERVIEW *[7 CFR 3550.53(a) and (g), 7 CFR 3550.54]*

Loan Originators use income information to: (1) help determine whether an applicant is eligible for a loan; (2) calculate the applicant's ability to repay a loan; and (3) determine the amount of the loan and the amount of payment subsidy the household can obtain. When reviewing an applicant's repayment income, the Loan Originator must determine whether the income is stable and dependable. The Loan Originator will generally need to look at two years of history to determine the dependability of the income. In addition, the Loan Originator must determine that there is a reasonable expectation that the income will continue. This section provides guidance for verifying and calculating income for each of these purposes.

A. Key Concepts for Income Determinations

1. Income Definitions

Three income definitions are used. Whenever income determinations are made, it is essential that the Loan Originator use the correct income definition and consider income from the appropriate household members. To determine whether the applicant will be able to repay a loan, the Loan Originator must use ***repayment income***. To determine whether an applicant is income-eligible to receive a program loan or payment subsidies, the Loan Originator must use ***adjusted income***. Adjusted income is calculated in 2 steps. First, the ***annual income*** of all household members is calculated. Then, certain household deductions for which the family may qualify are subtracted from annual income to compute adjusted income.

2. Whose Income To Count

For repayment income, the Loan Originator must consider only the income of household members who will be parties to the note. For adjusted income, the income of all household members must be considered. For both types, live-in aides, foster children, and foster adults living in the household are not considered household members.

3. Income Limits

Some program rules differ according to the income of the applicant. Three different income limits are used for the Section 502 and 504 programs. The National Office provides the income limits and updates the limits whenever they are revised. The income limits are included in Appendix 9. ***Adjusted income*** should be compared to the income limit to determine the category in which each household falls. Income limits are as follows:

- The very low-income limit is established at approximately 50 percent of the median income for the area, adjusted for household size;
- The low-income limit is established at approximately 80 percent of the median income for the area, adjusted for household size; and
- The moderate-income limit is established by adding $5,500 to the low-income limit for each household size.

4. Applicant Certification and Verification Requirements

Each applicant must provide the income, expense, and household information needed to enable the Agency to make income determinations. Most of this information is provided on the application, but some additional followup with the applicant may be required, as described in Paragraph 3.7. The applicant should be requested to provide two years of history for a reasonable determination of income. The documentation required will vary with the source of income. In some instances, less than two years of history may be acceptable when the Applicant provides, and the Loan Originator documents sound justification. For example, an applicant whose compensation changed from salary to commission income with the same employer in a similar job position may be considered to have dependable and stable income. In other instances, more than two years of history may be required. For example, when an applicant's income varies significantly from year to year, the Loan Originator should review a longer work history to establish an average income. Information provided by the applicant must be verified by the Loan Originator.

5. Stable and Dependable Income

The Agency has no minimum history requirement for employment in a particular position. The key concept is whether the applicant has a history of receiving stable income and a reasonable expectation that the income will continue. The Loan Originator must carefully assess the applicant's income to establish whether it can reasonably be expected to continue. If the Loan Originator determines that an applicant's income source is unstable and undependable, the income must be excluded from repayment but included in annual income.

- **Wage and Salary Income.** Income from employment may include a base hourly wage or salary, bonuses, overtime, and commission. When the applicant demonstrates a two year history of stable or rising income, current income from each of these sources may be used unless there is evidence to the contrary (such as the employer's indication that such income is NOT likely to continue.)

> **Example – Stable Income**
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> Steven Green has been working for the last 6 months for LMN Contractors as a Construction Foreman. Before that, he worked for PDQ Building Supply for 8months as a Shift Supervisor. There is a 6 week gap in his employment history which he explains as being the result of a lay-off after a large construction project (where he was employed for 15 months as a construction worker) was completed. Mr. Green's income is considered stable because the reasons for his job changes were related to changes in job opportunities. Even though his job changed several times, his line of work was similar.

- **Self-employment Income.** Income based on a two year history of self-employment, in the same line of work, is an acceptable indicator of stable and dependable income. Evaluation of a self-employed applicant with at least one year but less than two years of history requires an analysis of the applicant's previous experience and training to determine that income is stable and likely to continue. In cases of unusual self-employment, additional information such as a market feasibility study may be needed. Refer to Attachment 4-F for further guidance.

- **Other Sources of Income.** Income from public assistance, child support, alimony, or retirement that is consistently received is considered stable when: such payments are based on a law, written agreement or court decree, the amount and regularity of the payments, the eligibility criteria for the payments, such as the age of the child (when applicable), and the availability of means to compel payments.

Example – Dependable Income

Mary Brown receives SSI income for her dependent child who is 17 years of age. The SSI income should not be counted as repayment income because it clearly cannot be expected to continue. It would be counted as annual income since it is current verified income.

- **Seasonal Income.** Seasonal job income may be considered stable income when the applicant has worked in the same line of seasonal work for at least two years. When the applicant receives seasonal unemployment compensation, it must be clearly associated with seasonal layoffs, expected to recur and be reported on the applicant's federal income tax returns.

- **Less Than Two Years of History.** In some cases, a history of less than two years is acceptable. The determination requires a careful analysis by the Loan Originator. This may include an applicant who is either new to the work force or has returned to the work force after an extended absence. In these cases, the Loan Originator must look at the period of time the applicant has been employed, the employer's evaluation of the likelihood of continued employment (if available),

Example – Less Than Two Years History

For the last few years, Ellen Dixon has been a homemaker with no outside employment. Now that her children are old enough, she has taken a job as a teacher for which she has the necessary education and certifications. She completed her 6-month probation period and her employer considers that she is a permanent employee. Ms. Dixon's income can be considered stable and dependable. It is important to note that had Ms. Dixon not met the employer's probation period, her income would be counted in annual and adjusted income since it is current verified income but not for repayment ability because it is not considered stable and dependable.

education or training that qualifies the applicant for his/her current position (typically applies to skilled positions), and reasons for absence from the work force in making a determination that income is stable and likely to continue. Information provided by the applicant must be verified by the Loan Originator.

B. Using UniFi and the Income Worksheet to Compute Income

All 3 types of income are calculated in UniFi using data entered by the Loan Originator. Attachment 4-A provides a Sample Worksheet for Computing Income that helps Loan Originators organize applicant information for data entry and provides instructions to calculate each type of income manually. Attachment 4-B contains a case study using the worksheet to illustrate the calculations.

4.3 SOURCES OF INCOME

Attachment 4-C, Annual Income Sources and Attachment 4-D, Repayment Income Sources provide lists of potential sources of income and indicates whether each source is counted for repayment income and/or annual income. This section highlights and provides additional guidance about some of those sources.

A. Income That is Never Counted

The following income is ***never*** counted for either repayment or annual income:

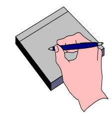
- Income received by live-in aides, regardless of whether the live-in aide is paid by the family or a social service program (family members cannot be considered live-in aides unless they are being paid by a health agency and have an address, other than a post office box elsewhere);

- Income received by foster children or foster adults who live in the household;

- Earned income of minor (however, earned income from a spouse that is a minor or unearned income attributable to a minor, such as child support, Aid to Families with Dependent Children (AFDC) payments, and other benefits paid on behalf of a minor are counted); or

- Payments received on reverse amortization mortgages (these payments are considered a drawdown on the applicant's assets).

B. Verifying Sources and Amounts



Loan Originators must verify income information provided by the applicant. As described in Paragraph 3.15, written verifications provided by third-party sources or documents prepared by third-party sources are generally preferred. Oral verifications, if accepted, must be documented carefully.

1. Verification Documents and Forms

Attachment 4-E summarizes verification requirements for key sources of income. Each applicant must sign *Form RD 3550-1, Authorization to Release Information* at the time of application. Copies of this form must accompany any request for verification from third-party sources. Appendix 2 provides sample certification and verification formats for a number of purposes.

2. Timing

Written income-related verifications are valid for 90 days unless the applicant has continuously worked for their present employer for the last 2 years, in which case the written verification of employment (*Form RD 1910-5, Request for Verification of Employment*) is valid for 120 days. Written verifications may be valid for an additional 60 days with oral reverification at the end of the appropriate period (90 or 120 days whichever is applicable). In no case may information that is older than 150 or 180 days (whichever is applicable) be used.

3. Projecting Income for a 12-Month Period

Current income and family circumstances may be used to estimate the household's income over the next 12 months, unless there is verifiable evidence of a likely change in circumstances or historical information does not support current income. For example, if one of the household members works overtime in the winter, and if income is being verified in the summer, historical overtime will be used to project income. Historical information may also be used to estimate income that is anticipated to be received for less than 12 months. For example, if one of the household members is a seasonal worker, the income attributable to that worker should be based upon past history, rather than annualizing current income.

Example - Annualizing Short-Term Income

Assume a family member who currently has no income historically has seasonal income during the summer months and earns on the average $4,000 during that time. Confirm with the applicant that the same seasonal pattern is expected and use historical data to project income for the coming 12 months.

4. Income of Temporarily Absent Family Members

Household members may be temporarily absent from the household for a variety of reasons, such as temporary employment or students who live away from home during the school year. The income of these household members is considered when computing annual income and, if the person is a party to the note, for repayment income.

Example - Temporarily Absent Member

James Brown and his wife have applied for a loan. At the moment, James is working on a construction job on the other side of the State and comes home every other weekend. He earns $600/week and uses approximately one-third of that amount for temporary living expenses. The full amount of the income earned would be counted for both repayment and annual income.

If the absent person is not considered a member of the household and is not a party to the note, the Loan Originator must not count their income, must not consider them when determining deductions for adjusted income, and must not consider them as a family member for determining which income limit to use.

5. Wage Matching

In states where the Agency has the legal authority to do wage matching, the Loan Originator will use wage matching to verify income for 5 percent of those households that receive *Form 1944-59, Certificate of Eligibility*. The wage matching request should include all adult members of the household, whether or not they have reported taxable income. If the State does not have sufficient resources to conduct all required wage matching, the State Director should request that the Deputy Administrator, Single Family Housing, authorize a lower percentage.

If the wage matching information does not correspond closely with the income reported by the household, the Loan Originator should discuss the discrepancies with the applicant, and adjust the household's income, as appropriate.

4.4 CALCULATING ANNUAL AND ADJUSTED INCOME

Adjusted income is used to determine eligibility for the Section 502 and 504 programs, as well as eligibility for and the amount of payment subsidies under Section 502.

A. Calculating Annual Income

Annual income is used as the base for computing adjusted income. Income of all household members, not just parties to the note, should be considered when computing annual income. Attachment 4-C can be used to determine which sources of income to count and which to exclude. Part II of the Calculation Worksheet in the case study of Attachment 4-B illustrates the calculation of annual income.

B. Calculating Deductions from Annual Income

Adjusted income is calculated by subtracting from annual income any of 5 deductions that apply to the household. Not all households are eligible for all deductions. Exhibit 4-1 summarizes these deductions. The remainder of this paragraph provides guidance on determining whether a family is eligible for each deduction and verifying and calculating these amounts. Part II of the Calculation Worksheet in the case study of Attachment 4-B also illustrates the use of these deductions and the calculation of adjusted income.

Exhibit 4-1
Allowable Deductions from Annual Income

Deduction	Elderly Households	Nonelderly Households
Dependent Deduction	Yes	Yes
Child Care Expenses	Yes	Yes
Elderly Household	Yes	No
Medical Expenses	Yes	No
Disability Assistance	Yes	Yes

C. Dependent Deduction

A deduction from annual income of $480 is made for each household member who qualifies as a dependent. Dependents are members of the household who are not the head or spouse, and who are age 17 or younger, an individual with a disability, or a full-time student.

D. Child Care Expenses

Reasonable unreimbursed child care expenses for the care of children age 12 and under are deducted from annual income if: (1) the care enables a household member to work, actively seek employment, or go to school; (2) no other adult household member is available to care for the children; and (3) in the case of child care that enables a household member to work, the expenses deducted do not exceed the amount of income included in annual income earned by the household member enabled to work. If the child care provider is a household member, the cost of the children’s care cannot be deducted.

To qualify for the deduction, the applicant must:

Verification of Child Care Expenses

The child care hours must parallel the hours the family member works or goes to school. Appendix 2 provides a sample format applicants can use to document child care. Other acceptable formats include a letter on the child care provider's letterhead or a copy of a signed child care contract.

- Identify the children who are receiving the child care and the family member who can work, seek employment or go to school as a result of the care;
- Demonstrate that there is no adult household member available to care for the children;
- Identify the child care provider, the hours of child care provided, and the costs; and
- If the expenses enable a family member to go to school, identify the educational institution. The family member need not be a full-time student.

E. Elderly Household Deduction

A single $400 deduction is subtracted from annual income for any elderly household. To be considered an elderly household, the head of household, spouse, or sole member of a family who is party to the note must be 62 years of age or older, or an individual with a disability.

Typical Disability Expenses

- Care attendant to assist an individual with disabilities with activities of daily living directly related to permitting the individual or another family member to work.
- Special apparatus, such as wheelchairs, ramps, adaptations to vehicles or work place equipment, if directly related to permitting the individual with disabilities or another family member to work.

In the case of a family where the deceased applicant or spouse was at least 62 years old or an individual with disabilities, the surviving family member shall continue to be classified as an "elderly household" for the purposes of determining adjusted income if:

- At the time of death of the deceased family member, the dwelling was financed by the Agency;
- The surviving family member occupied the dwelling with the deceased family member at the time of death; and
- The surviving spouse (if any) has not remarried.

F. Care of Household Members

Reasonable expenses for the care of an individual with disabilities in excess of 3 percent of annual income may be deducted from annual income if the expenses:

- Enable the individual with disabilities or another family member to work;
- Are not reimbursable from insurance or any other source; and
- Do not exceed the amount of earned income included in annual income by the person who is able to work as a result of the expenses.

To qualify for this deduction, applicants must identify the individual with a disability on the application. *Form RD 1944-4, Certification of Disability or Handicap* should be used to request verification of the individual's disability from a physician or other medical professional.

Typical Medical Expenses

- Services of physicians other health care providers
- Services of hospitals other health care facilities
- Medical premiums
- Prescription and nonprescription medicine
- Dental expenses
- Eyeglasses and eye examinations
- Medical or health products or apparatus (hearing aids, wheel chairs, etc.)
- Live-in or periodic medical care (e.g., visiting nurses or care attendants)
- Periodic payments on accumulated medical bills

G. Deduction for Medical Expenses (for Elderly Households Only)

Medical expenses may be deducted from annual income for elderly households if the expenses: (1) will not be reimbursed by insurance or another source; and (2) when combined with any disability assistance expenses are in excess of 3 percent of annual income.

If the household qualifies for the medical expenses deduction, expenses of the entire family are considered. For example, if a household included the head (grandmother, age 64), her son (age 37), and her granddaughter (age 6), the medical expenses of all 3 family members would be considered.

One of the most challenging aspects of determining allowable medical expenses is estimating a household's medical expenses for the coming year. While some anticipated expenses can be documented easily (for example, Medicare or other health insurance premiums and ongoing prescriptions), others need to be estimated. The Loan Originator should use historical information about medical bills to estimate future expenses. However, the estimates should be realistic. For example, if the household has a significant medical bill, the Loan Originator would count only that portion of the bill that is likely to be paid during the coming year.

Example - Calculating the Medical Expense Deduction

The Jensons are an elderly household with annual income of $25,000 and anticipated medical expenses of $3,000 that are not covered by insurance or another source. The allowable medical expenses would be:

Total Medical Expenses		$3,000
(less) 3% Annual Income ($25,000 x 0.03)	-$ 750	
Allowable Medical Expenses		$2,250

Note that for the calculation of assets discussed in Section 2 of this chapter, ***all*** households are eligible for a consideration of medical expenses, not just elderly households.

4.5 CALCULATING REPAYMENT INCOME

Repayment income is the amount of the household's income that is available to repay the Agency's debt. To compute repayment income, the Loan Originator should count only the income of persons who will be parties to the note. See Attachment 4-D for possible sources of income to be included.

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SECTION 2: EVALUATING BORROWER ASSETS *[7 CFR 3550.54(d)]*

4.6 OVERVIEW OF POLICIES RELATED TO ASSETS

Assets affect an applicant's ability to obtain a loan in 2 ways. First, applicants may be required to use assets to make a down payment covering some of the costs of purchasing a home. Second, many types of assets generate income that must be included in the calculations of annual and repayment income. Exhibit 4-2 presents a list of assets that must be considered when making these determinations and also identifies certain types of assets that are not considered.

A. Reporting Assets

Applicants must provide information about household assets at the time of loan application and whenever an income determination is made. Applicants must provide sufficient information to enable the Loan Originator to verify the asset information and compute the market and cash value of the asset. *Form RD 1944-62, Request for Verification of Deposit* provides basic information about borrower assets held by a lender. Two of the certification forms provided in Appendix 2, *Verification of Pensions and Annuities* and *Certification of Disposition of Assets*, can be used to obtain additional information about the applicant's assets.

Example - Calculating Cash Value of An Asset

Mr. Smith has $10,000 in an IRA account. The account's market value is $10,000. But in order to withdraw funds from the account, Mr. Smith must both pay a withdrawal penalty and taxes on the amount withdrawn.

The cash value of the IRA account is:

	$10,000	Market value
less	200	Withdrawal penalty
less	2,000	Tax
	$7,800	Cash Value

Exhibit 4-2

Types of Assets

The following types of assets must be considered.

Nonretirement assets including:

- Savings accounts and the average 2-month balance of checking accounts;
- Stocks, bonds, savings certificates, money market funds, and other investment accounts;
- Equity in real property or other capital investments;
- Trust funds that are available to the household;
- Lump-sum receipts, such as inheritances, capital gains, lottery winnings;
- Personal property (such as jewelry) held as an investment; and
- Cash value of life insurance policies.

Retirement assets including:

- Amounts in voluntary retirement plans that can be withdrawn, such as individual retirement accounts (IRAs), 401(K) plans, and Keogh accounts; and
- Amounts in other retirement and pension plans that can be withdrawn without retiring or terminating employment.

The following types of assets are not considered.

- The value of necessary items of personal property, such as furniture and automobiles;
- Assets that are part of any business, trade, or farming operation in which any member of the household is actively engaged;
- The value of an irrevocable trust fund, or the value of any trust over which no member of the household has control;
- Interests in American Indian trust land; and
- For income calculations, any assets on hand that will be used to reduce the amount of the loan.

B. Calculating Market and Cash Value

The ***market value*** of an asset is simply its dollar value on the open market. For example, the market value of $2,000 in a savings account is $2,000 and the market value of real estate is its appraised value. The ***cash value*** of an asset is the market value, less reasonable expenses to convert the asset to cash. For example, the cash value of stock worth $5,000 would be $5,000 less any broker's fee.

C. Retirement Assets

Retirement assets are savings and investments that have been specifically designated as retirement funds. Not all retirement assets are considered. If the applicant can receive the retirement funds only by borrowing them, or upon retirement or termination of employment, the funds are not counted as assets for determining income or for down payment requirements. If the applicant can withdraw retirement funds without retiring or terminating employment, the funds are counted as assets, even though penalties may apply.

4.7 LIMITATIONS ON ASSETS

The cash value of assets that are above the limitations described in this paragraph must be used to pay for costs related to the purchase of the home. For this purpose, only the assets of parties to the note are considered.

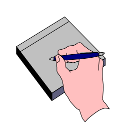
A. Limitation on Nonretirement Assets

If the cash value of nonretirement assets is greater than $7,500 for nonelderly households or $10,000 for elderly households, the cash value in excess of these amounts must be used toward the purchase of the property.

B. Limitation on Retirement Assets

For non-retired applicants, if the ***market value*** of retirement assets is greater than the applicable adjusted median income limit, the ***cash value*** of assets in excess of that amount must be used toward the purchase of the property. For retired applicants, if income is derived from either retirement assets alone or retirement assets and other retirement income, the applicant will not be required to use retirement assets as a downpayment. Real estate assets will be used as a test for other credit.

C. Exception to the Asset Limitations



In cases in which the family is experiencing unreimbursed medical expenses in excess of 3 percent of annual income, the Loan Approval Official may increase the applicable asset limit by the amount of the medical expenses in excess of 3 percent of annual income. The reasons for the waiver must be documented carefully.

4.8 CALCULATING INCOME FROM ASSETS FOR ANNUAL INCOME

For the purpose of computing annual income, the assets of ***all household members*** are considered. In addition, if any household member has disposed of assets for less than fair market value during the 2 years preceding the determination of annual income, the asset must be considered when calculating income from assets for annual income.

A. Two Methods for Calculating Income from Assets

Two different methods of calculating income from assets are used, depending upon the total cash value of household assets.

If the cash value of total assets is $5,000 or less, the amount of asset income included in annual income is the actual income to be derived from these assets.

If the cash value of total assets is more than $5,000, the amount of asset income included in annual income is the greater of: (1) the actual income to be derived from the assets; or (2) an imputed income from assets that is calculated by multiplying the total cash value of assets by a locally-determined passbook rate. Generally, the imputed income from assets is larger than the actual income to be derived from the assets when an applicant owns nonincome-producing assets of significant value.

Example - Income from Assets for Annual Income Calculation

Charles and Patty Brown, both age 40, have applied for a program loan. The Brown family has the following assets.

A certificate of deposit of $6,800 they have been saving for a down payment. It earned 6.8% or $462 of interest last year. Estimated cash value after paying penalties is $6,500.
A savings account with $4,000 earning 4% annually.
The 6-month balance in the checking account is $300 (noninterest-bearing account).

The cash value of the Browns' assets is $10,800 ($6,500 + $4,000 + $300). However, the Browns will be required to use $3,300 (assets in excess of $7,500) toward the purchase of the dwelling. Therefore, the cash value of assets to be counted toward income from assets is $7,500. The cash value of the remaining assets is more than $5,000. To compute income from assets, use the greater of actual income or imputed income.

	Cash Value	**Actual Income Earned**	**Imputed Income (local passbook rate is 4%)**
Checking Account	$ 300	$ 0	
Certificate of Deposit	$6,500	$442 ($6,500 x 0.068)	**$300 ($7,500 x 0.04)**
Savings ($4,000 - $3,300 down payment)	$ 700	$ 28 ($700 x 0.04)	
TOTAL	**$7,500**	**$470**	

B. Assets Disposed of for Less than Fair Market Value

Applicants who dispose of assets for less than fair market value have, in essence, voluntarily reduced their ability to afford housing. Therefore, assets disposed of for less than fair market value during the 2 years preceding a determination of annual income must be used in the annual income calculation. Assets disposed of for less than fair market value as a result of foreclosure, bankruptcy, divorce, or separation are not included in this calculation.

Example - Valuing a Disposed Asset

An applicant sold a property to a relative for $15,000 on July 1, 1996. The property was valued at $30,000 and had no loans against it.

Market value		$30,000
(Less) Settlement costs		$ 2,000
(Less) Sales price	$15,000	
Cash value		$13,000

The $13,000 would be counted as an asset for any annual income determination conducted until July 1, 1998. Even though there would be no actual income from this asset, the $13,000 would be used to establish total assets to determine the amount to be counted as annual income.

The Agency's application does not specifically ask whether assets were disposed of for less than fair market value. The Loan Originator should ask this question when reviewing the application for content and document the applicant's response.

The amount of income to be included in annual income calculation is the difference between the market value of the asset and the amount that was actually received (if any) in the disposition of the asset.

4.9 CALCULATING INCOME FROM ASSETS FOR REPAYMENT INCOME

Only the assets of parties to the note are considered and only the actual income to be derived from the assets is used to compute repayment income.

Example - Income from Assets for Repayment Income

Jose and Sylvia Gonzales, both age 40, have applied for a program loan. Sylvia's mother Maria (age 65) lives with them, but will not be a party to the note. The applicable adjusted median income limit for this household is $40,000. The family reports the following assets.

Jose's 401(K) account is valued at $9,000 and earned 6% or $540 last year. Estimated cash value after penalty and taxes is $7,000.

Jose and Sylvia's savings account with $8,500 earning 4% annually has no withdrawal penalties, and the $300 6-month balance in their checking account earns no interest.

Maria's savings account of $2,000 earned 2.5% interest last year.

Retirement Asset Test. Because the $9,000 market value of the Gonzales' 401(K) account is less than $40,000, the household is not required to use any retirement assets toward purchase of the home.

Nonretirement Asset Test. The cash value of the Gonzales' nonretirement assets is $8,800. Maria's account is not counted because she will not be a party to the note. The nonretirement limit applicable to the family is $7,500. Therefore, the Gonzales family must contribute at least $1,300 ($8,800 - $7,500) of their savings toward the purchase of the home.

	Market Value	**Cash Value**	**Actual Income Earned**
Checking	$ 300	$ 300	$ 0
Savings ($8,500 - $1,300)	$7,200	$ 7,200	$288 ($7,200 x 0.04)
401(K)	$9,000	$ 7,000	$540 ($9,000 x 0.06)
TOTAL	**$7,500**	**$14,500**	**$828** (counted in repayment income)

SECTION 3: CREDIT HISTORY *[7 CFR 3550.53(h)]*

4.10 OVERVIEW

An applicant's credit history is evaluated at 2 points during the application process -- first, through preliminary credit checks conducted when a complete application has been submitted, and later, through third-party verifications conducted when the applicant is selected for processing.

To be eligible for a Section 502 loan, applicants must demonstrate that they are reasonably able and willing to repay a Section 502 loan. This section begins with a discussion of the criteria that Loan Originators must use in assessing an applicant's credit history. It then describes the procedures for conducting preliminary credit checks and full credit reviews, and provides guidance for evaluating the information obtained. It concludes with criteria for making exceptions.

4.11 CREDIT REQUIREMENTS

The Loan Originator must evaluate the credit history for each applicant who will be a party to the note. An applicant's credit record does not have to be perfect to be eligible for a loan. A few instances of credit problems can be acceptable if an applicant's overall credit record demonstrates an ability and willingness to repay obligations. Exhibit 4-3 spells out the indicators of unacceptable credit that should be used to evaluate an applicant's credit history. These indicators must be followed consistently; however, the Loan Approval Official can make exceptions in limited circumstances, as described in Paragraph 4.15.

The Loan Originator must investigate all major indications of unacceptable credit to determine whether they are accurate, and whether there is an acceptable explanation for the problem that might justify an exception. Failure to understand the nature of a credit problem could put the Agency at risk of providing financing to an applicant who is unable or unwilling to repay the debt, or could cause the Agency to reject an applicant on the basis of inaccurate or incomplete information.

> **Cosigners**
>
> Cosigners must meet the same credit-worthiness requirements as applicants.

For instance, an applicant with little or no positive credit history reflected on a credit report will require further examination. Since some creditors do not report to the credit repositories, unreported recurring debts that may demonstrate the applicant's ability and willingness to meet debt obligations should be verified using third party verifications from impartial and unrelated parties, canceled checks that cover a sufficient period of time, or other acceptable means.

Exhibit 4-3
Indicators of Unacceptable Credit

- Little or no positive credit history. The lack of a positive credit history on the credit report may be mitigated if the applicant can document a willingness to pay recurring debts through other acceptable means such as third party verifications or canceled checks. Due to impartiality issues, third party verifications from relatives of household members are not permissible.
- Payments on any installment account where the amount of the delinquency exceeded one installment for more than 30 days within the last 12 months.
- Payments on any revolving account which was delinquent for more than 30 days on two or more occasions within the last 12 months.
- A foreclosure that has been completed within the last 36 months.
- An outstanding Internal Revenue Service (IRS) tax lien or any other outstanding tax liens with no satisfactory arrangement for payment.
- Two or more rent payments paid 30 or more days late within the last 2 years. If the applicant has experienced no other credit problems in the past 2 years, only 1 year of rent history will be evaluated. This requirement may be waived if the program loan will reduce shelter costs significantly and contribute to an improved repayment ability.
- Outstanding collection accounts with a record of irregular payments with no satisfactory arrangements for repayment, or collection accounts that were paid in full within the last 6 months, unless the applicant had been making regular payments previously.
- Non-Agency debts written off within the last 36 months, unless the debt was paid in full at least 12 months ago.
- Agency debts that were debt settled within the past 36 months, or are being considered for debt settlement.
- Delinquency on a federal debt.
- A court-created or court-affirmed obligation or judgment caused by nonpayment that is currently outstanding or has been outstanding within the last 12 months, ***except***:
    - ◊ A bankruptcy in which:
    - ♦ Debts were discharged more than 36 months prior to the date of application; or
    - ♦ Where an applicant successfully completed a bankruptcy debt restructuring plan and has demonstrated a willingness to meet obligations when due for the 12 months prior to the date of application.
    - ♦ A judgment satisfied more than 12 months before the date of application.

An applicant with an outstanding judgment obtained by the United States in a Federal court, other than the United States Tax Court, is *not* eligible for a Section 502 loan. This requirement is statutory and cannot be waived.

If an applicant's credit history is unacceptable, the Loan Originator should counsel the applicant about the specific problems identified, and ways to improve the household's credit record for the future. The Loan Originator should make it clear that establishing a pattern of meeting obligations that conforms to the Agency's standards might make it possible for the applicant to qualify for a Section 502 loan in the future.

The Loan Originator must use consistent standards and procedures when evaluating credit qualifications to ensure equity and fairness. Special areas of concern include:

- Determining what constitutes acceptable documentation;
- Counseling applicants about ways to correct adverse credit; and
- Interpreting subjective information.

4.12 CONDUCTING PRELIMINARY CREDIT CHECKS

When a complete application is received, the Loan Originator must make a preliminary determination of eligibility, as described in Paragraph 3.8. As part of the preliminary determination, the Loan Originator should conduct 4 preliminary credit checks to provide an indication of the applicant's credit history. These checks involve accessing the Department of Housing and Urban Development's Credit Alert Interactive Voice Response System (CAIVRS), ordering an Infile Credit Report, Borrower Cross Reference and Current/ Past Debt screens.

Four Preliminary Credit Checks

- CAIVRS
- Infile Credit Report
- Borrowers Cross Reference
- Current / Past Debt

Preliminary credit checks can save time and money, both for applicants and for Agency staff. By conducting such screening, the Loan Originator can get a preview of the information likely to appear on the credit report. After discussing the accuracy of the information with the applicant, the Loan Originator can make a recommendation to the applicant about the likelihood of receiving a loan, given the available information. If it appears that the applicant would not qualify for a loan, the preliminary credit check can save the applicant the cost of the credit report fee, which need not be paid unless a credit report is ordered.

A. Credit Alert Interactive Voice Response System

Except in very unusual circumstances, an applicant who is delinquent on a Federal debt is not eligible for a Section 502 loan. The Loan Originator can verify that the applicant has no delinquent Federal debt through CAIVRS. However, credit must not be denied based solely on the results of the CAIVRS inquiry.

The Loan Originator should record his or her CAIVRS identity number and the applicant's access code at the top of *Form RD 410-4, Uniform Residential Loan Application* to document that the applicant's delinquency status has been checked.

Exceptions to Delinquent Federal Debt

If the applicant has a delinquent Federal debt, the Administrator has the authority to grant an exception if arrangements for payment have been made and it is in the best interest of the Government.

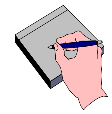
If CAIVRS indicates that the applicant has a delinquent Federal debt, the Loan Originator should suspend application processing, notify the applicant of the reason for the suspension, and provide the telephone number CAIVRS lists as a point of contact for resolving the delinquency. If the applicant does not notify the Agency within 30 days that the problem has been resolved, the application must be rejected and the applicant should be notified in writing. The Administrator may grant an exception to this requirement if it is in the best interest of the Government.

If the delinquency is paid in full or otherwise resolved within the 30-day time frame, application processing can continue. If the applicant resolves the issue after the application has been rejected, and wishes to reapply, the applicant must submit a new application, which must be processed according to the new submission date.

B. Infile Credit Report

The Loan Originator should order an Infile Credit Report for all applicants, in order to screen for potential credit problems, unless such a report was already ordered by a loan packager, real estate broker, or other entity. The results of the Infile Credit Report can help identify possible credit problems that should be corrected before the applicant pays a credit report fee. However, an applicant should never be rejected on the basis of the information contained in the Infile Credit Report.

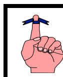
If the Infile Credit Report uncovers adverse information that could prevent the applicant from receiving a loan, the Loan Originator should discuss the findings with the applicant, and provide specific information from the Infile Credit Report to assist the applicant in addressing the credit problems. If the applicant acknowledges that the credit blemishes are accurate, but indicates that they were due to circumstances beyond his or her control, the Loan Originator should record those reasons as documentation for making an exception.



If the applicant has credit blemishes that appear to be serious enough to warrant rejecting the application, the Loan Originator should advise the applicant of the apparent problems. Depending on the length of the Field Office's waiting list and the specific problems identified, the Loan Originator should either advise the applicant that it would be wise to address the outstanding credit issues before continuing with the application, or to address the credit issues while the application awaits selection. The Loan Originator also should counsel the applicant about ways to correct the problems on the Infile Credit Report and provide ideas about ways to avoid credit problems in the future.

4.13 CONDUCTING FULL REVIEW OF CREDIT HISTORY

Once the applicant is selected for processing, the Loan Originator must obtain third-party verifications to determine whether the applicant's credit history meets the Agency's criteria. Procedures for verifying the accuracy of information provided by the applicant are described in Paragraph 3.15. Guidelines for reviewing the applicant's credit history are provided here.



> **Helpful Hint**
>
> Unless the applicant makes a written request for a copy of their credit report the Agency will not provide a copy of a credit report directly to the applicant.

If an applicant is denied assistance based upon information contained in a credit report, the Agency must provide the applicant:

- The name, address, and toll free number of the credit bureau;
- A statement to the applicant that the denial of their loan request was made by the Agency, and not the credit bureau;

- Notice of their right to obtain a free copy of their credit report from the credit bureau within 60 days from the date of the Agency's adverse action; and

- Notice of the applicant's right to dispute to the credit bureau the accuracy or completeness of the credit report provided to the Agency.

A. Credit Report

The credit report will include a summary listing of the applicant's credit activity, including open accounts and payment history, outstanding amounts due, and credit limits. If the credit report indicates that there may be any indicators of unacceptable credit, the Loan Originator should discuss the findings with the applicant and ask for clarifications. Exhibit 4.4 contains guidelines for reviewing the credit report. A copy of the credit report must be retained in the case file. If the credit report is more than 6 months old when the underwriting decision is being made, a new credit report must be ordered at no cost to the applicant.

For applicants with no outstanding judgments obtained by the United States in a Federal court and who have a credit score of 660 or higher on their residential mortgage credit report (RMCR), Exhibit 4-3 need not be used to identify indicators of unacceptable credit handling. In addition, *Form RD 1944-61, Credit History Worksheet*, need not be completed. These applicants can automatically be classified as having acceptable credit histories provided the Loan Originator has concluded that there is no significant adverse credit information from other sources (i.e. Landlord, CAIVRS, etc.). Credit scores can be used to reduce the time necessary to conduct a credit analyses, but under no circumstance can they be used to make adverse decisions.

To determine if an applicant meets the credit score threshold of 660 or higher to waive the use of Exhibit 4-3 to identify indicators of unacceptable credit handling, the following practice will be established:

- If the three credit scores (Beacon, Empirica, and Fair Issac) are listed on the RMCR, the middle numerical score should be used.

- If the RMCR only contains two scores, the lower of the two should be used.

- If the RMCR only contains one score, that score should be used.

- If no score is available, the credit bureau will report a "zero." Zero in these cases has the literal meaning of null, or indicating there was not enough information or credit references for the statistical model to compute a credit score value.

- If there is more than one applicant, each applicant must be viewed separately.

B. Other Credit Verifications

If the credit report fails to verify the credit sources reported by the applicant, the Loan Originator should send *Form RD 1944-60, Landlord's Verification* and *Form RD 410-8, Applicant Reference Letter*, to the parties indicated in the application. The forms should be accompanied by a preaddressed, prestamped envelope and *Form RD 3550-1, Authorization to Release Information*, which authorizes the respondent to release the information.

1. Landlord's Verification

Form RD 1944-60 is used to verify the applicant's past record of making timely rental payments. The Loan Originator should generate separate copies of *Form RD 1944-60* for each landlord listed on the application for the past 2 years.

If the landlord reports that during the past 12 months the applicant "always pays by the due date" or "pays within 1-10 days of the due date" and is current on the rent, the applicant's rental history should be considered satisfactory. If the landlord reports that the applicant "pays over 30 days late" or "generally stays behind schedule," or if the applicant is currently behind on the rent, the Loan Originator should follow up with a call to the landlord.

Confirmation that the applicant has paid 2 or more rent payments 30 or more days late within the last 2 years generally would be an indicator of unacceptable credit. However, if the amount of rent paid by the applicant was significantly higher than the likely cost of principal, interest, taxes and insurance (PITI) with a Section 502 loan, an exception might be appropriate.

2. Applicant Reference Letter

Form RD 410-8 is used to obtain information about an applicant's credit history that might not appear on a credit report, for example credit from a local store. It can be used to document an ability to handle credit effectively for applicants who have not used sources of credit that appear on a credit report. It also provides a mechanism for following up on repayment history for debts reported by the applicant on the application that do not appear on the credit report.

If *Form RD 410-8* indicates that the applicant has made debt payments more than 30 days late more than 2 times in the past year, the Loan Originator should follow up with a call to the creditor. Confirmation that the applicant has paid 2 or more debt payments 30 or more days late within the last 2 years generally would be an indicator of unacceptable credit.

Exhibit 4-4

Guidelines for Evaluating Credit Reports

- Different credit bureaus or repositories present information in different formats. Be familiar with the different formats and take time in reviewing the report to avoid errors.

- Obtain clarification of any questionable items or terms (for example, terms such as "slow" or "late pay" have varied meanings). No decisions should be made until the terms in question are translated into defined terms (e.g., for this repository, "slow pay" means 30 days late). Document clarification of terms in the case file.

- Upon receiving the credit report, verify the name, address, and Social Security Number.

- Compare the employment information and rental data on the credit report, if available, with the information on the application. (Note: the Agency's contract does not require that the credit bureau furnish that information.)

- Compare the remainder of the credit report to the application. Consider the following questions when reviewing the application.

    ◊ Are all the accounts reported on the credit report listed on the application? (Note: There may be additional accounts on the application that are not on the credit reports because not all creditors furnish information to a credit bureau or repository.)

    ◊ Does any of the information on the credit report contradict the application?

    ◊ What information indicates unacceptable credit? List late payments, chargeoffs and other relevant information.

- If the credit report reflects little or no positive credit history, ask the applicant for other documentation that may demonstrate a willingness to pay recurring debts like rent, utilities, phone, medical, etc. Third party verifications from impartial and unrelated parties or canceled checks that cover a sufficient period of time are acceptable forms of documentation.

- Highlight areas of concern and develop a list of questions or issues that need clarification from the applicant.

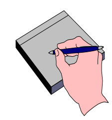
4.14 CREDIT HISTORY WORKSHEET

Form RD 1944-61, Credit History Worksheet is a checklist used to summarize the applicant's credit history and to determine whether there are any indicators of unacceptable credit. The Loan Originator should complete this form and include it in the case file to aid the Loan Approval Official in reviewing the applicant's credit history. See Exhibit 4-3 for Indicators of Unacceptable Credit.

Consistency in Credit Review

Consistent use of *Form RD 1944-61* can help ensure that every applicant's credit history is reviewed based on the same criteria and that adverse indicators are not inadvertently overlooked.

4.15 MAKING EXCEPTIONS



The Loan Originator should review the credit history for any signs of unacceptable credit using the criteria outlined in Exhibit 4-3. Credit history problems do not always reflect an unwillingness to meet financial obligations. If the applicant's credit history does not meet the standards outlined in Exhibit 4-3, the Loan Originator should document the circumstances and request approval for an exception from the Loan Approval Official in the following types of situations.

- **Reduced shelter costs.** The loan will significantly reduce the applicant's shelter costs, which will result in improved debt repayment ability.
- **Temporary situation.** The circumstances that caused the credit problems were temporary in nature and beyond the applicant's control. Examples include loss of job, delay or reduction in benefits, illness, or dispute over payment of defective goods or services.
- **Benefit to the Government.** The applicant is delinquent on a Federal debt, and the Agency loan will allow the applicant to take actions that benefit the Government. This type of exception can only be made by the Administrator.

The Loan Approval Official is not authorized to make an exception in the case of an applicant with an outstanding judgment obtained by the United States in a Federal court, other than the United States Tax Court.

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SECTION 4: OTHER ELIGIBILITY REQUIREMENTS

4.16 OWNING A DWELLING

An applicant who owns a dwelling generally is not eligible for a Section 502 loan, except for refinancing assistance, as described in Paragraph 6.5 B. However, if the applicant's dwelling is structurally unsound, functionally inadequate, or too small to accommodate the needs of the household, funds may be provided to improve the existing dwelling or to purchase a new one.

4.17 ABILITY TO OBTAIN OTHER CREDIT

To be eligible, the applicant must be unable to obtain credit from other sources on terms and conditions they can reasonably be expected to fulfill. Applicants must reduce the need for credit by using available assets, as described in Section 2. In addition, applicants who may be able to obtain a portion of the needed funds from a private lender must attempt to do so, as described in Chapter 10.

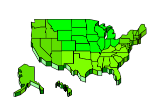
4.18 OCCUPYING THE PROPERTY *[7 CFR 3550.53(c)]*

To be eligible for a Section 502 loan, applicants must agree to personally occupy the dwelling on a permanent basis. On the basis of this requirement, 2 types of applicants require special review.

- **Active duty military applicants.** Because of the probability of transfer, military personnel on active duty should not receive loans without proof that a discharge will be received within a reasonable period of time, usually within 1 year, and the family will continue to occupy the home in case the applicant is transferred to another duty station before discharge.

- **Student applicants.** Due to the probability of moves after graduation, full-time students cannot obtain loans unless they intend to make the home a permanent residence and there are reasonable prospects of securing employment in the area after graduation.

4.19 LEGAL CAPACITY *[7 CFR 3550.53(e)]*



To be eligible for a loan, the applicant must be considered an adult under State law, and must have the legal capacity to incur the loan obligation. An applicant with a court-appointed guardian or conservator who is empowered to obligate the applicant in real estate matters is eligible for a loan. The Loan Originator should assume that any applicant has the legal capacity to enter into the loan unless there is evidence to the contrary.

4.20 SUSPENSION OR DEBARMENT *[7 CFR 3550.53(f)]*

Individuals who have been suspended or debarred from participation in Federal programs are not eligible for Agency assistance.

4.21 CITIZENSHIP STATUS *[7 CFR 3550.53(b)]*

To be eligible for Agency assistance, the applicant must either be a U.S. citizen, a U.S. non-citizen national, or a qualified alien and must provide acceptable evidence of eligible immigration status. Any applicant who is not a U.S. citizen, a U.S. non-citizen national, or a qualified alien should be rejected. U.S. non-citizen nationals should provide a copy of their birth certificate or passport as evidence of their status. Aliens must provide acceptable evidence that they are qualified aliens, as listed in Exhibit 4-5. The Loan Originator should review the original document and make legible photocopies of both the front and back. If the documentation appears to be altered or counterfeit, or if the alien presents unfamiliar INS documentation, the Loan Originator must contact the Bureau of Citizenship And Immigration Services (BCIS), formerly Immigration and Naturalization Service (INS), for verification. U.S. Department of Justice, Immigration and Naturalization Service Form G-845, Document Verification Request, may be used for this purpose.

4.22 TRUTHFUL APPLICATION

Applicants must provide truthful information when applying for assistance. Any inconsistencies discovered throughout the application process must be addressed. The Loan Originator must obtain sufficient documentation to verify the applicant's identity. Documentation will include picture identification (ID), evidence of age, and evidence of the taxpayer's identification number for each person that will sign the promissory note. A photocopy of these documents shall be placed in the case file. Acceptable forms of identification include a driver's license, passport, work related ID cards, or similar documents. If photographic ID is not available, the Loan Originator must thoroughly document why it is not available and how identity of the applicant was verified. In addition, if the applicant's taxpayer identification number is not included on the picture ID, another means of documentation is required to verify the taxpayer's identification number such as copy of the social security card, a pay stub or bank statement. Applicants who provide false information, or who fail to disclose relevant information, will be denied program assistance.

U.S. Citizens

Never ask about alien status if *Form RD 410-4, Uniform Residential Loan Application,* indicates the applicant is a U.S. citizen. ***Always*** require evidence if *Form RD 410-4* indicates that the applicant is a qualified alien.

U.S. Non-Citizen Nationals

Non-citizen nationals are persons born in American Samoa or Swains Island or after the date the U.S. acquired American Samoa or Swains Island, or a person whose parents are U.S. non-citizen nationals. ***Always*** require evidence of this relatively uncommon status.

Exhibit 4-5

Acceptable Evidence of Qualified Aliens

- *Form I-551, Alien Registration Receipt Card* or prior to 1979, *Form I-151* (for permanent resident aliens).
- *INS Form I-688B, Employment Authorization Card*, which must be annotated "Provision of Law" followed by one of the provisions listed below:
  - ◊ 274 a.12(c)(ii), or
  - ◊ 274 a.12(a)(1), or
  - ◊ 274 a.12(a)(3), or
  - ◊ 274 a.12(a)(4), or
  - ◊ 274 a.12(a)(5), or
  - ◊ 274 a.12(a)(10)
- *INS Form I-766, Employment Authorization Document*, annotated as follows:
  - ◊ A3, or
  - ◊ A5, or
  - ◊ A10
- *INS Form I-571, Refugee Travel Document*;
- *Form I-94, Arrival-Departure Record*, with one of the following annotations:
  - ◊ "Admitted as Refugee Pursuant to Section 207";
  - ◊ "Section 208" or "Asylum";
  - ◊ "Section 243(h)" or "Deportation stayed by Attorney General"; or
  - ◊ "Paroled Pursuant to Section 212(d)(5) of the Immigration and Nationality Act (INA)"
  - ◊ "Admitted under Section 203(a)(7) of the INA."
- If *Form I-94, Arrival-Departure Record*, is not annotated, it should be accompanied by one of the following documents:
  - ◊ A final court decision granting asylum (but only if no appeal is taken);
  - ◊ A letter from an asylum officer of the U.S. Immigration and Naturalization Service (INS) granting asylum (if application is filed on or after October 1, 1990) or from an INS district director granting asylum (if application filed before October 1, 1990);
  - ◊ A court decision granting withholding of deportation; or
  - ◊ A letter from an INS asylum officer granting withholding of deportation (if application filed on or after October 1, 1990).

Exhibit 4-5 (Continued)
Acceptable Evidence of Qualified Aliens

- A receipt issued by the INS indicating that an application for issuance of a replacement document in one of the above-listed categories has been made, and the applicant's entitlement to the document has been verified.

- Other acceptable evidence. If other documents are determined by the INS to constitute acceptable evidence of eligible immigration status, they will be announced by notice published in the federal register.

SECTION 5: PROCESSING THE CERTIFICATE OF ELIGIBILITY

4.23 DETERMINING REPAYMENT ABILITY *[7 CFR 3550.53(h)]*

The primary consideration in determining whether an applicant can afford to purchase a home is the applicant's repayment income. Repayment income, as described in Paragraph 4.5, is the amount of income parties to the note will have available to repay the debt.

However, other household expenses and debts and the availability of payment subsidies also greatly affect an applicant's repayment ability. The Agency bases underwriting decisions on an analysis of the percentage of income the applicant would be required to spend on housing costs and the applicant's total debt if the loan is approved. Using these 2 percentages, called ratios, is a standard practice throughout the lending industry. Borrowers must meet the Agency's standards for both ratios.

Maximum Ratios

PITI Ratio	
Very low-income applicants	29%
Other applicants	33%
TD Ratio (all applicants)	41%

A. The PITI Ratio

The PITI ratio compares the amount the applicant must spend on housing costs (including **P**rincipal on the loan, **I**nterest on the loan, real estate **T**axes, and property **I**nsurance) and flood Insurance (As Applicable) to the applicant's repayment income. For new construction, the fully assessed tax amount will be used to determine repayment ability Very low-income applicants are considered to have repayment ability if they do not have to pay more than 29 percent of Repayment income for PITI expenses. Applicants with incomes above the very low-income limit are considered to have repayment ability if they do not have to pay more than 33 percent of repayment income for PITI expenses.

Example - Calculating PITI Ratios

$360	Principal and Interest payment
$ 50	Taxes
$ 10	Flood Insurance
<u>$ 50</u>	<u>Insurance</u>
$470	Total for PITI
$18,000	Annual Repayment Income
$ 1,500	Monthly Repayment Income ($18,000 ÷ 12)

PITI Ratio = $470 ÷ $1,500 = 31.33%

Taxes: Must be on full assessed value

B. The TD Ratio

1. Maximum TD Ratio

The TD ratio compares applicant debt to repayment income. Applicants, regardless of income, are considered to have repayment ability when they do not have to spend more than 41 percent of repayment income on total debt.

2. Establishing TD

Total debt includes PITI, all long-term obligations, and short term-obligations that have a significant impact on repayment ability. The following items should be counted:

- PITI -- Principal, Interest, Taxes, and Insurance;
- Regular assessments, such as homeowner assessments;
- Long-term obligations with more than 6 months repayment remaining, including loans, alimony, and child support;
- Payments that come due in the next 12 months, including deferred loans and balloon payments;
- The minimum monthly payment required for revolving credit card debts; and
- Short-term obligations that are considered to have a significant impact on repayment ability, such as large medical bills and car or other credit payments.

Example - Calculating TD Ratios

$300	Principal and Interest payment
$ 60	Taxes
$ 50	Insurance
$410	PITI Subtotal
$300	Car payment
$100	Payments on credit card debt
$810	Total Debt
$25,000	Annual Repayment Income
$ 2,083	Monthly Repayment Income ($25,000 ÷ 12)

TD Ratio = $810 ÷ $2,083 = 38.89%

Debt from which the applicant has not been released need not be counted if the applicant can demonstrate that another party has assumed responsibility for the debt. For example, if a divorced applicant can show that the former spouse has made the last 12 months of mortgage payments, the mortgage payments on that property need not be counted when establishing total debt.

B. Determining the Maximum Loan Amount

The Loan Originator enters information provided by the applicant about household size, income and debts, and general program information, including the Maximum loan limit and median income for the area. Because a specific dwelling has not yet been identified, estimates can be used for taxes, insurance, and purchase-related costs. Once this information is entered, UniFi:

- Computes the PITI and TD ratios;
- Determines whether the applicant is eligible for payment subsidy, and how much payment subsidy the applicant would receive; and
- Computes the maximum loan amount for which the applicant qualifies, first using standard loan terms and then using any adjusted terms for which the applicant may qualify.

C. Using Market Data to Interpret UniFi Results

Each Field Office should collect and maintain sales information for each market area in its jurisdiction. By comparing the results of an applicant's maximum loan calculation to market data, Loan Originators can provide appropriate counseling for applicants and identify candidates for 100 percent private financing or leveraged loans. MLS and comparable sales data collected through appraisals are valuable sources of market information.

4.24 IDENTIFYING CANDIDATES FOR PRIVATE FINANCING

Very low-income applicants will not be required to seek private financing to leverage an Agency loan. However, the Loan Originator will provide information to these applicants about other sources of subsidized loans or grants.

Unless a low-income applicant's credit history is such that a private lender is unlikely to provide even a leveraged loan, the Loan Originator will use UniFi to calculate the maximum allowable loan the applicant could receive if 80 percent of the loan funds were provided by the Agency at standard rates and terms and 20 percent of the loan funds were provided by a private lender at market rates and terms.

If the resulting maximum loan appears sufficient to enable an applicant to purchase an appropriate home in the market area, the Loan Originator must notify the applicant that a final determination of eligibility cannot be made until the applicant has attempted to obtain private financing for at least 20 percent of the loan. Applicants should be referred to lenders offering rates and terms for which they appear to qualify. Chapter 10 provides additional guidance on processing leveraged loans and Attachment 10-C provides a sample information sheet to help applicants explain the Agency's leveraging requirements to the lender.

4.25 OTHER CONSIDERATIONS RELATED TO MAXIMUM LOAN AMOUNTS

The Eligibility Summary generated from UniFi may show that an applicant's maximum loan amount is too low to enable the applicant to purchase a property that meets program standards. Conversely, the total proposed loan payment associated with the maximum loan amount might be substantially higher than what the applicant is currently paying for housing. This condition could set the stage for payment shock.

In Exhibit 4.6, procedures for dealing with applicants that are eligible for insufficient loan amounts are outlined. This paragraph also discusses compensating factors and additional financial resources that the Loan Originator should consider to improve the applicant's purchasing ability only and concludes with a discussion on payment shock.

Exhibit 4-6

Establishing Procedures for Dealing with Low Loan Amounts

Each Field Office should set a minimum loan amount and consistently advise potential applicants, whose incomes will not support at least that level of loan that homeownership may not be appropriate at this time. There is no "right" cut-off level for a minimum loan amount -- each Field Office should set a level that is clearly less than the cost of a decent, safe, and sanitary dwelling in the area. The Loan Originator should counsel potential applicants who are likely to qualify for less than this amount about ways to change the factors that make homeownership inadvisable, such as reducing debt, or finding ways to increase income.

Counseling potential applicants who are unable to obtain the minimum loan will help prevent those who are clearly not appropriate homeownership candidates from going through the entire application process and paying a credit report fee, only to discover that there is no home available for a price they can afford. However, if, after counseling, a potential applicant who qualifies for an extremely low loan amount wishes to pursue a Section 502 loan, they must be given that opportunity.

A. Using Compensating Factors

Exceptions to the standard method of determining repayment ability may be made if there is information -- called compensating factors -- that indicates the prospective borrower may be able to make larger regular loan payments than the ratio analysis suggests. Compensating factors must be clearly documented in the applicants case file. Some of the compensating factors that can affect the amount of debt an applicant is permitted to take on are discussed below.

3. Payment History

The PITI and TD ratio analyses assume that households are able to contribute a specified percentage of income toward housing costs. However, if an applicant has historically paid a greater share of income for housing with the same income and debt level, a higher payment may be approved. Utility and maintenance costs must be considered as part of this analysis.

4. Savings History

Applicants with accumulated savings and a savings history that shows a capacity to set aside a larger-than-average portion of income may be approved for a higher payment.

Example - Using Savings History As A Compensating Factor

An applicant is currently paying $400 per month in rent and putting $175 per month in a savings account. Utility costs should be similar to those the applicant is currently paying, but maintenance costs will be about $50 per month higher. According to ratios, the applicant's repayment ability is $500 per month. However, since the applicant is currently using a total of $575 per month for a combination of rent and savings, a loan that requires a monthly payment of up to $550 ($575 - $25) may be considered.

5. Job Prospects

If an applicant has recently entered a profession in which they can expect significant pay increases, the Loan Originator may base repayment income on the anticipated future earnings of that applicant.

Similarly, if overtime income is available to increase the applicant's income, the Loan Originator may project the household's income with extra overtime included.

6. Adjustments for Nontaxable Income

The standard PITI and TD ratio limitations are based on an assumption that applicant income is taxable. If a particular source of income is not subject to Federal taxes, for example, certain types of disability payments or military allowances, the amount of continuing tax savings attributable to the nontaxable income source may be added to the applicant's repayment income. Nontaxable income will be multiplied by 120 percent to "gross up" such income. The State Director may approve use of higher percentages if they are justified by the Loan Originator.

Example - "Grossing Up" Nontaxable Income

The applicant's repayment income of $22,000 includes $5,000 of nontaxable income. The revised repayment income for the applicant would be calculated as follows:

$17,000	Taxable Income
+$6,000	"Grossed-up" Nontaxable Income ($5,000 x 1.2)
$23,000	Revised Repayment

Compensating factors must be approved by the State Director. To obtain approval, the Loan Originator must prepare a request that supports the use of compensating factors and the higher amount requested. The Loan Originator should forward the request and case file, through the Loan Approval Official, to the State Director. State Directors will conduct periodic post reviews of first year delinquent loans which were granted compensating factors. State Directors must make judicious use of compensation factors when applicants housing expanses are substantially increasing or the applicant credit blemished

B. Adding Additional Parties or Cosigners to the Note

Additional financial resources may be added by adding additional parties to the note or locating cosigners.

1. Additional Parties to the Note

Additional parties to the note must agree to occupy the dwelling and must qualify as borrowers, as described in Chapter 4. Counting the income of the additional parties increases repayment income.

2. Cosigners

Individuals who will not reside in the dwelling, but who are willing to be responsible for the debt may be consigners to the note. To supplement the applicant's purchasing power, a cosigner must demonstrate an ability and willingness to meet debt obligations as outlined in Section 3 and possess a TD ratio that does not exceed 41 percent. The cosigner's TD calculation would include the applicant's full note payment through RD, the applicant's leveraged loan payments (if applicable), the applicant's escrow payment, and all of the cosigner's long-term obligations (including their mortgage) as well as their short-term obligations that have a significant impact on repayment ability.

Again, cosigners can only be used to improve the applicant's purchasing power. Cosigners cannot be used to compensate for an applicant's unacceptable credit history.

C. Payment Shock

Payment shock represents the applicant's projected increase in housing expenses. The following formula is used to calculate payment shock as a percentage:

Payment shock = (Total proposed principal, interest, taxes, and insurance payment after subsidy / current housing expense excluding utilities) – 1

By way of example, presume that the RD payment after subsidy is $550, the leveraged lender's payment is $250, taxes and insurance are approximately $120, and the applicant's current rent is $400. In this scenario, the applicant's payment shock is 130 percent:

($550 + 250 + 120) / 400 = 2.30; 2.30 – 1 = 1.30 = 130 percent

In cases where payment shock is greater than 100 percent or could not be measured since the applicant does not currently have any housing expenses, no additional risk layering (i.e. adverse credit waivers, use of compensating factors, etc.) should be allowed without strong justification. Multiple layers of risk may be justified if the applicant has an excellent credit history reflecting timely repayment of credit obligations or a credit score of 660 or higher on their RMCR. Perhaps the applicant has demonstrated a conservative attitude toward the use of credit and an ability to accumulate savings or a stable employment history over the past two years, demonstrating a dependable income stream. Regardless of the justification, the Loan Approval Official must thoroughly document their rationale for allowing multiple layers of risk in the running case record.

In addition, the Loan Approval Official must counsel the applicant on this occurrence and emphasize that purchasing a home at their maximum qualification amount may strain their budget and not allow for unexpected expenses. Discuss the additional costs associated with homeownership (taxes, insurance, utilities, maintenance, etc.) and document the counseling effort in the running case record.

4.26 ISSUING THE CERTIFICATE OF ELIGIBILITY

When funds are available, eligible applicants who have not yet located properties should be issued *Form RD 1944-59, Certificate of Eligibility*. Applicants who are not seeking leveraged loans should be informed that the certificate is valid for a period of 45 days. Applicants seeking leveraged loans should be informed that the certificate is valid for a period of 60 days. Within that time the applicant must provide sufficient information to enable the Agency to conduct an appraisal of the property to be financed. Up to two 30 day extensions may be granted for applicants who demonstrate that they have been actively looking for a property. If the applicant has already submitted a contract for a property, *Form RD 1944-59* will not be issued. If an applicant's sales contract falls through, a new *Form RD 1944-59*, good for 45 days or 60 days, as applicable, should be issued. An application is no longer considered active and will be withdrawn when the certificate of eligibility has expired and all authorized extensions have been exhausted.

Applicants for a self-help loan will be issued Handbook Letter 16 (3550), Eligibility of Self-Help Applicants. UniFi may indicate the applicant qualifies for a higher loan amount than the actual cost of building a modest home using the self-help method. The dollar amount to be inserted in the eligibility letter will be based on the following:

l. The average cost of the most recent group of homes built in the area by the self-help method with consideration given to known price increases or decreases in materials, labor, land and/or time of construction (unless the applicant qualifies for less); or

2. The average cost of the homes that are to be built by the self-help method as determined by detailed cost estimates of the plans and specifications prepared by the self-help grant organization, in consultation with the local Rural Development staff and/or Technical and Management Assistant (T&MA) contractor. Consideration will also be given to known price increases or decreases in material, labor and/or time of construction (unless the applicant qualifies for less).

If the Loan Originator determines that a loan applicant cannot be determined eligible, Handbook Letter 15 (3550), Standardized Adverse Decision Letter, should be sent to the applicant. The form explains why the loan is not approvable. The appropriate attachment from Chapter 1 should be attached to provide the applicable review, mediation, and appeal rights.

ATTACHMENT 4-A

SAMPLE WORKSHEET FOR COMPUTING INCOME

PART I: REPAYMENT INCOME CALCULATION

1. Name	2. Identification

ASSETS (Consider only nonretirement assets and retirement assets that can be withdrawn by parties to the note):

Family Member	Asset Description	Market Value	Current Cash Value	Actual Income from Assets
3. Total		3a.	3b.	3c.
4. Assets to be used as down payment		4a.	4b.	4c.
5. Assets/income to be considered for repayment income purposes (Item 3 minus Item 4)		5a.	5b.	5c.

ANTICIPATED REPAYMENT INCOME (Consider only income of parties to the note using Attachment 4-D):

Family Member	a. Wages/ Salaries	b. Benefits/ Pensions	c. Public Assistance	d. Other Income	e. Asset Income
					Enter line 5c in Box e below
6. Totals	a.	b.	c.	d.	e.

7. Enter total of items 6a. through 6e. This is <u>Repayment Income</u>.	7.

PART II: ANNUAL AND ADJUSTED INCOME CALCULATION

1. Name	2. Identification

FAMILY ASSETS:(Consider assets of all household members):

Family Member	Asset Description	Current Cash Value	Actual Income from Assets
3. Total Assets		3a.	3b.
4. Assets/income to be used as down payment (from Part I)		4a.	4b.
5. Assets/income to be considered for annual income (Item 3 minus Item 4)		5a.	5b.
6. If Line 5a is greater than $5,000, multiply Line 5a. by ____ (passbook rate) and enter result here; otherwise, leave blank.			6.

ANTICIPATED ANNUAL INCOME (Consider income of all household members using Attachment 4-C:

Family Member	a. Wages/ Salaries	b. Benefits/ Pensions	c. Public Assistance	d. Other Income	e. Asset Income
					Enter the greater of Lines 5b or 6 in box e below
7. Totals	a.	b.	c.	d.	e.

8. Enter total of items 7a. through 7e. This is Annual Income.	8.

ANNUAL AND ADJUSTED INCOME CALCULATION (Continued)

9.	Annual income (enter line 8 from Part II).		9.
10.	Number of family members (except parties to the note or their spouses) under 18, disabled, or full-time students.	10.	
11.	Multiply line 10 by 480.		11.
12.	Child care deduction (reasonable expenses for care of children 12 and under that enable family member to work, actively seek employment, or further education).		12.
13.	Elderly household deduction (enter $400 if head of household or spouse who is party to the note is 62 or older or an individual with disabilities).		13.
14.	Disability assistance expenses (reasonable expenses for disabled family member that enable a family member to work).	14.	
15.	Medical expenses in excess of insurance reimbursement (elderly households only).	15.	
16.	3% of annual income (line 9 x 0.03).	16.	
17.	Allowable disability assistance/medical expenses (line 14 + line 15 minus line 16).		17.
18.	Total deductions (add lines 11, 12, 13 and 17).		18.
19.	Adjusted income (line 9 minus line 18).		19.

ATTACHMENT 4-B

CASE STUDY

SECTION 1 -- BACKGROUND

HOUSEHOLD MEMBERS

Name	Age	Relationship	Comments
David Brown	44	Head of household	Employed, party to note
Betsy Brown	44	Spouse	Employed, party to note
Cynthia Brown	70	David's mother	Disabled, Moved in when husband died
Janet Smith	19	Daughter	Full-time college student
Kathy Brown	14	Daughter	Full-time high school student
Chris Doe	8	Foster child	Full-time elementary student

HOUSEHOLD INCOME, ASSETS AND EXPENSES

Wages

David:	$250/week
Betsy:	$5.50/hour 20 hours/week
Janet:	$5.00/hour 20 hours/week
Kathy:	$4.00/hour 8 hours/week

Other Income and Assets

Betsy receives $100/month in child support from her ex-husband (Janet's father).
Cynthia receives $400/month social security benefits and has $600 in a noninterest bearing checking account.
County pays household $200/month to care for foster child.
Savings account balance $4,000, annual income $140.
Checking account balance (2-month average) $300, noninterest bearing account.
Certificate of deposit $4,000, cash value $4,000, income $400.

Expenses

Medical expenses not reimbursed, $1,500.
Child care expenses for foster child, $50/week.

INCOME LIMIT INFORMATION

Income Range	Number of Persons					
	1	2	3	4	5	6
Adjusted Median Income	$19,000	$23,000	$25,000	$27,000	$29,000	$31,000
Low-Income	$15,200	$18,400	$20,000	$21,600	$23,200	$24,800
Very Low-Income	$ 9,500	$11,500	$12,500	$13,500	$14,500	$15,500

SECTION 2 -- CALCULATION WORKSHEET

PART I: REPAYMENT INCOME CALCULATION

1. Name David and Betsy Brown	2. Identification

ASSETS (Consider only nonretirement assets and retirement assets that can be withdrawn by parties to the note):

Family Member	Asset Description	Market Value	Current Cash Value	Actual Income from Assets
David	Savings Account	$4,000	$4,000	$140
	Checking Account	$ 300	$ 300	-
	Certificate of Deposit	$4,000	$4,000	$400
3. Total		3a. $8,300	3b. $8,300	3c. $540
4. Assets to be used as down payment		4a. $800	4b. $ 800	4c. $ 28
5. Assets/Income to be considered for repayment income purposes (Item 3 minus Item 4)		5a. $7,500	5b. $7,500	5c. $512

ANTICIPATED REPAYMENT INCOME (Consider only income of parties to the note using Attachment 4-D):

Family Member	a. Wages/ Salaries	b. Benefits/ Pensions	c. Public Assistance	d. Other Income	e. Asset Income
David	$250 x 52 = $13,000			$200 x 12 = $2,400	Enter line 5c in box e below
Betsy	$5.50 x 20 x 52 = $5,720			$100 x 12 = $1,200	
6. Totals	a. $18,720	b.	c.	d. $3,600	e $512

7. Enter total of items 6a. through 6e. This is Repayment Income.	7. $22,832

PART II: ANNUAL AND ADJUSTED INCOME CALCULATION

1. Name David and Betsy Brown	2. Identification:

FAMILY ASSETS:(Consider assets of all household members):

Family Member	Asset Description	Current Cash Value	Actual Income from Assets
David	Savings Account (David)	$4,000	$140
	Checking Account	$ 300	-
	Certificate of Deposit	$4,000	$400
	Savings Account (Cynthia)	$ 600	-
3. Total Net Family Assets		3a. $8,900	3b. $540
4. Assets/Income to be used as down payment (from Part I)		4a. $ 800	4b. $ 28
5. Assets/Income to be considered for annual income (Item 3 minus Item 4)		5a. $8,100	5b. $512
6. If Line 5a is greater than $5,000, multiply Line 5a. by <u>3.5%</u> (passbook rate) and enter result here; otherwise, leave blank.			6. $284

ANTICIPATED ANNUAL INCOME (Consider income of all household members using Attachment 4-C):

Family Member	a. Wages/ Salaries	b. Benefits/ Pensions	c. Public Assistance	d. Other Income	e. Asset Income
David	$250 x 52 = $13,000				Enter the
Betsy	$5.50 x 20 x 52 = $5,720			$100 x 12 = $1,200	greater of
Cynthia		400 x 12 = $4,800			Lines 5b or 6
Janet	$480				in box e
					below
7. Totals	a. $19,200	b. $4,800	c.	d. $1,200	e. $512

8. Enter total of items 7a. through 7e. This is <u>Annual Income</u>.	8. $25,712

ANNUAL AND ADJUSTED INCOME CALCULATION (Continued)

9.	Annual income (enter line 8 from Part II).		9. $25,712
10.	Number of family members (except parties to the note or their spouses) under 18, disabled, or full-time students.	10. 3	
11.	Multiply line 10 by 480.		11. $ 1,440
12.	Child care deduction (reasonable expenses for care of children 12 and under that enable family member to work, actively seek employment, or further education).		12. $ 2,600
13.	Elderly household deduction (enter $400 if head of household or spouse who is party to the note is 62 or older or an individual with disabilities)		13. -
14.	Disability assistance expenses (reasonable expenses for disabled family member that enable a family member to work).	14. -	
15.	Medical expenses in excess of insurance reimbursement (elderly households only).	15. -	
16.	3% of annual income (line 9 x 0.03).	16. -	
17.	Allowable disability assistance/medical expenses. (line 14 + line 15 minus line 16).		17. -
18.	Total deductions (add lines 11, 12, 13 and 17).		18. $4,040
19.	Adjusted income (line 9 minus line 18).		19. $21,672

SECTION 3 -- COMMENTS

ANNUAL AND REPAYMENT INCOME CALCULATIONS

For Annual Income	For Repayment Income
• Count David's wages	• Count David's wages
• Count Betsy's wages	• Count Betsy's wages
• Count child support	• Count child support
• Count only $480 of Janet's wages	• Do not count Janet's wages
• Do not count Kathy's wages	• Do not count Kathy's wages
• Count Cynthia's Social Security	• Do not count Cynthia's Social Security
• Count actual income from assets	• Count actual income from assets
• Do not count payments for care of foster child	• Count payments for care of foster child

ASSET CALCULATIONS

Repayment Income from Assets

- Only the assets of parties to the note are considered. Therefore, Cynthia's checking account balance is not considered.
- The market value of the assets of the parties to the note exceeds $7,500. Therefore an $800 contribution of assets is required.

Annual Income from Assets

- Assets of all household members are considered. Therefore Cynthia's checking account balance is considered.
- The amount of any required asset contribution, in this case $800, is transferred from Part I of the calculation worksheet. It is not calculated based on total household assets.
- In addition, for annual income, the calculation of imputed income from assets must be made if assets exceed $5,000. In this case, the imputed income is less than the actual income.

ADJUSTED INCOME CALCULATION

Dependent Deduction

- Three dependent deductions are permitted for Kathy (a minor), Janet (an adult full-time student, who is not the head or spouse), and Cynthia (an adult individual with disabilities, who is not the head or spouse).
- A dependent deduction is not given for a foster child.

Child Care Deduction

- Child care expenses are permitted for the care of a foster child, but must not exceed the amount earned by the family member enabled to work. Betsy earns $110/week and pays $50/week for child care.
- Child care expenses are not permitted if another adult household member is available to care for the child. Janet is not available because she is a full-time student and Cynthia cannot care for the child because of her disability.

The full amount of the child care may be deducted.

Elderly Household Deduction

Even though an elderly person is a part of the household, this is not an elderly household because neither the head or spouse is 62 years of age or older or an individual with disabilities.

Medical Expense Deduction

Family medical expenses cannot be deducted because this is not an elderly family.

Disability Assistance Expenses

No disability assistance expenses were claimed. To be allowed a deduction, the expenses would have to be necessary to enable a family member to work.

ATTACHMENT 4-C
ANNUAL INCOME SOURCES

I. SOURCES OF INCOME COUNTED FOR ANNUAL INCOME

For annual income, consider income from the following sources that are attributable to any household member.

(1) The gross amount, before any payroll deductions, of base wages and salaries, overtime pay, commissions, fees, tips, bonuses, housing allowances, and other compensation for personal services of all adult members of the household. I or a proposed increase in income has been estimated to take place on or before loan approval, loan closing, or the effective date of the payment assistance agreement, it will be included as income. For annual income, count only the first $480 of earned income from adult full-time students who are not the head or spouse.

Employer paid and provided fringe benefits <u>are not included</u> in annual income regardless of whether the benefits are reported on the employee wage statement. Fringe benefits may include, but are not limited to:

- child care/pet-sitting
- medical/life insurance
- car /mileage allowance
- stock options
- discounts for merchandise
- sport/concert/movie tickets or entertainment
- charity donations in employee name
- any reimbursement of actual work expenses

Housing allowances may include, but are not limited to:

- Cash or non-cash contributions paid on behalf of the applicant by persons not living in the housing.
- allowances for members of the Armed Forces
- allowances for members of the Clergy
- allowances paid by Employer

(2) The <u>net</u> income from the operation of a Farm, Business, or Procession. The following provisions apply:

(i) Expenditures for business or farm expansion, capital improvements, or payments of principal on capital indebtedness shall not be used as deductions in determining income. A deduction is allowed in the manner prescribed by Internal Revenue Service (IRS) regulations only for interest paid in amortizing capital indebtedness.

(ii) Farm and non-farm business losses are considered "0" in determining annual income.

(iii) A deduction, based on straight line depreciation, is allowed in the manner prescribed by IRS regulations for the exhaustion, wear and tear, and obsolescence of depreciable property used in the operation of a trade, farm, or business by a member of the household. The deduction must be based on an itemized schedule showing the amount of straight-line depreciation.

(iv) Any withdrawal of cash or assets from the operation of a farm, business, or profession will be included in income, except to the extent the withdrawal is for reimbursement of cash or assets invested in the operation by a member of the household.

(v) A deduction is allowed for verified business expenses, such as lodging, meals, and fuel, for business trips made by salaried employees, such as long-distance truck drivers, who must meet these expenses without reimbursement.

(vi) For home-based operations such as child care, product sales, and the production of crafts, housing related expenses for the property being financed such as mortgage interest, real estate taxes, and insurance, which may be claimed as business expense deductions for income tax purposes, will not be deducted from annual income.

(3) Interest, dividends, and other net income of any kind from real or personal property, including:

(i) The share received by adult members of the household from income distributed from a trust fund.

(ii) Any withdrawal of cash or assets from an investment except to the extent the withdrawal is reimbursement of cash or assets invested by a member of the household.

(iii) Where the household has net family assets in excess of $5,000, the greater of the actual income derived from all net family assets or a percentage of the value of such assets based on the current passbook savings rate, as determined by the Agency.

(4) The full amount of periodic payments received from Social Security (including Social Security received by adults on behalf of minors or by minors intended for their own support), annuities, insurance policies, retirement funds, pensions, disability or death benefits, and other similar types of periodic receipts. However, deferred periodic amounts from supplemental income and social security benefits that are received in a lump sum amount or in prospective monthly amounts are not counted.

(5) Payments in lieu of earnings, such as unemployment and disability compensation, worker's compensation, and severance pay.

(6) Public assistance except as indicated in Part II (15) of this attachment.

(7) Periodic allowances, such as:

(i) Alimony and child support awarded in a divorce decree or separation agreement, unless the applicant certified the payments are not received, and the applicant provides documentation to the Agency that a reasonable effort has been made to collect the payments through the official entity responsible for enforcing such payments; or

(ii) Recurring monetary gifts or contributions from an organization or person who is not a member of the household.

(8) All regular pay, special pay (except for persons exposed to hostile fire), and allowances of a member of the armed forces who is the applicant or spouse, whether or not that family member lives in the home.

II. SOURCES OF INCOME EXCLUDED FROM ANNUAL INCOME

The following sources are never considered when calculating annual income

(1) Income from the employment of children (including foster children) under 18 years of age, except parties to the note and their spouses.
(2) Income of live-in aides and income directly received by foster children or foster adults.
(3) Payments received for the care of foster children or foster adults (usually persons with disabilities, unrelated to the applicant family, who are unable to live alone).

(4) Temporary, nonrecurring, or sporadic income (including gifts).

(5) Lump-sum additions to family assets, such as inheritances, insurance payments (including payments under health, accident, or hazard insurance, and worker's compensation), capital gains and settlement for personal or property losses (except as provided in Section I, (5)).

(6) Amounts received by the family that are specifically for, or in reimbursement of, the cost of medical expenses for any family member.

(7) Earnings in excess of $480 for each full-time student 18 years old or older, except parties to the note and their spouses.

(8) Reparation payments paid by a foreign government arising out of the Holocaust. If any applicant for an Agency loan was deemed ineligible because the applicant's income exceeded the low-income limit because of the applicant's Nazi persecution benefits, the Loan Approval Official should notify the applicant to reapply for a loan.

(9) Any earned income tax credit.

(10) Adoption assistance payments in excess of $480 per adopted child.

(11) Deferred periodic payments of supplemental security income and Social Security benefits that are received in either a lump sum amount or in prospective monthly amounts.

(12) The full amount of student financial assistance received by household members or paid directly to the educational institution.

(13) Amounts received by the family in the form of refunds or rebates under State or local law for property taxes paid on the dwelling unit.

(14) Amounts paid by a State agency to a family with a developmentally disabled family member living at home to offset the cost of services and equipment needed to keep the developmentally disabled family member at home.

(15) Any other revenue which a Federal statute exempts will not be considered income or used as a basis for determining eligibility for an Agency loan, payment assistance, or denying or reducing Federal financial assistance or benefits to which the recipient would otherwise be entitled. Additional financial assistance which is considered exempt income under Federal statutes includes:

(i)The imminent danger duty pay to a service person applicant or spouse away from home and exposed to hostile fire.

(ii) Any amount of crime victim compensation received through crime victim assistance (or payment or reimbursement of the cost of such assistance) because of the commission of a crime against the applicant under the Victims of Crime Act (42 U.S.C. 10602).

(iii) Payments to volunteers under the Domestic Volunteer Service Act of 1973, including, but not limited to:

(a) National Volunteer Antipoverty Programs which include Volunteers In Service To America (VISTA), Peace Corps, Service Learning Programs, and Special Volunteer Programs.

(b) National Older American Volunteer Programs for persons age 60 and over which include Retired Senior Volunteer Programs, Foster Grandparent Program,   Older American Community Services Program, and National Volunteer Programs to Assist Small

Business and Promote Volunteer Service to Persons with Business Experience, Service Corps of Retired Executives (SCORE), and Active Corps of Executives (ACE).

(iv) Payments received after January 1, 1989, from the Agent Orange Settlement Fund or any other fund established pursuant to the settlement in the "In Re Agent Orange" product liability litigations, M.D.L. No. 381 (E.D.N.Y.).

(v) Any allowance paid under 38 U.S.C. 1805 to a child suffering from spina bifida who is the child of a Vietnam veteran.

(vi) Payments received under the "Alaska Native Claims Settlement Act" or the "Maine Indian Claims Settlement Act."

(vii) Income derived from certain sub-marginal land of the United States that is held in trust for certain American Indian tribes.

(viii) Payments by the Indian Claims Commission to the Confederated Tribes and Bands of Yakima Indian Nation or the Apache Tribe of Mescalero Reservation (Pub.L. 95-433).

(ix) Income derived from the disposition of funds of the Grand River Band of Ottawa Indians

(x) The first $2,000 of per capita shares received from judgment funds awarded by the Indian Claims Commission or the Court of Claims, or from funds held in trust for an American Indian tribe by the Secretary of Interior.

(xi) Payments or allowances made under the Department of Health and Human Services Low-Income Home Energy Assistance Program.

(xii) Payments received from the Job Training Partnership Act.

(xiii) Payments received from programs funded under Title V of the Older Americans Act of 1965.

(xiv) The value of the allotment provided to an eligible household under the Food Stamp Act of 1977.

(xv) Any other income which is exempted under Federal statute.

(16) Payments received on reverse amortization mortgages (these payments are considered a drawdown on the applicant's assets).

(17) The special pay to a family member serving in the Armed Forces who is exposed to hostile fire.

(18) Amounts received by any family member participating in programs under the Workforce Investment Act of 1998 (29 U.S.C.2931) or any special training programs funded by HUD:

(i) Amounts received by a person with a disability that are disregarded for a limited time for purposes of Supplemental Security Income eligibility and benefits because they are set aside for use under a Plan to Attain Self-Sufficiency (PASS);

(ii) Amounts received by a participant in other publicly assisted programs which are specifically for or in reimbursement of out-of-pocket expenses incurred (special equipment, clothing, transportation, child care, etc.) and which are made solely to allow participation in a specific program;

(iii) Amounts received under a resident service stipend. A resident service stipend is a modest amount (not to exceed $200 per month) received by a resident for performing a service for the Public Housing Authority (PHA) or owner, on a part-time basis, that enhances the quality of life in the development. Such services may include, but are not limited to, fire patrol, hall monitoring, lawn maintenance, resident initiatives coordination, and serving as a member of the PHA's governing board. No resident may receive more than one such stipend during the same period of time;

(iv) Incremental earnings and benefits resulting to any family member from participation in qualifying State or local employment training programs (including training programs not affiliated with a local government) and training of a family member as resident management staff. Amounts excluded by this provision must be received under employment training programs with clearly defined goals and objectives, and are excluded only for the period during which the family participates in the employment training program; and

(v) Allowances, earnings and payments to AmeriCorps participants under the National and Community Service Act of 1990 (42 U.S.C. 12637(d)).

ATTACHMENT 4-D

REPAYMENT INCOME SOURCES

I. SOURCES OF INCOME COUNTED FOR REPAYMENT INCOME

For repayment income, consider income from the following sources that are: (1) attributable to parties to the note; and (2) represents a source of dependable income. Items marked with an asterisk are also counted for annual income.

*(1) The gross amount, before any payroll deductions, of wages and salaries, overtime pay, commissions, fees, tips, bonuses, and other compensation for personal services of all adult members of the household. If a cost of living allowance or a proposed increase in income has been estimated to take place on or before loan approval, loan closing, or the effective date of the payment assistance agreement, it will be included as income. For annual income count only the first $480 of earned income from adult full-time students who are not the head or spouse.

*(2) The <u>net</u> income from the operation of a farm, business, or profession. (See Attachment 4-F for additional guidance). The following provisions apply:

> (i) Expenditures for business or farm expansion, capital improvements, or payments of principal on capital indebtedness shall not be used as deductions in determining income. A deduction is allowed in the manner prescribed by Internal Revenue Service (IRS) regulations only for interest paid in amortizing capital indebtedness.
>
> (ii) Farm and nonfarm business losses are considered "0" in determining annual income.
>
> (iii) A deduction, based on straight line depreciation, is allowed in the manner prescribed by IRS regulations for the exhaustion, wear and tear, and obsolescence of depreciable property used in the operation of a trade, farm, or business by a member of the household. The deduction must be based on an itemized schedule showing the amount of straight line depreciation.
>
> (iv) Any withdrawal of cash or assets from the operation of a farm, business, or profession will be included in income, except to the extent the withdrawal is for reimbursement of cash or assets invested in the operation by a member of the household.
>
> (v) A deduction is allowed for verified business expenses, such as lodging, meals, and fuel, for business trips made by salaried employees, such as long-distance truck drivers, who must meet these expenses without reimbursement.

(vi) For home-based operations such as child care, product sales, and the production of crafts, housing related expenses for the property being financed such as mortgage interest, real estate taxes, and insurance, which may be claimed as business expense deductions for income tax purposes, will not be deducted from annual income.

*(3) Interest, dividends, and other net income of any kind from real or personal property, including:

(i) The share received by adult members of the household from income distributed from a trust fund.

(ii) Any withdrawal of cash or assets from an investment except to the extent the withdrawal is reimbursement of cash or assets invested by a member of the household.

(iii) Where the household has net family assets in excess of $5,000, the greater of the actual income derived from all net family assets or a percentage of the value of such assets based on the current passbook savings rate, as determined by the Agency.

*(4) The full amount of periodic payments received from Social Security (including Social Security received by adults on behalf of minors or by minors intended for their own support), annuities, insurance policies, retirement funds, pensions, disability or death benefits, and other similar types of periodic receipts. However, deferred periodic amounts from supplemental security income and social security benefits that are received in a lump sum amount or in prospective monthly amounts are not counted.

*(5) Payments in lieu of earnings, such as unemployment and disability compensation, worker's compensation, and severance pay.

*(6) Public assistance.

*(7) Periodic allowances, such as:

(i) Alimony and child support awarded in a divorce decree or separation agreement, unless the applicant certifies the payments are not received, and the applicant provides documentation to the Agency that a reasonable effort has been made to collect the payments through the official entity responsible for enforcing such payments; or

(ii) Recurring monetary gifts or contributions from someone who is not a member of the household.

*(8) All regular pay, special pay (except for persons exposed to hostile fire), and allowances of a member of the armed forces who is the applicant or spouse, whether or not that family member lives in the home.

(9) Adoption assistance payments in excess of $480 per adopted child.

(10) Payments received for the care of foster children or foster adults (usually individuals with disabilities, unrelated to the borrower, who are unable to live alone).

(11) Reparation payments paid by a foreign government arising out of the Holocaust. If any applicant for an Agency loan was deemed ineligible because the applicant's income exceeded the low income limit because of the applicant's Nazi persecution benefits, the Agency Loan Approval Official should notify the applicant to reapply for a loan.

(12) Any earned income tax credit.

(13) The amount of student financial assistance received by household members.(except for tuition, fees, books, equipment, materials and transportation).

(14) Amounts received by the family in the form of refunds or rebates under State or local law for property taxes paid on the dwelling unit.

(15) Any other revenue which a Federal statute exempts, will be considered repayment income. This includes:

(i) The imminent danger duty pay to a service person applicant or spouse away from home and exposed to hostile fire.

(ii) Payments to volunteers under the Domestic Volunteer Service Act of 1973, including, but not limited to:

(a) National Volunteer Antipoverty Programs which include Volunteers In Service To America (VISTA), Peace Corps, Service Learning Programs, and Special Volunteer Programs.

(b) National Older American Volunteer Programs for persons age 60 and over which include Retired Senior Volunteer Programs, Foster Grandparent Program, Older American Community Services Program, and National Volunteer Programs to Assist Small Business and Promote Volunteer Service to Persons with Business Experience, Service Corps of Retired Executives (SCORE), and Active Corps of Executives (ACE).

(iii) Payments received after January 1, 1989, from the Agent Orange Settlement Fund or any other fund established pursuant to the settlement in the "In Re Agent Orange" product liability litigations, M.D.L. No. 381 (E.D.N.Y.).

(iv) Payments received under the "Alaska Native Claims Settlement Act" or the "Maine Indian Claims Settlement Act."

(v) Income derived from certain submarginal land of the United States that is held in trust for certain American Indian tribes.

(vi) Payments or allowances made under the Department of Health and Human Services Low-Income Home Energy Assistance Program.

(vii) Payments received from the Job Training Partnership Act.

(viii) Income derived from the disposition of funds of the Grand River Band of Ottawa Indians.

(ix) The first $2,000 of per capita shares received from judgment funds awarded by the Indian Claims Commission or the Court of Claims, or from funds held in trust for an American Indian tribe by the Secretary of Interior.

(x) Payments received from programs funded under Title V of the Older Americans Act of 1965.

(xi) The value of the allotment provided to an eligible household under the Food Stamp Act of 1977.

(xii) Any other income which is exempted under Federal statute.

(16) Amounts paid by a State Agency to a family with a developmentally disabled family member living at home to offset the cost of services and equipment needed to keep the developmentally disabled family member in the home.

II. SOURCES OF INCOME EXCLUDED FROM REPAYMENT INCOME

The following sources are never considered when calculating repayment income.

(1) Income from the employment of persons under 18 years of age, except parties to the note and their spouses.

(2) Income of live-in aides and income directly received by foster children or foster adults.

(3) Temporary, nonrecurring, or sporadic income (including gifts).

(4) Lump-sum additions to family assets such as inheritances, capital gains, insurance payments included under health, accident, hazard, or worker's compensation policies, and settlements for personal or property losses.

(5) Amounts that are granted specifically for, or in reimbursement of, the cost of medical expenses.

(6) Payments received on reverse amortization mortgages (these payments are considered a drawdown on the applicant’s assets).

ATTACHMENT 4-E

SUMMARY OF VERIFICATION REQUIREMENTS FOR FREQUENTLY-REPORTED INCOME SOURCES

The Loan Originator must verify and document all information that is used to establish an applicant's eligibility, calculate the amount of the loan and any payment assistance for which the applicant qualifies, and determine whether applicant assets must be contributed. This Attachment summarizes verification requirements for income and asset determinations. Appendix 2 provides several sample formats to be used that will help in the verification process.

Whenever, verification from a third party is requested, a copy of *Form RD 3550-1, Authorization to Release Information* must accompany the request. The authorization from the applicant on the *Form RD 3550-1* permits the Loan Originator to ask for, and verification sources to release, the needed information. The verification and certification formats provided in Appendix 2 are not official Agency forms. They are samples that may be adapted as needed for particular circumstances. In some instances the same format can be used whether a third party is providing a verification or the applicant is making a certification. For example, the sample *Verification of Support* format could be completed by the ex-spouse who is providing the support, or by the applicant, who certifies to the amount of support being provided if the ex-spouse is not willing to provide the verification.

Type of Income or Verification Source	**Verification Requirements and Procedures**
Income	
Income Tax Return	A complete, legible copy of the most recently filed Federal income tax form must be submitted for each applicant, unless the person was exempted from filing a return. Returns should be filed in position 3 of the applicant's case file. The tax return reports the past year's income, while the application reports current income. Even so, it can serve as a valuable verification tool. Check the reported income, dependents, and assets against the information provided on the application. Identify and clarify with the applicant any information that appears inconsistent with the application.
Verification of Employment	The applicant must list all household members on the application and provide their employment status. The Loan Originator sends *Form RD 1910-5 Request for Verification of Employment* to each employer for verification. Pay stubs or other payroll records may be used to support or clarify income information provided.

Type of Income or Verification Source	**Verification Requirements and Procedures**
Self-Employed Persons	Self-employed applicants must provide current documentation of income and expenses, which cannot be older than the previous fiscal year. Appendix 2 provides a sample format for recording business expenses. The Loan Originator must compare the income and expense information provided by the applicant with the latest income tax return and clarify any discrepancies.
Unemployment and Unemployment Benefits	Unemployed applicants must complete *Form RD 3550-4, Employment Certification/Payment Assistance*, which provides their current employment status and requires them to agree to inform the Agency immediately, in writing, if the employment status changes. If an applicant has recently become unemployed, the Loan Originator should contact the former employer to confirm that the applicant is no longer employed and that re-employment is not expected. Applicants receiving unemployment benefits must provide the most recent award or benefit letter prepared and signed by the authorizing agency to verify the unemployment income. Appendix 2 provides a sample format for requesting information about unemployment benefits.
Regular, Unearned Income (e.g., Social security, pensions, workers compensation)	Borrowers must provide a copy of the most recent award or benefit letter prepared and signed by the authorizing agency. If the date of the letter is not within the last 12 months, require the applicant to submit information updating the award, for example, a cost-of-living (COLA) payment notice, Social Security Benefits Statement, or a notice of change in benefits. Appendix 2 provides sample formats for requesting this information.
Public Assistance	Borrowers must provide the most recent award or benefit letter prepared and signed by the authorizing agency to verify the amount of public assistance received. Appendix 2 provides a sample format for requesting this information.
Alimony or Child Support Payments	The applicant must provide a copy of the divorce decree, separation agreement, or other document indicating the amount of the required support payments. The applicant also must report the amount received during the past 12 months. If the applicant reports that the amount required by the agreement is not being received, the applicant must document that assistance from the State or local entity responsible for enforcing payment has been requested. Appendix 2 provides a sample format for requesting this information.

Type of Income or Verification Source	**Verification Requirements and Procedures**
Support for Foster Children or Adults	Payments received for the care of foster children or foster adults may be considered when calculating repayment income. Documentation must be provided indicating the amount of money received for the care of foster children or adults, and the anticipated period of time the support will be provided. Appendix 2 provides a sample format for requesting information.
Verification of Assets and Income from Assets	The Loan Originator sends *Form RD 1944-62, Request for Verification of Deposit* to financial institutions to verify account balances. For some assets such as mutual funds or 401(k) accounts copies of year-end statements can provide information about annual income. Applicants must certify whether any asset has been disposed of for less than fair market value. Appendix 2 provides a sample format for this certification and formats for inquiring about a variety of assets.
Verification of Gifts	If funds needed for the purchase will be provided by another person, the Loan Originator must send the donor *Form RD 3550-2, Request for Verification of Gift/Gift Letter* to verify whether the gift must be repaid and whether the funds have already been transferred.
Deductions	
Dependent Minor	No verification is required. The applicant must simply indicate the number of minors on the application. The dependent must qualify for the deduction each time a certification is made.
Full-Time Student Status and Education Benefits and Expenses	For repayment income only, the Loan Originator may consider educational benefits provided to parties to the note (except for tuition, fees, books, equipment, materials and transportation). Any amount provided for living expenses may be counted as repayment income. The applicant may be eligible to receive a deduction for dependents attending school full-time. The applicant must provide documentation from the school that the dependent is enrolled as a full-time student. Appendix 2 provides a sample format for requesting this information.

Type of Income or Verification Source	Verification Requirements and Procedures
Child Care Expenses	Reasonable child care expenses may be deducted from annual income. To qualify for the deduction, the applicant must: • Identify the children receiving the child care and the family member who can work or go to school as a result of the care; • Demonstrate that there is no adult household member available to care for the children; • Identify the child care provider, the hours of care provided, and the costs (e.g., letter on the child care provider's letterhead or a copy of a signed child care contract); and • Identify the educational institution and provide documentation of enrollment (if appropriate). Appendix 2 provides a sample format for requesting child care information.
Disability Expenses	To qualify for disability deductions, the applicant must describe the nature of the expense, provide documentation of the costs, and demonstrate that the expense enables a family member to work. *Form RD 1944-4, Certification of Disability or Handicap* should be used to verify the disability.
Medical Expenses	For elderly households only, allowable medical expenses may be deducted from annual income. Therefore, documentation of medical expenses is not generally required for nonelderly households. However, nonelderly households with unreimbursed medical expenses in excess of 3 percent of annual income may receive an exception to the asset limitations. In such cases, these medical expenses must be verified as well. Appendix 2 provides a sample format for documenting medical expenses.

ATTACHMENT 4-F

REVIEWING A SELF-EMPLOYED APPLICANT'S INCOME AND DEBT LOAD

The purpose of this attachment is to provide guidance on how to properly analyze a self-employed applicant's loan application for eligibility.

The primary business structure that our self-employed applicants engage in is sole proprietorships (be it a business, farming, or profession). In a sole proprietorship, the individual owner has unlimited personal liability for all debts of the business. The success of this type of organization depends solely on the individual who owns it. Business income or loss is folded into the individual owner's tax return.

To verify income, a sole proprietor must submit signed copies of his/her last two Federal Income Tax Returns (IRS Form 1040) along with the appropriate schedules: Schedule C (Profit or Loss from Business), Schedule F (Farm Income and Expenses), and/or other applicable schedules. The sole proprietor must also submit current documentation of income and expenses using the verification of business expenses form located in HB-1-3550, Appendix 2.

Once the proper documentation is received, the sole proprietor's repayment income will be calculated in the following manner:

Add the following allowable IRS deductions to net profit (item # 31 on Schedule C or item # 36 on Schedule F):

- Depletion (item # 12 on Schedule C / item not applicable on Schedule F)
- Depreciation (item # 13 on Schedule C or item #16 on Schedule F)
- Interest (item # 16 a. and b. on Schedule C or item # 23 a. and b. on Schedule F)

NOTE: Line item numbers were obtained from 2001 IRS forms and are subject to possible change.

Then subtract all business-related debts (expressed in annual terms not monthly) to determine the sole proprietor's repayment income. Business-related debts are debts incurred for the primary purpose of operating the business. Debts listed on the applicant's credit report will either be business-related and thus included in the formula noted below or will be personal in nature and thus included in the total debt ratio. Regardless of a debt's classification (business-related or personal), the applicant's payment history will be considered when reviewing credit worthiness.

(Net profit + Depletion + Depreciation + Interest) – Annual business-related debts = Repayment Income

The IRS requires that costs associated with going into business, business assets (i.e. land, buildings, vehicles, etc), and improvements be capitalized. Although a deduction for capital expenses is generally not permitted, the IRS does allow deductions for the amount spent through depletion/depreciation and for interest paid on business-related debts. The amounts deducted, however, do not necessarily equal the payments due on business-related debts. The above equation will properly address this issue.

Business-related debts will not be included in the debt-to-income ratios since they were accounted for in the calculation of repayment income.

Please note that the methodology described here applies only to repayment income, not adjusted or annual income.