CHAPTER 6: UNDERWRITING THE LOAN

SECTION 1: OVERVIEW OF THE UNDERWRITING PROCESS

6.1 INTRODUCTION

The underwriting process brings together the applicant eligibility requirements discussed in Chapter 4 and the property requirements discussed in Chapter 5 with the loan and subsidy requirements that are discussed in detail in this chapter. By putting all of this information together, the Loan Originator can determine the applicant's repayment ability, whether a loan can be approved, and the amount of the loan. This chapter is structured as follows:

- Section 1 reviews the concept of underwriting;
- Section 2 describes loan terms and requirements;
- Section 3 provides policies and procedures for determining whether the applicant is eligible for payment subsidy and the amount of the subsidy; and
- Section 4 provides policies and procedures for underwriting a loan for a specific property and preparing the loan approval recommendation.

6.2 WHAT IS UNDERWRITING?

Through the underwriting process, the Loan Originator evaluates an applicant's circumstances and the condition and value of the property to determine whether making a particular loan is a prudent use of funds. Exhibit 6-1 summarizes key underwriting decisions.

Underwriting has both objective and subjective elements. For example, income eligibility is an objective factor -- if the applicant's income exceeds program income limits, the applicant cannot receive a program loan. On the other hand, analyzing an applicant's credit history and estimating the value of the property both involve some degree of judgment. The underwriter's challenge is to make both objective and subjective decisions in a fair and impartial manner for all applicants.

The Agency's underwriting standards and procedures are similar in many respects to those used by private lenders. However, because the Agency's mission, in part, is to serve home buyers who are unable to obtain private credit, the underwriting process differs in 4 key respects:

- The Agency's criteria for an acceptable credit history are somewhat less stringent than those used by private lenders;
- Agency loan-to-value requirements enable many applicants to become homeowners with little or no down payment;
- In most circumstances, the Agency has the ability to offer subsidies that enhance an applicant's ability to repay the loan; and
- The Agency conducts quality checks on new loans as well as on withdrawn and rejected applications to confirm that the Loan Originator complied with the underwriting standards and procedures. Refer to Attachment 6-C for guidance on monitoring requirements.

Exhibit 6-1

Key Underwriting Decisions

Does the Applicant Meet Program Requirements?

The applicant must:

- Have the legal capacity to enter into a loan agreement;
- Have the financial resources to repay the loan;
- Have an acceptable credit history; and
- Meet the specific requirements for participation in the program, such as eligibility based on income and citizenship status.

Does the Property Meet Program Requirements?

The property must:

- Meet Agency standards regarding location and housing quality;
- Not have legal hindrances to the borrower's ownership of the property; and
- Have sufficient value to protect the Agency's financial investment in the property.

Does "The Deal" Work?

- Can the Agency offer loan terms and conditions that enable the applicant to afford the loan?
- Is the applicant willing and able to meet the terms and conditions the Agency can offer?

6.3 USING UNIFI TO FACILITATE UNDERWRITING

UniFi automatically completes most of the underwriting calculations discussed in this chapter. However, the Loan Originator must understand how the calculations are made, in order to enter the correct information into the system and, more importantly, to be able to explain the results to applicants.

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SECTION 2: LOAN TERMS AND REQUIREMENTS

6.4 ELIGIBLE LOAN PURPOSES AND USES *[7 CFR 3550.52]*

The Section 502 program is intended to help those who do not currently own adequate housing buy, build, relocate, rehabilitate, or improve a property to use as a permanent residence. All improvements must be on land that, after closing, is part of the security property. Eligible costs are listed below.

A. Site-Related Costs

Eligible site-related costs include:

- Providing a minimum adequate site, as described in Section 1 of Chapter 5, if the applicant does not already own an adequate site;
- Providing adequate utilities, including adequate and safe water supply and wastewater disposal facilities; and reasonable connection fees, assessments, or the pro rata installment costs for utilities such as water, sewer, electricity and gas; and
- Site preparation, including grading, foundation plantings, seeding or sodding, trees, walks, yard fences, and driveways.

B. Dwelling-Related Costs

In addition to costs for acquisition, construction, repairs, or the cost of relocating a dwelling, eligible dwelling-related costs include:

- Special design features or equipment necessary because of a physical disability of a member of the applicant's household;
- Approved energy saving materials, equipment, or construction methods (heating systems must use a type of fuel that is commonly used, economical, and dependably available);
- Storm cellars and similar protective structures; and
- Purchase and installation of essential equipment including range, refrigerator, clothes washer and/or dryer, if these items are normally sold with dwellings in the area, and if the purchase of these items is not the primary purpose of the loan.

C. Fees and Related Costs

Other eligible costs include:

- Legal fees; architectural and engineering services; costs of title clearance and loan closing services; the Agency-approved appraisal fee; surveying, environmental and tax service services; personal liability insurance fees under Mutual Self-Help Housing; and other incidental expenses approved by the Loan Approval Official (commissions, finders' fees, homeowner association fees and placement fees are ***not*** eligible costs);

- The buyer's portion of real estate taxes that the applicant must pay at the time of closing including delinquent taxes on a property owned by the applicant;

- Real estate taxes that become due during the construction period on houses to be built;

- The borrower's share of Social Security taxes and similar taxes for labor hired by the borrower in connection with making the planned improvements;

- Establishment of escrow accounts, including the initial escrow deposit, for the payment of taxes and property insurance premiums, except the first years property insurance premium;

- Payment of recapture amounts deferred by a former borrower;

- Costs associated with implementation of mitigation measures to ensure environmental compliance;

- For leveraged loans, lender charges and reasonable fees related to obtaining the non-Agency loan; and

- Fees to public agencies and private nonprofit organizations that are tax exempt under the Internal Revenue Code of 1986 for loan packaging. The charges must be reasonable considering the services provided and the cost of similar services in the same or a similar rural area. The fee cannot exceed the amount approved by the Agency in Exhibit B of RD Instruction 1944-B. A fee can be paid only if the development and packaging of the loan application has been done in accordance with Attachment 3-A, and cannot be paid for loans related to the purchase of REO property, to Mutual Self-Help Housing grantees, or to recipients of Housing Application Packaging Grants.

D. Loan Restrictions *[7 CFR 3550.52(e)]*

Agency loans cannot be used to finance properties that include in-ground swimming pools. It is not acceptable to remove a pool before or after closing to meet this requirement.

Agency funds cannot be used to purchase or improve structures designed for income-producing purposes or income-producing land. Home-based operations such as child care, product sales, or craft production that do not require specific features are not restricted.

6.5 REFINANCING

In general, Agency funds should not be used to refinance existing debt and are ***never*** to be used to refinance existing Agency debt when a property is sold to a new Agency borrower. In such cases, an assumption on new rates and terms transfers the debt to the new owner. However, refinancing is permitted in limited circumstances.

A. Refinancing Agency Debt [7 CFR 3550.52(c)]

Borrowers with Agency loans approved before August 1, 1968 or made on above-moderate or nonprogram terms are not eligible for payment subsidy. Borrowers with these types of loans may be permitted to refinance if the borrower is eligible to receive a program loan, the property is program-eligible, and the borrower is in danger of losing the property due to circumstances beyond the borrower's control.

B. Refinancing Non-Agency Debt *[7 CFR 3550.52(b)]*

1. Situations in Which Refinancing is Permissible

Refinancing of non-Agency debt, except for debt on manufactured homes, is permissible in 3 circumstances.

- **Refinancing for an existing home at risk of foreclosure.** An applicant who owns a home but is clearly unable to continue making payments and is at risk of losing it through foreclosure may be eligible for Agency refinancing if the delinquency is due to circumstances beyond the applicant's control, for example, loss of a job or illness.
- **Refinancing for an existing home in need of repairs.** Debt on an existing home may be refinanced if the home is in need of repairs totaling $5,000 or more to correct major deficiencies and make the dwelling decent, safe, and sanitary; and refinancing is necessary for the borrower to show repayment ability. In such cases the owner need not be at risk of losing the property through foreclosure.

- **Refinancing for a site without a dwelling.** Agency funds may be used to refinance non-Agency debt on a building site without a dwelling if the debt is for the sole purpose of purchasing the site, the applicant is unable to pay the debt, and the applicant is otherwise unable to acquire decent, safe, and sanitary housing. The site must meet the conditions described in Section 1 of Chapter 5. The Agency loan must include adequate funds to construct a dwelling on the site that conforms to the requirements of Section 2 of Chapter 5, and the applicant must occupy the property once it is constructed.

In any of these circumstances, a non-Agency loan can be refinanced only if the Agency will have adequate security.

2. Eligible Debt

In general, Agency funds can be used to refinance only debt that was incurred for eligible purposes, as described in Paragraph 6.4. For applicants who are in danger of foreclosure, Agency funds also may be used to repay a protective advance made by a mortgagee for costs related to the delinquency, such as accrued interest, insurance premiums, real estate tax advances, or preliminary foreclosure costs.

The primary debt to be refinanced must be secured with a lien against the security property and must have been made at rates and terms that were customary for long-term residential financing in the area at the time the debt was incurred.

For existing dwellings, but not for sites without a dwelling, short-term or unsecured debts also may be included in the refinancing if refinancing of these debts is necessary to establish a sound repayment ability, the debts were incurred for purposes that are eligible under Section 502, and they do not represent a significant portion of the loan.

3. Timing of the Debt

In general, the debt to be refinanced must have been incurred before the application was filed. Costs incurred after the application date, but before loan closing, may be refinanced if: (1) they are incurred for legal fees or other technical services related to the property, or for materials, construction or site acquisition; (2) the applicant is unable to pay the costs from personal resources or to obtain credit from other sources; and (3) failure to authorize the use of Agency funds to pay such costs would jeopardize the applicant's ability to repay the loan. The applicant should consult with the Loan Originator before incurring such expenses.

4. Verification of Debt

To verify that the debt to be refinanced meets these requirements, the Loan Originator must examine a statement from each creditor that shows the purpose for which the debt was incurred, the date on which it was incurred, the final due date, the interest rate, the amount and frequency of installments, the unpaid principal and accrued interest, and the amount of the delinquency, if any.

6.6 MAXIMUM LOAN AMOUNT *[7 CFR 3550.63]*

Unless an exception is granted, a loan may not exceed the area loan limit. The loan may exceed the area loan limit in an amount necessary to cover the Agency-approved appraisal fee, the tax service fee, and any required contribution to an escrow account for taxes and insurance (excluding the first year insurance premium). Appendix 10 contains the current area loan limits.

Effects of the Area Loan Limit

Market Value of the Property. The market value of the property can not exceed the area loan limit. Market value is generally accepted to mean the price for property agreed upon between a willing and informed buyer and a willing and informed seller and/or contractor under usual and ordinary circumstances when the property is exposed for sale on the open market with reasonable time allowed to find a purchaser. This determination shall be made at the time the purchase agreement or construction package is submitted and is not dependent on the appraised value.

Maximum Loan Amount. The total amount of the Agency loan, loans from other sources, or the applicant's own funds, including but not limited to the value of the site, cannot exceed the applicable area loan limit.

Costs of Appraisal or Closing. The loan an applicant receives must not exceed the area loan limit unless the applicant chooses to finance the appraisal fee, tax service fee, or the initial contribution to fund the escrow account, in which case the loan can exceed the area loan limit by the cost of these items.

A. Granting Exceptions

The State Director, or designee, is responsible for monitoring the number and dollar amount of the exceptions made under the following paragraphs. A log similar to Attachment 6-B will be maintained on a fiscal year basis. At a minimum, the log will capture the dollar amount that exceeds the area loan limit and whether the amount is due to closing costs (other than the appraisal fee, tax service fee, or the initial contribution to fund the escrow account) or the cost of acquisition or construction.

Exceptions to the area loan limit may be granted on a case-by-case basis when the current limit is insufficient to provide adequate housing. Exceptions may be granted to accommodate the specific needs of an applicant, for example, to serve exceptionally large households or to provide reasonable accommodation for a household member with a disability. Requests for exceptions may be approved by the State Director if the cost of the property will <u>not</u> exceed $3,600.

To request an exception, the Loan Originator must fully document the need for the exception. If approval is granted, the Loan Originator should follow UniFi procedures to override the maximum mortgage limits.

Exceptions also can be granted for subsequent loans that may cause the entire indebtedness to exceed the area loan limit only if necessary to protect the Government's interests. The State Director can authorize subsequent loans that exceed the area loan limits to accommodate the cost of necessary repairs, reasonable closing costs, and allowable excess costs (including the appraisal fee, tax service fee, and initial deposit to fund the escrow account), without authorization from the Deputy Administrator, Single Family Housing, even if the increase exceeds $3,600.

B. Special Situations

To further ensure that only modest housing is financed, the maximum loan amount will be limited in the following situations:

1. Housing Other than Self-Help

- If the applicant owns the building site free and clear or if an existing non-Agency debt on the site will not be refinanced with Agency funds, the market value of the lot will be deducted from the area loan limit.

- If Agency funds will be used to refinance non-Agency debt on the building site, the equity (market value minus the debt owed against the site) will be deducted from the area loan limit.

- When the applicant is purchasing a site below the market value, the difference between the market value and the sales price will be deducted from the area loan limit.

- When an applicant is receiving a housing grant or other form of affordable housing assistance for eligible loan purposes other than closing costs, the amount of such grants and other affordable housing assistance will be deducted from the area loan limit.

2. Self-Help Housing

The maximum loan amount for self-help housing will be determined by adding the total of the market value of the lot (including reasonable and typical costs of site development), the cost of construction, and the value of sweat equity. The total of these factors cannot exceed the area loan limit for the area.

6.7 LOAN-TO-VALUE (LTV) RATIO *[7 CFR 3550.63(b)]*

The LTV ratio is the relationship between the amount to be financed, including all leveraged loans and grants, and the market value of the security property. The value of the property is determined using the appraisal procedures described in Section 5 of Chapter 5. A loan may exceed the LTV limitations discussed in Paragraphs 6.7 A. and B. to allow the borrower to finance certain allowable excess costs. For any Agency loan, the amount that can be financed in excess of the allowable LTV includes the Agency-approved appraisal fee, the tax service fee, and the initial contribution to the escrow account.

Allowable Excess Costs

- Appraisal fee
- Tax service fee
- Initial contribution to escrow

A. Loans for Existing Dwellings (100% LTV)

For existing dwellings, the LTV limitation for a Section 502 loan, plus any other liens on the security property, is 100 percent of value plus allowable excess costs.

B. Loans for New Dwellings (90-100% LTV)

For loans on new dwellings, the permitted LTV ratio depends upon whether the applicant provides documentation that the construction quality is acceptable to the Agency. If construction that meets the Agency standards can be documented, the LTV limitation is 100 percent of value plus allowable excess costs.

Example - Maximum Loan Based on Loan to Value Ratios

$50,000 Appraised Value
$51,740 Total Costs Including:

$49,500	Purchase Price
$ 340	Appraisal and Tax servicing
$ 1,500	Closing Costs
$ 400	Costs to Establish Escrow

If the allowable LTV is 100%, the maximum loan is $50,740 (the appraised value plus allowable excess costs). $1,000 of the closing costs must be paid by the borrower in cash.

If the allowable LTV is 90%, the maximum loan is $45,740 (90% of the appraised value plus allowable excess costs). $6,000 must be paid by the borrower in cash.

If construction quality is not adequately documented, loans for new dwellings are limited to 90 percent of the market value plus allowable excess costs.

The following are acceptable documentation of construction quality.

- The Agency has issued a conditional commitment and inspected the property, as described in Section 1 of Chapter 9.
- The dwelling is covered by an approved 10-year warranty plan, as described in RD Instruction 1924-A, and there is a certificate of occupancy when issued by the local governing agency.
- The loan will be closed prior to the start of construction so that the Agency can monitor the construction following the procedures described in Section 6 of Chapter 5.
- The new dwelling is a manufactured home that meets the requirements set forth in Section 3 of Chapter 9.
- Applicant provide a complete set of plans and specifications and, to demonstrate that the construction was properly inspected, copies of all construction-phase reports prepared by a licensed construction inspector. In the case of properties inspected by the Federal Housing Administration (FHA) or Veterans Affairs (VA), a certification that the dwelling was built in accordance with approved plans and specification may be submitted in lieu of construction-phase reports.

C. Subsequent Loans for Necessary Repairs

If necessary to protect the Government's security interest, the Agency may make a subsequent loan that causes the total indebtedness to exceed the market value of the property and/or the area loan limit. The excess amount cannot exceed the cost of the necessary repairs, reasonable closing costs, and allowable excess costs. The Loan Originator should review the status of the borrower's account in MortgageServ and coordinate with the Centralized Servicing Center (CSC) as necessary.

D. Subsequent Loans for Closing Costs Only

When the Agency makes a subsequent loan to a program borrower for closing costs only at the time of the sale of an REO property or a property transfer and assumption, total indebtedness may exceed the market value and/or the area loan limit by up to 1 percent, plus allowable excess costs.

E. Refinanced Loan for Existing Agency Borrower

When the Agency refinances an existing Agency loan, the loan may exceed the market value of the property and/or the area loan limit only as necessary to cover the borrower's outstanding indebtedness, closing costs associated with the new loan, and allowable excess costs.

F. Affordable Housing Products

In those cases where participation may include a soft, silent or forgivable subordinate affordable housing product, which includes funding for purposes that are not listed in the eligible loan purposes (Paragraph 6.4) but are consistent with our objectives in affordable housing, the loan to value ratio may exceed the market value by 5 percent (5%) or the amount of those costs, which ever is lower. The sources of the additional funding should define the purpose. Examples include, but are not limited to, homeownership education, credit counseling, and gap funding.

Only affordable housing products that result in a lien against the property need to be considered in evaluating the loan to value ratio. Grants and similar funding that do not result in a lien and are not required to be paid back should not be considered in evaluating the loan to value ratio.

The State Director is authorized to grant exceptions for affordable housing participation that exceeds 5%, but may not exceed 10%, when it is in the best interest of the applicant and the Government to do so. Such exceptions will be logged in Attachment 6-B and the case file will include a detailed explanation of the reason for the exception.

6.8 REPAYMENT PERIODS *[7 CFR 3550.67]*

Loans must be scheduled for repayment over a period that does not exceed the useful life of the property. The standard maximum loan term for most Section 502 loans is 33 years.

A. Exceptions to the Standard 33-Year Maximum Term

Repayment may be scheduled over a 38-year term for:

- Initial loans, or subsequent loans made in conjunction with an assumption, if the applicant's adjusted income does not exceed 60 percent of the applicable area median income and the longer term is necessary to show repayment ability; and

- Subsequent loans ***not*** made in conjunction with an assumption, if the borrower's initial loan was for a period of 38 years, the borrower's adjusted income at the time the subsequent loan is approved does not exceed 60 percent of the applicable area median income, and the longer term is necessary to show repayment ability.

The repayment period is limited to a maximum of 10 years for loans under $7,500. Manufactured homes are eligible for a maximum loan term of 30 years.

B. Effect of Repayment Period on Payment Subsidy

Loans may be approved for less than the maximum period. However, before approving a loan with a payment term that is less than the maximum period, the Loan Originator should consider the effect this may have on any payment subsidy for which the applicant may be eligible. Because a shorter loan term could require the Agency to contribute a higher payment subsidy, an applicant with an initial loan term of less than 25 years cannot obtain payment subsidy. An applicant may receive payment subsidy on a secured subsequent loan with a term of less than 25 years if the initial loan had a term of 25 years or more. Section 3 of this chapter provides additional information about payment subsidies.

6.9 INTEREST RATES *[7 CFR 3550.66]*

A. Note Rates

The note rate is the interest rate shown in the promissory note. Exhibit B of RD Instruction 440.1 provides current interest rates for program and nonprogram loans. For program loans, the note rate used for the promissory note must be the lower of the Rural Housing (RH) 502 low or moderate interest rates in effect at loan approval or loan closing. For nonprogram loans, the nonprogram rate in effect at loan approval must be used for the promissory note.

B. Equivalent Interest Rates

As described in Section 3, borrowers who qualify may receive payment subsidies based upon a lower interest rate, called the equivalent interest rate (EIR). The EIR does not affect the promissory note. Instead, a separate agreement is executed annually (or more often if the subsidy amount changes) to document the amount of payment subsidy provided.

Example - Effect of Interest Rate and Repayment Period on Monthly Payments

Loan Amount	Loan Term	Monthly Payment
$50,000 @ 7%	33 years	$324.05
$50,000 @ 7%	38 years	$313.79
$50,000 @ 1%	33 years	$148.29
$50,000 @ 1%	38 years	$131.84

6.10 USE OF ASSETS *[7 CFR 3550.64]*

A. Asset Limits

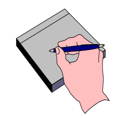
Applicants with assets in excess of established limits must use those assets for a down payment or other costs associated with the purchase of the property. Section 2 of Chapter 4 discusses assets in detail. Applicants may choose to use assets that fall below the established limits toward the purchase, even though they are not required to do so.

- Nonelderly applicants must use nonretirement assets in excess of $7,500 toward the purchase of the property.

- Elderly applicants must use nonretirement assets in excess of $10,000 toward the purchase of the property.

- All applicants must use retirement assets in excess of the applicable adjusted median income limit toward the purchase of the property unless the applicant is retired and derives income from either retirement assests alone or in combination with other retirement income.

B. Exception to the Asset Limits



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.

C. Eligible Uses of Assets

Eligible uses for excess assets or assets the applicant has elected to contribute include making payments to:

- Reduce the principal balance;
- Pay architectural, engineering, inspection, or testing fees related to new construction or repairs;
- Establish the escrow account for taxes and insurance; and
- Pay closing costs and related fees.

D. Ineligible uses of Assets

If an applicant has excess assets, those assets can not be used for purposes other than those listed in Paragraph 6.10 C.

SECTION 3: PAYMENT SUBSIDIES *[7 CFR 3550.68]*

6.11 AN OVERVIEW OF PAYMENT SUBSIDIES

The Agency uses payment subsidies to enhance an applicant's repayment ability for Section 502 loans. UniFi calculates the applicant's payment subsidy. The sample calculations provided in this section are intended to help the Loan Originator understand how the calculation works so that it can be explained to the applicant.

A. Two Types of Subsidy

1. Interest Credit

A borrower who initially received subsidy in the form of interest credit can continue to do so as long as the borrower remains eligible and continuously receives interest credit assistance. Subsequent loans to these borrowers should be subsidized with interest credit. Paragraph 6.13 describes the method for calculating subsidies using the interest credit method.

2. Payment Assistance

All other eligible applicants will receive payment assistance. This includes: applicants who receive new initial loans; borrowers obtaining subsequent loans who qualify for payment subsidy, but who are not currently receiving interest credit; and applicants who assume loans under new rates and terms. Borrowers who cease to receive interest credit will receive payment assistance if they subsequently begin to receive payment subsidies. Paragraph 6.12 describes the method for calculating payment assistance.

B. Applicant Eligibility

1. Income Eligibility

Applicants who obtain loans on nonprogram terms are not eligible for payment subsidies. To be eligible for an initial loan at the time of origination, an applicant must be income-eligible for the Section 502 loan -- that is, have adjusted income that does not exceed the applicable low-income limit at the time of loan approval and the applicable moderate-income limit at the time of loan closing. Initial approval of payment assistance for borrowers who become eligible after loan closing is the responsibility of CSC. A borrower who is receiving payment assistance can continue to receive it, even if their income exceeds the moderate income limit, as long as their EIR does not exceed the note rate

2. Occupancy Requirement

To be eligible to receive a payment subsidy, the applicant must personally occupy the dwelling, unless during the term of the loan the Agency determines that the dwelling is uninhabitable or that the borrower may be absent temporarily from the property for reasons acceptable to the Agency, such as seasonal or migratory employment, military call-ups, or hospitalization.

C. Loan Requirements

1. Loan Term

For an applicant to be eligible for a payment subsidy, initial loans and subsequent loans made in conjunction with a new rates and terms assumption must have a term of at least 25 years. Borrowers can receive a payment subsidy for a subsequent loan ***not*** made in conjunction with an assumption with a term of less than 25 years, if the initial loan had a term of at least 25 years.

2. Type of Loan

To receive payment subsidy, the loan must be made on program terms and must be secured by a mortgage on the property.

3. Pre-August 1, 1968 Loans

Payment subsidies are not available for loans that closed prior to August 1, 1968, even if the loan is assumed on new rates and terms after that date. Borrowers whose loans were made with funds provided prior to August 1, 1968, may be eligible to refinance the loan in order to receive payment assistance, as described in Paragraph 6.5 A.

D. Annual and Interim Reviews

In general, borrower income must be reviewed annually to determine whether the borrower is eligible to continue to receive payment subsidies. Annual and interim reviews of borrowers receiving payment subsidies are the responsibility of CSC.

Borrowers who receive payment subsidies must notify the Agency if any adult household member changes or obtains employment, the household composition changes, or if income increases by more than 10 percent. Borrowers may report other changes that would result in increased payment subsidies. The review period may be different in certain circumstances. Borrower(s) receiving payment assistance with adjusted incomes above 80 percent of the applicable adjusted median income will pay the equivalent interest rate for the appropriate income contained in Exhibit 6-3.

1. Self-Employed Applicants

For a self-employed applicant, the initial payment assistance agreement will run from the effective date to 3 months after the end of the applicant's business fiscal year, but not more than a 12-month period. This will allow subsequent agreements to coincide with the applicant's business fiscal year, with a 3-month overlap, to provide sufficient time for the applicant to supply verification of the previous year's income.

2. Unemployed Applicants

For an applicant receiving unemployment benefits, the agreement will be effective for the period during which the applicant will receive unemployment benefits, or, if the period is unknown, no longer than 6 months. The expiration date of the agreement will be established by the Loan Originator.

3. Annual Payment Borrowers

For an applicant currently paying an annual installment who receives a subsequent loan, the initial payment assistance agreement, including the subsequent loan, will be in effect until the next January 1st.

E. Recapture Requirement

Borrowers are required to repay all or a portion of the payment subsidy received over the life of the loan when the title to the property transfers, or the borrower ceases to meet the occupancy requirement described in Paragraph 6.11 B.2. At the time of loan closing, or whenever the borrower qualifies for payment subsidy for the first time, the borrower must sign *Form RD 3550-12, Subsidy Repayment Agreement*.

6.12 CALCULATING PAYMENT ASSISTANCE

A. Required Borrower Payment

The amount of payment assistance granted is the difference between the installment due at the promissory note rate and the amount the applicant must pay based upon income. Borrowers receiving payment assistance must pay the ***greater of***:

- A floor payment calculated as a percentage of adjusted income, less the cost of taxes and insurance; or
- The loan payment amortized at the applicable EIR.

Borrowers who receive leveraged loans are not subject to floor payments. Exhibit 6-2 provides a sample payment assistance calculation.

B. Establishing the Floor Payment

The floor payment is a minimum percentage of adjusted income that the borrower must pay for Principal, Interest, Taxes, and Insurance (PITI).

- Very low-income borrowers must pay a minimum of 22 percent.
- Low-income borrowers with adjusted incomes below 65 percent of the applicable adjusted median income must pay a minimum of 24 percent.

Exhibit 6-2

Sample Payment Assistance Calculation

The Jones family, with an adjusted income of $19,000, wishes to receive an initial loan with a principal amount of $60,000.

The following financial information is needed to calculate the payment assistance.

Loan Term: 33 years   Note Rate: 7%   Adjusted Median Income: $30,000

$19,000 Adjusted income
63% Percent of adjusted median ($19,000 ÷ $30,000)
$90 Monthly taxes and insurance

(1) Calculate the Payment at the Note Rate

$389 Payment at the note rate (amortized amount for $60,000 @ 7% for 33 years)

(2) Calculate the Floor Payment for PI*

24% Floor payment percentage for applicant @ 63% of median income
$380 Floor payment for PITI* ($19,000 ÷ 12 months x 0.24)
$290 Floor payment for PI* ($380 - $90 for taxes and insurance)

(3) Calculate the Payment at the EIR*

4% EIR* for applicant at 63% of median
$273 Payment at the EIR (amortized amount for $60,000 @ 4% for 33 years)

(4) Compute Monthly Payment Assistance

$389 Payment at the note rate
-$290 Required payment is the greater of (2) or (3)
$ 99 Monthly payment assistance

* PI = Principal and Interest.
PITI = Principal, Interest, Taxes, and Insurance
EIR = Equivalent Interest Rate

Low-income borrowers with adjusted incomes between 65 and 80 percent of the applicable adjusted median income must pay a minimum of 26 percent.

C. Calculating the Payment at the EIR

The EIR is determined by comparing the applicant's adjusted income to the applicable adjusted median income for the area in which the security property is located. The payment at the EIR is calculated by amortizing the loan using the applicant's loan amount, the term of the loan, and the EIR for which the applicant qualifies. Exhibit 6-3 provides the EIRs to be used.

Exhibit 6-3

Equivalent Interest Rates

Use the equivalent interest rate for the income range applicable to the applicant's adjusted income.

Adjusted Median Income Range	**Equivalent Interest Rate***
0%-50%	1.0%
50.01%-55%	2.0%
55.01%-60%	3.0%
60.01%-65%	4.0%
65.01%-70%	5.0%
70.01%-75%	6.0%
75.01%-80%	6.5%
80.01%-90%	7.5%
90.01-100%	8.5%
100.01%-110%	9.0%
110.01%-greater	9.5%

* EIR can never exceed the note rate.

D. Exceptions to the EIR

In rare circumstances, the Administrator may authorize an additional 1 percent reduction in the EIR if all of the following requirements are met:

- The reduced EIR will not be less than 1 percent;
- The security property is in a HUD high-cost area; and
- The applicant will be unable to acquire adequate housing unless the additional subsidy is authorized.

To request an exception, the Loan Originator must prepare a written justification that describes the area's housing costs and the applicant's circumstances, and demonstrates how the exception will permit the applicant to obtain housing. The request is submitted through the State Director.

6.13 CALCULATING INTEREST CREDIT

The amount of interest credit granted is the difference between the installment due at the promissory note rate and the amount the borrower must pay.

- 20 percent of adjusted monthly income, less the cost of taxes and insurance; or
- A loan payment reflecting the loan amount amortized at an interest rate of 1 percent.

Exhibit 6-4 provides a sample interest credit calculation.

Exhibit 6-4

Sample Interest Credit Calculation

The Joneses have received an interest credit subsidy on their initial loan since it was approved and have recently been approved for a subsequent loan to make needed repairs. The terms of the 2 loans are as follows:

	Principal Amount	Payment Period	Note Rate
Initial Loan	$60,000	33 years	7.0%
Subsequent Loan	$15,000	33 years	6.5%

The family's adjusted income is $22,000; monthly taxes and insurance are estimated at $90/month.

(1) Calculate the Annual Payment at the Note Rate

$389	Initial Loan (Amortized amount for $60,000 @ 7% for 33 years)
$ 92	Subsequent Loan ($15,000 @ 6.5% for 33 years)
$481	Total

(2) Calculate the Minimum Payment for Principal and Interest

$367	Minimum amount for PITI* ($22,000 ÷ 12 months x 0.20)
$277	Minimum amount for PI* ($367 - $90)

(3) Calculate the Required Payment at 1 Percent

$222	Monthly payment at the subsidized rate ($75,000 @ 1% for 33 years)

(4) Compute Monthly Interest Credit

$481	Monthly payment at the note rate
-$277	Required payment is the greater of (2) or (3)
$204	Monthly payment assistance

* PI = Principal and Interest
PITI = Principal, Interest, Taxes, and Insurance
EIR = Equivalent Interest Rate

SECTION 4: UNDERWRITING A LOAN FOR A SPECIFIC PROPERTY

6.14 APPROVING A SPECIFIC PROPERTY

A. Applicant Submission

Underwriting for a specific property begins after the applicant has been determined eligible and submits information about the property.

- Applicants who do not currently own the property must submit an option or sales contract and a location map with directions to the property. The sales contract must specify whether the purchaser or seller will be paying for the inspections and certifications. The location map should have sufficient detail to show the approximate boundaries and the relationship of the site to any roads, existing structures or other landmarks.

- Applicants who already own the property must submit evidence of ownership as described in Paragraph 5.11, a legal description, a property survey showing all structures on the site, and directions to the property.

B. Evaluation of the Property

Within 7 business days of submission by an applicant, who has been determined eligible for RHS assistance, the Loan Originator must visit the property to do a preliminary evaluation of the property to determine whether, with any planned construction or rehabilitation, it will meet the Agency's site, dwelling or environmental requirements, as described in Chapter 5. If the property appears to be acceptable, the Loan Originator requests an appraisal of the property. If the property is not acceptable, the Loan Originator must notify the applicant and provide a new *Form RD 1944-59, Certificate of Eligibility.*

6.15 FUNDS AVAILABLE FOR CLOSING

If the applicant must pay for closing costs that cannot be financed, or plans to make a down payment to reduce the loan amount, the Loan Originator must review *Form RD 1944-62, Request for Verification of Deposit* to ensure that the applicant has sufficient funds to pay the required costs, or can demonstrate that the funds will be available before closing. If additional funds are to be received from an outside source, the Loan Originator must ensure that the applicant has completed *Form RD 3550-2, Request for Verification of Gift/Gift Letter* to certify that the additional funds will not need to be repaid.

6.16 CALCULATING THE APPROVABLE LOAN AMOUNT

Once the Loan Originator verifies and enters all applicable applicant information and receives the appraisal, the UniFi can be used to determine whether the applicant appears to qualify for the needed loan amount, and if not, determine whether there are ways to make the loan feasible.

A. Calculating the Approvable Loan at Standard Terms

Once the required information is entered, the worksheet automatically computes the PITI and TD ratios, determines whether the applicant is eligible for a payment subsidy and the amount, and determines whether the applicant can afford the selected property using standard loan terms. If UniFi indicates that the loan can be approved, the Loan Originator should prepare the loan approval package, as described in Paragraph 6.17.

B. Working with Applicants Who Do Not Qualify Using Standard Terms

If the applicant cannot be approved for a loan using standard terms, the Loan Originator should determine whether any of the adjustments described below are possible. If any of the adjustments make the loan feasible, the Loan Originator should prepare the loan approval package, as described in Paragraph 6.17.

1. Possible Applicant Actions To Make A Loan Feasible

The Loan Originator should discuss with the applicant options for enhancing their ability to obtain Agency financing including: (1) identifying additional parties to the note; (2) seeking down payment assistance or other assistance programs to supplement the Agency loan; (3) providing an additional cash down payment to reduce the principal amount of the loan; (4) seeking a less expensive dwelling; or (5) obtaining leverage funds with terms more favorable than available from the Agency.

2. Possible Agency Actions to Make A Loan Feasible

The Loan Originator should first consider any compensating factors, as described in Paragraph 4.25 A., that have not yet been considered. The Loan Originator should then recompute the loan using a 38 year term provided the applicant's income qualifies for a 38 year loan. If the loan still is not feasible, the loan may be recommitted at a reduced EIR if the applicant is eligible, as described in Paragraph 6.12 D.

In the case of a subsequent loan, the Agency may authorize reamortization of the initial loan if the borrower cannot reasonably be expected to meet installment payments unless the account is reamortized. The Loan Originator should consult with CSC to determine whether reamortization is appropriate.

6.17 APPROVING CREDIT

The results of the underwriting analysis are summarized on UniFi's Maximum Loan Amount/Payment Assistance Information worksheet. This sheet can be used in discussions with applicants, and ***must*** be placed in the case file to document the results of the analysis.

If the results of the analysis indicate that the applicant's loan is feasible, the Loan Originator should recommend that it be approved. Before forwarding the case file, the Loan Originator should review it to ensure that all documentation required for approval, as listed in Attachment 6-A, is included. The Loan Originator also should reconfirm that the documentation in the case file demonstrates that:

- The applicant is eligible, as described in Chapter 4;
- The property is eligible, as described in Chapter 5; and
- The loan is feasible at approvable loan terms, as described in this chapter.

When the case file is complete, the Loan Originator forwards the case file to the Loan Approval Official for review and approval. Refer to Attachment 6-A for guidance on the documentation required prior to loan approval.

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ATTACHMENT 6-A

DOCUMENTATION REQUIRED PRIOR TO APPROVING A LOAN

APPLICANT ELIGIBILITY

APPLICATION

RD 410-4, Uniform Residential Loan Application
RD 3550-1, Authorization to Release Information
RD 1944-12, Rural Housing Loan Application Package (if applicable)

SETTLEMENT INFORMATION

RD 1940-41, Truth in Lending Statement
RD 440-58, Estimate of Settlement Costs

INCOME

RD 1910-5, Request for Verification of Employment or acceptable alternative documentation
Oral Reverifications (if applicable)
RD 1944-62, Request for Verification of Deposit
RD 3550-2, Request for Verification of Gift/Gift Letter
RD 3550-4, Employment Certification/Payment Assistance
Documentation, Income Tax Return
Documentation, Documentation of Other Income (verification of assets deposited, public assistance, child support payments, unemployment benefits, pensions and annuities, Social Security award or benefit letter, copies of year end statement for mutual funds or 401K)
Documentation, Documentation of Deductions (child care expenses, medical expenses, educational assistance expense, full-time student status)
RD 1944-4, Certification of Disability or Handicap (if applicable)
Documentation, Separation Agreement (if applicable)
Documentation, Divorce Decree (if applicable)

CREDIT HISTORY

Documentation, Infile Credit Report and CAIVRS
Documentation, Residential Mortgage Credit Report (The RMCR cannot be more than 6 months old when the underwriting decision is being made.)
RD 410-8, Applicant Reference Letter (if applicable)
RD 1944-60, Landlord's Verification
RD 1944-61, Credit History Worksheet

OTHER REQUIREMENTS

Documentation, Evidence of Alien Status (if applicable)
Checked Debarment List

PROPERTY ELIGIBILITY

PROPERTY INFORMATION

Sales Contract or *RD 440-34, Option to Purchase Real Property*
Metes and Bounds Description
Plot Plan (new construction and major rehabilitation only)
Map to Locate Property and Comparables

ENVIRONMENTAL INFORMATION

RD 1940-22, Environmental Checklist for Categorical Exclusions
FEMA Form 81-93, Standard Flood Hazard Determination
RD 1940-21, Environmental Assessment for Class I Action (as appropriate)

APPRAISAL INFORMATION

RD 1922-8, Uniform Residential Appraisal Report
Form 1007, Marshall and Swift Square Foot Appraisal Form (required only if comparables are not strong)
RD 1922-15, Administrative Appraisal Review for Single Family Housing

CERTIFICATES (for existing housing and already-existing new construction not covered by a 10-year warranty)

Termite Inspection Certificate
Thermal Certification
Plumbing/Water/ Sewage Certification
Electrical Heating/Cooling Certification

EXISTING HOUSING

Documentation of Inspection
Contractor's Estimate or Bid (if applicable)

NEW CONSTRUCTION OR REHABILITATION

Drawings and Specifications (for new construction must have *RD 1924-25, Plan Certification*)
RD 1924-2, Description of Materials
RD 1924-19, Builder's Warranty or Insured 10-Year Home Warranty

ATTACHMENT 6-B

STATE DIRECTOR EXCEPTION(S) TO AREA LOAN LIMITS

STATE: ______________________________ DATE: _______________

Date of Request	Name/ Case Number	$ Amount of Request over Area Loan Limit	Reason for Exceeding Area Loan Limit ($ Amt) (paragraph 6.6)		Affordable Housing Products (paragraph 6.7)	SD Action	
			Closing Costs (other than the allowable fees)	Cost(s) of Purchase or Construction		Appr'd	Denied
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			
		$	$	$			

ATTACHMENT 6-C

LOAN UNDERWRITING REVIEW

Quality loan underwriting not only ensures that the Agency properly and prudently uses funds, it impacts the first year delinquency rate. The first year delinquency rate reflects the Agency's ability to provide borrowers with the necessary skills and tools to become successful homeowners and impacts the longevity of the program. High quality loan underwriting coupled with homeownership education can contribute to a reduction in the first year delinquency rate thus supporting continued funding of our programs.

A. State Office Monitoring

State Offices should monitor their first year delinquency rates using the monthly report prepared by the Collection Services Branch in CSC. This report contains an attachment that provides the rolling new loan delinquency rates for the last 12 months. In addition, State Offices can obtain first year delinquency data using BRIO. On a quarterly basis, State Offices should conduct a review of all Field Offices with a first year delinquency rate that has remained above the State average for the preceding 3-month period. For those Field Offices that fall within this category, State Offices are asked to conduct an onsite visit or request case files to conduct a review of the delinquent loans (especially those involved in foreclosure or bankruptcy) made in those Field Offices during the fiscal year to date. The Single Family Housing Processing & Servicing Review Guide, which is part of the State Internal Review, should be used to perform the reviews.

At the end of each quarter, state offices should also conduct a review of at least 5 percent or three complete applications, whichever is greater, that were withdrawn or rejected in every field office during that quarter. Do not include pre-qualifications (product code of 999) in the review. The following guide entitled, "single family housing withdrawn/rejected review," should be completed on each selected application. The results of the review should be used for training the field office staff.

Single Family Housing Withdrawn/Rejected Review

Applicant's Name: ___________________________

Account Number: ____________________________

1. Was the applicant's PITI and TD ratio calculated correctly? Yes___ No___

2. Were all sources of income considered? Yes___ No___

3. Were all allowable deductions made? Yes___ No___

4. If the applicant lacked adequate repayment ability, were they counseled about adding additional parties to the note or locating a cosigner? Yes___ No___ N/A___

5. If the applicant's adjusted income did not exceed 60 percent of the applicable area median income and the conditions outlined in HB-1-3550, Chapter 6 were met, was a 38-year term considered? Yes___ No___ N/A___

6. If the applicant's family was experiencing unreimbursed medical expenses in excess of 3 percent of annual income, was the applicable asset limit increased by the amount of the medical expenses in excess of 3 percent of annual income? Yes___ No___ N/A___

7. Were any of the following compensating factors applicable but not considered in the eligibility determination? Yes___ No___ N/A___

   - Payment History: The applicant historically paid a greater share of income for housing with the same income and debt level.
   - Savings History: The applicant had accumulated savings and a savings history that showed a capacity to set aside a larger-than-average portion of income.
   - Job Prospects: The applicant recently entered a profession in which he/she could expect a significant pay increase.
   - Adjustments for Nontaxable Income: The applicant had a source of income not subject to Federal taxes, which could be grossed up.

8. If the applicant had credit blemishes, did the local office explore the reasons behind the occurrences to ascertain if a credit waiver was feasible? Yes___ No___ N/A___

9. Were applicable appeal and ECOA rights provided? Yes___ No___

____

B. National Office Monitoring

The National Office will routinely hold teleconferences with selected States to discuss their first year delinquency and monitoring efforts. During these teleconferences, the results of the State's docket reviews will be discussed and action plans to improve loan underwriting will be developed.