U.S. Department of Housing and Urban Development
Office of Public and Indian Housing

Special Attention of:

All Section 184 Approved Mortgagees,
Indian Housing Authorities,
Tribally Designated Housing Entities,
and Tribes

Notice PIH-2014-22

Effective: September 16, 2014
Expires: This Notice remains effective until until amended, superseded, or rescinded

---

SUBJECT: Section 184 Indian Loan Guarantee Program Processing Guidelines.

PURPOSE: The purpose of this Notice is to provide information to lenders that make loans under the Section 184 Program to individual tribal members, about HUD's guidelines and procedures for issuing loan guarantees.

HUD intends to issue a comprehensive guidebook on the guidelines and procedures that must be followed for the Section 184 program. It will cover both the servicing requirements in PIH 2014-11, and the underwriting guidelines of this Notice. Until then, this Notice provides guidance on the guidelines and procedures that must be followed for HUD to guarantee a Section 184 loan.

BACKGROUND: The Indian Housing Loan Guarantee program is authorized by Section 184 of the Housing and Community Development Act of 1992, P.L. 102-550, enacted October 28, 1992, as amended. Regulations are at 24 CFR part 1005. The Section 184 program addresses the special needs of American Indians and Alaska Natives by making it possible to achieve homeownership with market-rate financing. Historically, American Indians and Alaska Natives have had limited retail banking opportunities and limited access to private mortgage capital, primarily because much of the land in Indian Country is held in trust by the federal government. Land held in trust for a tribe cannot be encumbered or alienated, and land held in trust for an individual Indian must receive federal approval through the Bureau of Indian Affairs before a lien is placed on the property.

This loan guarantee program maximizes a relatively minimal federal investment by insuring approximately 4,000 loans each year, and by expanding markets for lenders. The program provides an incentive for private lenders to market loans to this traditionally underserved population by guaranteeing 100 percent repayment of the unpaid principal and interest due in the event of default. Lenders get the guarantee by making mortgage loans to American Indian and Alaska Native families, Indian tribes, and tribally designated housing entities to purchase, construct, refinance, and/or rehabilitate single family homes on trust or restricted land, and in tribal areas of operation. There is no income limit or minimum required to participate, but borrowers must qualify for the loans.

This Notice explains how the Section 184 program advises lenders to underwrite purchase transactions. All lenders should ensure that all necessary information has been included in the loan file. The Office of Loan Guarantee, which operates the Section 184 program, reserves the right to return to lenders any incomplete packages.

GUIDELINES:

1. Overview and Qualification of Applicants

Overall, underwriters should focus their review on two major factors: (1) prospect of loan repayment; (2) and the property value.

Eligibility: For applicants to be eligible for a Section 184 loan, they first must meet the following two threshold qualifications:

1) Membership in Tribe- An applicant must be a member of a federally recognized tribe, a regional or village corporations as defined in the Alaska Native Claims Settlement Act, or one of the following five state tribes: Coharie Tribe (North Carolina); Haliwa-Saponi Tribe (North Carolina); Lumbee Tribe (North Carolina); Waccamaw Siouan Tribe (North Carolina); MOWA band of Choctaw (Alabama).

To determine if a tribe is federally recognized, the underwriter should consult the Bureau of Indian Affairs website for the most up-to-date tribal directory (found at www.bia.gov). Proof of membership or enrollment in a federally recognized tribe (or one of the five approved state tribes) will be determined through possession of a tribally issued enrollment card or through possession of a letter from the tribal enrollment office stating that the applicant is a member of the tribe.

Alaskan Corporation Membership- To determine if a regional or village corporation in Alaska is eligible for the Section 184 program under the Alaska Native Claims Settlement Act, the lender must consult the list of eligible corporations on the HUD website at: http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/ih/homeownership/184

Membership in an eligible Alaskan corporation will be determined by whether the applicant can demonstrate possession of a common stock in one of the approved Alaskan corporations. A copy of the common stock certificate must be included in the loan file.

2) Indian Operating Area- the property that will be the security for the mortgage that is guaranteed by the Section 184 program must be in an approved Indian operating area. As of 2014 there are Indian operating areas in 39 states. The map of approved Indian operating areas can be found on the HUD website at: http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/ih/homeownership/184

Note: Eligible tribal members are not limited to purchasing a home in a place where their tribe is authorized to provide housing. For example, if an Oklahoma tribal member wants to purchase a home in Alaska that is allowed.

Applicant Prequalification- HUD does not prequalify applicants. Lenders are responsible for ensuring applicants meet the program requirements prior to requesting the assignment of a case number. Once the eligibility thresholds have been satisfactorily determined, an eligible lender should request a case number from the Office of Loan Guarantee. The case number request should be submitted on HUD Form 50131. A case number is valid for up to 180 days from issuance. Unless an extension is requested from the Office of Loan Guarantee, after 180 days case numbers will be cancelled by HUD without further notice and a lender must send a new request for a case number.

At the time that a case number is requested, the lender will need to determine whether the property is located on land held in trust by the federal government and if so, whether they want to underwrite the loan themselves, through the Direct Guarantee process, or whether they want to send it to HUD for underwriting.

However, before HUD can underwrite any loan, the lender will need to secure documentation from the tribe's Environmental Review Record (ERR) verifying that an environmental review was performed in accordance with 24 CFR Part 58 by the tribe whose land is impacted by the proposed mortgage.

Also, except where the ERR documents that the proposed action is exempt under 24 CFR 58, the tribe whose land is impacted will need to send HUD a Request for Release of Funds, which will have to be approved by HUD as part of the underwriting process.

Please note that lenders must utilize the direct guarantee process for underwriting all loans occurring on lands that are not held in trust by the federal government and that there is no environmental review required for these loans (except in the case of a waiver involving collateral under Section 14.B of this Notice).

For questions on how to become approved to be Direct Guarantee lender, please see the Section 184 website at:
http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/ih/homeownership/184

If a loan file is to be underwritten by HUD staff, all documentation should be two-hole punched, bound in a legal-sized folder, and organized in accordance with the applicable checklist HUD form 50127. This folder should have a label with the applicant's name and case number. The file should be shipped, to the loan guarantee specialist designated on the case number request form.

2. General Operating Information

Application Format- Lenders must submit a Uniform Residential Loan Application (URLA) for all applicants. The application must be signed by both the applicant(s) and the loan officer, or other appropriate person from the lender.

Criteria for Review of Application- The underwriting review assesses the applicant's ability and willingness to repay the mortgage debt.

1) The applicant's ability to repay the debt is assessed by considering income history and stability; employment history and stability; and debts.
2) The applicant's willingness to repay the mortgage debt is assessed by considering both credit and pay history.

Age of Documentation- Credit, income, and valuation verification may not be older than 60 days at underwriting and may not be older than 120 days when the loan closes. Since some loans will take longer than this to close, lenders may have to update credit and income information periodically during loan processing. An underwriter must use the most recent information available in making an approval decision.

General Authorization- Rather than requiring applicants to sign multiple verification forms, the lender may have the applicant sign a general authorization form that gives the lender blanket authority to verify the information needed to process the mortgage loan application. In addition, electronic signatures are acceptable.

Citizenship and Immigration Status- Citizenship of the United States is not required for program eligibility. When a borrower indicates on the loan application that he or she holds something other than U.S. citizenship, the lender must determine residency status from the documentation provided by the borrower.

- Lawful Permanent Resident Aliens: For those borrowers with lawful permanent resident alien status, OLG will guarantee the mortgage under the same terms and conditions as U.S. citizens.

  The lender must document the mortgage file with evidence of permanent residency and indicate on the Uniform Residential Loan Application (URLA) that the borrower is a lawful permanent resident alien. Evidence of lawful permanent residency is issued by the Bureau of Citizenship and Immigration Services (BCIS) (formerly the Immigration and Naturalization Service) within the Department of Homeland Security.

- Non-Permanent Resident Aliens: OLG will also guarantee a mortgage made to a non-permanent resident alien provided that the property will be the borrower's principal residence, the borrower has a valid Social Security Number, and the borrower is eligible to work in the U.S. as evidenced by an Employment Authorization Document (EAD) issued by BCIS.

  If the authorization for temporary residency status will expire within one year and a prior history of residency status renewals exists, the lender may assume continuation will be granted. If there are no prior renewals, the lender must determine the likelihood of renewal, based on information from the BCIS.

Although social security cards may indicate work status, such as “not valid for work purposes,” an individual’s work status may change without the change being reflected on the actual social security card. Therefore, the social security card is not to be used as evidence of work status for non-permanent resident aliens; the BCIS employment authorization document is to be used.

Non-Purchasing Spouse- When a potential applicant is married but does not want to include his or her spouse on the title to the home or on the mortgage note a lender needs to verify the state law that governs the issue. The reason for this is that many states require that in order to perfect a valid and enforceable first lien, a non-purchasing spouse may be required to sign either the security instrument or documentation evidencing that he or she is relinquishing all rights to the property.

In one of these states, if the non-purchasing spouse executes the security instrument, he or she is not considered an applicant, and need not sign the loan application. Where there is a non-purchasing spouse who signs the security instrument relinquishing rights to the property pursuant to applicable state laws, the non-purchasing spouse does not have to sign the mortgage note. Signing the security instrument for such purposes does not make the non-purchasing spouse a co-applicant.

Except for the obligations specifically excluded by state law, the debts of the non-purchasing spouse must be included in the applicant’s qualifying ratios, if the applicant resides in a community property state or the property to be mortgaged is located in a community property state. Although the non-purchasing spouse's credit history is not to be considered a reason for credit denial, a tri-merge credit report must be obtained for the non-purchasing spouse in order to determine the debt-to-income ratio. Community property states include but are not limited to: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin

Evaluation of Credit, Capacity, and Collateral- After the above mentioned preliminary matters are taken care of, an underwriter should begin to evaluate the following factors to determine if a loan is likely to perform: a) credit reputation; b) financial capacity; and c) collateral. If one of these components is not acceptable or if there is excessive layering of risk across components, the mortgage is not acceptable to be guaranteed by the Section 184 program.

3. Credit Requirements

There is no minimum credit score required to qualify for the program. However, in all cases the applicant/borrower must be creditworthy. Thus, regardless of a credit score an underwriter must fully analyze the applicant's credit history and payment pattern.

Required Credit Reports- To make an informed decision about an applicant's credit reputation, a Three Repository Merged Credit Report (TRMCR) must be obtained on each applicant. The lender must also separately develop credit information for any open debt listed on the loan application but not referenced on the credit report. While the TRMCR should prove sufficient for processing most loan applications, the following circumstances may require ordering a Residential Mortgage Credit Report (RMCR):

- The applicant disputes accounts on the TRMCR:
- The applicant states that collections, judgments or liens reflected as open on the TRMCR have been paid, but cannot provide separate supporting documentation;
- The applicant claims that certain debts shown on the TRMCR have different balances and/or payments, but cannot provide current statements (less than 30 days old); or
- The lender's underwriter determines that it would be prudent to use an RMCR in lieu of a TRMCR to properly underwrite the loan.

Charges for Credit Reports- In all cases, the applicant may be charged only the amount billed by the credit reporting agency. An applicant may not be charged for both a TRMCR and an RMCR on the same loan except when delays on the part of the applicant require the TRMCR to be updated and a RMCR is ordered for one of the reasons described above.

Standards for Credit Reports- Credit reports used in the underwriting decision must meet the following criteria:

- If the credit report submitted is not the original, the lender must certify in writing that it is an unaltered credit report;
- Contain all credit that is available in the repositories, be accurate and complete, and provide an account of the credit, residence history, and public record information of each applicant to be responsible for the mortgage debt. The report must include all credit and legal information not considered obsolete under the Fair Credit Reform Act. This includes bankruptcies, judgments, lawsuits, foreclosures, and tax liens that have occurred within the last 7 years;
- Contain 24 months of employment and residency history if not verified in other separate documentation;
- Identify each applicant's name, social security number, date accounts were opened, credit limit, required payments, unpaid balance, and payment history of each account;

- Payment history must appear in the "number of times past due" format and be otherwise easy to read and understandable;
- Must have no whiteouts, erasures, or alterations;
- Indicate the name and physical address of the credit reporting agency, and each account listed must show the primary repository from which the particular information was obtained; and
- Show the name of the party ordering the report.

<u>Delinquent accounts</u>- When delinquent accounts are revealed on an applicant's credit report, the underwriter must determine if the late payments were due to a disregard for financial obligations, an inability to manage these obligations, or factors beyond the control of the applicant.
With each derogatory credit item that appears on an applicant's credit report, the underwriter should note these issues in the loan file and determine if additional clarifying information is needed. When an underwriter discovers a derogatory credit item that has occurred within the last 2 years he or she will determine if a written explanation is needed from the applicant(s) about why the issue occurred and why it is unlikely to occur in the future (there is no required format for this written explanation). Reporting of significant derogatory credit beyond 2 years that includes multiple accounts may also require a written explanation.

Exception: To reduce the burden on lenders and underwriters, if an applicant has only two or fewer late payments (no more than 30 days late) that show up on their credit report, and otherwise has a good payment history, no written explanation from the applicant is needed. Any minor derogatory incidents occurring beyond 2 years before the loan application do not require a written explanation. However, these items should still be noted in the loan binder.

Decision standard: When delinquent accounts are revealed on the applicant's credit report, underwriters must use their best judgment and experience to determine whether the late payments were due to a disregard for financial obligations, an inability to manage these obligations, or factors beyond the control of the applicant.

Before a final loan approval decision is made, underwriters must be confident that they have all necessary explanations for derogatory credit, and believe it likely in their professional opinion that these sorts of derogatory credit issues are unlikely to continue in the future. If an underwriter determines that derogatory credit issues are likely to continue, loan approval should not be given.

<u>Major Credit Issues</u>- An applicant is not eligible for a Section 184 guaranteed mortgage if he or she is presently delinquent on any type of federal debt, unless there is evidence of an accepted repayment plan, and 12 months of timely payments have been made by the applicant to the federal agency owed.

If an underwriter determines by looking at an applicant's credit report that he or she has previously defaulted on a FHA, USDA, VA, or Section 184 loan, the underwriter will then need to determine if the federal government had to sell that home for less than the unpaid principal balance on that loan. The determination will need to be made by getting in touch with the federal agency that insured/guaranteed the applicant's previous loan. When an applicant has previously been a party to a foreclosure of a home insured or guaranteed by the federal government, unless an underwriter can satisfactorily demonstrate that an applicant does not have any delinquent debt to the federal government, the loan cannot qualify for a Section 184 guarantee.

Additionally, an underwriter is to try and determine if an applicant has any delinquencies by running the applicant through HUD's Credit Alert Interactive Voice Response System (CAIVRS), a federal government-wide repository of information on individuals with delinquent or defaulted federal debt and for whom a payment of an insurance claim has occurred. Lenders must screen all applicants, including nonprofit agencies acting as an applicant, using CAIVRS. Underwriters can access CAIVRS either through the Federal Housing Administration (FHA) Connection system or the functional equivalent. Underwriters must write the CAIVRS authorization code for each applicant on the mortgage credit analysis worksheet, HUD form 50132.

Alternative Credit- When and only if an applicant has not established a conventional credit history (as reported by the three major credit bureaus) or a minimum conventional credit history, the lender is permitted to develop a credit history from other means, such as rent, utility payments, auto insurance, phone bill, etc. For an applicant to credit qualify using alternative credit, an underwriter must establish a minimum of two credit sources that have at least a 12 month repayment history demonstrating an applicant's ability to repay a loan.

**Alternative credit may not be used to replace or offset bad credit shown on a traditional credit report.

Suspensions and Debarment- An applicant who is suspended or debarred is not eligible for a section 184 guaranteed mortgage. A participant who is subject to a limited denial of participation in programs administered by HUD's Office of Public and Indian Housing is not eligible for a section 184 guaranteed mortgage. The lender must examine HUD's "Limited Denial of Participation (LDP) List" and the government-wide General Services Administration's (GSA's) "System for Award Management." If the name of any party to the transaction appears on either list, the application is not eligible for a loan guarantee. (An exception is made when the seller appears on the LDP list and the property being sold is the seller's principal residence or when a party is shown on the LDP list as being denied participation in a program other than Public and Indian Housing.) A copy of the LDP/GSA verification must be submitted in the underwriting case binder.

Common issues- Accounts listed as "rate by mail only" or "need written authorization" require separate verification. Each account with a balance must be verified within 60 days of the date of the credit report. The applicant must explain all credit inquires shown on the credit report for the last 90 days.

- The lender must ascertain if any recent debts were incurred to obtain part of the required cash investment on the property being purchased. Using unsecured debt to obtain a down payment is not allowed.
- If the credit report reveals debt that was not previously disclosed on the URLA (loan application), the lender must obtain a new URLA disclosing all debts shown on credit report.

4. Debt Analysis

In addition to the issues listed above in Section 3 of the Guidelines, applicants should not have any of the following items on their credit report:

Judgments, Garnishments, or Liens- There must be at least 2 years between a judgment, garnishment, or lien entered against the applicant and the mortgage application. After the two year seasoning period, the applicant must show evidence of payment in full for at least 12 months prior to the date of application. In addition, the applicant must furnish a written letter of explanation and must have reestablished good credit.

Collections- All collections must show evidence of payment in full prior to the date of application. In addition, the applicant must furnish a written letter of explanation and must have otherwise good credit.

Disputed Accounts- When a borrower disputes the ownership of accounts showing up on their credit report, or claim that collections, judgments, garnishments, or liens have been paid, the applicant must submit documentation that reasonably supports their assertions. An underwriter must determine if the applicant's documentation reasonably supports their contention that the item is disputed. If there is reasonable evidence that the dispute will be resolved in the applicants favor then the loan may proceed without seeking a waiver.

Bankruptcy- A bankruptcy must have been discharged fully, and the applicant must have reestablished good credit and demonstrated an ability to manage financial affairs. There must be at least 2 years between the discharge of the bankruptcy and the mortgage application. A shorter elapsed time–but not less than 12 months–may be considered, if the lender is able to document that extraordinary circumstances caused the bankruptcy (such as an extended illness that was not covered by health insurance) and that the applicant's current situation is such that the events that led to the bankruptcy are not likely to recur. In all cases, the lender must have sufficient documentation to support the decision that the applicant is credit worthy.

An applicant paying off debts under Chapter 13 of the Bankruptcy Act or making payments through a Consumer Credit Counseling plan may also qualify if:

- One year of the pay-out period has elapsed and performance has been timely and current; and
- The applicant receives court approval (if Chapter 13) to enter into the mortgage transaction.

Mortgage Foreclosure- An applicant that had a mortgage foreclosed is not eligible to apply for another government loan until 3 years after the date the insurance claim was paid to the lender (for additional information see section 3 above). If the applicant has previously had a Section 184 insured home foreclosed upon, they are permanently ineligible for a future Section 184 loan.

Mortgage Short Sale- Applicants that were in default at the time of the short sale (or pre-foreclosure sale/deed in lieu of foreclosure) are not eligible to apply for another government loan until three (3) years from the date of the sale. If the applicant has previously had a Section 184 insured home end in a short sale, they are permanently ineligible for a future Section 184 loan.

Note- Under the Debt Collection Improvement Act, applicants who owe outstanding delinquent debts to the federal government are not eligible for loan guarantees. This requirement cannot be waived by the Director of the Office of Loan Guarantee.

5. Determining Income

Income may not be used in calculating the applicant's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue.

A. Stability of Income.

The lender must verify the applicant's employment from all sources for the most recent **2 full years**, and the applicant must:

1) Explain any gaps in employment that span one or more months, and

2) Indicate if he/she was in school or the military for the recent 2 full years, providing evidence supporting this claim, such as college transcripts, or discharge papers.

Underwriters should favorably consider an applicant for a mortgage if he/she changes jobs frequently within the same line of work, but continues to advance in income or benefits. In this analysis, income stability takes precedence over job stability.

When analyzing the probability of continued employment, underwriters must examine the applicant's past and current employment record, and the employer's confirmation of current ongoing employment.

Note: An applicant with a 25 percent or greater ownership interest in a business is considered self-employed, and will be evaluated as a self-employed applicant for underwriting purposes.

Applicants Returning to Work After an Extended Absence- An applicant's income may be considered effective and stable when recently returning to work after an extended absence (defined as an absence of 6 months or more) if he/she can adequately explain this absence as well as:

1). Show current employment of 6 months or longer; and
2). Can document a 2 year work history prior to an absence from employment using traditional employment verifications, and/or copies of IRS Form W-2s or pay stubs.

B. Salaries, Wages, and Other Forms of Income.

The income of each applicant who will be obligated for the mortgage debt must be analyzed to determine whether his/her income level can be reasonably expected to continue through at least the first 3 years of the mortgage loan. In most cases, an applicant's income is limited to salaries or wages; however, income from other sources can be considered as effective when it is properly verified and documented by the creditor. In addition to all requirements stated below, the program requires lenders to obtain IRS tax transcripts for the most recent 2 year periods, for all loan applications prior to underwriting.

Notes: Effective income for applicants planning to retire during the first 3 year period of the proposed mortgage must include the amount of documented retirement benefits, Social Security payments, or other payments expected to be received in retirement.

Overtime and Bonus Income- Overtime and bonus income can be used to qualify the applicant if he/she has received this type of income for the past 2 years, and it will likely continue. If the employment verification states that the overtime and bonus income is unlikely to continue, it may not be used in qualifying.

To calculate how much overtime and bonus income can be considered effective, the creditor must develop an average earning trend of these sources of income for the past 2 years. If either of these earning trends shows a decline, the lender is to use the bonus/overtime income from the time period with the lowest earnings.

Periods of overtime and bonus income less than 2 years may be acceptable, provided the lender can justify and document in writing the reason for using the income for qualifying purposes.

Part-Time & Seasonal Income- Part-time and seasonal income can be used to qualify the applicant if the lender documents that the applicant has worked the part-time or seasonal job for the past 2 years, and plans to continue. Many low-and-moderate income families rely on part-time and seasonal income for day-to-day needs, and lenders should not restrict consideration of such income when qualifying these applicants.

Part-time income received for less than 2 years may be included as effective income, provided that the lender justifies and documents compensating factors.

Seasonal income is considered uninterrupted, and may be used to qualify the applicant, if the creditor documents that the applicant: a) has worked the same job for the past two years, and b) expects to be rehired the next season.

Note: "part-time" income refers to employment taken to supplement the applicant's income from regular employment; part-time employment is not a primary job and it is worked less than 40 hours per week.

<u>Commission Income</u>- A commissioned applicant is one who receives more than 25 percent of his or her annual income from commissions. Commission income must be averaged over the previous 2 years. To qualify commission income, the applicant must provide: a) copies of signed tax returns and tax transcripts for the last 2 years; and b) the most recent pay stub that shows year-to-date commissions.

Applicants whose commission income was received for more than one year, but less than 2 years, may be considered favorably only if the underwriter can soundly rationalize accepting the commission income.

Commission income that is less than 25 percent of an applicant's annual income should be treated under the same standards as overtime and bonus income.

Note: Unreimbursed business expenses must be subtracted from gross income.

*Exception***:** Exceptions may be made for situations in which the applicant's compensation was changed from salary to commission within a similar position with the same employer. An applicant may also qualify when the portion of earnings not attributed to commissions would be sufficient to qualify the applicant for the mortgage.

<u>Employer Differential Payments</u>- When an employer subsidizes an applicant's mortgage payment through direct payments, the amount of the payments: a) is considered gross income, and b) cannot be used to offset the mortgage payment directly for qualifying purposes, even if the employer pays the servicing creditor directly.

*<u>Retirement Income</u>***-** Retirement income must be verified from the former employer, or from Federal tax returns and tax transcripts. If any retirement income, such as employer pensions or 401(k)s, will cease within the first full 3 years of the mortgage loan, such income may not be used in qualifying.

*<u>Social Security Income</u>***-** Social Security income must be verified by obtaining a benefit verification letter issued by the Social Security Administration.

Notes:

- The lender must obtain a complete copy of the current awards letter;

- Not all Social Security income is for retirement-aged recipients; therefore, documented continuation is required; for example, requesting the initial award letter that indicates the award review cycle;
- Some portion of Social Security income may be "grossed up" if deemed nontaxable by the IRS.

Automobile Allowance and Expense Account Payments- Only the amount by which the applicant's automobile allowance or expense account payments exceed actual expenditures may be considered income. To establish the amount to add to gross income, the applicant must provide the following: a) IRS Form 2106, Employee Business Expenses, for the previous two years; and b) employer verification that the payments will continue.

If the applicant uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income. Expenses that must be treated as recurring debt include: a) the applicant's monthly car payment; and b) any loss resulting from the calculation of the difference between the actual expenditures and the expense account allowance.

C. Self Employed Applicants and Applicants Employed by a Family Owned Business.

Applicants Employed by a Family Owned Business- In addition to normal employment verification, an applicant employed by a family owned business is required to provide evidence that he/she is not an owner of the business, which may include: a) copies of signed personal tax returns, or b) a signed copy of the corporate tax return showing ownership percentage.

Self Employed Applicants- Any applicant with a 25 percent or greater ownership interest in a sole proprietorship, corporation, limited liability or "S" corporation, or partnership is considered self-employed. Income from self-employment is considered stable, and effective, if the applicant has been self-employed for 2 or more years. Due to the high probability of failure during the first few years of a business, the requirements described in the table below are necessary for applicants who have been self-employed for less than 2 years.

If the period of self-employment is:	**Then:**
Between one and 2 years	To be eligible for a mortgage loan, the individual must be have at least two years of documented previous successful employment in the line of work in which the individual is self-employed, or in a related occupation. Note: A combination of one year of employment and formal education or training in the line of work in which the individual is self-employed, or in a related occupation is also acceptable.
Less than one year	The income from the applicant may not be considered effective income.

Documentation Requirements for Self-Employed Applicants- Self-employed applicants must provide the following documentation:

- signed, dated individual tax returns, with all applicable tax schedules for the most recent 2 years; or for a corporation, "S" corporation, or partnership, signed copies of Federal business income tax returns for the last 2 years, with all applicable tax schedules;
- year to date profit and loss (P&L) statement and balance sheet; and

- 2 years of tax transcripts obtained directly from the IRS;
- Evidence of quarterly tax payments for current year.

<u>Establishing an Applicant's Earnings Trend</u>- When qualifying an applicant for a mortgage loan, the lender must establish the applicant's earnings trend from the previous 2 years using the applicant's tax returns and tax receipts.

If an applicant provides quarterly tax returns, the income analysis may include income through the period covered by the tax filings. Alternatively if an applicant is not subject to quarterly tax returns, or does not file them, then the income shown on the P&L statement may be included in the analysis (using the year to date P&L statement), provided the income stream based on the P&L is consistent with the previous years' earnings.

If the P&L statements submitted for the current year show an income stream considerably greater than what is supported by the previous year's tax returns, the lender must base the income analysis solely on the income verified through the tax returns.

If the applicant's earnings trend for the previous 2 years is downward and the most recent tax return or P&L is less than the prior year's tax return, the applicant's most recent year's tax return or P&L must be used to calculate his/her income.

<u>Analyzing the Business's Financial Strength</u>- To determine if the business is expected to generate sufficient income for the applicant's needs, the lender must carefully analyze the business's financial strength, including the source of the business's income. Annual earnings that are stable or increasing are acceptable, while businesses that show a significant decline in income over the analysis period are not acceptable.

Income Analysis: Individual Tax Returns (IRS Form 1040). The amount shown on an applicant's IRS Form 1040 as adjusted gross income must either be increased or decreased based on the lender's analysis of the individual tax return and any related tax schedules.

Tips for Analyzing IRS Form 1040. The table below contains information for analyzing IRS Form 1040:

IRS Form 1040 heading	**Description**
Wages, Salaries, and Tips	An amount shown under this heading may indicate that the individual: • Is a salaried employee of a corporation, or • Has other sources of income This section may also indicate that the spouse is employed, in which case the spouse's income must be subtracted from the applicant'sadjusted gross income.
Business Income and Loss (from Schedule C)	Sole proprietorship income calculated on Schedule C is business income. Depereciation or depletion may be added to be back to the adjusted gross income.
Rents, Royalties, Partnerships (from Schedule E)	Any income received from rental properties or royalties may be used as income, after adding back any depreciation shown on Schedule E.
Capital Gains and Losses (from Schedule D)	Capital gains or losses generally occur only one time, and should not be considered when determining income.

	However, if the individual has a constant turnover of assets resulting in gains or losses, the capital gain or loss must be considered when determining the income. Three years tax returns are required to evaluate an earnings trend. If the trend: • Results in a gain, it may be added as effective income, or • Consistently shows a loss, it must be deducted from the total income. Creditor must document anticipated continuation of income through verified assets. *Example:* A creditor can consider the capital gains for an individual who purchases old houses, remodels them, and sells them for profit.
Interest and Dividend Income (from Schedule B)	This taxable/tax-exempt income may be added back to the adjusted gross income only if it has been received for the past 2 years; and is expected to continue. If the interest-bearing asset will be liquidated as a source of the case investment, the underwriter must appropriately adjust the amount.
Farm Income or Loss (from Schedule F)	Any depreciation shown on Schedule F may be added back to the adjusted gross income.
IRA Distributions, Pensions, Annuities, and Social Security Benefits	The non-taxable portion of these items may be added back to the adjusted gross income, if the income is expected to continue for 3 years of the mortgage.
Adjustment to Income	Adjustments to income may be added back to the adjusted gross income if they are: • IRA and Keogh retirement deductions; • Penalties on early withdrawal of savings; • Health insurance deductions; and • Alimony payments.
Employee Business Expenses	Employee business expenses are actual cash expenses that must be deducted from the adjusted gross income.

Income Analysis: Corporate Tax Returns (IRS Form 1120). A corporation is a State-chartered business owned by its stockholders. The general rule is corporate compensation to the officers, generally in proportion to the percentage of ownership, is shown on the: a) corporate tax return IRS Form 1120; and b) individual tax returns.

When an applicant's percentage of ownership does not appear on the tax returns, the lender must obtain the information from the corporation's accountant, along with evidence that the applicant has the right to any compensation. To determine an applicant's self-employed income from a corporation, the adjusted business income must: a) be determined; and b) multiplied by the applicant's percentage of ownership in the business.

The table below describes the items found on IRS Form 1120 for which an adjustment must be made in order to determine adjusted business income.

Adjustment item	Description of adjustment
Depreciation and Depletion	Add the corporation's depreciation and depletion back to the after-tax income.
Taxable Income	Taxable income is the corporation's net income before Federal taxes. Reduce taxable income by the tax liability.
Fiscal Year vs. Calendar Year	If the corporation operates on a fiscal year that is different from the calendar year; adjust the proportionate corporate income to the individual tax return accordingly.
Cash Withdrawals	The applicant's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating.

Income Analysis: "S" Corporation Tax Returns (IRS Form 1120S). An "S" corporation is generally a small, start-up business, with gains and losses passed to stockholders in proportion to each stockholder's percentage of business ownership. Income for owners of "S" corporations comes from IRS Form W-2 wages, and is taxed at the individual rate.

Alternatively, the IRS Form 1120S, Compensation of Officers line item is transferred to the applicant's individual IRS Form 1040. "S" corporation depreciation and depletion may be added back to income in proportion to the applicant's share of the corporation's income. In addition, the income must also be reduced proportionately by the total obligations payable by the corporation in less than one year.

Income Analysis: Partnership Tax Returns (IRS Form 1065). A partnership is formed when two or more individuals form a business, and share in profits, losses, and responsibility for running the company. Each partner pays taxes on his/her proportionate share of the partnership's net income. Both general and limited partnerships report income on IRS Form 1065, and the partners' share of income is carried over to Schedule E of IRS Form 1040.

The lender must review IRS Form 1065 to assess the viability of the business. Both depreciation and depletion may be added back to the income in proportion to the applicant's share of income. Income must also be reduced proportionately by the total obligations payable by the partnership in less than one year.

Note: Cash withdrawals from the partnership may have a severe negative impact on the partnership's ability to continue operating, and must be considered in the income analysis (for example obtaining a letter from the corporation's accountant addressing the withdrawal).

D. Non-Employment Related Applicant Income

Alimony, Child Support, or Maintenance Payments- these forms of income may be considered effective only if:

- payments are likely to be received consistently for the first 3 years of the mortgage;
- the applicant provides the required documentation, which includes a copy of the final divorce decree; legal separation agreement; court order; or voluntary payment agreement;
- the applicant can provide acceptable evidence that payments have been received during the last 12 months, such as: cancelled checks; deposit slips; tax returns; or court records.

Notes: Periods less than 12 months may be acceptable, provided the lender can adequately document the payer's ability and willingness to make timely payments.

Interest and Dividends**-** Interest and dividend income (including tribal distributions or per capita income from gaming) may be used provided that tax returns or account statements support a 2-year receipt history. This income must be averaged over the 2 years. Subtract any funds that are derived from these sources and are being used for the cash investment, before calculating the projected interest or dividend income.

Per Capita Income**-** This is a form of income commonly paid to tribal members from tribal trust income (the most common example is income derived from tribal gaming operations). Per capita income may be used provided that tax returns support a 2 year receipt history. This income must be averaged over the 2 years. Subtract any funds that are derived from these sources and are being used for the cash investment, before calculating the per capita income.

Treaty Rights/Trust Land Income**-** Because of treaties with the federal and state governments, tribal members may have non-taxable income derived from sources such as timber sales on trust lands, lease payments from trust lands, or fishing and gathering rights. Such income is not reported through normal tax reporting methods.

Additionally, lenders must find a way to verify and confirm the amount of non-taxable income (acceptable forms of this documentation include statements from the tribe, the local BIA office, sales receipts, or banking records). Any income derived from non-taxable income should be averaged over a 2-year period.

Notes Receivable**-** Notes receivable income may be used to qualify an applicant if the following documentation is provided: a) a copy of the note to establish the amount and length of payment, and b) evidence that these payments have been consistently received for the last 12 months through deposit slips, cancelled checks, or tax returns.

Military Income**-** Military personnel not only receive base pay, but often are entitled to additional forms of pay, such as income from variable housing allowances; clothing allowances; flight or hazard pay; rations; and proficiency pay. These types of additional pay are acceptable when analyzing an applicant's income as long as the probability of such pay to continue is verified in writing.
Note: The tax-exempt nature of some of the above payments should also be considered.

VA Benefits**-** Direct compensation for service-related disabilities from the Department of Veterans Affairs (VA) is acceptable, provided the creditor receives documentation from the VA. However, education benefits used to offset education expenses are not acceptable as a form of income.

Government Assistance Programs**-** Income received from government assistance programs is acceptable as long as the paying agency provides documentation indicating that the income is expected to continue for at least 3 years. If the income from government assistance programs will not be received for at least 3 years, it may not be used in qualifying.
Unemployment income must be documented for 2 years, and there must be reasonable assurance that this income will continue. This requirement may apply to seasonal employment.

Mortgage Credit Certificate(MCC)- If a government entity subsidizes the applicant's mortgage payments, either through direct payments or through tax rebates, these payments can be considered as acceptable income if verified in writing. Either type of subsidy may be used to directly offset the mortgage payment before calculating the qualifying ratio. The expense involved in obtaining an MCC is considered a prepaid expense and cannot be financed in the closing costs.

Education Benefits- Education benefits received to offset education expenses are not considered income.

Eligible Investment Properties- Follow the steps in the table below to calculate an investment property's income or loss if the property to be subject to a mortgage is an eligible investment property.

1	Subtract the monthly payment (PITI) from the monthly net rental income of the subject property. Note: Calculate the monthly net rental by taking the gross rents, and subtracting the 25 percent reduction for vacancies and repairs
2	Does the calculation in Step 1 yield a positive number? • If yes, add the number to applicant's monthly gross income. • If no, and the calculation yields a negative number, consiter it a recurring monthly obligation

Rental Income- Rent received for properties owned by the applicant is acceptable as long as the lender can document the stability of the rental income through: a) A current lease; or b) a rental history over the previous 24 months that is free of unexplained gaps greater than 3 months (such gaps could be explained by student, seasonal, or military renters, or property rehabilitation). A separate schedule of real estate is not required for rental properties as long as all properties are documented on the Uniform Residential Loan Application.

Note: The underwriting analysis may not consider rental income from any property being vacated by the applicant, except under the circumstances described below.

Rental Income From Applicant Occupied Property- The rent for multiple unit property where the applicant resides in one or more units and charges rent to tenants of other units may be used for qualifying purposes.

- Projected rent for the tenant-occupied units may not be used for qualifying income. IRS Form 1040, Schedule E must be used to establish the multi-unit rental history, in conjunction with current leases.

Income from Roommates in a Single Family Property- Income from roommates or a boarder in a single family property occupied as the applicant's primary residence is not acceptable. However, the rental income from a roommate or boarder may be considered effective, if shown on the applicant's tax return. If not on the tax return, rental income paid by the roommate/boarder may not be used in qualifying.

Documentation Required to Verify Rental Income- Analysis of the following required documentation is necessary to verify all applicant income: a) IRS Form 1040 Schedule E; and b) Current leases/rental agreements.

Analyzing IRS Form 1040 Schedule E- The IRS Form 1040 Schedule E is required to verify all rental income. Depreciation shown on Schedule E may be added back to the net income or loss. Positive rental income is considered gross income for qualifying purposes, while negative income must be treated as a recurring liability. The lender must confirm that the applicant still owns each property listed, by comparing Schedule E with the real estate owned section of the URLA.

Exclusion of Rental Income From Property Being Vacated by the Applicant- Underwriters may not consider any rental income from an applicant's principal residence that is being vacated in favor of another principal residence. This policy ensures that an applicant has sufficient income to make both mortgage payments without any rental income. This applies solely to a principal residence being vacated in favor of another principal residence. It does not apply to existing rental properties disclosed on the loan application and confirmed by tax returns (Schedule E of form IRS 1040).

E. Non-Taxable and Projected Income

Certain types of regular income may not be subject to federal tax. Such types of nontaxable income include: some portion of Social Security, some Federal government employee retirement income, Railroad Retirement Benefits, certain types of disability and public assistance payments, child support, military allowances, and some state government retirement income. When these types of income are present, the amount of continuing tax savings attributed to regular income not subject to federal taxes may be added to the applicant's gross income. The percentage of non-taxable income that may be added cannot exceed the appropriate tax rate for the income amount. Additional standard allowances for dependents are not acceptable. To do this, the creditor:

1) should document and support the amount of income grossed up for any non-taxable income source, and
2) should use the tax rate used to calculate the applicant's last year's income tax.

If the applicant is not required to file a Federal tax return, the tax rate to use is 25 percent.

Additionally, projected or hypothetical income is not acceptable for qualifying purposes.

Exception: An exception for projected income is permitted for income from the following sources: cost-of-living adjustments; performance raises; and bonuses. However, for these exceptions to apply the income must be a) verified in writing by the employer; and b) scheduled to begin within 30 days of loan closing.

<u>*Projected Income for New Job*</u>- Projected income is acceptable for qualifying purposes for an applicant scheduled to start a new job within 60 days of loan closing if there is a guaranteed, non-revocable contract for employment. The lender must verify that the applicant will have sufficient income or cash reserves to support the mortgage payment and any other obligations between loan closing and the start of employment. Examples of this type of scenario are teachers whose contracts begin with the new school year, or physicians beginning a residency after the loan closes fall under this category. The loan is not eligible for endorsement if the loan closes more than 60 days before the applicant starts the new job. To be eligible for endorsement, the lender must obtain from the applicant the most recent 30 day's pay stubs or other acceptable evidence indicating that he/she has started the new job.

<u>6. Types of Liabilities</u>

Creditors must evaluate all liabilities, defined as on-going debt, for applicants to the Section 184 program. This section outlines the basic requirements of such a review.

Recurring Obligations- Recurring obligations include: a) all installment loans; b) revolving charge accounts; c) real estate loans; d) alimony; e) child support; and f) other continuing obligations.

Debt to Income Ratio Computation for Recurring Obligations- The creditor must include the following when computing the debt to income ratios for recurring obligations:

- Monthly housing expense (including principal, interest, taxes, insurance, and condo/HOA fees; and
- Additional recurring charges extending 10 months or more, such as payments on installment accounts, child support or separate maintenance payments, revolving accounts, and alimony

Debts that will be paid in full in less than 10 months must be included if the amount of the debt affects the applicant's ability to pay the mortgage during the months immediately after loan closing, especially if the applicant will have limited or no cash assets after loan closing.

Note: Monthly payments on revolving or open-ended accounts, regardless of the balance, are counted as a liability for qualifying purposes even if the account appears likely to be paid off within 10 months or less.

Revolving Account Monthly Payment Calculation- If the credit report shows any revolving accounts with an outstanding balance but no specific minimum monthly payment, the payment must be calculated as the greater of 5 percent of the balance or $10.

Note: If the actual monthly payment is documented from the creditor or the lender obtains a copy of the current statement reflecting the monthly payment, that amount may be used for qualifying purposes.

Reduction of Alimony Payment for Qualifying Ratio Calculation- Since there are tax consequences of alimony payments, the lender may choose to treat the monthly alimony obligation as a reduction from the applicant's gross income when calculating qualifying ratios, rather than treating it as a monthly obligation.

Real Estate Loans (Departure Residence)- When an applicant is vacating his or her current principal residence that has a mortgage but he or she will not be selling this residence prior to purchasing a home with Section 184 financing, loan approval is based on establishing evidence that the applicant is relocating with a new employer or being transferred by the current employer to an area beyond a reasonable commuting distance (50 miles or more).

If the applicant meets this standard then they must also meet the three following requirements:

1. Income and Credit Qualification. Applicant must income and credit-qualify based on **both full PITIs**. HUD will not include rental income from the departure residence in the applicant's debt to income ratio.

2. Value of Departure Residence. The departure residence must evidence a loan to value ratio of 75 percent or less, as determined by either a current (no more than 180 days old) residential appraisal, or by comparing the unpaid principal balance to the original sales price of the property.

3. Rental lease agreement: The applicant must have: a) an executed rental lease with a one- year term that will commence on or before the purchase of the new home (provide copy of the lease, evidence of the security deposit, and/or evidence the first month's rent was paid to the

homeowner; and b) the applicant must provide evidence that the home will be sold after closing by providing listing agreement and/or documentation to support pending sale in lieu of renting.

Contingent Liability- A contingent liability exists when an individual is held responsible for payment of a debt if another party, jointly or severally obligated, defaults on the payment.
The contingent liability policies described in this topic apply unless the applicant can provide conclusive evidence from the debt holder that there is no possibility that the debt holder will pursue debt collection against him/her should the other party default.

Contingent Liability on Mortgage Assumptions- Contingent liability must be considered when the applicant remains obligated on an outstanding mortgage secured by a property which has been sold or traded within the last 5 years without a release of liability.

Exemption- When a mortgage is assumed, contingent liabilities need not be considered if any of the following factors are present:
a) The originating lender of the mortgage being underwritten obtains, from the servicer of the assumed loan, a payment history showing that the mortgage has been current during the previous 24 months;
b) Value of the property, as established by an appraisal or the sales price on the HUD-1 Settlement Statement from the sale of the property, results in a loan-to-value (LTV) ratio of 75 percent or less;
c) There was a divorce and the applicant's ex-spouse was awarded both the property and responsibility for payment of the mortgage as a part of the legal separation or divorce settlement. A copy of the separation agreement or divorce decree is acceptable evidence. The liability must have been current prior to the date of the divorce or legal separation, while the applicant was liable.
d) The applicant was transferred by his or her employer and is covered by a home sale guarantee plan. A copy of the relocation agreement is acceptable evidence.

Contingent Liability on Cosigned Obligations- Contingent liability applies, and the debt must be included in the underwriting analysis, if an individual applying for a mortgage is a cosigner/co-obligor on a car loan; student loan; mortgage; or any other obligation. If the creditor obtains documented proof that the primary obligor has been making regular payments during the previous 12 months and does not have a history of delinquent payments on the loan during that time, the payment does not have to be included in the applicant's monthly obligations.

Projected Obligations- Debt payments, such as a student loan, car lease, or balloon-payment note scheduled to begin or come due within 12 months of the mortgage loan closing, must be included by the creditor as anticipated monthly obligations during the underwriting analysis.
Debt payments do not have to be classified as projected obligations if the applicant provides written evidence that the debt will be deferred to a period outside the 12-month timeframe. If a borrower has a loan in forbearance or deferment due to a hardship (not due to being in school), then the projected student loan amount must be included by the creditor as anticipated monthly obligations during the underwriting analysis.

Obligations Not Considered Debt- Obligations not considered debt, and therefore not included in the debt-to-income ratio, include: federal, state, and local taxes; Federal Insurance Contributions Act (FICA) or other retirement contributions, such as 401(k) accounts (including repayment of debt secured by these funds); commuting costs; union dues; open accounts with zero balances (at time of loan application); automatic deductions to savings accounts; child care; and voluntary deductions.

7. Determining Ability to Pay

Once the lender has reviewed the applicant's income and liabilities, the lender can then determine the applicant's ability to pay. This section describes the criteria for this calculation under the Section 184 program.

Debt-to-Income Ratio- Without compensating factors as discussed below, to qualify for a Section 184 loan, the ratio or the applicant's total monthly debt to total monthly income at the time of the loan application cannot exceed 41 percent.

The monthly payment shall include all of the items discussed in section 6 above as well as all re-occurring expenses related to the purchase of the home including (but not limited to) principal and interest payments on the mortgage; hazard insurance premiums; flood insurance premiums; real estate taxes; and homeowner or condominium association dues.

Compensating Factors- A debt-to-income ratio up to 43 percent may be acceptable if at least two out of the five compensating factors listed below are presented. Compensating factors include, but are not limited to:

- Minimal housing increase (no more than 15 percent)
- Strong credit history (credit score of 700 or greater)
- The applicant has additional income that has not been included in qualifying that will, if used as qualifying income, reduce the debt-to-income ratio to below 41 percent
- The applicant has substantial cash reserves after closing (six months or greater)
- Loan-to-Value ratio is 75 percent or less

Projected Increase in Housing Expense- The projected increase in the applicant's housing expense from his or her present housing expense must be carefully analyzed. If the new housing expense will significantly exceed the previous housing expense, then the lender must determine if the applicant has either exhibited an ability to accumulate savings or can otherwise show that he or she has the ability to manage financial affairs.

For example, if a person's rent payment was $50, and their proposed new mortgage is $800 a lender can favorably consider the applicant for approval if it can be shown that the applicant was able to save on a monthly basis the $750 difference between the present rent charge and the projected future mortgage payment for a period of time exceeding 6 months.

Lenders may also document other reasonable compensating factors to allow for loan approval, despite the significant increase in projected housing expense (however, the projected mortgage interest deduction on the applicant's federal income tax return, while beneficial to the applicants, is not a compensating factor and may not be included in the analysis.)

Payment History on Previous Mortgages or Rental/Residence- The lender must include a recent 24-month history of mortgage, rental, or other residency. Verification sources can include credit report, mortgage payment information from the financial institution, verification of rent from landlord and/or other alternative documents to support residency. All documentation must cover a 24-month payment history and identify the address and amount of monthly payment.

Underwriting multi-unit properties (two, three, and four unit properties)- When evaluating the viability of a multi-unit property the underwriter must evaluate the following factors.

1. The rental income from all units must be equal to or greater than the monthly mortgage payment.
2. Applicants must qualify for the mortgage based on income, credit, and the necessary cash to close.
3. The applicant(s) must demonstrate their financial ability to pay the full PITI; projected rents cannot be used to offset the monthly mortgage payment.
4. The applicant must have cash reserves of six months of mortgage payments (PITI) after closing.

8. Section 184 Loan Limits

Loan Limit Maximum/Ceiling- The maximum loan limit for every eligible county is determined by taking the lesser of the national conforming loan limits, or 150 percent of the median home value in that county.

The national conforming loan limits are set by the Federal Housing Financing Agency (currently set at $417,000 in the lower 48 states and $625,000 in Alaska). At no time will a one-unit loan be allowed to exceed these limits under the Section 184 program.

The median home price for every eligible county is determined annually by using the American Community Survey (ACS) issued by the U.S. Census Bureau. Once the median home price is determined by the ACS, this amount is multiplied by 150 percent. For example, in 2012, the median home price for Nassau County, Florida was $216,300.67. Thus, 150 percent of the median home value was determined by taking this number and multiplying it by 1.5, which gave the county a loan limit of $324,451(since this number was less than the conforming loan limit of $417,000).

For a county with a higher median cost home, such as San Diego County, California, this works slightly differently. In 2012, the median home price for San Diego County, California was $349,167. Thus, 150 percent of the median home value was determined by taking this number and multiplying it by 1.5, which would allow a loan of up to $523,751. However, loan limits are set as the lesser of 150 percent of the median home value or conventional loan limits; thus, the actual program loan limit for San Diego County, California is $417,000.

Note- Refinance transactions involving a refinance of an existing Section 184-guaranteed mortgage with a new Section 184-guaranteed mortgage are exempt from these new loan limits so long as the new mortgage does not exceed the current principal balance of the existing Section 184 mortgage.

Loan Limit Minimum/Floor- In many tribal areas, the remoteness of the tribe can inflate the cost of construction. Additionally, there are many rural areas where the cost calculation of existing stock is impacted by the predominance of manufactured housing or housing in need of significant rehabilitation. This has resulted in some areas having an artificially low median housing price that is not an accurate indicator of the true cost for standard, quality housing.

In these areas, HUD will apply a standardized maximum loan limit "floor," which will be 65 percent of the national conforming loan limit (65% **X** 417,000 = $271,050). The mortgage amount in these areas would be the greater of either 150 percent of the current median home price, or 65 percent of the national conforming limit. Practically, what this means is that no county will have a loan limit less than $271,050.

Notes-

- When calculating the loan limits described above, lenders do not need to include the guarantee fee as a part of the loan.
- At no time will the Section 184 program guarantee a mortgage amount that exceeds the appraised value of a home.
- If an applicant takes out a secondary loan on the property, the combined indebtedness of the mortgages may, however, exceed the loan limit maximum, but not the appraised value.
- Loan limits for all counties eligible for a Section 184 insured mortgage can be found on the Section 184 program HUD webpage: http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/ih/homeownership/184.

9. Maximum Applicant Financing.

As dictated by the Section 184 statute, the maximum loan eligible for a guarantee can never exceed 97.75 percent of the appraised value of the property (or 98.75 percent if the value of the property is $50,000 or less).

However, the maximum mortgage amount that HUD will insure on a purchase transaction is calculated by multiplying the appropriate loan-to-value (LTV) factor by the **lesser of** the property's (1) sales price subject to certain allowable adjustments, **or** (2) appraised value.

To be eligible for a Section 184 guarantee, the applicant must make a required investment of at least 2.25 percent of the lesser of the appraised value or the sales price of the property (or 1.25 percent if the value of the property is $50,000 or less). Closing costs (non-recurring closing costs, pre-paid expenses, and discount points) may not be used to help meet the applicant's minimum required investment.

Note- When calculating the LTV limits above, do not include the Section 184 guarantee fee as a part of the loan.

A. Settlement Requirements Needed to Close

General procedures- Lenders must comply with all provisions of the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA).

Lender-Paid Closing Costs- Lenders may pay the applicant's closing costs, prepaid items, and the loan guarantee fee. Costs paid in this manner cannot be included in the sales price when calculating the acquisition cost, and the maximum mortgage amount and must be disclosed on the HUD-1 Settlement Statement.

Seller Paid Closing Costs- Sellers may pay the applicant's closing costs, prepaid items, and the loan guarantee fee. Costs paid in this manner cannot be included in the acquisition cost when determining the maximum mortgage amount and the lender paid closing costs must be disclosed on the HUD-1 Settlement Statement. Additionally, the amount paid by the seller cannot exceed 6 percent of the executed sales contract.

Items that Cannot Be Financed- closing costs, prepaid items, discount points, per diem interest, non-realty items, real estate broker fees, and mortgage broker fees are all costs that cannot be financed with a Section 184 loan.

Prepaid items- These items are collected at closing to cover: accrued and un-accrued hazard insurance premiums; taxes and interim interest; and other similar fees and charges.

Discount points- These are paid by the applicant and become a part of the total cash required to close. They are not eligible for meeting the minimum down payment requirement.

Per Diem Interest- The lender must use a minimum of 15 days of per diem interest when estimating prepaid items on the Good Faith Estimate (GFE). To reduce the burden on applicants whose loans were scheduled to close at the end of the month, but did not due to unforeseen circumstances, lenders and applicants may agree to credit the per diem interest to the applicant and have the mortgage payments begin the first of the succeeding month. The dollar amount of the per diem interest credit may not be used to reduce the applicant's required cash investment.

Non-Realty- Chattel or personal property items that the applicant agrees to pay for separately, including the amount subtracted from the sales price when determining the maximum mortgage, are included in the total cash requirements for the loan.

Real Estate Broker Fees- If an applicant is represented by a real estate broker and must pay any fee directly to the broker, that expense must be included in the total of the applicant's settlement requirements, and appear on the HUD-1 Settlement Statement. If the seller pays the broker fee as part of the sales commission, it is not considered an inducement to purchase, or part of the seller contributions limitation, as long as the seller is paying only the normal sales commission for that market. Any additional seller-paid commission to the broker is considered an inducement to purchase. To determine if the seller paid a buyer-broker fee in addition to the normal sales commission for the market, the lender must obtain a copy of the original listing agreement, and compare it with the HUD-1 Settlement Statement.

Mortgage Broker Fees- The lender must include mortgage broker fees in the total of the applicant's cash settlement requirements and on the HUD-1 Settlement Statement, if he/she pays a fee directly to a mortgage broker. This requirement applies only when the applicant independently engages a mortgage broker exclusively to seek financing, and pays the broker directly. The mortgage broker cannot be the same as the originating lender.

B. Acceptable Source of Applicant's Funds

Under the Section 184 program, the applicant is required to make a minimum downpayment into the transaction of at least 2.25 percent of the lesser of the appraised value of the property or the sales price. Additionally, the applicant must have sufficient funds to cover applicant-paid closing costs and fees at the time of settlement. Funds used to cover the required minimum downpayment, as well as closing costs and fees, must come from acceptable sources, and must be verified and properly documented.

Verification of Earnest Money Deposit- The lender must verify the deposit amount and the source of funds used by the applicant. Satisfactory documentation includes a copy of the applicant's cancelled check and a bank statement, as well as a verification of deposit or bank transaction statement dated after the earnest money deposit check has cleared.

Acceptable sources of applicant funds- can include earnest money deposit; savings and checking accounts; gift funds from a relative or charity which does not directly or indirectly receive a financial benefit as a result of making the gift; secured funds; sales proceeds; trade equity; sale of personal property; savings bonds and other similar certificates; cash on hand; IRAs; 401(k) and Keogh accounts; stocks and bonds; private savings clubs; sweat equity; tribal/government assistance; documented rent credit (determined by the appraisal); and employer assistance plans.

Checking or Savings Accounts- If there is a large increase in a checking or savings account, or the account was opened recently, an explanation and evidence of source of funds must be obtained by the lender. To make this determination, a lender must receive 2 months of recent bank statements.

Cash on Hand- Applicants who have saved cash at home, and are able to adequately demonstrate the ability to do so, are permitted to have this money included as an acceptable source of funds to close the mortgage. To include cash saved at home when assessing the applicant's cash assets, the money must be verified, whether deposited in a financial institution, or held by the escrow/title company, and applicant must provide satisfactory evidence of the ability to accumulate such savings. To use this source, the lender must satisfactorily determine the reasonableness of the accumulation based on the applicant's income, the time period of savings, spending habits, and history of using financial institutions.

IRAs, 401(k), and other retirement accounts- Up to 60 percent of the value of these accounts may be included in the underwriting analysis, unless the applicant provides conclusive evidence that a higher percentage may be withdrawn, after subtracting any federal income tax and withdrawal penalties.

Notes: Redemption evidence is required; and the portion of the assets not used to meet closing requirements may be counted as reserves at the 60 percent rate.

Stocks and Bonds- The lender may use the most recent monthly or quarterly statement provided by the stockbroker or financial institution managing the portfolio to verify the value of stocks and bonds. The applicant's actual receipt of funds must be verified and documented.

Savings Bonds- Government-issued bonds are counted at the original purchase price, unless eligibility for redemption and the redemption value are confirmed. Actual receipt of funds must be verified.

C. Property Related Acceptable Sources of Funds

This topic contains information on personal property or real property as acceptable sources of applicant funds.

Sale of Personal Property- If the applicant intends to sell personal property items (such as cars, recreational vehicles, stamp, coin, or baseball card collections) to obtain funds required for closing, the applicant must provide conclusive evidence the items have been sold and satisfactory estimate of their worth. The estimated worth of the items being sold may be in the form of published value estimates, such as those issued by automobile dealers, philatelic or numismatic associations or a separate written appraisal by a qualified appraiser (with no financial interest in the loan transaction). Only the lesser of this estimate of value or the actual sales price less any obligation(s) secured by the personal property, is considered as assets to close. The assets received must be deposited and verified.

Sales Proceeds from Real Property- The net proceeds from an arms-length sale of a currently owned property may be used for the cash investment on a new house. The applicant must provide a fully executed HUD-1 Settlement Statement as satisfactory evidence of the accrued cash sales proceeds. If the property has not sold as of the time of underwriting, the applicant's approval must be conditioned upon verifying the actual proceeds received by the applicant. The lender must document both the actual sale and the sufficiency of the net proceeds required for settlement.

Note: If the property will not be sold by the time of the subject settlement, the property must meet the departure residence requirements and the existing mortgage must be included as a liability for qualifying purposes.

Trade Equity- The applicant may agree to trade his or her home to the seller as part of the cash investment. The amount of the applicant's equity is determined by subtracting all liens against the property being traded plus any real estate commission due from the lesser of that property's appraised value or sales/trade price. Evidence of ownership is also required. Any remaining balance on the lien not covered by the equity cannot be included as an acquisition cost for the new loan.

The appraisal must be a residential appraisal (conventional, HUD, or VA) and not more than 120 days old on the date of the trade. Additionally, if the property being traded has a HUD-FHA insured mortgage, HUD-FHA assumption processing requirements and restrictions apply.

Rent Credit- The cumulative amount of rental payments that exceed the appraiser's estimate of fair market rent may be considered accumulation of the applicant's cash investment. The rent with option to purchase or other rent credit agreement and the appraiser's estimate of market rent must be included in the loan package.

If the sales agreement reveals that the renter has been living in the property (or one owned by the seller) rent-free, or that an agreement was made allowing the renter to occupy at a rental amount considerably below fair market in anticipation of eventual purchase of the property, this must be treated as an inducement to purchase with an appropriate reduction to the sales price when calculating the applicant's acquisition cost.

Exceptions may be granted in situations such as when a builder fails to deliver the property at an agreed-to time, and then permits the applicant to occupy that property or another unit for less than market rent temporarily until construction is complete.

Sweat Equity- Labor performed or materials furnished by the applicant on the property being purchased may be considered as the equivalent of a cash investment to the extent of the estimated cost of the work or materials. (Sweat equity may be "gifted" subject to both the gift requirements and additional requirements shown below.)

On existing construction, only the repairs or improvements listed on the appraisal or work plans or specifications are eligible for sweat equity. Any work completed or materials provided before the appraisal is made are not eligible. On proposed construction, the sales contract must indicate the work to be performed by the homebuyer during the construction.

The applicant's labor may be considered as the equivalent of cash if the applicant can demonstrate his or her ability to complete the work in a satisfactory manner. The lender must document the contributory value of the labor through either the appraiser's estimate or a cost estimating method. Delayed work (on-site escrow), clean-up, debris removal, and other general maintenance cannot be included as sweat equity. Sweat equity on a property other than the property being purchased is not acceptable.

Compensation for work performed on other properties must be monetary and be properly documented and verified if the funds are to be used to close the subject transaction. If materials furnished by the applicant are to be used to purchase a property, then the market value of the materials must be provided.

Note- There can be no cash back to the applicant with sweat equity; sweat equity cannot be used as a source of down payment funds on a single-close loan.

Borrower Funded Land Improvements – Improvements made to land already owned (or controlled through a valid lease on trust land) by an applicant may be used to meet the 2.25 percent cash investment. For these improvements to be valued they must be included in the appraised value of the land. Additionally for these funds to count towards the applicant's cash investment the underwriter must document that the improvements came from an acceptable source of funds.

Unacceptable Borrowed Funds- Signature loans, cash advances on credit cards, and similar unsecured financing are not permissible sources of funds for the borrower.

D. Loans as Source of Funds

Certain types of loans are acceptable sources of the applicant's own funds to close. However, the monthly payments arising from these loans must be included in the appropriate qualifying ratios. The monthly payments under the insured mortgage and the secondary loan cannot exceed the applicant's ability to repay the mortgage (the debt to income ratio can never exceed 43%, as outlined in Section 7 of these Guidelines).

Secured Loans- The applicant may borrow against any collateral authorized under federal, state, or tribal law, provided that the loan is fully secured by assets such as stocks, bonds, and real estate other than the property being purchased. Unsecured loans are not allowed.

Loans secured against deposited funds, where repayment may be obtained through extinguishing the asset, do not require consideration of repayment for qualifying purposes. The asset securing the loan may not be included as assets to close, or otherwise considered available to the applicant.

Secondary Financing- Any financing other than the first mortgage that creates a lien against the subject property is considered secondary financing. Secondary financing can be provided by governmental entities, family members, or even lenders.

The Section 184 guaranteed first mortgage, when combined with any type of second mortgage or other junior lien may not result in cash back to the applicant.

The combined loan-to-value (CLTV) ratio of all liens cannot exceed 100 percent of the appraised value of the property. (Note: The cost to acquire the property is the sales price plus applicant-paid closing costs, discount points, repairs and rehabilitation expenses, and prepaid expenses.) The lender must use the maximum approved credit limit of the existing subordinate lien to calculate the CLTV ratio.

The required monthly payments for both the Section 184 guaranteed first mortgage and the second mortgage, plus other housing expenses and all recurring charges, cannot exceed the applicant's reasonable ability to repay (the debt-to-income ratio can never exceed 43 percent, as outlined in Section 7 of these Guidelines).

Unless the applicant provides conclusive evidence that the borrowed funds do not require repayment (e.g., some thrift and retirement plans or various loans secured by deposited funds or a soft second mortgage from the tribe or IHA/TDHE), the monthly debt resulting from the loan must be included in the applicant's qualifying ratios.

However, the Section 184 program reserves the right to reject any secondary financing that does not serve the needs of the intended applicant, or if the costs to the participant outweigh the benefits derived by the applicant.

Any time secondary financing is part of the transaction, an executed copy of the loan document(s) describing the terms of the secondary financing and the HUD-1 Settlement Statement must be maintained in the endorsement binder.

The Section 184 guaranteed first mortgage cannot exceed the program loan limits, however the combined indebtedness of the mortgages may exceed the loan limit maximum as outlined in Section 9.

The source, amount, and repayment terms must be disclosed in the mortgage application, and the applicant must acknowledge that he/she understands and agrees to the terms of the secondary financing.

Determining Whether Governmental Funds are a Loan or Gift- Governmental entities may provide either gift or loan funds for tribal members in order meet the required cash investment. However, when governmental funds are used HUD regulations require that there must be a binding commitment accompanying the assistance that guarantees an appropriate useful life of the funds. Confusion can arise when lenders mistake this binding commitment with a loan agreement.

When a lender is making the determination of whether governmental funds being used are to be treated as a gift or a loan, the key piece of analysis is whether there ever is an expectation that the borrower will need to repay the funds while the borrower is living in the Section 184 guaranteed home. So long as there is no expectation that the borrower will repay the loan(whether on a monthly basis or any other time period) while living in the Section 184 guarantee home, then the funds should be treated like a gift and don't need to be included in the qualifying ratios mentioned in the "secondary financing" guidance above.

Family Member Loans- Family members may lend the applicant, on a secured basis, 100 percent of the applicant's required funds to close. This may include the downpayment, closing costs, prepaid expenses, and discount points.

The second mortgage must have equal monthly payments and may not contain any balloon provisions. The minimum term for a second mortgage is 5 years. If the family member providing the secondary financing borrows those funds, the source may not be any entity with an interest in the sale of the property.

The loan from the family member, whether borrowed from an acceptable source or the family member's own savings, is to be secured by the subject property, and only the family member provider may be the noteholder. Section 184 will not approve any form of securitization of the note that results in any entity other than the family member being the noteholder, whether at loan settlement or at any time during the mortgage life cycle.

When the funds loaned by the family member are borrowed from an acceptable source, the applicant may not be a co-obligor on the note. *Example:* A son may not be the co-obligor on the note used to secure the money borrowed by his parents which, in turn, was loaned to the son for the downpayment on the property.

Second Mortgages- HUD will permit second mortgages from lenders when the purchase price of the home is higher than Section 184 loan limits. However, the second mortgage must be included in qualifying ratios. Additionally, the second mortgage cannot substitute for the 2.25 percent down payment and payment of closing costs and prepaid expenses by the applicant or an eligible donor. Lastly, the combined first and second mortgages cannot exceed the appraised value.

E. Gift Funds

For funds to be considered a gift there must be no expected or implied repayment of the funds to the donor by the applicant.

An outright gift for the cash requirement is acceptable if the donor is the applicant's relative, the applicant's employer or labor union, a charitable organization, a governmental agency or public entity (specifically including tribal entities) that has a program to provide homeownership assistance to low-and-moderate-income families or first-time homebuyers, or a close friend with a clearly defined and documented interest in the applicant.

The gift donor may not be a person or entity with an interest in the sale of the property, such as the seller, real estate agent or broker, builder, or any entity associated with them. Gifts from these sources are considered inducements to purchase and must be subtracted from the sales price. No repayment of the gift may be expected or implied.

Regardless of when gift funds are made available to an applicant, the lender must be able to determine that the gift funds were not provided by an unacceptable source, and were the donor's own funds. When the transfer occurs at closing, the lender is responsible for verifying that the closing agent received the funds from the donor for the amount of the gift, and that the funds were from an acceptable source.

Only family members may provide equity credit as a gift on a property being sold to other family members.

The Section 184 program deems the payment of consumer debt by third parties as an inducement to purchase. When someone other than a family member has paid off debts or other expenses on behalf of the applicant the funds must be treated as an inducement to purchase, and there must be a dollar-for-dollar reduction to the sales price when calculating the maximum insurable mortgage.

The lender must document any gift funds through a gift letter, signed by the donor and applicant. The gift letter must show the donor's name; address; telephone number; specify the dollar amount of the gift; the nature of the donor's relationship to the applicant; and that no repayment is required.

Note: The dollar for dollar reduction to the sales price also applies to gift funds not meeting the requirements that the gift be for downpayment assistance, and provided by an acceptable source.

<u>Tribe/TDHE Down Payment/Buy Down Assistance</u>- Tribes/TDHEs using their own funds can provide assistance to whomever they choose. In this case, the tribe/TDHE (donor) should provide a written verification that the source of assistance is from their own funds and not provided from NAHASDA, HOME funds, or any other HUD funds unless eligibility is established.

If the tribe/TDHE is using NAHASDA funds, it must comply with all applicable NAHASDA regulations. Specifically, the assistance is generally limited to families with income at or below 80% of median income in the area.

Interest Rate Buy Downs- Interest rate buydowns are designed to reduce the applicant's monthly payment during the early years of the mortgage. At settlement, an escrow account is established. Each month, the servicing lender draws down an amount equal to the difference between the principal and interest payment (P&I) at the Note rate, and the P&I at the buydown rate. Interest rate buy downs will be acceptable on purchase transactions only.

Buydown funds may come from the seller, the lender, the applicant, or any other interested party. Funds from the seller or any other interested third party are considered seller contributions, and must be included when considering the limit on seller contributions.

While interest rate buydowns are permitted, the loan must be underwritten at the note rate. Lenders may not underwrite at the buydown rate. Buydowns may be treated only as a compensating factor.

Lenders are responsible for ensuring that the buydown must not result in a reduction of more than two percentage points below the interest rate on the note; the bought-down rate may increase by no more than one percentage point per year; the applicant's payment may change only once a year; the funds described in the escrow agreement are placed in escrow before or at closing; and a copy of the fully-executed escrow agreement, signed by the applicant and provider of funds, is provided in the case binder.

Any remaining escrow funds not distributed at the time the mortgage loan is prepaid in full must be applied to the outstanding balance due on the mortgage. In the event of foreclosure, the claim for mortgage guarantee benefits must be reduced by the amount remaining in the buydown escrow account, if any.

The escrow agreement may provide that assistance payments continue for applicant(s) who assume the mortgage must not permit reversion of undistributed escrow funds to the provider if the property is sold or the mortgage is prepaid in full, and must not allow unexpended escrow funds to be provided to the applicant in cash, unless the applicant established the escrow account.

Escrow funds must be held in an escrow account by a financial institution supervised by a Federal or state agency. Payments must be made by the escrow agent to the lender or servicing agent. If escrow payments are not received for any reason, the applicant is responsible for making the total payment as described in the mortgage note.

The maximum debt-to-income ratio may never exceed 41 percent when an interest rate buy down occurs.

10. Adjustments to Sales Price

The following items are allowable adjustments to the sales amount that will be financed. However, at no time can the amount of money that is sought to be financed exceed 97.75 percent of the appraised value of the property (or 98.75 percent if the value of the property is $50,000 or less).

Repairs and Improvements- Repairs or improvements required by the appraiser as essential for property eligibility may be eligible for inclusion in the mortgage. To be eligible for inclusion, the repairs or improvements must either be mandated by the appraiser to meet health and safety requirements, or be improvements that are allowable under the Section 184 rehabilitation loan. The requirements for rehabilitation are that a minimum of $10,000 in repairs is required in order to include rehabilitation in the financing of a Section 184 loan. By themselves, minor or cosmetic repairs that are not a specified condition in the appraisal are not eligible expenses.

Note- Repairs completed on the property by the applicant are not eligible to be included in the loan.

Energy-Related Weatherization Items- If the applicant is responsible for payment of energy-related weatherization items, then such items may be eligible for inclusion in the mortgage. Weatherization items include thermostats, insulation, storm windows and doors, weather stripping and caulking, etc. However, there are monetary caps as follows:

- $2,000 without a separate value determination;
- $3,500 if supported by a value determination by an approved appraiser or contractor; or
- More than $3,500 subject to a value determination and an on-site inspection made by an appraiser/inspector that is listed on the applicable FHA Roster or by the lender.

Seller Contributions (financing concessions) **-** These are contributions made by the seller to facilitate the sale. This can take the form of payment by the seller of applicant's closing costs, discount points, interest rate buy downs, prepaid and escrow items collected at closing, payments of mortgage interest (but not principal), and loan guarantee fee.

Seller contributions are not subtracted dollar for dollar from sales price, but are limited to six percent of the contract sales price before a dollar-for-dollar reduction would be required. The normal applicant's closing costs paid by the seller (or other interested third party) are not included in the calculation of the applicant's acquisition cost.

Inducements to Purchase (Sales Concessions) **-** Inducements to purchase include those costs that the seller pays to consummate the transaction. The value or amount of these concessions must be subtracted dollar for dollar from the sales price before the mortgage amount is computed. Inducements to purchase include decorating allowances; moving costs; and personal property items, such as cars, boats, riding lawn mowers, furniture, and televisions, given by the seller to consummate the sale. The value of the item must be subtracted from the sales price of the property and the appraised value if it has not been deducted by the appraiser.
Certain items, depending upon local custom or law, may be considered as part of the real estate transaction, with no adjustment to sales price or value necessary. Such items include ranges, refrigerators, dishwashers, washers and dryers, carpeting, and window treatments. The appraiser determines if these items affect value.

Replacement of existing equipment or other realty items, such as carpeting or air conditioners, by the seller before closing does not require a value adjustment, provided no cash allowance is given to the applicant.

Seller Payment of Applicant's Sales Commission on Present Residence- If the applicant is purchasing a property with a mortgage to be guaranteed by HUD, and is also selling his or her present residence, and the builder or seller of the property being purchased agrees to pay any portion of the applicant's sales commission on the present house, that amount must be treated as a sales concession and subtracted dollar for dollar from the sales price.

Similarly, if the applicant does not pay a real estate commission on the sale of a present home, this constitutes a sales concession if the real estate broker or agent is involved in both transactions and the seller of the property purchased by the applicant pays a real estate commission exceeding that typical for the area. In these situations, the amount paid by the seller above the normal real estate commission is considered a sales concession and must be subtracted from the sales price of the property being purchased.

Excess Rent- Excess rent credit must be subtracted dollar for dollar from the sales price before calculating the mortgage amount.

Escrow Holdback- If repairs or improvements as addressed on the sales contract or appraised value cannot be completed before loan closing, the lender must establish an escrow holdback, using Mortgagee's Assurance of Completion form (HUD Form 50118), to ensure eventual completion of all required repairs. At closing, the lender must collect an amount equal to 1.5 times the cost of the repair or improvement as established by the bid from the contractor. The lender must obtain a final inspection to confirm completion of the repairs and must document payment in full for the repair/improvement.

Real Estate Transaction Items- Certain items, depending upon local custom or law, may be considered as part of the real estate transaction, with no adjustment to sales price or value necessary. Such items include ranges, refrigerators, dishwashers, washers/dryers, carpeting, and window treatments. The appraiser determines if these items affect value. Replacement of existing equipment or other realty items, such as carpeting or air conditioners, by the seller before closing does not require a value adjustment, provided no cash allowance is given to the applicant.

11. Transactions Affecting Maximum Mortgage

Certain types of loan transactions affect the amount of financing available to an applicant and how the maximum mortgage amount is calculated. These transactions include: identity of interest transactions, properties with non-occupying co-applicants, three-and-four-unit properties, and properties where a house will be constructed by the applicant.

Identity-of-Interest Transactions- An identity-of-interest transaction occurs when there is a sale between parties with a family or business relationship. These transactions are restricted to a maximum loan-to-value ratio of 85 percent. However, an underwriter may grant an exception to this policy in the following circumstances:

- A family member purchases another family member's principal residence. If the seller's investment property is sold from one family member to another, the maximum mortgage is the lesser of 85 percent of the appraised value, or the appropriate LTV factor applied to the sales price, plus or minus required adjustments.
- An employee of a builder purchasing one of the builder's new homes or models as a principal residence.
- A current tenant purchasing the property that he or she has rented for at least 6 months predating the sales contract. A lease or other written evidence must be submitted verifying occupancy.
- Sales by corporations that transfer employees out of an area, purchase the transferred employee's home, and then resell the residence to another employee.

Non-Occupying Co-applicants and Co-Signers- A non-occupying applicant transaction involves two or more applicants where one or more of the applicant(s) will not occupy the property as his/her primary residence. These transactions are restricted to a maximum loan-to-value ratio of 75 percent. However, use of the standard Section 184 loan-to-value ratio is available for applicants related by blood (e.g., parent-child, siblings, aunts-uncles/nieces-nephews), or for unrelated individuals who can document evidence of a family-type, longstanding and substantial relationship not arising out of the loan transaction.

Note: If a parent is selling to a child, the parent cannot be the co-applicant with the child, unless the LTV is 75 percent or less.

All applicants, regardless of occupancy status, must sign the security instrument and mortgage note. Please note however, that cosigners do not execute the security instrument, nor take title to the property; however, they still must sign the mortgage note.

If the LTV exceeds 75 percent, a mortgage with non-occupying applicant(s) is limited to a one-unit property. The non-occupying applicant arrangement may not be used to develop a portfolio of rental properties. The financial contribution by the non-occupying applicant and the number of properties owned may indicate that the family members are acting as "strawbuyers." An applicant may only have one Section 184 mortgage at a time; therefore, an applicant that already has a Section 184 mortgage may not act as a non-occupying co-applicant or co-signor.

<u>Building on Own Land</u>- An applicant is eligible for maximum financing if he/she is building a home on land that he/she already owns or acquires separately, and receives no cash from the settlement (this section shall also apply when an applicant has a valid lease on land held in trust). When an applicant is building on their own property, the appropriate loan-to-value (LTV) limits are applied to the lesser of the appraised value of the proposed home and land, or documented cost of the property.

The documented cost of the property includes the builder's price, or sum of all subcontractor bids and materials, cost of the land (if the land has been owned more than 6 months or was received as an acceptable gift, the value of the land may be used instead of its cost), and interest and other costs associated with any construction loan obtained by the applicant to fund construction of the property.

Equity in the land (value or cost, as appropriate, minus the amount owed) may be used for the applicant's entire cash investment. However, the applicant may not receive more than minimal cash at closing ($250 or less). If the borrower receives more than $250 cash at closing, the loan is limited to 85% of the appraised value. Replenishing the applicant's own cash expended during construction is not considered "cash back," provided that the applicant can substantiate with cancelled checks and paid receipts all out-of-pocket funds used for construction.

To determine if an applicant has made the required 2.25 percent cash investment or its equivalent in land equity when building on his/her own land, all such mortgage transactions must be summarized on the appraisal. Additionally, the calculated LTV ratio must reflect as it does on other purchase transactions, the lesser of the sales price or appraised value.

<u>12. Loan Parameters</u>

Loan Term- Loan maturity may not exceed 30 years, and must be fully amortized over the life of the loan (balloon mortgages are not permitted).

Interest Rates- Lenders will set interest rates for guaranteed mortgages commensurate with the nature of the loan, the level of risk, and other customary factors. The Section 184 program prohibits the use of adjustable rate or balloon mortgages.

Interest rates on loans covering construction must remain fixed throughout the term of the loan. Since the loan is fully guaranteed, the interest rate should reflect current market rates for permanent, rather than construction financing.

Amount- The mortgage amount requested for the reservation of funds may not exceed the maximum mortgage calculated, and must be within the applicant's ability to pay. The total dollar value is determined by rounding down if the dollar value is .49 or less; otherwise, the amount is rounded up to the next dollar.

Payment Factors- Lenders may use a six-digit factor for the monthly principal and interest payment. A tolerance not to exceed 4 cents per $1,000 is permitted.

Property Flipping- If the owner of a property is attempting to sell a home they acquired within the previous 90 days from the date of the contract of sale to the applicant that property will not be eligible for a Section 184 loan.

Underwriters may grant an exception to this rule under the following circumstances:

- All transactions must be arms-length, with no identity of interest between the buyer and seller or other parties participating in the sales transaction. Some ways that the lender can ensure that there is no inappropriate collusion or agreement between parties is to assess and determine the following: the seller holds title to the property; LLCs, corporations, or trusts that are serving as sellers were established and are operated in accordance with applicable state and Federal law; no pattern of previous flipping activity exists for the subject property, as evidenced by multiple title transfers within a 12-month time frame (chain of title information for the subject property can be found in the appraisal report); the property was marketed openly and fairly.

- In cases when the sales price of the property is 20 percent or more over and above the seller's acquisition cost, an exception is possible only if the lender verifies and docments that the seller has completed sufficient legitimate renovation, repair, and rehabilitation work on the subject property to substantiate the increase in value or, in cases where no such work is performed, the appraiser provides appropriate explanation of the increase in property value since the prior title transfer; and orders a property inspection and provides the inspection report to the purchaser before closing (the inspector must have no interest in the property or relationship with the seller, and must not receive compensation for the inspection from any party other than the lender).

13. Land Value/Appraisal Review

The appraisal process is the lender's tool for determining if a property meets the minimum requirements and eligibility standards for a Section 184 guaranteed mortgage. Underwriters bear the responsibility for ensuring that the appraised property is adequate security for the proposed mortgage. For this reason, the program requires underwriters to perform a thorough analysis of all property appraisals with a focus on the major risk factors found in these three areas:

- Value
- Property Condition
- Fraud

Underwriters shall ensure that the appraisal properly reports the facts, analyses and conclusions made by the appraiser. All risk factors should be disclosed, analyzed and reported. A thorough review of the appraisal by the underwriter will assist in mitigating these risks.

The Section 184 Program follows FHA appraisal guidance found in the HUD Handbook 4150.2 *Valuation Analysis for Single Family One- to Four- Unit Dwellings,* Appendix C – *Appraisal of Single Family Homes on Native American Lands* and Appendix D – *Valuation Protocol*. A full copy of HUD Handbook 4150.2 can be obtained at www.hud.gov.

It is imperative that the underwriter verify that the assigned Appraiser and Reviewer have the required competencies to perform the valuation. Specific knowledge should include:

- An understanding of the property type and the unique property rights in Indian country.
- The local geographic area and market.
- Any unique market conditions.

Any underwriter with questions about appraisal guidelines and/or specific appraisal issues may e-mail questions to 184Appraisals@HUD.gov

A. **Purpose of the Review**

The Underwriter's review of the appraisal must accomplish the following:

- Verify that the appraisal report is complete, clear, and prepared according to industry-accepted appraisal techniques.
- Determine that the appraiser's methodology is appropriate and that the appraiser's conclusions are consistent, sound, supportable, logical, and based on data in the appraisal report.
- Identify all property-related conditions and requirements that must be satisfactorily resolved before the property can become the security for a guaranteed loan.
- Confirm that the photographs accurately reflect the appraiser's description of the subject and comparable properties.

B. **Specific Underwriting Considerations**

When reviewing the appraisal, the underwriter should consider the items listed below for each section of the appraisal, in addition to the lender's required standard review.

If the underwriter is not satisfied with content of the appraisal after considering the following items, he/she should request additional information from the appraiser until a comfort level for approval or rejection has been reached. If any of the items below cannot be satisfied the underwriter must explain in writing the sound reason why that requirement can be relaxed.

1. **Appraisal Section – SUBJECT:**
   a. The property address and legal description on the appraisal must match the address shown on the contract and 1003.
   b. The applicant named on the appraisal must match the contract and the Uniform Residential Loan Application.
   c. The name of the seller must match the current owner of public record.
   d. The occupant must be the owner on a refinance. The Occupant and Assignment Type must be consistent with owner occupancy.
   e. If the property is a PUD or condominium, verify if there is a fee, and if so, whether that fee is shown. Verify that the Title Binder supports this.
   f. All condominiums must meet program requirements.
   g. Any disclosed current or recent listing for the sale of the subject property within the past 12 months must be explained.

2. **Appraisal Section – CONTRACT:**
   a. The appraiser must analyze the contract and provide a narrative of the analysis.
   b. The contract price and date shown on the appraisal must match the information on the contract, including all addendums in the file.
   c. The appraiser must address any financial assistance to be paid by any party on behalf of the applicant. Verify that the amount and contributing party shown is correct.
   d. All seller concessions must be disclosed.
   e. The appraiser's comments must be consistent with entries.

3. **Appraisal Section – NEIGHBORHOOD:**
   a. If property values are listed as something other than stable or increasing, the appraiser must provide an explanation.
   b. Declining market trends require two comparable sales within 90 days and two listings must be provided in the Sales Comparison Approach.
   c. Supply/demand must be listed as a shortage or in balance; other entries must be explained.
   d. The location type must be consistent with the location map and neighborhood description.
   e. Verify that the appraised value is between the low and high ranges. Analyze whether the appraiser addresses a value greater than 10 percent of the predominant value.
   f. The present land use must add up to 100 percent.
   g. The marketing time must be 6 months or less, or an explanation must be documented.
   h. The appraiser's comments must be consistent with entries.

4. **Appraisal Section – SITE:**
   a. The site dimensions must be shown, including square footage or acreage.
   b. If the subject property has a large parcel, the appraiser must address excess or surplus land.
   c. Both the zoning classification and description must be shown.
   d. When zoning is "legal/non-conforming" the appraiser must address whether the subject can be rebuilt if it is destroyed.
   e. When the appraiser indicates the subject's zoning compliance is legal non-conforming or illegal, the specific conditions, verification sources, and impact on the value/marketability must be adequately addressed and analyzed.
   f. The current use of the property must be the highest and best use.
   g. The appraiser must indicate if the water and sewer is public or private.
   h. The appraiser must address non-public utilities and off-site improvements.
   i. The appraiser must address whether the property is on a public or private street.
   j. The appraiser must address whether the subject property is in a flood hazard area.
   k. Review public mapping sites such as Zillow, MapQuest or Google Earth to determine if the Neighborhood Section is complete and accurate or if any adverse site conditions exist. The appraiser should describe any and all adverse site conditions. Determine if any adverse site conditions make the property ineligible for Section 184 financing.
   l. The property must be free of any adverse external factors or land use changes.
   m. The appraiser's comments must be consistent with entries.

5. **Appraisal Section – IMPROVEMENTS:**
   a. The description of the improvements must be consistent with the photographs.
   b. The appraiser should comment on whether there is an Accessory Dwelling Unit (ADU). The gross living area of the ADU must not be included in the value in any way other than an amenity.

c. The appraiser must use the UAD (Uniform Appraisal Dataset) condition ratings (C1-C6).
d. The difference between the year built and effective age must be reasonable.
e. The exterior and interior items must be in average or better condition.
f. Interior photographs must be provided.
g. The appraiser must indicate any evidence of infestation, dampness, or settlement.
h. There must be a permanent heat source.
i. The room count and square footage must agree with the room count and square footage in the sales comparison and cost approach, if completed.
j. The subject must be free from physical deficiencies that would affect livability, soundness, or structural integrity.
k. The property should conform to the neighborhood; if it does not, the appraiser should comment.
l. The appraiser's comments must be consistent with entries.

6. Appraisal Section – SALES COMPARISON:

The sales comparison approach may only be used for tribal trust or individual trust properties if sufficient sales are available.

a. Appraiser must be able to adequately communicate about the local tribal housing market.
b. Sales used may be up to 18 months old for tribal trust properties.
c. The appraiser may use sales obtained from the local tribal or Bureau of Indian Affairs (BIA) realty offices.
d. When appraising fee simple properties, if no credible comparable properties are available, the appraiser must provide a narrative justification discussing the market prior to using other supporting sources and the cost approach.
e. The appraiser must provide the number of comparable listings and the number of closed sales in the subject neighborhood, along with a price range. This information must confirm the information shown in the Neighborhood Section.
f. The sale dates for comparable properties must be within 6 months, or addressed with adequate support.
g. When time value adjustments are made, the appraiser must provide commentary and proper support. This must be consistent with the Neighborhood Section.
h. Comparable properties must be within close proximity of the subject.
i. The comparable properties must have sales prices and gross living areas that bracket with the subject. Review the sales comparison grid for inconsistent bracketing of sales price and gross living area. Failure to properly bracket is a common overvaluation technique.
j. Verify that the comparable sourcing is acceptable.
k. The appraiser must provide the sales type and financing type, along with the amount of any concessions, as applicable.
l. Comparable properties should have similar characteristics that would most likely impact marketability (style, square footage, bedroom count, etc.).
m. Determine if the subject property has any auxiliary features (studio, mother-in-law suite (ADU), guest quarters, etc.). Verify that marketability is demonstrated by the comparables used. Document if the property should be considered a 2-4 family property.
n. If the subject has a unique design (log home, earth berm, etc.), the appraiser must comment and address the impact on marketability.
o. No single value adjustment for any of the comparable properties used should be greater than 10 percent.

p. Net and gross value adjustments greater than 15 percent and 25 percent respectively for any of the comparable properties must be addressed by the appraiser.
q. Value adjustments must be made consistently for the same item descriptions.
r. At least three closed comparable sales must be provided and mapped with relation to the subject property. The location of these comparable sales must be reasonable.
s. Below-grade square footage must not be used in the overall value calculation.
t. Any "upgrade" adjustments (pool, outbuildings, etc.) must be addressed by the appraiser.
u. The appraiser must research the sale or transfer history of the subject and comparable sales.
v. Determine if the appraiser's research revealed any prior sales or transfers for the subject in the past 3 years from the effective date of the appraisal.
w. Determine if the appraiser's research revealed any prior sales or transfers for the comparables in the past year form the effective date of the appraisal.
x. The subject and comparable properties must be void of foreclosure or non-arm's length transactions.
y. The appraiser must provide a summary of the sales comparison approach. The appraiser must provide an explanation for comparable selection. The appraiser must explain the rationale for adjustments. The appraiser must explain any adjustments exceeding guidelines. The appraiser must explain which comparable sale or sales is/are given most weight for consideration and why.
z. The appraiser's comments must be consistent with entries.

7. Appraisal Section – RECONCILIATION:

a. Is the value indicated by the Sales Comparison Approach or the Cost Approach? If an approach is not developed, the appraiser must report and explain this.
b. Verify that the appraisal is marked appropriately "as is", "subject to repairs", "subject to completion" or "subject to an inspection".
c. Determine whether "subject to" conditions are adequately explained. The appraiser must provide an itemized cost-to-cure in the report.
d. If "subject to" verify that conditions or inspection reports are attached.
e. The appraisal must be less than 120 days old at closing. If it is not, an update is required.

8. Appraisal Section – ADDITIONAL ITEMS:

a. Verify that there are reasonable/sufficient comments when items such as second kitchens, in-law suites, commercial influences, and condition adjustments are present.
b. Verify that the subject sketch includes dimensions and layout. Determine that it is consistent with the appraiser's description.
c. Verify that the subject layout appears to be functional, or if there are functional deficiencies, ensure that they are addressed.
d. The subject and comparable photographs are included and legible.
e. The subject and comparables photographs look similar.
f. All addendums that are referenced are attached.
g. If no similar or good comparable properties were available, the appraiser explained to what extent the market was researched.
h. For rural or large acreage properties, the improvements, use, and outbuildings appear to be residential in nature.
i. For large acreage properties, the comparable properties have similar lot sizes. To make this comparison, the appraiser must indicate the typical lot size.
j. Verify that the appraiser has addressed any excess or surplus land.
k. Verify that the appraisal is signed and dated.

l. Verify that the appraiser is licensed or state certified
m. Verify that a copy of the license or state certification has been attached.

9. Appraisal Section – COST APPROACH:

The cost approach is the most reliable approach in determining a home's value when it is on trust land. The Cost Approach should be used when an insufficient number of sales are available.

a. No value is given for tribal trust land.
b. Value of improvements may be eligible.
c. Land value may be assigned to individual trust land.
d. Verify that the site value is supported.
e. The remaining economic life estimate must be provided and exceed the term of the proposed new loan.
f. When the cost approach is used, the appraiser must provide the Marshall & Swift form 1007 or a similar such service. The reference page numbers of cost tables or factors used must be provided.
g. The underwriter must be able to replicate the cost value using the information provided.
h. The Marshall & Swift form 1007 must not include any values that are not allowed by Section 184 for trust transactions.
i. Eligible leasehold improvements include any on-site improvements to the property that are eligible for Section 184 financing. This is inclusive of site improvements such as well/septic, utility connections, driveways, decks, patios, substantial fencing, landscaping, garages, and pools if normal and customary for the area. Off-site improvements may be pass-through expenses to the applicant if the prorated costs for roads, sidewalks, and utility connections, etc. are assessed to the lease or as an acquisition cost associated with pre-developed home site costs to lots/land.

10. Appraisal Section – PUD INFORMATION

a. Verify that the appraiser provided the homeowner's association fee on page one, if any.
b. The legal name of the project provided must match the sales contract and title commitment.
c. All questions regarding the project and phases must be completed.
d. Determine if the homeowner's association owns or leases the common elements.
e. The appraiser must provide a description of the common elements and/or recreational facilities, if any.

11. Appraisal Section – MARKET CONDITION ADDENDUM 1004MC:

a. If foreclosures are a factor, verify that the appraiser addressed trends and the impact on the value.
b. Verify that the form is fully completed.
c. Verify that the appraiser has provided detailed comments, if not fully completed.

12. Appraisal Section – CONDOMINIUM MARKET CONDITION INFORMATION:

a. The property must be FHA approved.
b. Verification that 50 percent or more of the units are owner-occupied.
c. The appraiser must provide the condominium fee on page one, if any.
d. The appraiser must address any trends for the project.
e. The legal name of the project must be provided and match the sales contract and title commitment.
f. All questions regarding the project and phases must be completed.
g. Determine if the association owns or lease the common elements.

h. The appraiser must provide a description of the common elements and/or recreational facilities, if any.

13. Appraisal Section – ADDITIONAL CERTIFICATION:

a. The appraiser must indicate whether he/she has performed prior services on the subject property in the past 3 years.

14. Appraisal Section – NEW CONSTRUCTION / REHABILITATION:

a. The appraisal must provide all of the exhibits required by Section 184.
b. The exhibits must be consistent with the description provided by the appraiser.
c. The appraiser must complete the appraisal as if the improvements have been completed.

15. Manufactured Homes – General Eligibility Criteria

a. Minimum gross living area is 570 sq. ft.
b. Must be built after June 15, 1976.
c. When located on fee simple land, the home must be classified and taxed as real estate.
d. Home must be de-titled.
e. HUD labels and the data plate must be located.
f. Missing label information can be obtained from http://www.ibts.org/label_req.htm The cost is approximately $50 and takes 3-5 business days to receive.
g. On trust land, HUD will accept whatever standard or code the tribe has adopted.
h. On fee simple land, the home must have a permanent foundation, and the home must be attached to the ground with mechanical fasteners. An engineer's certification is required for the foundation and attachment of the home to the ground.
i. The lender must provide to HUD either a certification to the state that the foundation substantially complies with the HUD Handbook Permanent Foundation Guide for Manufactured Housing, or evidence that it is installed in accordance with stated adopted standards, or certification from an engineer that the foundation is of sufficient size and strength to support the unit(s), and is attached in a manner that will withstand normal wind and snow loads.

14. Waivers

If an applicant does not meet any of the above requirements then a lender can petition the Director of the Office of Loan Guarantee for a waiver from that policy. All waiver requests should be put in writing, include a detailed explanation and appropriate documentation to support the waiver request, and either e-mailed to the Director or sent to 451 Seventh Street SW, Room 5143, Washington DC 20410. HUD will attempt to provide a decision to the waiver request within 15 business days of receipt.

A. Waiver Involving Credit Reputation or Financial Capacity

If an applicant does not meet any of the above requirements related to credit reputation or financial capacity, but the lender believes that the applicant is very likely to successfully meet the mortgage obligations, then a lender can petition the Director of the Office of Loan Guarantee for a waiver from that policy with no additional steps.

B. Waiver Involving Collateral

If an applicant does not meet any of the above requirements related to the subject property (the collateral), or it is necessary for HUD to review the physical characteristics of the property, then a lender can petition the Director of the Office of Loan Guarantee for a waiver from that policy. However, before a waiver can be considered either HUD will need to complete an environmental review under 24 CFR Part 50, or the tribe will need to perform an environmental review and receive approval of a request for release of funds in accordance with 24 CFR Part 58.

C. Waiver Involving People with a Disability

Lenders may petition for a waiver of the applicable loan limit to reflect a higher purchase price for features that would make the property accessible to a person with a disability. In addition, transactions covered by Section 504 of the Rehabilitation Act or the Fair Housing Act may require HUD to consider a waiver of loan limits as a reasonable accommodation. Lenders whose borrowers require accessible features may contact the Director of the Office of Loan Guarantee for more information or to request a waiver that affords access to the Loan Guarantee Program to persons with disabilities.

15. Reservation of Funds

After the Direct Guarantee underwriter has evaluated the credit reputation and capacity of the applicant, as well as whether the proposed property is adequate security for the loan, the underwriter is to make a reservation of funds request by filling out HUD Form 50143. So long as HUD Form 50143 is properly filled out and adequate funding exists a cohort number will be issued. However, any lender who closes a loan or allows construction to begin before receipt of a cohort number, runs the risk that the Congressionally appropriated funds could be exhausted.

Cohort numbers issued by HUD are valid for 60 days, but if necessary, lenders may request an extension of a cohort number from HUD. In addition, cohort numbers for loans when the lender is carrying the interim construction can be valid for up to 180 days depending on the date of the oldest credit documentation.

16. Declining a Section 184 Loan

When a lender determines for whatever reason that they are not willing or able to process a Section 184 loan, they are not only to notify the borrower as required by law they are also to notify HUD of this fact. This should be done by sending a copy of the adverse action notice to HUD by e-mail at Section184@HUD.gov, or by postal mail to 451 Seventh Street SW, Room 5143, Washington DC 20410.

FOR FURTHER INFORMATION: Contact Matthew Douglas at (202)-402-6434. Persons with hearing or speech impairments may access their Area Office of Native American Programs via TTY by calling the Federal Information Relay Service at (800) 877-8339.

/s/

Jemine A. Bryon, Acting Assistant Secretary
for Public and Indian Housing