CHAPTER 4: BORROWER ELIGIBILITY

4.1 OVERVIEW

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

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

SECTION 1: EVALUATING BORROWER INCOME

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

Loan Originators use income information to: (1) help determine whether an applicant is eligible for a loan; (2) calculate the applicant's ability to repay a loan; and (3) determine the amount of the loan and the amount of payment subsidy the household can obtain. When reviewing an applicant's repayment income, the Loan Originator must determine whether the income is stable and dependable. The Loan Originator will generally need to look at two years of history to determine the dependability of the income. In addition, the Loan Originator must determine that there is a reasonable expectation that the income will continue. This section provides guidance for verifying and calculating income for each of these purposes. Additional examples are based on Housing and Urban Development (HUD) Handbook 4350.3.

A. Key Concepts for Income Determinations

1. Income Definitions

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

- **Annual Income** is the amount of income that is used to determine an applicant's eligibility for assistance. Annual income is defined as all amounts, monetary or not, that go to, or are received on behalf of, the applicant/borrower, co-applicant/co-borrower, (even if the household member is temporarily absent), or any other household member; all amounts anticipated to be received from a source outside the family during the 12-month period, all amounts that are not specifically excluded by regulations, and amounts derived (during the 12-month period) from assets to which any member of the family has access.

- **Adjusted Income** is used to determine whether a household is income eligible for payment assistance. It is based on annual income and provides for deductions to account for varying household circumstances and expenses.

- **Repayment Income** is used to determine whether an applicant has the ability to make monthly loan payments. It is based only on the income attributable to parties to the note and includes some income sources excluded for the purpose of adjusted income. Repayment Income is used during servicing **only** to determine if a borrower is eligible for a Moratorium or Reamortization as described in Paragraph 5.5, of HB-2-3550.

2. Whose Income To Count

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

An individual permanently confined to a nursing home or hospital may not be applicant or co-applicant but may continue as a family member at the family's discretion. The family has a choice with regard to how the permanently confined individual's income will be counted. **The family may elect <u>either</u> of the following**:

- ***Include*** the individual's **income and receive allowable deductions** related to the medical care of the permanently confined individual; or
- ***Exclude*** the individual's **income and not receive allowable deductions** based on the medical care of the permanently confined individual.

Exhibit 4-1 is a table which lists whose income is to be counted.

Exhibit 4-1

INCOME TO BE COUNTED

Members	**Employment Income**	**Other Income** (including income from assets)
Applicant, Co-Applicant/Borrower	Yes	Yes
Spouse	Yes	Yes
Other Adult	Yes	Yes
Permanently Confined Family Member	Optional*****	Optional*****
Dependents (children under 18)	No	Yes
Full-time Student over 18	See Note	Yes
Non-Members		
Foster Child	No	No
Foster Adult	No	No
Live-in Aide	No	No

NOTE: The earned income of a full-time student 18 years old or older who is not the Applicant, Co-Applicant/Borrower, Spouse, or Adult member of the household is excluded after it exceeds $480.

***Remember**: The family chooses at loan closing to include or exclude the permanently confined individual's income.

3. Income Limits

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

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

4. Applicant Certification and Verification Requirements

Each applicant must provide the income, expense, and household information needed to enable the Agency to make income determinations. Most of this information is provided on the application, but some additional follow-up with the applicant may be required, as described in Paragraph 3.8. The applicant should be requested to provide two years of history for a reasonable determination of income. The documentation required will vary with the source of income. In some instances, less than two years of history may be acceptable when the Applicant provides, and the Loan Originator documents sound justification. For example, an applicant whose compensation changed from salary to commission income with the same employer in a similar job position may be considered to have dependable and stable income. In other instances, more than two years of history may be required. For example, when an applicant's income varies significantly from year to year, the Loan Originator should review a longer work history to establish an average income. Information provided by the applicant must be verified by the Loan Originator.

Whenever verification from a third party is requested, a copy of *Form RD 3550-1, Authorization to Release Information*, **must** accompany the request. Authorization from each adult household member on the *Form RD 3550-1* permits the Loan Originator/Servicer to ask for, and verification sources to release, the needed information.

The verification and certification formats that are provided in Appendix 2 are not official Agency forms. They are samples that may be adapted as needed for particular circumstances. In some instances the same format can be used whether a third party is providing the verification or the applicant is making a certification.

5. Stable and Dependable Income

The Agency has no minimum history requirement for employment in a particular position. The key concept is whether the applicant has a history of receiving stable income and a reasonable expectation that the income will continue. The Loan Originator must carefully assess the applicant's income to establish whether it can reasonably be expected to continue for the next two years (e.g. child support and contract income). The applicant must provide an explanation letter for employment gaps in excess of 30 days unless their income history is clearly seasonal in nature. The Loan Originator must review the employment gap explanation to make a determination on the applicant's ability to receive stable and dependable income. If the Loan Originator determines that an applicant's income source is unstable and undependable, the income must be excluded from repayment but included in annual income.

- **Wage and Salary Income.** Income from employment may include a base hourly wage or salary, overtime pay, commissions, fees, tips, bonuses, housing allowances, and other compensation for personal services of all adult members of the household. When the applicant demonstrates a two-year history of stable or rising income, current income from each of these sources may be used unless there is evidence to the contrary (such as the employer's indication that such income is NOT likely to continue).

Example – Stable Income

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

Example – Dependable Income

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

- **Self-employment Income.** Income based on a two-year history of self-employment, in the same line of work, is an acceptable indicator of stable and dependable income.

Example – Self-Employment, Commission and Other Irregular Income

Julie McAhren sells beauty products door-to-door on consignment. She makes most of her money in the months prior to Christmas but has some income throughout the year. She has no formal records of her income other than a copy of the IRS Form 1040 she files each year. With no other information available, use the income reflected on Julie's copy of her Form 1040 as her annual income and make the income adjustments according to Attachment 4-C.

Betty House sells real estate on commission. She makes most of her money during the summer months. She has no formal records of her income other than a copy of a 1099 and the Tax Return (Form 1040) she files each year. The gross earning on the 1099 should not be used as her annual income. Use the income and other information on the tax return in conjunction with Attachment 4-C to calculate the self-employment income.

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

Examples – Other Sources of Income

Janis Phillips is not always well enough to work full-time. When she is well, she works as a typist with a temporary agency. Last year was a good year and she worked a total of nearly six months. This year, however, she has more medical problems and does not know when or how much she will be able to work. Because she is not working at the time, it will be best to exclude her employment income and remind her that she must report the date when she resumes work.

Sam Shah receives social security disability. He reports that he works as a handyman periodically. He cannot remember when or how often he worked last year; he says it was a couple of times. Sam's earnings appear to fit into the category of nonrecurring, sporadic income that is not included in annual income. Tell Sam his earnings are not being included in his annual income this year, but he must report any regular work or steady jobs he takes.

Ken Hammer receives social security disability. He reports that he works as a handyman periodically. He cannot remember when or how often he worked last year. He says it was a couple of times last year, however, his tax return does not indicate any gross wages from his handyman work. Mr. Hammer's income would be considered nonrecurring and sporadic income and would not be included in annual or repayment income.

Jane Smith receives child support payments for her sixteen and a half-year old son. She has a copy of the court appointed child support agreement, which states that the child support will end when son turns 18, and a computer print-out of a 12 month child support payment history. The child support income should be counted in the annual income but excluded from the repayment income calculation because it is not expected to continue in the near future.

- **Irregular Income**: Irregular income from employment are earnings that may vary on a weekly, monthly, or seasonal basis depending on the type of income. This income is not guaranteed, nor received on a regular basis. Irregular income includes over-time, bonus, second job, part-time, and seasonal income. Irregular income may be considered stable when the applicant has worked in the same line of work for at least two years. Loan Originators may accept less than a two-year history (but no less than 12-months) of irregular income if there is a strong likelihood that the applicant will continue to receive that income. Loan Originators must establish the income trend and calculate a monthly average for the irregular income. When the applicant receives seasonal unemployment compensation, it must be clearly associated with seasonal layoffs expected to recur and be reported on the applicant's federal income tax returns. Commission-based pay is also considered irregular income. Additional guidance on calculating commission income is provided in Attachment 4-C.

Examples – Seasonal Income

Ross Bosser is a roofer who works from April through September. He does not work in rain or windstorms. His employer is able to provide information showing the total number of regular and overtime hours Ross worked during the past three years. To calculate Ross's anticipated income, use the average number of regular hours over the past three years times his current regular pay rate, and the average overtime hours times his current overtime rate.

Bob Digger is a landscaper. He works from April through September. He does not work in bad weather. His employer is able to provide information showing the total number of regular and overtime hours Mr. Digger worked during the past year. To calculate Mr. Digger's anticipated income, use the average numbers of regular hours worked over the past year times his current hour's rate, and the average overtime hours times his current overtime rate.

- **Less Than Two Years of History.** In some cases, a history of less than two years is acceptable. The determination requires a careful analysis by the Loan Originator. This may include an applicant who is either new to the work force or has returned to the work force after an extended absence. In these cases, the Loan Originator must look at the period of time the applicant has been employed, the employer's evaluation of the likelihood of continued employment (if available), education or training that qualifies the applicant for his/her current position (typically applies to skilled positions), and reasons for absence from the work force in making a determination that income is stable and likely to continue. Information provided by the applicant must be verified by the Loan Originator.

Example – Less Than Two Years History

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

B. Using UniFi and the Income Worksheet to Compute Income

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

4.3 SOURCES OF INCOME

Loan Originators will consider sources of income to determine annual and repayment income. This section provides guidance on income that will and/or will not be counted.

A. Income Considered for Annual and Repayment Income

For <u>annual income</u>, consider income from the following sources that are attributable to any household member. For <u>repayment income</u>, consider income from the following sources that are: attributable to parties to the note and represent a source of dependable income.

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

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

- Child care/pet-sitting,
- Medical/life insurance,
- Car/mileage allowance,
- Stock options,
- Discounts for merchandise,
- Sport/concert/movie tickets or entertainment,
- Charity donations in employee name,
- Any reimbursement of actual work expenses**.**

Housing allowances may include, but are not limited to:

- **Cash or non-cash contributions paid on behalf of the applicant/borrower by persons not living in the house,**
- Allowances for members of the Armed Forces,
- Allowances for members of the Clergy,
- Allowances paid by employer.

2. The <u>net</u> income from the operation of a farm, business, or profession. The following provisions apply:

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

   - Farm and non-farm business losses are considered "0" in determining annual income. A negative amount must **not** be used to offset other family income.

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

- Any withdrawal of cash or assets from the operation of a farm, business, or profession, or salaries or other amounts distributed to family members from the farm, business, or profession, will be included in income, except to the extent the withdrawal is for reimbursement of cash or assets invested in the operation by a member of the household.

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

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

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

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

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

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

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

Example – Adjustment for Prior Overpayment of Benefits

Dan Steven's social security payment of $250 per month is being reduced by $25 per month for a period of six months to make up for a prior overpayment. Count Dan's social security income as $225 per month for the next six months and as $250 per month for the remaining six months.

5. Payments in lieu of earnings, such as unemployment and disability compensation, worker's compensation, and severance pay. Unemployment income requires a two year documentation of receipt and reasonable assurance of its continuance. This may be appropriate for individuals employed on a seasonal basis (e.g., farm laborers, construction workers, etc.).

6. Public assistance **except** as indicated in **Paragraphs 4.3 C. and D.**

7. Periodic allowances, such as:

   - Alimony and child support awarded by the court in a divorce decree or separation agreement unless the applicant certifies the payments are not received, and the applicant provides documentation to the Agency that he or she has taken all reasonable legal actions to collect amounts due, including filing with the appropriate courts or agencies responsible for enforcing payment; or

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

Examples – Regular Cash Contributions

The father of a young single parent pays her monthly utility bills. On average, he provides $100 each month. The $100 per month must be included in the family's annual income.

The daughter of an elderly applicant gives her mother $175 each month to assist with her living expenses. The daughter plans to continue subsidizing her mother's expenses. The $175 per month must be included in the annual income.

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

B. Additional Income Considerations for Repayment Income

Consider these additional sources of income that are attributable to parties to the note and represent a source of dependable income for repayment income only.

1. Housing assistance payment (HAP). (HUD's Housing Choice Voucher–Homeownership Program sometimes referred to as Section 8 for Homeownership.) See Chapter 8.9 on how HAP payments should be handled. For additional information on the Housing Choice Voucher – Homeownership Program, visit http://www.hud.gov/offices/pih/programs/hvc/homeownership.

2. Adoption assistance payments in excess of $480 per adopted child.

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

4. Certain income tax credits regularly received via the applicant's employer. The two considered income tax credits are advanced earned income tax credits and mortgage credit certificates.

Examples – Advanced Earned Income Tax Credit

Aidan Conner receives an earned income tax credit (EITC) of $1,200 per year. He filed IRS Form W-5, Earned Income Credit Advance Payment Certificate, to have his employer include a portion of his EITC in his regular bi-weekly paychecks, which equated to an additional $46.15 with each paycheck. Aidan's advanced EITC can be counted as repayment income.

Jessica Jackson, who is a household member only, receives an EITC of $2,000 per year when filing her federal tax return. Since Jessica is not a party to the note, her EITC is not counted as repayment income. Even if Jessica was to decide to become the co-applicant on the application, her EITC would not be counted as repayment income since it is not received in advance through her employer.

Sara McJones, who is a self-employed hairdresser, wants her EITC to be considered when calculating her repayment income. Since a self-employed person cannot advance the EITC to themselves, her EITC cannot be counted as repayment income.

6. The full amount of student financial assistance received by household members or paid directly to the educational institution who are parties to the note. Financial assistance *includes* grants, educational entitlements, work study programs, and financial aid packages. It *does not include* tuition, fees, student loans, books, equipment, materials and transportation. Any amount provided for living expenses may be counted as **repayment income**.

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

8. Any other revenue which a Federal statute exempts will be considered **repayment income.** This includes:

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

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

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

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

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

    - Payments received under the "Alaska Native Claims Settlement Act" or the "Maine Indian Claims Settlement Act."

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

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

- Payments received from the Job Training Partnership Act.
- Income derived from the disposition of funds of the Grand River Band of Ottawa Indians.
- The first $2,000 of per capita shares received from judgment funds awarded by the Indian Claims Commission or the Court of Claims, or from funds held in trust for an American Indian tribe by the Secretary of Interior.
- Payments received from programs funded under Title V of the Older Americans Act of 1965.
- Any other income which is exempted under Federal statute.

9. Amounts paid by a State Agency to a family with a developmentally disabled family member living at home to offset the cost of services and equipment needed to keep the developmentally disabled family member in the home.
10. The special pay to a family member serving in the Armed Forces who is exposed to hostile fire.

C. Income Never Considered for Annual and Repayment Income

The following sources are *never* considered when calculating <u>annual income</u> or <u>repayment income:</u>

1. Income from the employment of persons under 18 years of age, except parties to the note and their spouses.
2. Special-Purpose Payments. These are payments made to the applicant's household that would be discontinued if not spent for a specific purpose. Payments which are intended to defray specific expenses of an unusual nature and which are expended solely for those expenses should not be considered as income. Examples include, but are not necessarily limited to, the following:

   A. Medical Expenses. Funds provided by a charitable organization to defray medical expenses, to the extent to which they are actually spent to meet those expenses.

B. Foster Children/Adults. Payments for the care of foster children or adults who are not otherwise related to the mortgagor's household by blood, marriage, or operation of law.
NOTE: Foster children are not considered members of the family. Therefore, no adjustments to income are to be made because of their presence.

C. Supplemental Nutrition Assistance Program (formerly the Food Stamp Program). Provides eligible households with electronic benefits they can use like cash at most grocery stores.

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

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

5. Amounts that are granted specifically for, or in reimbursement of, the cost of medical expenses for any family member.

6. Payments received on reverse amortization mortgages (these payments are considered draw-down on the applicant’s assets).

7. Amounts received by any family member participating in programs under the Workforce Investment Act of 1998 (29 U.S.C. 2931):

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

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

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

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

D. Additional Income Never Considered for Annual Income

In addition, the following sources are *never* considered when calculating annual income:

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

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

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

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

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

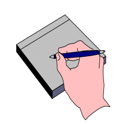
6. Housing assistance payment (HAP) (HUD'S Housing Choice Voucher Homeownership Program, sometimes referred to as Section 8 for Homeownership). The HAP is not included in the household's annual income for the purpose of determining the income category in which the household falls or determining payment assistance.

7. Adoption assistance payments in excess of $480 per adopted child.

Examples – Income Exclusions

- **<u>The Value of Food Provided through the Meals on Wheels Program or Other Programs Providing Food for the Needy</u>**. Shane Michaels received a hot lunch each day during the week in the community room and an evening meal in his apartment. One meal is provided through the Meals on Wheels program. A local church provided the other. The value of the meals he receives is not counted as income.
- **<u>Groceries provided by persons not living in the household</u>**. Melissa Bostic's mother purchases and delivers groceries each week for Melissa and her two year old. The value of these groceries is not counted as income despite the fact that these are a regular contribution or gift.
- **<u>Amounts Received Under WIC or the School Lunch Act</u>**. Cody Britt's two children receive a free breakfast and reduced priced lunches at school every day through the Special Supplemental Food Program for Women, Infants and Children (WIC). The value of this food is not counted as income.
- **<u>Deferred periodic payments of social security benefits</u>**. Andrew Ray received $32,000 in deferred social security benefits following a lengthy eligibility dispute. This delayed payment of social security benefits is treated as an asset, not as income.
- **<u>Income from training programs</u>**. Jamey Hawkins is participating in a qualified state-supported employment training program every afternoon to learn improved computer skills. Each morning, she continues her regular job as a typist. The $250 a week she receives as a part-time typist is included in annual income. The $150 a week she receives for participation in the training program is excluded in annual income.
- **<u>Advanced Earned Income Tax Credit</u>**. Connie June Fisher is eligible for an earned income tax credit that she receives in advance via her monthly paychecks from her employer. These payments are excluded from annual income
- **<u>Student financial assistance</u>**. Dylan Nessel won a scholarship from the local civic association. The association sends him a $1,000 check each semester to help with tuition costs. These funds are excluded from annual income.

E. Verifying Sources and Amounts



The Loan Originator must verify income information provided by the applicant. Paragraph 3.16, describes the different types of verifications. Paystubs and Federal Income Tax Returns with W-2s supported by oral verifications are preferred. Written verifications provided by third-party sources or documents prepared by third-party sources are required when the applicant is unable to provide sufficient recent, reliable and consistent documentation.

Each applicant must sign *Form RD 3550-1, Authorization to Release Information*, at the time of application. Copies of this form must accompany any request for verification from third-party sources. *Form SSA-3288, Consent for Release of Information*, may also be used for Social Security verifications. A complete copy of the latest filed and signed Federal Income Tax return **must** be provided by the applicant. ***IRS Form W-2, Wage and Tax Statement***, **must** be attached to the applicant's Federal Income Tax return in order for it to be considered a complete return. ***IRS Form 4506-T, Request for Transcript of Tax Return***, may be used to obtain a copy of a transcript of tax return(s) if the applicant cannot provide copies of actual returns filed. Appendix 2 provides sample certification and verification formats for a number of purposes.

The following chart provides guidance on acceptable alternative sources of verifications of different types of income:

INCOME	(If **Preferred Source** of Verification cannot be obtained without cost, **Acceptable Alternative** may be used.)
Type of Income or Verification Source	**Verification Requirements and Procedures**
WAGES or SALARY	
Paycheck Stubs or Payroll Earnings Statements for not less than four (4) consecutive weeks **Preferred Source** **AND**	The applicant must list all household members on the application and provide their employment status. The documents must be "originals." (The original paycheck stubs or payroll earnings statements may be returned to the applicant after RHS has made clear copies for the applicant file. Copies provided by any other source, such as the real estate agent, are unacceptable.) They must be consecutive and "most recent" as of the date the loan application is made; must clearly identify the applicant (or adult household member) as the employee by name and/or social security number; must show the gross earnings for that pay period and year-to-date; and must be computer-generated or typed. **Must be complemented with oral verification of employment as follows.**
Oral Verification as permitted in Paragraph 3.16 A.2. **Preferred Source**	Document in the running record the date of contact and list: The employer's name/address/phone number/contact person and title; the employee's name, date of employment, present position and probability of continued employment; the source of the phone number (applicant, realtor, yellow pages, website);and the name and title of the Rural Development employee that contacted the employer. Note: The oral verification is to confirm the applicant's present employment and to verify the probability of continued employment only. Income information should not be discussed during an oral verification of employment.
Electronic Verification **Acceptable Alternative (in lieu of paycheck stubs only)**	It must clearly identify the applicant (or adult household member) as the employee by name and/or social security number, cover the most recent pay period as of the date the initial loan application is made, and show the gross earnings for the most recent 30-day pay period and year-to-date. **<u>Must also obtain oral verification of employment.</u>**
Written Verification of Employment **Acceptable Alternative**	If paycheck stubs or earnings statements are inconsistent or not available, the Loan Originator must send *Form RD 1910-5, Request for Verification of Employment*, to each employer for verification.

Type of Income or Verification Source	Verification Requirements and Procedures
For SELF-EMPLOYED PERSONS	
Income & Expense Statement **Preferred Source**	Self-employed applicants (or adult household members) must provide current documentation of income and expenses, which cannot be older than the previous fiscal year. The Loan Originator must compare the income and expense information provided by the applicant with the last two complete Federal Income Tax Returns (IRS Form 1040) along with Schedules C & F and/or other applicable schedules, and clarify any discrepancies. *IRS Form W-2* must be attached to the applicant's Federal Income Tax return in order for it to be considered a complete return when the applicant has wage income. *IRS Form 4506-T* may be used to obtain a copy of a transcript of tax return(s) if the applicant can not provide copies of actual returns filed. (**NOTE**: Other sources of commercial software such as Turbo Tax **are not acceptable alternatives**.) Appendix 2 provides a sample format for recording business expenses.
SUPPLEMENTAL VERIFICATION	
Seasonal Employment **Preferred Source**	A household member who is a seasonal worker must provide the most recent Federal income Tax return, the prior year's W-2s and/or prior year's 1098 statements. *IRS Form 4506-T* may be used to obtain a copy of a transcript of tax return(s) if the borrower can not provide copies of actual returns filed.
Unemployment and Unemployment Benefits, Disability & Worker's Compensation, Severance Pay (except lump-sum additions) **Preferred Source**	All applicants (or adult household members) must complete *Form RD 3550-4, Employment and Asset Certification*, which provides his/her current employment status and requires them to agree to inform the Agency immediately, in writing, if the employment status changes. If an applicant has recently become unemployed, the Loan Originator should contact the former employer to confirm that the applicant is no longer employed and that re-employment is not expected. Applicants (or adult household members) receiving unemployment benefits must provide the most recent award or benefit letter prepared and signed by the authorizing agency to verify the non-employment income. Appendix 2 provides a sample format for requesting information about unemployment benefits. It must clearly identify the adult household member as the employee by name and/or social security number and cover the most recent earnings as of the date the verification is submitted.

Electronic Verification **Acceptable Alternative**	Electronic verification for that period, copy of checks, or bank statements, all showing gross earnings. All authorized deductions must be added back to checks or bank statements to reflect gross amount.
Income Tax Credits: Advanced Earned Income Tax Credits (Advanced EITC) and Mortgage Credit Certificates (MCC) Preferred Source for Advanced EITC Paycheck Stubs or Payroll Earnings Statements for not less than four (4) weeks **Acceptable Alternative for Advanced EITC and Preferred Source for MCC** Applicable IRS Form or Letter from Employer	To count towards repayment income, an applicant receiving an EITC must file IRS Form W-5, Earned Income Credit Advance Payment Certificate. An applicant receiving a MCC must file IRS Form W-4, Employee's Withholding Allowance Certificate. These IRS forms enable the applicant's employer to include a portion of the applicant's income tax credit in their regular paycheck. Income tax credits not advanced through the applicant's employer on at least a monthly basis **can not** be included in repayment income but may warrant consideration as a compensating factor. The documents must be "originals" and will be returned to the applicant after RHS has made clear copies for the applicant's file. They must be the "most recent" and identify the applicant by name and/or social security number. Signed copies of the applicable IRS Form (W-5 for Advanced EITC and W-4 for MCC) or a letter from the employer stating the applicant has executed and the employer has accepted the document.
Regular, Unearned Income (e.g., Social Security, SSI, Retirement Funds, Pensions, Annuities, Disability or Death Benefits) (except deferred periodic payments) **Preferred Source** **Acceptable Alternative**	The applicant (or adult household member) must provide a copy of the most recent award or benefit letter prepared and signed by the authorizing agency. If the date of the letter is not within the last 12 months, require the applicant to submit information updating the award, for example, a cost-of-living (COLA) payment notice, Social Security Benefits Statement, or a notice of change in benefits. Appendix 2 provides sample formats for requesting this information. The two most recent bank statements showing the amount of monthly benefits received. and IRS Form 1099 for the previous year.

Alimony or Child Support Payments **Preferred Source** ElectronicVerification **Acceptable Alternative**	The applicant (or adult household member) **must** obtain a payment history for the last 12 months from the court appointed entity responsible for handling payments. The average amount received will be used in the income calculations. The two most recent bank statements showing electronic deposit of the monthly alimony and/or child support received **AND** a copy of the court appointed divorce decree or separation agreement (if the divorce is not final) that provides for the payment of alimony or child support and states the amount and the period of time over which it will be received.

Divorce Decree
Acceptable Alternative
 	
Cancelled Checks
Acceptable Alternative
	If (**and only if**) there is not a court appointed entity responsible for handling payments, the applicant (or adult household member) may provide a copy of the divorce decree, separation agreement, or other document indicating the amount of the required support payments. If the applicant reports that the amount required by the agreement is not being received, the applicant must provide adequate documentation of the amount being received (i.e. copies of the checks or money orders from the payer, etc.) and certify the payments are being received or not received.
	
	If (**and only if**) there is not a court appointed entity responsible for handling payments and formal documents were never issued, support payments can be certified as being received or not received.

Support for Foster Children or Adults **Preferred Source**	Payments received for the care of foster children or foster adults may be considered when calculating repayment income. Documentation must be provided indicating the amount of money received for the care of foster children or adults, and the anticipated period of time the support will be provided. Appendix 2 provides a sample format for requesting information.
Verification of Assets and Income from Assets and Investments **Preferred Source**	*Form RD 3550-4, Employment and Asset Certification*, will be used to confirm that the household's combined net assets do not exceed $5,000 and whether or not assets have been disposed of for less than the fair market value in the past 2 years. Obtain the two most recent complete bank or brokerage statements showing the transaction history and the current balance. If account information is reported on a quarterly basis, obtain the most recent quarterly statement. To further document interest and dividend income the applicant must provide copy of Federal tax forms and schedules clearly identifying income from interest, dividends, and capital gains. For some assets such as mutual funds or 401(k) accounts, copies of year-end statements can provide information about annual income.

	If the Loan Originator has reasons to question the accuracy of the applicant's self certification or bank statements, the Loan Originator sends *Form RD 1944-62, Request for Verification of Deposit,* to financial institutions to verify account balances.
Verification of Gifts **Preferred Source**	If funds needed for the purchase will be provided by an organization or another person not living in the household, the Loan Originator must send the donor *Form RD 3550-2, Request for Verification of Gift/Gift Letter*, to verify whether the gift must be repaid and whether the funds have already been transferred.
DEDUCTIONS	
	For recurring gifts, if there is no history of the gift being received prior to application and the gift amount is needed to establish the applicant has repayment ability, the Loan Originator must determine and document that the gift is stable and dependable.
Type of Expense or Verification Source	**Verification Requirements and Procedures**
Disability Assistance Expenses **Preferred Source**	To qualify for disability deductions, the applicant must describe the nature of the expense, provide documentation of the costs, and demonstrate that the expense enables a family member to work. *Form RD 1944-4, Certification of Disability or Handicap,* should be used to verify the disability.
Medical Expenses **Preferred Source**	For elderly households only, allowable medical expenses may be deducted from annual income. Therefore, documentation of medical expenses is not generally required for non-elderly households. However, non-elderly households with un-reimbursed medical expenses in excess of 3 percent of annual income may receive an exception to the asset limitations. In such cases, these medical expenses must be verified as well. Appendix 2 provides a sample format for documenting medical expenses.
Childcare Expenses	Reasonable childcare expenses may be deducted from annual income. To qualify for the deduction, the applicant must: • Identify the children receiving child care and the family member who can work or go to school as a result of the care; • Demonstrate there is no adult household member available to care for the children; • Identify the child care provider, hours of care provided, and costs (e.g., letter on the child care provider's letterhead or a copy of a signed child care contract); and • Identify the educational institution and provide documentation of enrollment (if appropriate). Appendix 2 provides a sample format for requesting childcare information.

2. Timing

Documentation used to verify employment, income, assets, and deductions must be no more than 120 days old, or 180 days old for new construction, by closing date. If any of the verification documents are older than allowed, the Loan Originator must update them before settlement. The age of certain documents, such as divorce decree and tax returns, do not necessarily affect the validity of the underwriting decision. These types of documents are exempt from the document age restriction unless there is evidence that the applicant's circumstances have changed thus warranting updated verifications.

3. Projecting Expected Income for the Next 12 Months

Once an income source is verified, the Loan Originator must project the expected income from this source for the next 12 months. This projection should be based on a comparison and analysis of the figures derived from using all applicable calculation methods. To establish earning trends and avoid underestimating income (especially from overtime), the more methods used the better. However, some income sources will only lend themselves to one method. The four calculation methods are:

- Straight-based where the benefit or wage amount is converted to the annual equivalent.
- Average where the income as reported on the benefit statements or pay stubs for the last 30 days is averaged and then converted to the annual equivalent.
- Year-to-date (YTD) where the YTD gross earnings are divided by the YTD interval, which is the number of calendar days elapsed between January 1 of the current year and the last date covered by the most recent income verification, and then multiplied by 365. The earning activity during the YTD interval should be closely examined to determine the appropriateness of this method. Do not use this method if the earning activity during the YTD interval is insufficient to make an annual projection or is not reflective of the likely earning activity for the period outside the YTD interval (the time between the last date covered by the most recent income verification and December 31 of the current year).
- Historical where the income as reported on the previous year's tax return is used.

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After the Loan Originator determines the suitable methods and performs the calculations, he/she must determine which figure is most representative of income likely to be received during the next 12 months. If the figures are disparate and one figure is not clearly the most representative, an average of the resulting figures may be used. Conservatively selecting the lowest figure without analysis is not acceptable. The selection must be carefully deliberated and may require additional verification.

Example - Projecting Expected Income for the Next 12 Months

Ken Anderson has worked for B & N Auto for the last two years. According to the verification of employment, Mr. Anderson earns $10/hour, works 40 hours per week, and is expected to work 25 hours of overtime in the next 12 months. Since Mr. Anderson is paid weekly, he submitted his last four pay stubs through the pay period ending May 1st that show gross pay (including overtime) of $460, $415, $475, and $445. It also shows gross YTD earnings of $5,885. Mr. Anderson's tax return for last year showed gross wages of $16,640.

Straight-based: Base pay: $10/hour x 40 hours/week x 52 weeks/year = $20,800

Overtime: $15/hour x 25 hours/year = $375

Total wages: $21,175

Average: ($460 + $415 + $475 + $445) / 4) x 52 weeks/year

= $23,335

YTD: ($5,885 / 121 days) x 365 = $17,754

Historical: $16,640

Looking at the four results, there is no clear earning pattern. The Loan Originator should investigate further to determine why significant discrepancies exist between the calculation methods and what figure should be used. Is B & N experiencing an unusual and temporary large workload? Was Mr. Anderson absent from work for an extended period of time? Did Mr. Anderson receive a pay increase from last year? These are just a few examples of the questions that should be answered.

NOTE: These calculations should be documented in writing and included in the case file. A web based work sheet is available at**: http://incomecalc.sc.egov.usda.gov/**

4. Income of Temporarily Absent Family Members

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

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

Examples - Temporarily Absent Family Member

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

Adam Watson works as an accountant. However, he suffers from a disability that periodically requires lengthy stays at a rehabilitation center. When he is confined to the rehabilitation center, he receives disability payments equaling 80% of his usual income. During the time he is not in the unit, he will continue to be considered a family member. Even though he is not currently in the unit, his total disability income will be counted as part of the family's annual income.

Desirae Bitz accepts temporary employment in another location and needs a portion of her income to cover living expenses in the new location. The full amount of the income must be included in annual income.

Terri Glass is on active military duty. Her permanent residence is her parents' home where her husband and children live. Terri is not currently exposed to hostile fire. Therefore, because her spouse and children are in the parents' home, her military pay must be included in annual income. (If her spouse or dependents were not in the parent's home, she would not be considered a family member and her income would not be included in annual income.)

5. Wage Matching

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

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

4.4 CALCULATING ANNUAL AND ADJUSTED INCOME

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

A. Calculating Annual Income

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

B. Calculating Deductions from Annual Income

Adjusted income is calculated by subtracting from annual income any of 5 deductions that apply to the household. Not all households are eligible for all deductions. Exhibit 4-2 summarizes these deductions. The remainder of this paragraph provides guidance on determining whether a family is eligible for each deduction and verifying and calculating these amounts. Part II of the Calculation Worksheet in the case study of Attachment 4-B also illustrates the use of these deductions and the calculation of adjusted income.

Exhibit 4-2
Allowable Deductions from Annual Income

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

C. Dependent Deduction

A deduction from annual income of $480 is made for each household member who qualifies as a dependent. Dependents are members of the household who are not the borrower, co-borrower, or spouse, are age 17 or younger, are an individual with a disability, or are a full-time student. The applicant/borrower, co-applicant/co-borrower, or spouse of applicant/borrower (even if the household member is temporarily absent) may never qualify as a dependent. A foster child, an unborn child, a child who has not yet joined the family, or a live-in aide may never be counted as a dependent.

If more than one family shares custody of a child, the family with primary custody can claim the dependent deduction for that child. If there is a dispute about which family should claim the dependent deduction, the family should provide copies or court orders or tax returns showing which family has claimed the child for income tax purposes.

D. Child Care Expenses

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

Child care attributable to the work of a full-time student (except for applicant/borrower, co-applicant/co-borrower, or spouse of applicant/borrower) is limited to not more than $480, since the employment income of full-time students in excess of $480 is not counted in the annual income calculation. Child care payments on behalf of a minor who is not living in the household cannot be deducted.

To qualify for the deduction, the applicant must:

- Identify the children who are receiving child care and the family member who can work, seek employment or go to school (academic or vocational) as a result of the care;
- Demonstrate there is no adult household member available to care for the children during the hours care is needed;
- Identify the child care provider, hours of child care provided, and costs;

- Verify the expense is not reimbursed by an agency or individual outside the family; and
- If the expenses enable a family member to go to school, identify the educational institution. The family member need not be a full-time student.

Verification of Child Care Expenses

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

Example – Child Care Expense Not Counted

Joshua Gladson pays $200 per month in child support. It is garnished from his monthly wages of $1000. After the child support is deducted from his salary, he receives $800. The full monthly salary of $1000 must be counted as income.

Example – Child Care Deduction
Separate Expenses for Time at Work and Time at School

Lou and Bryce have two children. Both parents work, but Lou works only part-time and goes to school half-time. She pays $4 an hour for eight hours of child care a day. For four of those hours, she is at work; for four of them she attends school. She receives no reimbursement for her child care expense.

Her annual expense for child care during the hours she works is $4,000 and at school is $4,000. She earns $6,000 a year. Bryce earns $18,000.

Lou's child care expense while she is working can not exceed the amount she is earning while at work. In this case, that is not a problem. Lou earns $6,000 during the time she is paying $4,000. Therefore, her deduction for the hours while she is working is $4,000.

Lou's expense while she is at school is not compared to her earnings. Her expense during those hours is $4,000 and her deduction for those hours will also be $4,000.

Lou's total child care deduction is $8,000 ($4,000 + $4,000). The total deduction exceeds the amount of Lou's total earnings, but the amount she pays during the hours she works does not exceed her earnings. If Lou's child care costs for the hours she worked were greater than her earnings, she would not be able to deduct all of her child care costs.

E. Elderly Household Deduction

A single $400 deduction is subtracted from annual income for any elderly household. To be considered an elderly household, a party to the note must be 62 years of age or older or an individual with a disability. Because this is a "family deduction" each household receives only one deduction, even if more than one member is elderly or disabled.

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

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

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

F. Deduction for Disability Assistance Expense

Families are entitled to a deduction for un-reimbursed, anticipated costs for attendant care and "auxiliary apparatus" for each family member who is a person with disabilities, to the extent these expenses are reasonable and necessary to enable any family member 18 years of age or older who may or may not be the member who is a person with disabilities (including the member who is a person with disabilities) to be employed. The applicant must describe the nature of the expense, provide documentation of the costs, and demonstrate that the expense enables a family member to work. Reasonable documented expenses for care of the individual with disabilities in excess of 3 percent of annual income may be deducted from annual income if the expenses:

- Enable the individual with disabilities or another family member to work;
- Are not reimbursable from insurance or any other source; and

- Do not exceed the amount of earned income included in annual income by the person who is able to work as a result of the expenses. If the disability assistance enables more than one person to be employed, the combined incomes of all persons must be included.

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

Example – Eligible Disability Assistance Expenses

The payments made on a motorized wheelchair for the 42-year-old son of the applicant/borrower enable the son to leave the house and go to work each day on his own. Prior to purchase of the motorized wheelchair, the son was unable to make the commute to work. These payments are an eligible disability assistance expense.

NOTE: Auxiliary apparatus includes, but is not limited to, items such as wheelchairs, ramps, adaptations to vehicles, or special equipment to enable a sight-impaired person to read or type, but only if these items are directly related to permitting the disabled person or other family member to work. If the apparatus is <u>not</u> used exclusively by the person with a disability, the total cost must be prorated to allow a specific amount for disability assistance.

- **Include payments on a specially-equipped van to the extent they exceed the payments that would be required on a car purchased for transportation of a person who does not have a disability.**
- **The cost of maintenance and upkeep of an auxiliary apparatus is considered a disability assistance expense (e.g., veterinarian and food costs of a service animal; cost of maintaining equipment that is added to a car, but not the cost of maintaining the car).**

Payments to a care attendant to stay with a disabled 16-year-old child allow the child's mother to go to work every day. These payments are an eligible disability assistance expense. When the same provider takes care of children and a disabled person over age 12, prorate the total cost and allocate a specific cost to attendant care. The sum of both child care and disability assistance expenses cannot exceed the employment income of the family member enabled to work.

NOTE: Attendant care includes, but is not limited to, expenses for home medical care, nursing services, housekeeping and errand services, interpreters for hearing-impaired, and readers for persons with visual disabilities.

Example – Calculating a Deduction for Disability Assistance Expenses

Applicant/Borrower earned income	$14,500
Co-Applicant/Co-Borrower earned income	+$12,700
Total Income	$27,200
Care expenses for disabled 15-year-old	$ 3,850
Calculation:	$ 3,850
(3% of annual income)	-$ 816
Allowable disability assistance expenses	$ 3,034

(NOTE: $3,034 is not greater than amount earned by co-applicant/co-borrower, who is enabled to work.)

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

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

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

Examples - Typical Medical Expenses

- Services of physicians, nurses, dentists, opticians, chiropractors, and other health care providers
- Services of hospitals, laboratories, clinics, and other health care facilities
- Medical, Medicaid and long-term care premiums, and expenses to HMO
- Prescription and nonprescription medicine prescribed by a physician
- Dental expenses, x-rays, fillings, braces, extractions, and dentures
- Eyeglasses, contact lenses, and eye examinations
- Medical or health products or apparatus (hearing aids, batteries, wheel chairs, etc.)
- Attendant care or periodic medical care (visiting nurses or assistance animal and its upkeep)
- Periodic scheduled payments on accumulated medical bills
- Travel expense and lodging for medical treatment

Examples - Excluded Medical Expenses

- Unnecessary cosmetic surgery to improve the patient's appearance such as face lifts, hair transplants/removal, and liposuction
- Health Club or YMCA dues, steam baths for general health or to relieve physical or mental discomfort not related to a particular medical condition
- Household help even if recommended by a doctor
- Medical savings account (MSA)
- Nutritional and herbal supplements, vitamins, and "natural medicines" unless these can be obtained legally only with a physician's prescription
- Non-prescription drugs unless prescribed by a physician for a particular medical condition
- Personal use items unless used primarily to prevent or alleviate a physical or mental defect or illness

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

Example - Calculating the Medical Expense Deduction

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

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

Example – Medical Expense Paid over a Period of Time

Chynna Ray and Justin Grog did not have insurance to cover Justin's operation four years ago. They have been paying $105 a month toward the $5,040 debt. Each year that amount

($105 x 12 months or $1,260) has been included in total medical expenses. A review of their file indicates that a total of $5,040 has been added to total medical expenses over the four-year period. Over the four-year period they have missed five payments and still owe $525. Although they still owe this amount, the bill cannot be included in their current medical expenses because the expense has already been deducted.

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

H. Calculating Repayment Income

Repayment income is the amount of the household's income that is available to repay the Agency's debt. To compute repayment income, the Loan Originator should count only the income of persons who will be parties to the note.

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

Example – "Grossing Up" Nontaxable Income

The applicant's repayment income of $22,000 includes $5,000 of nontaxable income.

The revised repayment income for the applicant would be calculated as follows:

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

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

4.5 OVERVIEW OF POLICIES RELATED TO ASSETS

Assets affect an applicant's ability to obtain a loan in 2 ways. First, applicants may be required to use assets to make a down payment covering some of the costs of purchasing a home. Second, many types of assets generate income that must be included in the calculations of annual and repayment income. Asset documentation may also provide useful information for loan underwriting. Exhibit 4-3 presents a list of assets that must be considered when making these determinations and also identifies certain types of assets that are not considered.

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Exhibit 4-3
Types of Assets

The following types of assets must be considered.

Non-retirement assets including:

- Savings accounts; the average 2-month balance of checking accounts; safe deposit boxes and home;
- Stocks, bonds, Treasury bills, savings certificates, money market funds, and other investment accounts;
- Equity in real property or other capital investments;
- Revocable trust funds that are available to the household;
- Lump-sum receipts, such as inheritances, capital gains, lottery winnings and settlement on insurance claims (including health and accident insurance, worker's compensation, and personal or property losses);
- Assets held in foreign countries;
- Personal property (such as jewelry, coin collection or antique cars) held as an investment; and
- Cash value of life insurance policies.

Retirement assets including:

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

The following types of assets are not considered.

- The value of necessary items of personal property, such as furniture, clothing, cars, wedding rings and other jewelry not held as an investment, and vehicles specially equipped for persons with disabilities;
- Assets that are part of any business, trade, or farming operation in which any member of the household is actively engaged;
- The value of an irrevocable trust fund, or the value of any trust over which no member of the household has control;
- Term life insurance policies where there is no cash value;
- Assets that are not effectively owned by, accessible to, and provide no income to the applicant;
- Interests in American Indian trust land; and
- For income calculations, any assets on hand that will be used to reduce the amount of loan.

Example – Assets that are Part of an Active Business

Megan and Tylar Wasson own a copier and courier service. None of the equipment that they use in their business is counted as an asset (e.g., the copiers, the FAX machines, the bicycles).

A. Reporting Assets

Applicants must provide information about household assets at the time of loan application and whenever an income determination is made. Applicants must provide sufficient documentation to enable the Loan Originator to verify the asset information and compute the market and cash value of the asset. Applicants must provide assets documentation as required on Paragraph 4.3 regardless of the balance or value of the assets disclosed. In addition, *Form RD 3550-4, Employment and Asset Certification*, will be used to confirm whether or not the household's combined net assets do not exceed $5,000 and whether or not assets have been disposed of for less than the fair market value in the past 2 years.

Example – Calculating Cash Value of An Asset

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

The cash value of the IRA account is:

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

B. Verification of Assets

Copies of bank or brokerage company statements provide more information than just account balances. The transaction history reveals recurring deposits or debits that may impact the applicant's ability to qualify for a loan. Assets statements must cover account activity for the most recent two-month period (or, if account information is reported on a quarterly basis, for the most recent quarter). Loan originators must:

- Confirm that the applicant has enough funds for closing.
- Obtain a credible explanation from the applicant regarding the source of funds for any large deposits or increase in the account balance . A large deposit may be the proceeds from a new personal loan not yet reported to the credit bureaus.

C. Calculating Market and Cash Value

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

D. Retirement Assets

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

Example – Withdrawals from IRAs or 401K Accounts

Jim Dunn retired recently. He has an IRA account but is not receiving periodic payments from it because his pension is adequate for his routine expenses. However, he has withdrawn $2,000 for a trip with his children. The withdrawal is not a periodic payment and is not counted as income.

Example – Withdrawals from a Keogh Account

Riley Hales has a Keogh account valued at $30,000. When she turns 70 years old, she begins drawing $2,000 a year. Continue to count the account as an asset. Determine the cash value and imputed income from the asset. Do not count the $2,000 she withdraws as income.

Example – Retirement Benefits as Lump-Sum and Periodic Payments

Upon retirement, Ashley Gardner received a lump-sum payment of $15,000. She will also receive periodic pension payments of $350 a month.

The lump-sum amount of $15,000 is generally treated as an asset. In this instance, however, Ashley spent $5,000 of the lump sum on a trip following her retirement. The remaining $10,000 she placed in her mutual fund with other savings. The entire mutual fund will be counted as an asset.

Ashley is now not able to withdraw the balance from her pension. Therefore, count the $350 monthly pension payment as annual income and do not list the pension account as an asset.

4.6 LIMITATIONS ON ASSETS

The cash value of net family assets that are above the limitations described in this paragraph must be used to pay for costs related to the purchase of the home.

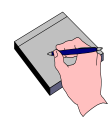
A. Limitation on Nonretirement Assets

If the cash value of nonretirement assets is greater than $15,000 for nonelderly households or $20,000 for elderly households, the cash value in excess of these amounts must be used toward the purchase of the property.

B. Limitation on Retirement Assets

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

C. Exception to the Asset Limitations



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

4.7 CALCULATING INCOME FROM ASSETS FOR ANNUAL INCOME

For the purpose of computing annual income, the current assets of ***all household members*** are considered. In addition, if any household member has disposed of assets for less than fair market value during the 2 years preceding an annual income determination, the asset must be considered unless it was disposed of as a result of foreclosure, bankruptcy, divorce, or separation. The amount of income is the difference between the market value of the asset and the amount that was actually received in the disposition of the asset.

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

Example - Income from Assets for Annual Income Calculation

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

A certificate of deposit of $6,800 they have been saving for a down payment. It earned 6.8% or $462 of interest last year. Estimated cash value after paying penalties is $6,500.
A savings account with $11,500 earning 4% annually.
The 6-month balance in the checking account is $300 (non interest-bearing account).

The cash value of the Browns' assets is $18,300 ($6,500 + $11,500 + $300). However, the Browns will be required to use $3,300 (assets in excess of $15,000) toward the purchase of the dwelling. Therefore, the cash value of assets to be counted toward income from assets is $15,00. The cash value of the remaining assets is more than $5,000. To compute income from assets, use the greater of actual income or imputed income.

	Cash Value	**Actual Income Earned**	**Imputed Income (local passbook rate is 4%)**
Checking Account	$ 300	$ 0	**$600 ($15,000 x 0.04)**
Certificate of Deposit	$6,500	$442 ($6,500 x 0.068)	
Savings ($11,500 - $3,300 down payment	$ 8,200	$ 328 ($8,200 x 0.04)	
TOTAL	**$15,000**	**$770**	

Example – Valuing a Disposed Asset

David Orr sold a property to a relative for $15,000 on July 1, 2005. The property was valued at $37,500 and had no loans against it.

Market Value	$37,500
(*Less*) Settlement costs	$ 2,000
(*Less*) Sales price	$15,000
Cash Value	$20,500

The $20,500 would be counted as an asset for any annual income determination conducted until July 1, 2007. Even though there would be no actual income from this asset, the $20,500 would be used to establish total assets to determine the amount to be counted as annual income.

4.8 CALCULATING INCOME FROM ASSETS FOR REPAYMENT INCOME

Only assets held by note signers are considered and only the actual income derived from the assets, which are determined stable and dependable, are used to compute repayment income. Do not consider assets with a total cash value of $5,000 or less unless it would significantly and adversely impact the loan qualification amount, in which case over and above *Form RD 3550-4* must be obtained.

Example - Income from Assets for Repayment Income

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

> Jose's 401(K) account is valued at $9,000 and earned 6% or $540 last year. Estimated cash value after penalty and taxes is $7,000.
>
> Jose and Sylvia's savings account with $16,000 earning 4% annually has no withdrawal penalties, and the $300 6-month balance in their checking account earns no interest.
>
> Maria's savings account of $2,000 earned 2.5% interest last year.

Retirement Asset Test. Because the $9,000 market value of the Gonzales' 401(K) account is less than $40,000, the household is not required to use any retirement assets toward purchase of the home. Income from the 401(k) retirement account is not available for use on a monthly basis and should not be counted as repayment income The interest earned is counted as annual income.

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

	Market Value	**Cash Value**	**Repayment Income**
Savings ($16,000 - $1,300)	$14,700	$ 14,700	$588 ($14,700 x 0.04)
401(K)	$9,000	$ 7,000	$0
TOTAL	**$15,000**	**$ 15,000**	**$588** (counted in repayment income)
Savings ($16,000 - $1,300)	$14,700	$ 14,700	$588 ($14,700 x 0.04)

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

4.9 OVERVIEW

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

4.10 CREDIT REQUIREMENTS

The Loan Originator must evaluate the credit history of each proposed party to the note. An applicant's credit record does not have to be perfect; a few instances of credit problems can be acceptable if an applicant's overall credit record demonstrates an ability and willingness to repay obligations. Exhibit 4-4 outlines indicators of unacceptable credit that must be investigated by the Loan Originator. These indicators are not automatic disqualifiers. The Loan Approval Official can make exceptions in limited circumstances, as described in Paragraph 4.14.

> **Cosigners**
>
> Cosigners must meet the same credit-worthiness requirements as applicants and cannot be used to compensate for an applicant's unacceptable credit history.

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

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

Exhibit 4-4
Indicators of Unacceptable Credit

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

  ◊ A bankruptcy in which:

  ♦ Debts were discharged more than 36 months prior to the date of application; or

  ♦ Where an applicant successfully completed a bankruptcy debt restructuring plan and has demonstrated a willingness to meet obligations when due for the 12 months prior to the date of application.

  ◊ A judgment satisfied more than 12 months before the date of application.

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

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

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

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

4.11 CONDUCTING PRELIMINARY CREDIT CHECKS

If funding is not available and the applicant will be placed on the waiting list, the Loan Originator should conduct a preliminary review of the applicant's credit history by accessing the Department of Housing and Urban Development's (HUD's) online Credit Alert Interactive Voice Response System (CAIVRS), ordering an infile credit report, and checking MortgageServ's Borrower Cross Reference screen (Customer/XREF/Social Security) provided these checks were not performed during a pre-qualification review.

Three Preliminary Credit Checks

- CAIVRS
- Infile Credit Report
- Borrowers Cross Reference

If these preliminary credit checks reveal indicators of unacceptable credit, the Loan Originator should discuss the findings with the applicant; providing enough detail information so that the applicant can identify and address the issue. For contractual reasons, a copy of the infile credit report may not be provided to the applicant. If the applicant acknowledges that the credit blemishes are accurate, but indicates that they were due to circumstances beyond his or her control, the Loan Originator should record those reasons in the running record and ask the applicant for supporting documentation. The Loan Originator should also counsel the applicant on possible ways to remedy the problems while on the waiting list. Be sure to explain to the applicant that fulfilling suggestions provided by the RHS staff will improve their chances of qualifying for a loan, but does not guarantee loan approval.

Although the Agency cannot provide copies of the infile credit report, Loan Originators should advise that the applicant can obtain a free credit report by calling 1-877-322-8228 or logging into http://www.annualcreditreport.com. By law, individuals are entitled to receive one free credit file disclosure every 12 months from each of the nationwide consumer credit reporting companies – Equifax, Experian and TransUnion.

A. Credit Alert Interactive Voice Response System

Except in very unusual circumstances, an applicant who is delinquent on a Federal debt is not eligible for a Section 502 loan. The Loan Originator can verify whether the applicant has delinquent Federal debt through CAIVRS. However, credit must not be denied based solely on the results of the CAIVRS inquiry.

The Loan Originator should print HUD's online CAIVRS results page and file it in the applicant's case file to document that the applicant's delinquency status has been checked.

Exceptions to
Delinquent Federal Debt

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

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

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

B. Infile Credit Report

The Loan Originator should order an infile credit report for applicants placed on the waiting list, in order to screen for potential credit problems, unless such a report was already ordered during a pre-qualification review or was ordered by a loan packager, real estate broker, or other entity. The results of the infile credit report, which are not binding and cannot be used to determine borrower eligibility, can help identify possible credit problems that may be remedied during the waiting period.

For applicants who currently reside at the same address, regardless of marital status, a joint infile credit report should be ordered so that the Agency can realize cost savings. Refer to the DLOS Training Manual for guidance on joining spouses on the Registration Borrower Data Retail/BKR screens in UniFi.

Note that both infile credit reports and residential mortgage credit reports (discussed below) are considered a hard inquiry on the applicant's credit report. Since hard inquires are used when determining the applicant's credit score care must be taken to avoid unnecessary orders. Do not order subsequent infile credit reports to confirm that a debt has been paid or for other similar reasons and do not order an infile credit report after a residential mortgage credit report has been ordered.

4.12 CONDUCTING FULL REVIEW OF CREDIT HISTORY

Once the applicant is selected for processing, the Loan Originator must order a residential mortgage credit report and obtain the applicable third-party credit verifications to determine whether the applicant's credit history meets the Agency's criteria. . If the applicant was never placed on the waiting list, check HUD's CAIVRS and MortgageServ's Borrower Cross Reference screen; do not order an infile credit report.

> **Helpful Hint**
>
> Unless the applicant makes a written request for a copy of their residential mortgage credit report, the Agency will not provide a copy. Applicants are not entitled to a copy of their infile credit report.

Procedures for obtaining third-party verifications are described in Paragraph 3.16. Guidelines for reviewing the applicant's credit history are provided here.

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

- The name, address, and toll free number of the credit bureau;
- A statement to the applicant that the denial of their loan request was made by the Agency, and not the credit bureau;
- Notice of their right to obtain a free copy of their credit report from the credit bureau within <u>60 days</u> from the date of the Agency's adverse action; and
- Notice of the applicant's right to dispute to the credit bureau the accuracy or completeness of the credit report provided to the Agency.

A. Residential Mortgage Credit Report

The Residential Mortgage Credit Report (RMCR) will include a Beacon, Classic 2004 FICO, and Fair Issac credit score. The report will include data from the three main repositories, updated verifications on all tradelines with a balance (updated to within 90 days), a court records check that includes adverse items for the prior 7-year period, and a 2-year employment and rental history. The RMCR will also provide the results of a check against the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) database. OFAC administers and enforces economic and trade sanctions against targeted foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction. If an OFAC match message appears on the RMCR, refer to the U.S. Treasury website at http://www.treas.gov/offices/enforcement/ofac/faq/answer.shtml for guidance on how to determine if the match is valid. If a due diligence review concludes that the match is valid, the applicant should be denied assistance and referred to the OFAC contact number for further information as per the aforementioned website.

For applicants with no outstanding judgments obtained by the United States in a Federal court and who have more than one credit score listed on their RMCR that result in a reliable credit score of 640 or higher on their RMCR, Exhibit 4-4 need not be used to identify indicators of unacceptable credit handling. In addition, *Form RD 1944-61*, *Credit History Worksheet*, need not be completed. These applicants are automatically classified as having acceptable credit histories regardless of what is listed on the RMCR. To avoid potential disparate treatment, additional credit analysis is not appropriate. Credit scores are used to reduce the time necessary to conduct a credit analyses, but under no circumstance can they be used to make adverse decisions.

To ascertain if an applicant has a reliable credit score of 640 or higher to preclude the use of Exhibit 4-4 to identify indicators of unacceptable credit handling, the following practice will be established:

- If the three credit scores are listed on the RMCR, the middle numerical score should be used.
- If the RMCR only contains two scores, the lower of the two should be used.
- If the RMCR only contains one score, a full credit analysis must be completed.
- If no score is available, the credit bureau will report a "zero." Zero in these cases has the literal meaning of null, or indicating there was not enough information or credit references for the statistical model to compute a credit score value.

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

- Loan Originators must review the RMCR to validate the reliability of the credit score. Based on the program's overall credit guidelines, a credit score is valid if the applicant has a minimum of three trade lines that have been opened and active for at least 12 months.

- Loan Originators must obtain nontraditional credit verifications to augment a credit report where a credit score was generated but based on only a few and/or recently established trade lines or if the applicant has less than two scores. However, non-traditional credit must never be used to enhance the credit of an applicant with a negligent credit history (poor payment history, excessive use of credit, over the credit limit balances, etc.) or to offset derogatory references found in the applicant's traditional credit report, such as collections and judgments.

If the resulting credit score is less than 640 and the RMCR contains any indicators of unacceptable credit as outlined in Exhibit 4-4, the Loan Originator should discuss the findings with the applicant and ask for third-party verifications that support the applicant's assertions. A copy of the RMCR must be retained in the case file. If the RMCR is more than 6 months old when the underwriting decision is to be made, a new report must be ordered at no cost to the applicant.

B. Fair and Accurate Credit Transactions

In accordance with the Fair and Accurate Credit Transactions (FACT) Act of 2003, the Agency is required to disclose to the applicant, upon request, the score that a credit bureau distributed and was used in connection with their loan. In addition, we are required to disclose the key factors affecting the applicant's credit scores. Therefore, Attachment 3-H, Credit Score Disclosure, must be provided to the applicant. It must be explained to the applicant that the credit score was not used to determine loan approval. The Agency only uses the credit score to presume acceptable credit in lieu of other credit underwriting practices.

The FACT Act also added a new section to the Fair Credit Reporting Act to prohibit creditors from obtaining or using medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit.

Consumer reporting agencies are prohibited from providing a lender with a credit report that contains identifying information for medical debts (be it a collection, judgment, etc.). The name of the medical service provider and the nature of the medical service is suppressed or coded so that lender decisions are not based on discriminatory factors. However, suppression or coding of identifying information for medical debts does not eliminate the need for consideration. Medical debts that are chronically late, placed in collection, or turned into judgments remain indicators of unacceptable credit handling that must be addressed (unless the applicant has a reliable credit score of 640 or higher).

Since the indicators of unacceptable credit handling are general guidelines that aid in determining the degree of risk and are not absolute underwriting criteria, the Loan Originator must subjectively consider the circumstances that resulted in the blemished debt. If the identifying information for a medical debt is suppressed or coded and the applicant is claiming that the debt resulted from a situation that was beyond their control, the applicant must provide adequate third-party documentation to support their claim.

If the applicant cannot identify the medical debt given the payment information (date opened, balance owing, etc.), the applicant will have to contact the repository directly to obtain a copy of their credit report. Credit reports provided by a repository directly to a consumer will not have the medical information suppressed. To avoid a fee, the applicant can obtain a free credit report by calling 1-877-322-8228 or logging into http://www.annualcreditreport.com. By law, individuals are entitled to receive one free credit file disclosure every 12 months from each of the nationwide consumer credit reporting companies – Equifax, Experian and TransUnion.

An exception can not be granted on that the applicant's assertion that they were unaware of the blemished debt or that the blemished debt is not theirs. Supporting documentation must be furnished before a Loan Approval Official considers granting an exception.

C. Other Credit Verifications

If the applicant's credit score is under 640, the Loan Originator should send *Form RD 1944-60, Landlord's Verification* and *Form RD 410-8, Applicant Reference Letter*, to the parties indicated in the application if not reflected on the RMCR. The forms should be accompanied by a preaddressed, pre-stamped envelope and *Form RD 3550-1, Authorization to Release Information*, which authorizes the respondent to release the information.

1. Landlord's Verification

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

If the landlord reports that during the past 24 months (or whatever is applicable) the applicant "always pays by the due date" and is current on the rent, the applicant's rental history should be considered satisfactory. If the landlord reports that the applicant "pays over 30 days late" or "generally stays behind schedule," or if the applicant is currently behind on the rent, the Loan Originator should follow up with a call to the landlord.

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

2. Applicant Reference Letter

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

3. Non Traditional / Alternative Credit

For applicants who do not use traditional credit, or that have a limited credit history, the Loan Originator must develop a credit history from at least three (3) nontraditional credit sources such as rental payments, utility payment records, automobile insurance payments, or other means of direct access from the credit provider. Loan Originators must verify that the providers of nontraditional credit exist, and confirm that the borrower, in fact, has credit history with the creditor. Payments made to relatives for credit sources are ineligible as a nontraditional credit reference.

a. **Verification of a Nontraditional Credit Provider**: To verify the credit information, Loan Originators must use a published address or telephone number for that creditor, such as listing in the yellow pages.

b. **Confirming the Existence of a Nontraditional Credit**: Documentation to confirm that the nontraditional credit exists and that the applicant has sufficient credit references to evaluate his/her ability and willingness to repay debt may include 12 month payment history from the following sources:

- **Preferred Sources**: Rental housing; utilities (if not included in the rent payment); telephone service; cable television and internet service, insurance payments (payroll deductions to pay for insurance premiums are not considered alternatice credit).

- **Alternative Sources**: Payments to child care providers; school tuition; payments to local retail stores and storage units companies; payment arrangements for the uninsured portion of any medical bills; etc.

The 12-month payment history may be obtained by sending *Form RD 410-8, Applicant Reference Letter*, to the nontraditional creditors indicated by the applicant or by obtaining canceled checks, money order receipts, and/or a12-month bill statements or payment history print-out from the creditor. General statements such as “satisfactory” or “in good standing” are not sufficient to establish a satisfactory repayment history. Loan Originators should carefully evaluate the bill statements to establish the payment history (past due amounts, late payment charges).

Exhibit 4-5
Guidelines for Evaluating Credit Reports

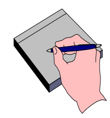
- Different credit bureaus or repositories present information in different formats. Be familiar with the different formats and take time in reviewing the report to avoid errors.
- Obtain clarification of any questionable items or terms (for example, terms such as "slow" or "late pay" have varied meanings). No decisions should be made until the terms in question are translated into defined terms (e.g., for this repository, "slow pay" means 30 days late). Document clarification of terms in the case file.
- Upon receiving the credit report, verify the name, address, and Social Security Number.
- Compare the employment information and rental data on the credit report, if available, with the information on the application.
- Compare the remainder of the credit report to the application. Consider the following questions when reviewing the application.
    - ◊ Are all the accounts reported on the credit report listed on the application? (Note: There may be additional accounts on the application that are not on the credit reports because not all creditors furnish information to a credit bureau or repository.)
    - ◊ Does any of the information on the credit report contradict the application?
    - ◊ What information indicates unacceptable credit? List late payments, chargeoffs and other relevant information.
    - ◊ Does the credit report have accounts included in a consumer credit counseling program? If so, document t a12-months repayment history under the plan with all payments made on time and the applicant has written permission from the counseling Agency to enter into a mortgage transaction.
    - ◊ Does the applicant rely heavily on the use of revolving credit? Account balances that are at, near, or over the credit limit may indicate that the applicant is overextended.
    - ◊ Is the applicant responsible for the tradeline or an authorized user? If most accounts in the credit report are designated as "authorized user" (ECOA code 3), the applicant must provide supporting documentation to demonstrate that he or she has made the monthly payments for the past 12 months.
- If the credit report reflects little or no credit history, ask the applicant for other documentation that may demonstrate a willingness to pay recurring debts like rent, utilities, phone, medical, etc. Third party verifications from impartial an unrelated parties or canceled checks that cover a sufficient period of time are acceptable forms of documentation.
- Review the number and dates of credit inquiries. The presence of many and recent credit inquiries in different industries may indicate that the applicant is looking for credit to finance purchases. Confirm that the applicant has not obtained new credit that is yet to be reflected in the credit report.
- Highlight areas of concern and develop a list of questions or issues that need clarification from the applicant.

4.13 CREDIT HISTORY WORKSHEET

If the applicant's credit score is under 640, *Form RD 1944-61, Credit History Worksheet,* must be used to summarize the applicant's credit history and to determine whether there are any indicators of unacceptable credit as outlined in Exhibit 4-4. The Loan Originator should complete this form and include it in the case file to aid the Loan Approval Official in reviewing the applicant's credit history.

4.14 ASSESSING ADVERSE CREDIT

A. Making Exceptions



The Loan Originator should review the credit history for any signs of unacceptable credit using the criteria outlined in Exhibit 4-4. Credit history problems may be more reflective of an inability than an unwillingness to meet financial obligations. However, derogatory credit may also be the result of extenuating circumstances causing a significant reduction in income and/or increase in financial obligations. Extenuating circumstances are events beyond the applicant's control and unlikely to reoccur. The applicant must provide a letter to explain the nature of the event that led to the derogatory credit and provide supporting documentation accordingly. The Loan Approval Official must carefully review the documentation provided by the applicant to confirm that the adverse credit was in fact due to extenuating circumstances. Compensating factors may be used and must be well documented to support the exception and the decision to approve the loan. The Loan Approval Official may consider an exception in the following types of situations.

- **Reduced shelter costs.** The applicant's rental or mortgage payment history has been unacceptable and the loan will significantly reduce the applicant's shelter costs, which will result in improved debt repayment ability.

- **Temporary situation.** The circumstances that caused the credit problems were temporary in nature and beyond the applicant's control. Examples include loss of job, delay or reduction in benefits, illness, or dispute over payment of defective goods or services.

- **Benefit to the Government.** The applicant is delinquent on a Federal debt, and the Agency loan will allow the applicant to take actions that benefit the Government. **This type of exception can only be made by the Administrator.**

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

B. Resolving Collection Accounts

Paying an outstanding account is not, in itself, justification to say the applicant has demonstrated a willingness to meet obligations. Payment of a collection account could deplete the applicant's cash resources that could be used for reserve or closing costs., The Loan Originator may determine it is not necessary to pay a collection account if there is evidence that the account does not affect the Agency's first lien position. . If there were extenuating circumstances to the adverse credit, the Loan Originator may determine that the late payments are not reflective of the applicant's ability to meet financial obligations or manage debts. All extenuating circumstances and any compensating factors must be documented on the Credit History Worksheet.

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SECTION 4: OTHER ELIGIBILITY REQUIREMENTS

4.15 OWNING A DWELLING

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

4.16 ABILITY TO OBTAIN OTHER CREDIT

To be eligible, the applicant must be unable to obtain credit from other sources on terms and conditions they can reasonably be expected to fulfill. Applicants must reduce the need for credit by using available assets, as described in Section 2. In addition, applicants should be encouraged to obtain a portion of the needed funds in the form of affordable housing products.

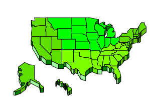
4.17 OCCUPYING THE PROPERTY *[7 CFR 3550.53(c)]*

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

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

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

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



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

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

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

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

To be eligible for Agency assistance, the applicant must be a U.S. citizen, a U.S. non-citizen national, or a qualified alien and provide acceptable evidence of eligible immigration status. Any applicant who is not a U.S. citizen, a U.S. non-citizen national, or a qualified alien should be rejected. Aliens and alien non-citizen nationals must provide acceptable evidence that they are qualified aliens as listed in Attachment 4-D.

The Rural Development has entered into an "Interagency Agreement" with the Department of Homeland Security, U. S. Customs and Immigration Service (USCIS) to allow access to the Systematic Alien Verification for Entitlements (SAVE) program database. This program enables Housing Program staff to obtain online immigration status information to determine a non-citizen applicant's program eligibility. In most cases, SAVE will provide immediate responses concerning the immigration status of an applicant.

4.21 TRUTHFUL APPLICATION

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

U.S. Citizens

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

U.S. Non-Citizen Nationals

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

SECTION 5: PROCESSING THE CERTIFICATE OF ELIGIBILITY

4.22 DETERMINING REPAYMENT ABILITY *[7 CFR 3550.53(g)]*

The primary consideration in determining whether an applicant can afford to purchase a home is the applicant's repayment income. Repayment income, as described in Paragraph 4.4 H., is the amount of income parties to the note will have available to repay the debt.

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

Maximum Ratios

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

Under the special program called **Rural Energy Plus Program,** Paragraph 4.24 D., the qualifying ratios (both the front PITI and back TD ratios) used to determine an applicant's ability to repay a home loan may be exceeded by up to two percentage points if an energy-efficient home is purchased. Eligible applicants will receive this increased flexibility if they are purchasing a newer home that is energy efficient. In some cases, applicants may be able to afford a larger loan amount due to the qualifying flexibility because lower utility costs associated with newer homes equate to more income that can be applied to mortgage and other debt payment in a given month.

A. The PITI Ratio

The PITI ratio compares the amount the applicant must spend on housing costs (including **P**rincipal on the loan, **I**nterest on the loan, real estate **T**axes, and property **I**nsurance) and flood Insurance (as applicable) to the applicant's repayment income. The leveraged loan payment is included in PITI.

Example - Calculating PITI Ratios

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

PITI Ratio = $470 ÷ $1,500 = 31.33%

Taxes: Must be on full assessed value

For new construction, the fully assessed tax amount will be used to determine repayment ability Very low-income applicants are considered to have repayment ability if they do not have to pay more than 29 percent of Repayment income for PITI expenses. Applicants with incomes above the very low-income limit are considered to have repayment ability if they do not have to pay more than 33 percent of repayment income for PITI expenses.

B. The TD Ratio

1. Maximum TD Ratio

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

2. Establishing TD

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

- PITI -- Principal, Interest, Taxes, and Insurance (including leverage loan payments);
- Regular assessments, such as homeowner assessments;
- Long-term obligations with more than 6 months repayment remaining, including loans, alimony, and child support;
- Payments that come due in the next 12 months;
- Deferred debt regardless of the length of the deferment period. Examples of deferred debt are items purchased under a retailer's "no payments until" offer and student loans where repayment has not commenced since the borrower is still in school. If the credit report does not reflect the anticipated monthly payment due at the end of deferment, the Loan Originator should obtain verification of the monthly payment directly from the creditor or request a copy of the loan agreement from the applicant. For student loans, the monthly payment can be estimated using 1 percent of the loan balance report on the credit report if the other verification methods are not feasible.
- Short-term obligations that are considered to have a significant impact on repayment ability, such as large medical bills and car or other credit payments.

- The minimum monthly payment required for revolving credit card debts. If a revolving account is paid off and closed before settlement, the monthly payment may be excluded from the TD ratio. The Loan Originator must obtain documentation to verify the account has been closed.

Example - Calculating TD Ratios

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

TD Ratio = $810 ÷ $2,083 = 38.89%

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

- Contingent liabilities. If the applicant is a cosigner on a loan or any other obligation, the debt must be included in the TD ratio. The Loan Originator should never omit a credit report liability with a balance greater than zero from the loan application unless strong supporting documentation is provided to evidence that the primary signer has been making on time payments during the previous 12 months.

- If the applicant recently obtained additional credit, verify the terms of the new obligation and include the monthly payment in the total debt ratio.

C. Determining the Maximum Loan Amount

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

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Paragraph 4.22 Determining Repayment Ability *[7 CFR 3550.53(g)]*

* Computes the PITI and TD ratios;

* Determines whether the applicant is eligible for payment subsidy, and how much payment subsidy the applicant would receive; and

* Computes the maximum loan amount for which the applicant qualifies, first using standard loan terms and then using any adjusted terms for which the applicant may qualify.

* The Loan Originator will print out and sign the estimated UniFi Eligibility Summary and place it in position 3 of the applicant case file.

D. Using Market Data to Interpret UniFi Results

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

4.23 RESERVED

4.24 OTHER CONSIDERATIONS RELATED TO MAXIMUM LOAN AMOUNTS

The maximum loan amount that the applicant qualifies for as shown on the Eligibility Summary generated from UniFi may be too low to enable the applicant to purchase a property that meets program standards. Exhibit 4-6 outlines the procedure on how to handle this situation. Conversely, the maximum loan amount and the resulting payment may be too high; setting the stage for payment shock.

This paragraph provides guidance on compensating factors and additional financial resources that the Loan Originator should consider to improve the applicant's purchasing ability only and concludes with a discussion on payment shock.

Exhibit 4-6

Establishing an Area's Minimum Loan Amount

Each Field Office should set, following the methodology provided by their State Office, a minimum loan amount in each area that is "clearly less than" the amount needed to purchase a decent, safe, and sanitary dwelling in that area. For example, if a county's area loan limit is $140,000, but based on an examination of properties financed by the Agency in that county during the last 12 months shows that the lowest amount of financing needed to purchase a decent, safe, and sanitary home was $75,000, a minimum loan amount of $60,000 may be set.

If the applicant does not qualify for the minimum loan amount and the Loan Originator has concluded that compensating factors are not applicable and adding a party to the application is not viable, Handbook Letter 15 (3550), Standardized Adverse Decision Letter, should be sent to the applicant along with Attachment 1-B. The letter should state that the applicant's qualifying loan amount (be sure to enter that amount) is not sufficient to meet the program's purpose as outlined in the 7 CFR Part 3550, Paragraph 3550.2.

A. Using Compensating Factors

Exceptions to the standard method of determining repayment ability may be made if there is information -- called compensating factors -- that indicates the prospective borrower may be able to make larger regular loan payments than the ratio analysis suggests. Compensating factors must be clearly documented in the applicant's case file.

All compensating factors must be approved by the next level supervisor. To obtain approval, the Loan Originator must prepare a written request that supports the use of compensating factors and the higher amount requested. The Loan Originator should forward the request and case file to the next level supervisor for approval.

Some of the compensating factors that can affect the amount of debt an applicant is permitted to have are discussed below:

1. Payment History

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

2. Savings History

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

Example - Using Savings History As A Compensating Factor

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

3. Job Prospects

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

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

4. Adjustments for Nontaxable Income

The next level supervisor may approve use of "grossing up" income over 120 percent if it is reasonably justified in writing by the Loan Originator.

B. Adding Additional Parties or Cosigners to the Note

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

1. Additional Parties to the Note

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

2. Cosigners

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

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

C. Payment Shock

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

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

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

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

In cases where payment shock is greater than 100 percent or could not be measured since the applicant does not currently have any housing expenses, no additional risk layering (i.e. adverse credit waivers, use of compensating factors, etc.) should be allowed without strong justification. Multiple layers of risk may be justified if the applicant has an excellent credit history reflecting timely repayment of credit obligations or a reliable credit score of 640 or higher on their RMCR. Perhaps the applicant has demonstrated a conservative attitude toward the use of credit and an ability to accumulate savings or a stable employment history over the past two years, demonstrating a dependable income stream. Regardless of the justification, the Loan Approval Official must thoroughly document their rationale for allowing multiple layers of risk in the running case record.

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

D. Rural Energy Plus Program

A home that is built to meet the 2006 International Energy Conservation Code (IECC-06) or a subsequent comparable code is considered an Energy Efficient Home (EEH), and borrowers purchasing them are eligible for the two percentage point increase in the qualifying ratios. An existing home that meets the same standard, or is being retrofitted to meet it, is also eligible.

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A new home built to IECC standards offers considerable energy efficiency and save homeowners money in their utility costs. After the mortgage payment, utility bills are usually the largest housing-related expense for homeowners each month. An energy-efficient home, with such features as proper insulation, high efficiency heating and cooling systems, and energy-efficient windows, can lower utility bills significantly.

Rural Development State Offices are responsible for determining if the 2006 IECC code or a comparable code exists in their state and for which loan ratio flexibility may apply. State architects and engineers or the National Office's Program Support Staff will be able to help make technical interpretations. The IECC-06 is a relatively common code throughout the country, and has thermal requirements that exceed Rural Development's standard thermal requirements for new homes.

Unless the applicant tenders the purchase of an EEH from the onset, the established qualifying ratios as outlined in the 7 CFR 3550, Paragraph 3550.53 (g) should be used when conducting a pre-qualification or issuing a Certificate of Eligibility (COE).

If a proposal to purchase an EEH is submitted, the established qualifying ratioscan be exceeded by adjusting the principal, interest, taxes and insurance (PITI) field. The following formulas will be used to ascertain what amount to enter in the Loan Origination System: Even when flexibility ratios are used, the area loan limit cannot be exceeded except by allowable closing costs.

Rural Energy Plus Program Maximum Ratios

PITI Ratio

If the PITI ratio is the limiting ratio and the applicant is in the very-low income category: Monthly repayment income times 31%

If the PITI ratio is the limiting ratio and the applicant is in the low income category: Monthly repayment income times 35%

TD Ratio (all applicants)

If the TD ratio is the limiting ratio regardless of income category: Monthly repayment income times 43%

The increased ratios under this program are an enticement to buy an EEH and are not to be considered an additional risk layer.

4.25 ISSUING THE CERTIFICATE OF ELIGIBILITY

If the Loan Originator determines that an applicant is eligible for a loan, the decision will be documented in the form of a written narrative in the running record of the applicant case file.

When funds are available, eligible applicants who have not yet located properties or, who own their building site but have not provided a construction package, should be issued

Form RD 1944-59, Certificate of Eligibility. First-time homebuyers must be informed that by accepting a Certificate of Eligibility they agree to provide documentation of completion of an approved homeownership education course prior to closing on their loan. The Loan Originator must note on the running record that they informed the Applicant of the homeownership education requirement. Applicants who are not seeking leveraged loans should be informed that the certificate is valid for a period of 45 days. Applicants seeking leveraged loans should be informed that the certificate is valid for a period of 60 days. Within that time the applicant must provide sufficient information to enable the Agency to conduct an appraisal of the property to be financed. COE will be honored even if loan limits change before the expiration of the commitment. Up to two 30 day extensions may be granted for applicants who demonstrate that they have been actively looking for a property. Area loan limits changes must be considered on any COE extension. If the applicant has already submitted a contract for a property, *Form RD 1944-59* will not be issued. If an applicant's sales contract falls through, a new *Form RD 1944-59*, good for 45 days or 60 days, as applicable, should be issued. An application is no longer considered active and will be withdrawn when the certificate of eligibility has expired and all authorized extensions have been exhausted.

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

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

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

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

ATTACHMENT 4-A

SAMPLE WORKSHEET FOR COMPUTING INCOME

PART I: REPAYMENT INCOME CALCULATION

1. Name	2. Identification

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

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

ANTICIPATED REPAYMENT INCOME (Consider only income of parties to the note as described in HB-1-3550, Paragraph 4.3):

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

7. Enter total of items 6a. through 6e. This is Repayment Income.	7.

PART II: ANNUAL AND ADJUSTED INCOME CALCULATION

1. Name	2. Identification

FAMILY ASSETS:(Consider if the cash value of total household assets is more than $5,000):

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

ANTICIPATED ANNUAL INCOME (Consider income of all household members as described in HB-1-3550, Paragraph 4.3):

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

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

ANNUAL AND ADJUSTED INCOME CALCULATION (Continued)

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

ATTACHMENT 4-B

CASE STUDY

SECTION 1 -- BACKGROUND

HOUSEHOLD MEMBERS

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

HOUSEHOLD INCOME, ASSETS AND EXPENSES

Wages

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

Other Income and Assets

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

Expenses

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

INCOME LIMIT INFORMATION

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

SECTION 2 -- CALCULATION WORKSHEET

PART I: REPAYMENT INCOME CALCULATION

1. Name David and Betsy Brown	2. Identification

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

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

ANTICIPATED REPAYMENT INCOME (Consider only income of parties to the note as described in HB-1-3550, Paragraph 4.3):

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

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

PART II: ANNUAL AND ADJUSTED INCOME CALCULATION

1. Name David and Betsy Brown	2. Identification:

FAMILY ASSETS:(Consider if the cash value of total household assets is more than $5,000):

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

ANTICIPATED ANNUAL INCOME (Consider income of all household members as described in HB-1-3550, Paragraph 4.3):

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

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

ANNUAL AND ADJUSTED INCOME CALCULATION (Continued)

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

SECTION 3 -- COMMENTS

ANNUAL AND REPAYMENT INCOME CALCULATIONS

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

ASSET CALCULATIONS

Repayment Income from Assets

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

Annual Income from Assets

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

ADJUSTED INCOME CALCULATION

Dependent Deduction

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

Child Care Deduction

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

The full amount of the child care may be deducted.

Elderly Household Deduction

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

Medical Expense Deduction

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

Disability Assistance Expenses

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

ATTACHMENT 4-C

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

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

An applicant who has a 25% or greater ownership interest in a business is considered "self-employed" and a cash flow analysis of the applicant's income is required. The legal structure of a business determines the way business income or loss is reported to the IRS. Loan Originators must understand the applicant's business structure to effectively document, calculate, and analyze annual and repayment income.

Understanding Business Structures

The following are the most common business structures for self-employed applicants.

a. *Sole Proprietorship*: The business structure most often encountered is a sole proprietorship (be it a business, farming, or profession). A sole proprietor is someone who owns an unincorporated business by himself or herself and has unlimited personal liability for all debts of the business. Business income or loss is folded into the individual owner's tax return.

b. *Partnership*: A partnership is an arrangement between two or more individuals who have put together their assets and/or skills to operate a business and who will share, as stated in the agreement, profit and losses.

c. *Limited Liability Corporation (LLC)*: A LLC is a legal business structure designed to offer its members (owners) the tax efficiencies of a partnership and the limited liability advantages of a corporation. Although the member-owners generally have limited liability, there may be some instances in which they are required to personally guarantee some of the loans that the limited liability corporation obtains.

d. *S-Corporation*: An S Corp is a legal entity that has a limited number of stockholders (up to 75) and elects not to be taxed as a regular corporation. The small business gains and losses are passed on to the stockholders in proportion to each stockholder's percentage of business ownership and it is taxed at their individual tax rates. This is another commonly encountered type of business.

Documenting Self-Employment Income:

"Complete Copies of Individual and Business Income Tax Returns"

A self-employed applicant must submit signed copies of his/her **last two** complete *U.S. Individual Income Tax Returns* (*IRS Form 1040*) with *IRS Form W-2* attached, if the applicant also has wage income, along with the appropriate IRS forms and schedules as noted in the table below. If the business is a corporation, S corporation or partnership, a complete, signed copy of the business income tax return for the last 2 years, with all applicable schedules, is also required. The following table provides general guidance regarding the minimum documentation required for self-employed applicants. (Please note that the place the information is found is based on a tax return from a certain year and may be different)

Form of Business or Commission Income	**Individual Profit & Loss will be reported in…**	**Business Profit or Loss will be reported in…**
Sole Proprietorship	Form 1040, Line 12: Business Income or (loss) Schedule C (Form 1040), Profit or Loss from Business	Form 1040, Schedule C: Profit or Loss from Business
Partnerships and Limited Liability Corporations	Form 1040, Line 17: Rental real estate, royalties, partnerships, S corporations, trusts, etc. Schedule E (Form 1040), Supplemental Income and Loss	IRS Form 1065, U.S. Partnership Return of Income Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc.
S Corporations	Form 1040, Line 17: Rental real estate, royalties, partnerships, S corporations, trusts, etc. Schedule E (Form 1040), Supplemental Income and Loss	IRS Form 1120S, U.S. Income Tax Return for an "S" Corporation (IRS Form 1120S) Schedule K-1 (Form 1120S), Shareholder's Share of Income, Deductions, Credits, etc.

The applicant must also submit current documentation of income and expenses using the verification of business expenses form located in Appendix 2. *IRS Form 4506-T, Request for Transcript of Tax Return*, may be used to obtain a copy of a transcript of tax return(s) if the applicant cannot provide copies of actual returns filed.

If an applicant has been self-employed between one and two years, the applicant must demonstrate and the Loan Originator must document two years of previous successful employment in a similar line of work. The applicant's individual tax returns must reflect a history of receiving income at the same (or greater) level in a field that provides the same products or services as the current business.

The income for an applicant that has been self-employed for less than one year is not to be considered stable for repayment purposes.

Calculating Self-Employment Income:
"Making a Cash Flow Analysis"

Individuals and businesses complete tax forms to calculate taxable income or loss. Tax forms by themselves do not tell lenders how much qualifying income an applicant has for a mortgage. The Loan Originator needs to make certain adjustments to the income (or loss) reported in IRS Form 1040 in order to have an accurate picture of the applicant's cash flow. The IRS allows self-employed applicants and business owners to make non-cash deductions to reduce taxable income. Depreciation is the classic example of how a non-cash deduction reduces taxable income but increases the applicant's income for loan qualification purposes. The Loan Originator must carefully review all tax forms to identify non-cash deductions (increasing income) and/or additional expenses (reducing income). The following are the most common adjustments to the net profit/income reported in the applicable tax forms/schedules:

Add Back	Subtract
Depreciation	Employee Business Expenses
Depletion	Meals and Entertainment Exclusion
Nonrecurring Losses	Nonrecurring income (generally reported as "Other Income"
Amortization / Causality Loss (if non recurring)	Nonrecurring Capital Loss
Recurring Capital Gains	

Analyzing Self-Employment Income:
"Income Must be Stable and Dependable"

When analyzing self employment income the Loan Originator must perform a detailed review of the applicant's individual and business tax returns to confirm that the income is stable and dependable (likely to continue).

In general, income from self-employment is considered stable if the applicant has been self-employed for two or more years. Because self-employment income may change each year, the Loan Originator should always develop an average monthly income by using at least two full years of the applicant's self-employment income. An average takes in consideration typical market fluctuations, thus better predicting the applicant's long-term earning ability.

Dependable income refers to the likelihood of continuity of the income. Making this determination requires the Loan Originator to predict future income. The Loan Originator should look at income trends and the stability of the income source. Any specific indication of an upcoming event that might change the applicant's employment or income should be addressed in the loan file and considered in the underwriting decision. For example, if the most recent tax return shows an income considerable higher than reported in the previous tax year, the Loan Originator should investigate further to determine whether the higher income is due to business expansion or a onetime event unlikely to reoccur and continue. Income from a nonrecurring transaction should be excluded from the income calculations. Similarly, a nonrecurring loss should not be deducted from the income calculation.

Other Types of Income Needing a Cash Flow Analysis:

"Special Attention to Commission / Contract Income and Other Business Expenses"

An applicant that receives 25% or more of the annual income in commission, bonuses or tips most likely engages in business activities needing a cash flow analysis. This income may be reported in the IRS Form W-2 or IRS Form 1099 (e.g. real estate agents/contract employees). Non-reimbursed business expenses reported in *IRS Form 2106, Employee Business Expenses*, should be deducted from the income reported on the applicant's tax return.

Commission, bonuses and, tips income may be considered stable if the applicant has received this income for the past two years. After making the cash flow analysis, the Loan Originator should develop a two-year average to make an income determination.

Summary

Income from self-employment may be unpredictable, subject to market/economic fluctuations. Due to the inherent risk of self-employment income, the Loan Originator must consider internal and external economic factors when analyzing self-employment income.

When an applicant is self-employed, or has income needing a cash flow analysis, do not use the total income reported on IRS Form 1040, IRS Form W-2, or IRS Form 1099. Instead, analyze each income line item individually and make the necessary adjustments to the total income/profit. If Loan Originators fail to perform a detailed review and analysis of the borrower's tax return both annual and repayment incomes will be miscalculated.

ATTACHMENT 4-D

REVIEWING DOCUMENTATION FOR CITIZENSHIP STATUS

The purpose of this attachment is to: 1. provide guidance on acceptable evidence that a non-U.S. citizen is a qualified alien; 2. provide access and use guidance for the Systematic Alien Verification for Entitlements (SAVE) database maintained by the Department of Homeland Security (DHS); and 3. describe what documentation non-U.S. citizens must provide, when SAVE does not supply a determination, in order to be considered for SFH program assistance.

A "qualified alien" is defined under the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) (8 U.S.C. Section 1641) as:

1) An alien who is lawfully admitted for permanent residence under the Immigration and Nationality Act;
2) An alien who is granted asylum under Section 208 of such Act;
3) A refugee who is admitted to the United States under Section 207 of such Act;
4) An alien who is paroled into the United States under Section 212(d)(5) of such Act for a period of at least 1 year;
5) An alien whose deportation is being withheld under Section 243(h) of such Act; or
6) An alien who is granted conditional entry pursuant to Section 203(a)(7) of such Act as in effect prior to April 1, 1980;
7) An alien who is a Cuban/Haitian Entrant as defined by Section 501(e) of the Refugee Education Assistance Act of 1980; or
8) An alien who has been battered or subjected to extreme cruelty under Section 431 of the Immigration and Nationality Act (INA).

Native Americans born in Canada also may be considered as lawfully admitted for permanent residence under the Jay Treaty as defined further in this attachment.

SAVE System Access:

Rural Development has entered into an "Interagency Agreement" with the DHS United States Citizenship and Immigration Service (USCIS) to allow access to the SAVE program database. This program enables Rural Development staff to obtain online immigration status information to assist in determining a non-citizen applicant's program eligibility. In most cases, SAVE will provide an immediate response concerning the immigration status of an applicant.

The Loan Originator (LO) must secure proof of identity and evidence that non-citizens who apply for a direct loan are qualified aliens. In all cases, non-citizens legally admitted into the United States will have an Alien Identification Number. <u>In the rare occasion where a number is not available or known, the **applicant** should contact the CIS.</u> (There are cases where an alien has been legally in the US for a long period of time, and the Department of Homeland Security has supplied them with a number, but the alien did not ever receive or has misplaced the number.) The LO should obtain the non-citizen's Alien Identification Number and submit it to SAVE to promptly obtain the applicant's eligibility status based on the alien's Class of Admission (COA).

Selected Agency personnel will be supplied a user name and password to access the SAVE website. Each State Office in need of an ID may submit the name, telephone number, and address of one person who will administer user access to SAVE for the State by email to SFHDirectProgram@wdc.usda.gov. The person will then be given "supervisor" access and will be able to establish other SAVE supervisors and users as needed within their State Office jurisdiction.

Agency staff must complete the SAVE tutorial section once logged on to and prior to using the system. After the tutorial is completed, the employee will be able to enter the applicant's Alien Identification Number (9 digits) into the "Alien number" field, select the program for which the alien is seeking a benefit, and submit the information for processing. <u>**NOTE: Only enter the Alien Identification Number into SAVE**</u>. Social Security numbers, driver's license numbers, or any other number other than an Alien Identification Number **will not** yield a valid result.

The system will normally respond within seconds with the applicant's eligibility and a COA code. In some cases, SAVE will also give a "System Response" indicating the alien's status; however in most cases, the Agency should rely on the COA code.

Agency staff should compare the COA code to those in the tables below. If the code appears in the "Eligible for Benefits" table, print the case verification for the file and proceed with loan processing. Regardless of the COA code, if the response states, "LAWFUL PERMANENT RESIDENT – EMPLOYMENT AUTHORIZED," the applicant is eligible for program assistance.

Alien COA Codes ELIGIBLE for Benefits

A11	AS7	C21	CB7	E12	EC7	F38	HD7	IW2	P23	SK2	SR3
A12	AS8	C22	CF1	E13	EC8	F41	HD8	IW6	PH6	SK3	SR6
A16	B11	C23	CF2	E14	ES1	F42	HD9	IW7	R2	SK4	SR7
A17	B12	C24	CH6	E15	ES6	F43	HE6	K19	R3	SK6	SR8
A31	B16	C25	CR1	E16	EW0	F46	HE7	K20	R51	SK7	T51
A32	B17	C26	CR2	E17	EW3	F47	HE8	K1C	RE	SK8	T52
A33	B20	C27	CR6	E18	EW4	F48	HE9	K1P	RE5	SK9	T53
A36	B21	C28	CR7	E19	EW5	FX1	IB0	LA6	RE6	SL1	T56
A37	B22	C29	CU0	E21	EW8	FX2	IB1	LB1	RE7	SL6	T57
A38	B23	C31	CU6	E22	EW9	FX3	IB2	LB2	RE8	SD3	T58
A41	B24	C32	CU7	E23	F11	FX6	IB3	LB6	RE9	SM0	USC
A42	B25	C33	CU8	E26	F12	FX7	IB5	LB7	RF	SM1	W16
A46	B26	C36	CU9	E27	F16	FX8	IB6	M1	SD1	SM2	W26
A47	B27	C37	CUP	E28	F17	GA6	IB7	M2	SF1	SM3	W36
AA1	B28	C38	CX1	E30	F20	GA7	IB8	M83	SF2	SM4	W46
AA2	B29	C41	CX2	E31	F21	GA8	IC6	M93	SF6	SM5	X
AA3	B31	C42	CX3	E32	F22	HA6	IC7	MR0	SF7	SM6	XB3
AA6	B32	C46	CX6	E34	F23	HA7	IF1	MR6	SG1	SM7	XE3
AA7	B33	C47	CX7	E35	F24	HA8	IF2	MR7	SG2	SM8	XF3
AA8	B36	C51	CX8	E36	F25	HA9	IR0	NA3	SG6	SM9	XN3
AM1	B37	C52	DS1	E37	F26	HB6	IR1	NC6	SG7	SN1	XR3
AM2	B38	C53	DV1	E39	F27	HB7	IR2	NC7	SH1	SN2	Y64
AM3	BX1	C56	DV2	E51	F28	HB8	IR3	NC8	SH2	SN3	Z03
AM6	BX2	C57	DV3	E52	F29	HB9	IR4	NC9	SH6	SN4	Z13
AM7	BX3	C58	DV6	E53	F31	HC6	IR5	NP8	SH7	SN6	Z15
AM8	BX6	C7P	DV7	E56	F32	HC7	IR6	NP9	SJ2	SN7	Z33
AR1	BX7	CB1	DV8	E57	F33	HC8	IR7	P1-1	SJ6	SN8	Z43
AR6	BX8	CB2	E10	E58	F36	HC9	IR9	P21	SJ7	SN9	Z56
AS6	C20	CB6	E11	EC6	F37	HD6	IW1	P22	SK1	SR2	Z66
											Z83

The following table represents COA codes that are either inconclusive or indicate the applicant is not a qualified alien. In these cases, the loan should not be processed without additional documentation that establishes the alien is qualified to receive Federal assistance. The alien should submit at least one of the items described in the section below titled "Documentation that a Non-Citizen is a Qualified Alien." If the alien is not able to submit such documentation, they have not established they are a qualified alien and a loan will not be processed.

Ineligible or Inconclusive COA Codes

991	**BC3**	**DE**	**EX7**	**H1C**	**IT3**	**N3**	**NT8**	**R52**	**S2D**	**SL6**	**T43**	**TW2**
992	**BC6**	**DEC**	**EX8**	**H2**	**IT6**	**N4**	**O1**	**R53**	**SB1**	**SO1**	**T46**	**TW3**
993	**BC7**	**DT1**	**EXC**	**H3**	**IT7**	**N5**	**O2**	**R56**	**SC1**	**SO2**	**T47**	**U1**
994	**BC8**	**DT2**	**EXP**	**H4**	**IT8**	**N6**	**O3**	**R57**	**SC2**	**SU0**	**TA**	**U2**
999	**BCC**	**DT3**	**F1**	**H2B**	**J1**	**N7**	**OP**	**R58**	**SC6**	**SU2**	**TB**	**U3**
A1	**BCD**	**DT4**	**F2**	**H2R**	**J2**	**N8**	**P1**	**RAD**	**SC7**	**SU6**	**TC**	**U4**
A2	**BE**	**DT5**	**F3**	**HK1**	**K1**	**N9**	**P2**	**RE1**	**SD1**	**SU7**	**T48**	**U5**
A3	**C1**	**DT6**	**FFD**	**HK2**	**K2**	**N51**	**P3**	**RE2**	**SD2**	**SU8**	**T1D**	**UN**
ABD	**C2**	**DT7**	**FFG**	**HK3**	**K3**	**N52**	**P4**	**RE3**	**SD3**	**SU9**	**T2D**	**UU**
ABS	**C3**	**DT8**	**FFP**	**HK6**	**K4**	**N53**	**PAC**	**RE4**	**SD6**	**SY6**	**T3D**	**V1**
AO	**C4**	**DX**	**FFW**	**HK7**	**L1**	**N56**	**PEN**	**REC**	**SD7**	**SY7**	**TC1**	**V2**
AS	**CC**	**E1**	**FUG**	**HK8**	**L2**	**N57**	**PL1**	**REM**	**SD8**	**SY8**	**TC2**	**V3**
AS1	**CH**	**E2**	**G1**	**HR 2267**	**LE1**	**N58**	**PL2**	**REP**	**ST0**	**T1**	**TD**	**W1**
AS2	**CP**	**E3**	**G2**	**I1**	**LE2**	**NATO1**	**Q1**	**RN6**	**ST6**	**T2**	**TF1**	**W2**
AS3	**CS1**	**EF**	**G3**	**I51**	**LPR**	**NATO2**	**Q2**	**RN7**	**ST7**	**T3**	**TF2**	**WI**
ASD	**CS2**	**EP**	**G4**	**I52**	**LU1**	**NATO3**	**PL2**	**RW**	**ST8**	**T4**	**TN**	**W1D**
ASP	**CS3**	**ER**	**G5**	**I53**	**LU2**	**NATO4**	**PR**	**S1**	**ST9**	**T5**	**TR**	**W2D**
ASR	**CSS**	**ERF**	**GB**	**I56**	**MI1**	**NATO5**	**Q1**	**S2**	**SDF**	**T21**	**TR1**	**W3D**
AY1	**D1**	**ERP**	**GR**	**I57**	**MI2**	**NATO6**	**Q2**	**S4**	**SE1**	**T22**	**TR2**	**WB**
AY2	**D2**	**ERR**	**GT**	**I58**	**MI3**	**NATO7**	**Q3**	**S8**	**SE2**	**T23**	**TR6**	**WD**
AW	**DA**	**EWI**	**H1**	**ID6**	**M11**	**NT1**	**R1**	**S9**	**SE3**	**T26**	**TR7**	**WR**
B1	**DAS**	**EX1**	**H1A**	**IJ**	**Ml2**	**NT2**	**R5**	**S13**	**SE6**	**T27**	**TRM**	**WT**
B2	**DEP**	**EX2**	**H2A**	**IMM**	**Ml3**	**NT3**	**R2**	**S16**	**SE7**	**T28**	**TS1**	**Z14**
BC1	**DHR**	**EX3**	**H1B**	**IT1**	**N1**	**NT6**	**R4**	**S26**	**SE8**	**T41**	**TS2**	**ZM1**
BC2	**DNA**	**EX6**	**H1B1**	**IT2**	**N2**	**NT7**	**R51**	**S1D**	**SL1**	**T42**	**TW1**	**ZM2**

The SAVE screens provide the ability to "Request Additional Verification" as illustrated in the screen print below**. If SAVE is unable to provide a COA code, Agency staff <u>should not</u> click on the "Request Additional Verification" button without checking with the National Office first.** There is an additional cost to "Request Additional Verification" and in most cases this option will not yield a better result. Frequently, aside from the additional cost, the "Request Additional Verification" function will only result in SAVE requesting that the alien documentation be mailed to USCIS along with a USCIS form.

The Agency should rely on the COA code returned by the first submission to SAVE. On occasion, a SAVE user may receive a COA code that is not mentioned in this attachment. In such cases, the SAVE user should contact the National Office for further assistance.

As previously mentioned in this attachment, LOs must secure proof of identity and evidence that non-citizens who apply for direct loan assistance are qualified aliens. All non-citizens legally admitted into the United States will have an Alien Identification Number which should be checked through the SAVE system by Agency staff to verify the non-citizens immigration status in this country. However, the following documentation may also be obtained to verify whether the non-citizen applicant is a qualified alien, or it may be used in cases where the SAVE feedback was inconclusive.

Please note that if the SAVE response was inconclusive and the alien submits one of the documents below, or if the SAVE inconclusive result arose from an Alien Identification Number which was taken from one of the documents listed below, then the authenticity or validity of the document may be in question. **In such cases, Agency personnel must immediately contact the National Office for additional instructions.**

Documentation that a Non-Citizen is a Qualified Alien

Any of the following documents are acceptable evidence of eligible immigration status:

- *USCIS Form I-551, Alien Registration Receipt Card* (for permanent or conditional resident aliens).

- In some cases, the USCIS will stamp a page of the alien's passport with the following information:

    - PROCESSED FOR I-551
    - TEMPORARY EVIDENCE OF
    - LAWFUL ADMISSION FOR
    - PERMANENT RESIDENCE
    - VALID UNTIL ______________
    - EMPLOYMENT AUTHORIZED

  In these cases, the USCIS official will handwrite the expiration date of the stamp in the blank space after the words "valid until," and may also handwrite the date of issuance above the stamp. Whenever this documentation is submitted as evidence of qualified alien status, a copy of the passport, including the stamped page, should be sent to the nearest USCIS District Office along with *USCIS Form G-845S, "Documentation Verification Request*." The USCIS will return *Form G-845S* to the requesting office with an indication whether the document is valid and relates to a permanent or conditional resident alien. *USCIS Form G-845S* is available on line at http://www.uscis.gov//files//form/g-845s.pdf.

- *USCIS Form I-688B, Employment Authorization Card*, which must be annotated "Provision of Law" followed by one of the provisions listed below:

    - 274 a.12(c)(11),
    - 274 a.12(a)(1),
    - 274 a.12(a)(3),

- 274 a.12(a)(4),
- 274 a.12(a)(5), or
- 274 a.12(a)(10).

- *USCIS Form I-766, Employment Authorization Document*, annotated as follows:
  - A3,
  - A5, or
  - A10.
- *USCIS Form I-571, Refugee Travel Document*;
- *USCIS Form I-94, Arrival-Departure Record*, with one of the following annotations:
  - "Admitted as Refugee Pursuant to Section 207";
  - "Section 208" or "Asylum";
  - "Section 243(h)" or "Deportation stayed by Attorney General";
  - "Paroled Pursuant to Section 212(d)(5) of the INA"; or
  - "Admitted under Section 203(a) (7) of the INA."
- If *USCIS Form I-94* is not annotated, it will still be acceptable evidence of eligible immigration status if it is accompanied by one of the following documents:
  - A final court decision granting asylum (but only if no appeal is taken);
  - A letter from a USCIS officer granting asylum (if application was filed on or after October 1, 1990) or from a USCIS district director granting asylum (if application was filed before October 1, 1990);
  - A court decision granting withholding of deportation; or
  - A letter from a USCIS asylum officer granting withholding of deportation (if application was filed on or after October 1, 1990).
- A receipt issued by the USCIS indicating that an application for issuance of a replacement document in one of the above-listed categories has been made, and the applicant's entitlement to the document has been verified.

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

The LO should review the original of the above documents and make legible photocopies of both the front and back. If the aforementioned documentation appears to be altered or counterfeit, or if the alien presents unfamiliar USCIS documentation, the LO must complete *USCIS Form G-845, Document Verification Request*, and forward it to the nearest USCIS District Office for review. *Form G-845* is available on the internet at the following address: http://www.uscis.gov/files/form/g-845s.pdf. Legible copies of the alien's documentation should be attached to *Form G-845* when submitted. Note that there is a 10 business day USCIS processing period. The original documents should be returned to the non-citizen. The locations of USCIS District Offices are available on the internet at the following address: https://egov.immigration.gov/crisgwi/go?action=offices.type&OfficeLocator.office_type=LO.

Documentation for Native Americans in the United States under the Jay Treaty

Native Americans covered by the Jay Treaty of 1794 and born in Canada may also be eligible as lawfully admitted for permanent residence if they meet the requirements of 8 U.S.C. Section 1359. They might not possess any of the documentation described above, and the Agency might not be able to verify their status through SAVE. To establish that they are a qualified alien, the Native American should provide **all** of the documentation listed below as described in the Wabanaki Legal News which is available on the internet at http://www.ptla.org/wabanaki/jaytreaty.htm

- A letter from their Native American tribe stating that the alien has at least 50 percent Native American or Aboriginal blood (also referred to as the blood quantum);
- Their Canadian "Certificate of Indian Status Card" with a red stripe along the top;
- Their birth certificate;
- If an Haudenosaunee, their Red I.D. Card;
- If an Inuit, an Inuit enrollment card from one of the regional Inuit lands claim agreements;
- Their Social Security Card issued by the U.S. Social Security Administration; and
- Their Canadian or U.S. driver license.