

II. ORIGINATION THROUGH POST-CLOSING/ENDORSEMENT

A. Title II Insured Housing Programs Forward Mortgages

5. Manual Underwriting of the Borrower

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The Mortgagee must manually underwrite those applications where the AUS issues a Refer or applications which were downgraded to a manual underwrite.

If a Mortgage receiving the AUS Refer or downgrade to manual processing involves a HUD employee, the Mortgagee must underwrite the transaction in accordance with the guidance in this Manual Underwriting section. The Mortgagee must submit the underwritten mortgage application to the Processing and Underwriting Division Director at the [Jurisdictional HOC](#) for [final underwriting approval](#).

a. Credit Requirements (Manual)

i. General Credit Requirements (Manual)

FHA's general credit policy requires Mortgagees to analyze the Borrower's credit history, liabilities, and debts to determine creditworthiness.

The Mortgagee must either obtain a Tri-Merged Credit Report (TRMCR) or a Residential Mortgage Credit Report (RMCR) from an independent consumer reporting agency.

The Mortgagee must utilize the same credit report and credit scores sent to TOTAL.

The Mortgagee must obtain a credit report for each Borrower who will be obligated on the mortgage Note. The Mortgagee may obtain a joint report for individuals with joint accounts.

The Mortgagee must obtain a credit report for a non-borrowing spouse who resides in a community property state, or if the subject Property is located in a community property state. The credit report must indicate the non-borrowing spouse's SSN, where an SSN exists, was matched with the SSA, or the Mortgagee must either provide separate documentation indicating that the SSN was matched with the SSA or provide a statement that the non-borrowing spouse does not have an SSN. Where an SSN does not exist for a non-borrowing spouse, the credit report must contain, at a minimum, the non-borrowing spouse's full name, date of birth, and previous addresses for the last two years.

The Mortgagee is not required to obtain a credit report for non-credit qualifying Streamline Refinance transactions.

ii. Types of Credit History (Manual)

If a traditional credit report is available, the Mortgagee must use a traditional credit report. However, if a traditional credit report is not available, the Mortgagee must develop the Borrower's credit history using the requirements for [Non-Traditional and Insufficient Credit](#).

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(A) Traditional Credit (Manual)

If the TRMCR or RMCR generates a credit score, the Mortgagee must utilize traditional credit history.

(1) Requirements for the Credit Report

Credit reports must obtain all information from at least two credit repositories pertaining to credit, residence history, and public records information; be in an easy to read and understandable format; and not require code translations. The credit report may not contain whiteouts, erasures, or alterations. The Mortgagee must retain copies of all credit reports.

The credit report must include:

- the name of the Mortgagee ordering the report;
- the name, address, and telephone number of the consumer-reporting agency;
- the name and SSN of each Borrower; and
- the primary repository from which any particular information was pulled, for each account listed.

A truncated SSN is acceptable for FHA mortgage insurance purposes provided that the mortgage application captures the full nine-digit SSN.

The credit report must also include:

- all inquiries made within the last 90 Days;
- all credit and legal information not considered obsolete under the Fair Credit Reporting Act (FCRA), including information for the last seven years regarding:
 - bankruptcies;
 - Judgments;
 - lawsuits;
 - foreclosures; and
 - tax liens; and
- for each Borrower debt listed:
 - the date the account was opened;
 - high credit amount;
 - required monthly payment amount;
 - unpaid balance; and
 - payment history.

(2) Updated Credit Report or Supplement to the Credit Report

The Mortgagee must obtain an updated credit report or supplement if the underwriter identifies inconsistencies between any information in the mortgage file and the original credit report.

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(3) Credit Information Not Listed on Credit Report

A Mortgagee must develop credit information separately for any open debt listed on the mortgage application but not referenced in the credit report by using the procedures for [Independent Verification of Non-Traditional Credit Providers](#).

(4) Specific Requirements for Residential Mortgage Credit Report

In addition to meeting the general credit report requirements, the RMCR must:

- provide a detailed account of the Borrower's employment history;
- verify each Borrower's current employment and income through an interview with the Borrower's employer or explain why such an interview was not completed;
- contain a statement attesting to the certification of employment for each Borrower and the date the information was verified; and
- report a credit history for each trade line within 90 Days of the credit report for each account with a balance.

(B) Non-Traditional and Insufficient Credit (Manual)

For Borrowers without a credit score, the Mortgagee must either obtain a Non-Traditional Mortgage Credit Report (NTMCR) from a credit reporting company or independently develop the Borrower's credit history using the requirements outlined below.

(1) Non-Traditional Mortgage Credit Report

(a) Definition

An NTMCR is designed to access the credit history of a Borrower who does not have the types of trade references that appear on a traditional credit report and used either as:

- a substitute for a TRMCR or an RMCR; or
- a supplement to a traditional credit report that has an insufficient number of trade items reported to generate a credit score.

(b) Standard

Mortgagees may use a NTMCR developed by a credit reporting agency that verifies the following information for all non-traditional credit references:

- the existence of the credit providers;
- that the credit was actually extended to the Borrower; and
- the creditor has a published address or telephone number.

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The NTMCR must not include subjective statements such as “satisfactory” or “acceptable,” must be formatted in a similar fashion to traditional references, and provide the:

- creditor’s name;
- date of opening;
- high credit;
- current status of the account;
- 12-month history of the account;
- required monthly payment;
- unpaid balance; and
- payment history in the delinquency categories (for example, 0x30 and 0x60).

(2) Independent Verification of Non-Traditional Credit Providers

The Mortgagee may independently verify the Borrower’s credit references by documenting the existence of the credit provider and that the provider extended credit to the Borrower.

- a. To verify the existence of each credit provider, the Mortgagee must review public records from the state, county, or city or other documents providing a similar level of objective information.
- b. To verify credit information, the Mortgagee must:
 - use a published address or telephone number for the credit provider and not rely solely on information provided by the applicant; and
 - obtain the most recent 12 months of canceled checks, or equivalent proof of payment, demonstrating the timing of payment to the credit provider.
- c. To verify the Borrower’s rental payment history, the Mortgagee must obtain a rental reference from the appropriate rental management company, provided the Borrower is not renting from a Family Member, demonstrating the timing of payment of the most recent 12 months in lieu of 12 months of canceled checks or equivalent proof of payment.

(3) Sufficiency of Credit References

To be sufficient to establish the Borrower’s credit, the credit history must include three credit references, including at least one of the following:

- rental housing payments (subject to independent verification if the Borrower is a renter);
- telephone service; or
- utility company reference (if not included in the rental housing payment), including:
 - gas;
 - electricity;

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- water;
- television service; or
- Internet service.

If the Mortgagee cannot obtain all three credit references from the list above, the Mortgagee may use the following sources of unreported recurring debt:

- insurance premiums not payroll deducted (for example, medical, auto, life, renter's insurance);
- payment to child care providers made to businesses that provide such services;
- school tuition;
- retail store credit cards (for example, from department, furniture, appliance stores, or specialty stores);
- rent-to-own (for example, furniture, appliances);
- payment of that part of medical bills not covered by insurance;
- a documented 12-month history of savings evidenced by regular deposits resulting in an increased balance to the account that:
 - were made at least quarterly;
 - were not payroll deducted, and;
 - caused no insufficient funds (NSF) checks;
- an automobile lease;
- a personal loan from an individual with repayment terms in writing and supported by canceled checks to document the payments; or
- a documented 12-month history of payment by the Borrower on an account for which the Borrower is an authorized user.

iii. Evaluating Credit History (Manual)

(A) General Credit (Manual)

The underwriter must examine the Borrower's overall pattern of credit behavior, not just isolated unsatisfactory or slow payments, to determine the Borrower's creditworthiness.

The Mortgagee must not consider the credit history of a non-borrowing spouse.

(B) Types of Payment Histories (Manual)

The underwriter must evaluate the Borrower's payment histories in the following order: (1) previous housing expenses and related expenses, including utilities; (2) installment debts; and (3) revolving accounts.

(1) Satisfactory Credit

The underwriter may consider a Borrower to have an acceptable payment history if the Borrower has made all housing and installment debt payments on time for

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the previous 12 months and has no more than two 30-Day late Mortgage Payments or installment payments in the previous 24 months.

The underwriter may approve the Borrower with an acceptable payment history if the Borrower has no major derogatory credit on revolving accounts in the previous 12 months.

Major derogatory credit on revolving accounts must include any payments made more than 90 Days after the due date, or three or more payments more than 60 Days after the due date.

(2) Payment History Requiring Additional Analysis

If a Borrower's credit history does not reflect satisfactory credit as stated above, the Borrower's payment history requires additional analysis.

The Mortgagee must analyze the Borrower's delinquent accounts to determine whether late payments were based on a disregard for financial obligations, an inability to manage debt, or extenuating circumstances. The Mortgagee must document this analysis in the mortgage file. Any explanation or documentation of delinquent accounts must be consistent with other information in the file.

The underwriter may only approve a Borrower with a credit history not meeting the satisfactory credit history above if the underwriter has documented the delinquency was related to extenuating circumstances.

(C) Payment History on Housing Obligations (Manual)

The Mortgagee must determine the Borrower's Housing Obligation payment history through:

- the credit report;
- verification of rent received directly from the landlord (for landlords with no Identity of Interest with the Borrower);
- verification of Mortgage received directly from the Servicer; or
- a review of canceled checks that cover the most recent 12-month period.

The Mortgagee must verify and document the previous 12 months' housing history. For Borrowers who indicate they are living rent-free, the Mortgagee must obtain verification from the property owner where they are residing that the Borrower has been living rent-free and the amount of time the Borrower has been living rent free.

A Mortgage that has been modified must utilize the payment history in accordance with the modification agreement for the time period of modification in determining late housing payments.

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(D) Collection Accounts (Manual)

(1) Definition

A Collection Account is a Borrower's loan or debt that has been submitted to a collection agency through a creditor.

(2) Standard

The Mortgagee must determine if collection accounts were a result of:

- the Borrower's disregard for financial obligations;
- the Borrower's inability to manage debt; or
- extenuating circumstances.

(3) Required Documentation

The Mortgagee must document reasons for approving a Mortgage when the Borrower has any collection accounts.

The Borrower must provide a letter of explanation, which is supported by documentation, for each outstanding collection account. The explanation and supporting documentation must be consistent with other credit information in the file.

(E) Charge Off Accounts (Manual)

(1) Definition

Charge Off Account refers to a Borrower's loan or debt that has been written off by the creditor.

(2) Standard

The Mortgagee must determine if Charge Off Accounts were a result of:

- the Borrower's disregard for financial obligations;
- the Borrower's inability to manage debt; or
- extenuating circumstances.

(3) Required Documentation

The Mortgagee must document reasons for approving a Mortgage when the Borrower has any Charge Off Accounts.

The Borrower must provide a letter of explanation, which is supported by documentation, for each outstanding Charge Off Account. The explanation and supporting documentation must be consistent with other credit information in the file.

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(F) Disputed Derogatory Credit Accounts (Manual)

(1) Definition

Disputed Derogatory Credit Account refers to disputed Charge Off Accounts, disputed collection accounts, and disputed accounts with late payments in the last 24 months.

(2) Standard

The Mortgagee must analyze the documentation provided for consistency with other credit information to determine if the derogatory credit account should be considered in the underwriting analysis.

The following items may be excluded from consideration in the underwriting analysis:

- disputed medical accounts; and
- disputed derogatory credit resulting from identity theft, credit card theft or unauthorized use provided the Mortgagee includes a copy of the police report or other documentation from the creditor to support the status of the account in the mortgage file.

(3) Required Documentation

If the credit report indicates that the Borrower is disputing derogatory credit accounts, the Borrower must provide a letter of explanation and documentation supporting the basis of the dispute.

If the disputed derogatory credit resulted from identity theft, credit card theft or unauthorized use balances, the Mortgagee must obtain a copy of the police report or other documentation from the creditor to support the status of the accounts.

(G) Judgments (Manual)

(1) Definition

Judgment refers to any debt or monetary liability of the Borrower, and the Borrower's spouse in a community property state unless excluded by state law, created by a court, or other adjudicating body.

(2) Standard

The Mortgagee must verify that court-ordered Judgments are resolved or paid off prior to or at closing.

Judgments of a non-borrowing spouse in a community property state must be resolved or paid in full, with the exception of obligations excluded by state law.

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Regardless of the amount of outstanding Judgments, the Mortgagee must determine if the Judgment was a result of:

- the Borrower's disregard for financial obligations;
- the Borrower's inability to manage debt; or
- extenuating circumstances.

Exception

A Judgment is considered resolved if the Borrower has entered into a valid agreement with the creditor to make regular payments on the debt, the Borrower has made timely payments for at least three months of scheduled payments and the Judgment will not supersede the FHA-insured mortgage lien. The Borrower cannot prepay scheduled payments in order to meet the required minimum of three months of payments.

The Mortgagee must include the payment amount in the agreement in the calculation of the Borrower's Debt-to-Income (DTI) ratio.

The Mortgagee must obtain a copy of the agreement and evidence that payments were made on time in accordance with the agreement.

(3) Required Documentation

The Mortgagee must provide the following documentation:

- evidence of payment in full, if paid prior to settlement;
- the payoff statement, if paid at settlement; or
- the payment arrangement with creditor, if not paid prior to or at settlement, and a subordination agreement for any liens existing on title.

(H)Bankruptcy (Manual)

(1) Standard: Chapter 7

A Chapter 7 bankruptcy (liquidation) does not disqualify a Borrower from obtaining an FHA-insured Mortgage if, at the time of case number assignment, at least two years have elapsed since the date of the bankruptcy discharge. During this time, the Borrower must have:

- re-established good credit; or
- chosen not to incur new credit obligations.

An elapsed period of less than two years, but not less than 12 months, may be acceptable, if the Borrower:

- can show that the bankruptcy was caused by extenuating circumstances beyond the Borrower's control; and
- has since exhibited a documented ability to manage their financial affairs in a responsible manner.

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(2) Standard: Chapter 13

A Chapter 13 bankruptcy does not disqualify a Borrower from obtaining an FHA-insured Mortgage, if at the time of case number assignment at least 12 months of the pay-out period under the bankruptcy has elapsed.

The Mortgagee must determine that during this time, the Borrower's payment performance has been satisfactory and all required payments have been made on time; and the Borrower has received written permission from bankruptcy court to enter into the mortgage transaction.

(3) Required Documentation

If the credit report does not verify the discharge date or additional documentation is necessary to determine if any liabilities were discharged in the bankruptcy, the Mortgagee must obtain the bankruptcy and discharge documents.

The Mortgagee must also document that the Borrower's current situation indicates that the events which led to the bankruptcy are not likely to recur.

(I) Foreclosure and Deed-in-Lieu of Foreclosure (Manual)

(1) Standard

A Borrower is generally not eligible for a new FHA-insured Mortgage if the Borrower had a foreclosure or a DIL of foreclosure in the three-year period prior to the date of case number assignment.

This three-year period begins on the date of the DIL or the date that the Borrower transferred ownership of the Property to the foreclosing Entity/designee.

Exceptions

The Mortgagee may grant an exception to the three-year requirement if the foreclosure was the result of documented extenuating circumstances that were beyond the control of the Borrower, such as a serious illness or death of a wage earner, and the Borrower has re-established good credit since the foreclosure.

Divorce is not considered an extenuating circumstance. An exception may, however, be granted where a Borrower's Mortgage was current at the time of the Borrower's divorce, the ex-spouse received the Property, and the Mortgage was later foreclosed.

The inability to sell the Property due to a job transfer or relocation to another area does not qualify as an extenuating circumstance.

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(2) Required Documentation

If the credit report does not indicate the date of the foreclosure or DIL of foreclosure, the Mortgagee must obtain the Closing Disclosure, deed or other legal documents evidencing the date of property transfer.

If the foreclosure or DIL of foreclosure was the result of a circumstance beyond the Borrower's control, the Mortgagee must obtain an explanation of the circumstance and document that the circumstance was beyond the Borrower's control.

(J) Pre-Foreclosure Sales (Short Sales) (Manual)

(1) Definition

Pre-Foreclosure Sales, also known as Short Sales, refer to the sales of real estate that generate proceeds that are less than the amount owed on the Property and the lien holders agree to release their liens and forgive the deficiency balance on the real estate.

(2) Standard

A Borrower is generally not eligible for a new FHA-insured Mortgage if they relinquished a Property through a Short Sale within three years from the date of case number assignment.

This three-year period begins on the date of transfer of title by Short Sale.

(a) Exception for Borrower Current at the Time of Short Sale

A Borrower is considered eligible for a new FHA-insured Mortgage if, from the date of case number assignment for the new Mortgage:

- all Mortgage Payments on the prior Mortgage were made within the month due for the 12-month period preceding the Short Sale; and
- installment debt payments for the same time period were also made within the month due.

(b) Exception for Extenuating Circumstances

The Mortgagee may grant an exception to the three-year requirement if the Short Sale was the result of documented extenuating circumstances that were beyond the control of the Borrower, such as a serious illness or death of a wage earner, and the Borrower has re-established good credit since the Short Sale.

Divorce is not considered an extenuating circumstance. An exception may, however, be granted where a Borrower's Mortgage was current at the time of

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the Borrower's divorce, the ex-spouse received the Property, and there was a subsequent Short Sale.

The inability to sell the Property due to a job transfer or relocation to another area does not qualify as an extenuating circumstance.

(3) Required Documentation

If the credit report does not indicate the date of the Short Sale, the Mortgagee must obtain the Closing Disclosure, deed or other legal documents evidencing the date of property transfer.

If the Short Sale was the result of a circumstance beyond the Borrower's control, the Mortgagee must obtain an explanation of the circumstance and document that the circumstance was beyond the Borrower's control.

(K) Credit Counseling/Payment Plan

Participating in a consumer credit counseling program does not disqualify a Borrower from obtaining an FHA-insured Mortgage, provided the Mortgagee documents that:

- one year of the pay-out period has elapsed under the plan;
- the Borrower's payment performance has been satisfactory and all required payments have been made on time; and
- the Borrower has received written permission from the counseling agency to enter into the mortgage transaction.

iv. Evaluating Liabilities and Debts (Manual)

(A) General Liabilities and Debts (Manual)

(1) Standard

The Mortgagee must determine the Borrower's monthly liabilities by reviewing all debts listed on the credit report, *URLA*, and required documentation.

All applicable monthly liabilities must be included in the qualifying ratio. Closed-end debts do not have to be included if they will be paid off within 10 months and the cumulative payments of all such debts are less than or equal to 5 percent of the Borrower's gross monthly income. The Borrower may not pay down the balance in order to meet the 10-month requirement.

Accounts for which the Borrower is an authorized user must be included in a Borrower's DTI ratio unless the Mortgagee can document that the primary account holder has made all required payments on the account for the previous 12 months. If less than three payments have been required on the account in the previous 12 months, the payment amount must be included in the Borrower's DTI.

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Negative income must be subtracted from the Borrower's gross monthly income, and not treated as a recurring monthly liability unless otherwise noted.

Loans secured against deposited funds, where repayment may be obtained through extinguishing the asset and these funds are not included in calculating the Borrower's assets, do not require consideration of repayment for qualifying purposes.

(2) Required Documentation

The Mortgagee must document that the funds used to pay off debts prior to closing came from an [acceptable source](#), and the Borrower did not incur new debts that were not included in the DTI ratio.

(B) Undisclosed Debt and Inquiries (Manual)

(1) Standard

When a debt or obligation is revealed during the application process that was not listed on the mortgage application and/or credit report, the Mortgagee must:

- verify the actual monthly payment amount;
- include the payment amount in the agreement in the Borrower's monthly liabilities and debt; and
- determine that any unsecured funds borrowed were not/will not be used for the Borrower's MRI.

The Mortgagee must obtain a written explanation from the Borrower for all inquiries shown on the credit report that were made in the last 90 Days.

(2) Required Documentation

The Mortgagee must document all undisclosed debt and support for its analysis of the Borrower's debt.

(C) Federal Debt (Manual)

(1) Definition

Federal Debt refers to debt owed to the federal government for which regular payments are being made.

(2) Standard

The Mortgagee must include the debt. The amount of the required payment must be included in the calculation of the Borrower's total debt to income.

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(3) Required Documentation

The Mortgagee must include documentation from the federal agency evidencing the repayment agreement and verification of payments made, if applicable.

(D) Alimony, Child Support, and Maintenance (Manual)

(1) Definition

Alimony, Child Support, and Maintenance are court-ordered or otherwise agreed upon payments.

(2) Standard

For Alimony, if the Borrower's income was not reduced by the amount of the monthly alimony obligation in the Mortgagee's calculation of the Borrower's gross income, the Mortgagee must verify and include the monthly obligation in its calculation of the Borrower's debt.

Child Support and Maintenance are to be treated as a recurring liability and the Mortgagee must include the monthly obligation in the Borrower's liabilities and debt.

(3) Required Documentation

The Mortgagee must obtain the official signed divorce decree, separation agreement, maintenance agreement, or other legal order.

The Mortgagee must also obtain the Borrower's pay stubs covering no less than 28 consecutive Days to verify whether the Borrower is subject to any order of garnishment relating to the Alimony, Child Support, and Maintenance.

(4) Calculation of Monthly Obligation

The Mortgagee must calculate the Borrower's monthly obligation from the greater of:

- the amount shown on the most recent decree or agreement establishing the Borrower's payment obligation; or
- the monthly amount of the garnishment.

(E) Non-Borrowing Spouse Debt in Community Property States (Manual)

(1) Definition

Non-Borrowing Spouse Debt refers to debts owed by a spouse that are not owed by, or in the name of the Borrower.

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(2) Standard

If the Borrower resides in a community property state or the Property being insured is located in a community property state, debts of the non-borrowing spouse must be included in the Borrower's qualifying ratios, except for obligations specifically excluded by state law.

The non-borrowing spouse's credit history is not considered a reason to deny a mortgage application.

(3) Required Documentation

The Mortgagee must verify and document the debt of the non-borrowing spouse.

The Mortgagee must make a note in the file referencing the specific state law that justifies the exclusion of any debt from consideration.

The Mortgagee must obtain a credit report for the non-borrowing spouse in order to determine the debts that must be counted in the DTI ratio.

(F) Deferred Obligations (Manual)

(1) Definition

Deferred Obligations (excluding Student Loans) refer to liabilities that have been incurred but where payment is deferred or has not yet commenced, including accounts in forbearance.

(2) Standard

The Mortgagee must verify and include deferred obligations in the calculation of the Borrower's liabilities.

(3) Required Documentation

The Mortgagee must obtain written documentation of the deferral of the liability from the creditor and evidence of the outstanding balance and terms of the deferred liability. The Mortgagee must obtain evidence of the actual monthly payment obligation, if available.

(4) Calculation of Monthly Obligation

The Mortgagee must use the actual monthly payment to be paid on a deferred liability, whenever available.

If the actual monthly payment is not available for installment debt, the Mortgagee must utilize the terms of the debt or 5 percent of the outstanding balance to establish the monthly payment.

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(G) Student Loans (Manual)

(1) Definition

Student Loan refers to liabilities incurred for educational purposes.

(2) Standard

The Mortgagee must include all Student Loans in the Borrower's liabilities, regardless of the payment type or status of payments.

(3) Required Documentation

If the payment used for the monthly obligation is:

- less than 1 percent of the outstanding balance reported on the Borrower's credit report; and
 - less than the monthly payment reported on the Borrower's credit report;
- the Mortgagee must obtain written documentation of the actual monthly payment, the payment status, and evidence of the outstanding balance and terms from the creditor.

(4) Calculation of Monthly Obligation

Regardless of the payment status, the Mortgagee must use either:

- the greater of:
 - 1 percent of the outstanding balance on the loan; or
 - the actual documented payment; or
- if the actual documented payment is less than 1 percent of the outstanding balance, the Mortgagee may use the lower payment only if it will fully amortize the loan over its term.

(H) Installment Loans (Manual)

(1) Definition

Installment Loans (excluding Student Loans) refer to loans, not secured by real estate, that require the periodic payment of P&I. A loan secured by an interest in a timeshare must be considered an Installment Loan.

(2) Standard

The Mortgagee must include the monthly payment shown on the credit report, loan agreement or payment statement to calculate the Borrower's liabilities.

If the credit report does not include a monthly payment for the loan, the Mortgagee must use the amount of the monthly payment shown in the loan agreement or payment statement.

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(3) Required Documentation

If the monthly payment shown on the credit report is utilized to calculate the monthly debts, no further documentation is required.

If the credit report does not include a monthly payment for the loan, or the payment reported on the credit report is greater than the payment on the loan agreement or payment statement, the Mortgagee must obtain a copy of the loan agreement or payment statement documenting the amount of the monthly payment. If the credit report, loan agreement or payment statement shows a deferred payment arrangement for an Installment Loan, refer to the [Deferred Obligations](#) section.

(I) Revolving Charge Accounts (Manual)

(1) Definition

A Revolving Charge Account refers to a credit arrangement that requires the Borrower to make periodic payments but does not require full repayment by a specified point of time.

(2) Standard

The Mortgagee must include the monthly payment shown on the credit report for the Revolving Charge Account. Where the credit report does not include a monthly payment for the account, the Mortgagee must use the payment shown on the current account statement or 5 percent of the outstanding balance.

(3) Required Documentation

The Mortgagee must use the credit report to document the terms, balance and payment amount on the account, if available.

Where the credit report does not reflect the necessary information on the charge account, the Mortgagee must obtain a copy of the most recent charge account statement or use 5 percent of the outstanding balance to document the monthly payment.

(J) 30-Day Accounts (Manual)

(1) Definition

A 30-Day Account refers to a credit arrangement that requires the Borrower to pay off the outstanding balance on the account every month.

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(2) Standard

The Mortgagee must verify the Borrower paid the outstanding balance in full on every 30-Day Account each month for the past 12 months. 30-Day Accounts that are paid monthly are not included in the Borrower's DTI. If the credit report reflects any late payments in the last 12 months, the Mortgagee must utilize 5 percent of the outstanding balance as the Borrower's monthly debt to be included in the DTI.

(3) Required Documentation

The Mortgagee must use the credit report to document that the Borrower has paid the balance on the account monthly for the previous 12 months. The Mortgagee must use the credit report to document the balance, and must document that funds are available to pay off the balance, in excess of the funds and Reserves required to close the Mortgage.

(K) Business Debt in Borrower's Name (Manual)

(1) Definition

Business Debt in Borrower's Name refers to liabilities reported on the Borrower's personal credit report, but payment for the debt is attributed to the Borrower's business.

(2) Standard

When business debt is reported on the Borrower's personal credit report, the debt must be included in the DTI calculation, unless the Mortgagee can document that the debt is being paid by the Borrower's business, and the debt was considered in the cash flow analysis of the Borrower's business. The debt is considered in the cash flow analysis where the Borrower's business tax returns reflect a business expense related to the obligation, equal to or greater than the amount of payments documented as paid out of company funds. Where the Borrower's business tax returns show an interest expense related to the obligation, only the interest portion of the debt is considered in the cash flow analysis.

(3) Required Documentation

When a self-employed Borrower states debt appearing on their personal credit report is being paid by their business, the Mortgagee must obtain documentation that the debt is paid out of company funds and that the debt was considered in the cash flow analysis of the Borrower's business.

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(L) Disputed Derogatory Credit Accounts (Manual)

(1) Definition

Disputed Derogatory Credit Accounts refer to disputed Charge Off Accounts, disputed collection accounts, and disputed accounts with late payments in the last 24 months.

(2) Standard

If the Borrower has \$1,000 or more collectively in Disputed Derogatory Credit Accounts, the Mortgagee must include a monthly payment in the Borrower's debt calculation.

The following items are excluded from the cumulative balance:

- disputed medical accounts; and
- disputed derogatory credit resulting from identity theft, credit card theft or unauthorized use.

Disputed Derogatory Credit Accounts of a non-borrowing spouse in a community property state are not included in the cumulative balance.

(M) Non-derogatory Disputed Account and Disputed Accounts Not Indicated on the Credit Report (Manual)

(1) Definition

Non-Derogatory Disputed Accounts include the following types of accounts:

- disputed accounts with zero balance;
- disputed accounts with late payments aged 24 months or greater; or
- disputed accounts that are current and paid as agreed.

(2) Standard

If a Borrower is disputing non-derogatory accounts, or is disputing accounts which are not indicated on the credit report as being disputed, the Mortgagee must analyze the effect of the disputed accounts on the Borrower's ability to repay the loan. If the dispute results in the Borrower's monthly debt payments utilized in computing the DTI ratio being less than the amount indicated on the credit report, the Borrower must provide documentation of the lower payments.

(N) Contingent Liabilities (Manual)

(1) Definition

A Contingent Liability is a liability that may result in the obligation to repay only where a specific event occurs. For example, a contingent liability exists when an

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individual can be held responsible for the repayment of a debt if another legally obligated party defaults on the payment. Contingent liabilities may include Cosigner liabilities and liabilities resulting from a mortgage assumption without release of liability.

(2) Standard

The Mortgagee must include monthly payments on contingent liabilities in the calculation of the Borrower's monthly obligations unless the Mortgagee verifies that there is no possibility that the debt holder will pursue debt collection against the Borrower should the other party default or the other legally obligated party has made 12 months of timely payments.

(3) Required Documentation

(a) Mortgage Assumptions

The Mortgagee must obtain the agreement creating the contingent liability or assumption agreement and deed showing transfer of title out of the Borrower's name.

(b) Cosigned Liabilities

If the cosigned liability is not included in the monthly obligation, the Mortgagee must obtain documentation to evidence that the other party to the debt has been making regular on-time payments during the previous 12 months, and does not have a history of delinquent payments on the loan.

(c) Court Ordered Divorce Decree

The Mortgagee must obtain a copy of the divorce decree ordering the spouse to make payments.

(4) Calculation of Monthly Obligation

The Mortgagee must calculate the monthly payment on the contingent liability based on the terms of the agreement creating the contingent liability.

(O)Collection Accounts (Manual)

(1) Definition

A Collection Account refers to a Borrower's loan or debt that has been submitted to a collection agency by a creditor.

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(2) Standard

If the credit reports used in the analysis show cumulative outstanding collection account balances of \$2,000 or greater, the Mortgagee must:

- verify that the debt is paid in full at the time of or prior to settlement using an acceptable [source of funds](#);
- verify that the Borrower has made payment arrangements with the creditor; or
- if a payment arrangement is not available, calculate the monthly payment using 5 percent of the outstanding balance of each collection and include the monthly payment in the Borrower's DTI ratio.

Collection accounts of a non-borrowing spouse in a community property state must be included in the \$2,000 cumulative balance and analyzed as part of the Borrower's ability to pay all collection accounts, unless specifically excluded by state law.

(3) Required Documentation

The Mortgagee must provide the following documentation:

- evidence of payment in full, if paid prior to settlement;
- the payoff statement, if paid at settlement; or
- the payment arrangement with creditor, if not paid prior to or at settlement.

If the Mortgagee uses 5 percent of the outstanding balance, no documentation is required.

(P) Charge Off Accounts (Manual)

(1) Definition

Charge Off Account refers to a Borrower's loan or debt that has been written off by the creditor.

(2) Standard

Charge Off Accounts do not need to be included in the Borrower's liabilities or debt.

(Q) Private Savings Clubs (Manual)

(1) Definition

Private Savings Club refers to a non-traditional method of saving by making deposits into a member-managed resource pool.

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(2) Standard

If the Borrower is obligated to continue making ongoing contributions under the pooled savings agreement, this obligation must be counted in the Borrowers' total debt.

The Mortgagee must verify and document the establishment and duration of the Borrower's membership in the club and the amount of the Borrower's required contribution to the club.

(3) Required Documentation

The Mortgagee must also obtain the club's account ledgers and receipts, and verification from the club treasurer that the club is still active.

(R) Obligations Not Considered Debt

Obligations not considered debt include:

- medical collections
- federal, state, and local taxes, if not delinquent and no payments required
- automatic deductions from savings, when not associated with another type of obligation
- Federal Insurance Contributions Act (FICA) and other retirement contributions, such as 401(k) accounts
- collateralized loans secured by depository accounts
- utilities
- child care
- commuting costs
- union dues
- insurance, other than property insurance
- open accounts with zero balances
- voluntary deductions, when not associated with another type of obligation

b. Income Requirements (Manual)

Effective Income Definition

Effective Income refers to income that may be used to qualify a Borrower for a Mortgage. Effective Income must be reasonably likely to continue through at least the first three years of the Mortgage, and meet the specific requirements described below.

i. General Income Requirements (Manual)

The Mortgagee must document the Borrower's income and employment history, verify the accuracy of the amounts of income being reported, and determine if the income can be considered as Effective Income in accordance with the requirements listed below.

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The Mortgagee may only consider income if it is legally derived and, when required, properly reported as income on the Borrower's tax returns.

Negative income must be subtracted from the Borrower's gross monthly income and not treated as a recurring monthly liability unless otherwise noted.

ii. Employment Related Income (Manual)

(A) Definition

Employment Income refers to income received as an employee of a business that is reported on IRS Form W-2.

(B) Standard

The Mortgagee may use Employment related Income as Effective Income in accordance with the standards provided for each type of Employment related Income.

(C) Required Documentation

For all Employment related Income, the Mortgagee must verify the Borrower's most recent two years of employment and income, and document using one of the following methods.

(1) Traditional Current Employment Documentation

The Mortgagee must obtain the most recent pay stubs covering a minimum of 30 consecutive Days (if paid weekly or bi-weekly, pay stubs must cover a minimum of 28 consecutive Days) that show the Borrower's year-to-date earnings, and one of the following to verify current employment:

- a written Verification of Employment (VOE) covering two years; or
- an electronic verification acceptable to FHA.

Re-verification of employment must be completed within 10 Days prior to the date of the Note. Verbal re-verification of employment is acceptable.

(2) Alternative Current Employment Documentation

If using alternative documentation, the Mortgagee must:

- obtain copies of the pay stubs covering the most recent 30 consecutive Days (if paid weekly or bi-weekly, pay stubs must cover a minimum of 28 consecutive Days) that show the Borrower's year-to-date earnings;
- obtain copies of the original IRS W-2 forms from the previous two years; and
- document current employment by telephone, sign and date the verification documentation, and note the name, title, and telephone number of the person with whom employment was verified.

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Re-verification of employment must be completed within 10 Days prior to the date of the Note. Verbal re-verification of employment is acceptable.

(3) Past Employment Documentation

Direct verification of the Borrower's employment history for the previous two years is not required if all of the following conditions are met:

- The current employer confirms a two year employment history, or a paystub reflects a hiring date.
- Only base pay is used to qualify (no Overtime or Bonus Income).
- The Borrower executes [IRS Form 4506](#), *Request for Copy of Tax Return*, [IRS Form 4506-T](#), *Request for Transcript of Tax Return*, or [IRS Form 8821](#), *Tax Information Authorization*, for the previous two tax years.

If the applicant has not been employed with the same employer for the previous two years and/or not all conditions immediately above can be met, then the Mortgagee must obtain one or a combination of the following for the most recent two years to verify the applicant's employment history:

- W-2(s)
- VOE(s)
- electronic verification acceptable to FHA
- evidence supporting enrollment in school or the military during the most recent two full years

iii. Primary Employment (Manual)

(A) Definition

Primary Employment is the Borrower's principal employment, unless the income falls within a specific category identified below. Primary employment is generally full-time employment and may be either salaried or hourly.

(B) Standard

The Mortgagee may use primary Employment Income as Effective Income.

(C) Calculation of Effective Income

(1) Salary

For employees who are salaried and whose income has been and will likely be consistently earned, the Mortgagee must use the current salary to calculate Effective Income.

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(2) Hourly

For employees who are paid hourly, and whose hours do not vary, the Mortgagee must consider the Borrower's current hourly rate to calculate Effective Income.

For employees who are paid hourly and whose hours vary, the Mortgagee must average the income over the previous two years. If the Mortgagee can document an increase in pay rate the Mortgagee may use the most recent 12-month average of hours at the current pay rate.

iv. Part-Time Employment (Manual)

(A) Definition

Part-Time Employment refers to employment that is not the Borrower's primary employment and is generally performed for less than 40 hours per week.

(B) Standard

The Mortgagee may use Employment Income from Part-Time Employment as Effective Income if the Borrower has worked a part-time job uninterrupted for the past two years and the current position is reasonably likely to continue.

(C) Calculation of Effective Income

The Mortgagee must average the income over the previous two years. If the Mortgagee can document an increase in pay rate the Mortgagee may use a 12-month average of hours at the current pay rate.

v. Overtime and Bonus Income (Manual)

(A) Definition

Overtime and Bonus Income refers to income that the Borrower receives in addition to the Borrower's normal salary.

(B) Standard

The Mortgagee may use Overtime and Bonus Income as Effective Income if the Borrower has received this income for the past two years and it is reasonably likely to continue.

Periods of Overtime and Bonus Income less than two years may be considered Effective Income if the Mortgagee documents that the Overtime and Bonus Income has been consistently earned over a period of not less than one year and is reasonably likely to continue.

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(C) Calculation of Effective Income

For employees with Overtime or Bonus Income, the Mortgagee must average the income earned over the previous two years to calculate Effective Income. However, if the Overtime or Bonus Income from the current year decreases by 20 percent or more from the previous year, the Mortgagee must use the current year's income.

vi. Seasonal Employment (Manual)

(A) Definition

Seasonal Employment refers to employment that is not year round, regardless of the number of hours per week the Borrower works on the job.

(B) Standard

The Mortgagee may consider Employment Income from Seasonal Employment as Effective Income if the Borrower has worked the same line of work for the past two years and is reasonably likely to be rehired for the next season. The Mortgagee may consider unemployment income as Effective Income for those with Effective Income from Seasonal Employment.

(C) Required Documentation

For seasonal employees with unemployment income, the Mortgagee must document the unemployment income for two full years and there must be reasonable assurance that this income will continue.

(D) Calculation of Effective Income

For employees with Employment Income from Seasonal Employment, the Mortgagee must average the income earned over the previous two full years to calculate Effective Income.

vii. Employer Housing Subsidy (Manual)

(A) Definition

Employer Housing Subsidy refers to employer-provided mortgage assistance.

(B) Standard

The Mortgagee may utilize Employer Housing Subsidy as Effective Income.

(C) Required Documentation

The Mortgagee must verify and document the existence and the amount of the housing subsidy.

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(D) Calculation of Effective Income

For employees receiving an Employer Housing Subsidy, the Mortgagee may add the Employer Housing Subsidy to the total Effective Income, but may not use it to offset the Mortgage Payment.

viii. Employed by Family-Owned Business (Manual)

(A) Definition

Family-Owned Business Income refers to Employment Income earned from a business owned by the Borrower's family, but in which the Borrower is not an owner.

(B) Standard

The Mortgagee may consider Family-Owned Business Income as Effective Income if the Borrower is not an owner in the family-owned business.

(C) Required Documentation

The Mortgagee must verify and document that the Borrower is not an owner in the family-owned business by using official business documents showing the ownership percentage.

Official business documents include corporate resolutions or other business organizational documents, business tax returns or [Schedule K-1 \(IRS Form 1065\)](#), *U.S. Return of Partnership Income*, or an official letter from a certified public accountant on their business letterhead.

In addition to traditional or alternative documentation requirements, the Mortgagee must obtain copies of signed personal tax returns or tax transcripts.

(D) Calculation of Effective Income

(1) Salary

For employees who are salaried and whose income has been and will likely continue to be consistently earned, the Mortgagee must use the current salary to calculate Effective Income.

(2) Hourly

For employees who are paid hourly, and whose hours do not vary, the Mortgagee must consider the Borrower's current hourly rate to calculate Effective Income.

For employees who are paid hourly and whose hours vary, the Mortgagee must average the income over the previous two years. If the Mortgagee can document

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an increase in pay rate the Mortgagee may use the most recent 12-month average of hours at the current pay rate.

ix. Commission Income (Manual)

(A) Definition

Commission Income refers to income that is paid contingent upon the conducting of a business transaction or the performance of a service.

(B) Standard

The Mortgagee may use Commission Income as Effective Income if the Borrower earned the income for at least one year in the same or similar line of work and it is reasonably likely to continue.

(C) Required Documentation

For Commission Income less than or equal to 25 percent of the Borrower's total earnings, the Mortgagee must use traditional or alternative employment documentation.

For Commission Income greater than 25 percent of the Borrower's total earnings, the Mortgagee must obtain signed tax returns, including all applicable schedules, for the last two years. In lieu of signed tax returns from the Borrower, the Mortgagee may obtain a signed [IRS Form 4506](#), *Request for Copy of Tax Return*, [IRS Form 4506-T](#), *Request for Transcript of Tax Return*, or [IRS Form 8821](#), *Tax Information Authorization*, and tax transcripts directly from the IRS.

(D) Calculation of Effective Income

The Mortgagee must calculate Effective Income for commission by using the lesser of (a) the average net Commission Income earned over the previous two years, or the length of time Commission Income has been earned if less than two years; or (b) the average net Commission Income earned over the previous one year. The Mortgagee must calculate net Commission Income by subtracting the unreimbursed business expenses from the gross Commission Income.

The Mortgagee must reduce the Effective Income by the amount of any unreimbursed employee business expenses, as shown on the Borrower's Schedule A. For information on analyzing the Borrower's 1040, review [Analyzing IRS Forms](#).

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x. Self-Employment Income (Manual)

(A) Definition

Self-Employment Income refers to income generated by a business in which the Borrower has a 25 percent or greater ownership interest.

There are four basic types of business structures. They include:

- sole proprietorship;
- corporations;
- limited liability or “S” corporations; and
- partnerships.

(B) Standard

(1) Minimum Length of Self-Employment

The Mortgagee may consider Self-Employment Income if the Borrower has been self-employed for at least two years.

If the Borrower has been self-employed between one and two years, the Mortgagee may only consider the income as Effective Income if the Borrower was previously employed in the same line of work in which the Borrower is self-employed or in a related occupation for at least two years.

(2) Stability of Self-Employment Income

Income obtained from businesses with annual earnings that are stable or increasing is acceptable. If the income from businesses shows a greater than 20 percent decline in Effective Income over the analysis period, the Mortgagee must document that the business income is now stable.

A Mortgagee may consider income as stable after a 20 percent reduction if the Mortgagee can document the reduction in income was the result of an extenuating circumstance, the Borrower can demonstrate the income has been stable or increasing for a minimum of 12 months, and the Borrower qualifies utilizing the reduced income.

(C) Required Documentation

(1) Individual and Business Tax Returns

The Mortgagee must obtain signed, completed individual and business federal income tax returns for the most recent two years, including all schedules.

In lieu of signed individual or business tax returns from the Borrower, the Mortgagee may obtain a signed [IRS Form 4506](#), *Request for Copy of Tax Return*,

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[IRS Form 4506-T](#), *Request for Transcript of Tax Return*, or [IRS Form 8821](#), *Tax Information Authorization*, and tax transcripts directly from the IRS.

(2) Profit & Loss Statements and Balance Sheets

The Mortgagee must obtain a year-to-date Profit and Loss (P&L) statement and balance sheet if more than a calendar quarter has elapsed since date of most recent calendar or fiscal year-end tax return was filed by the Borrower. A balance sheet is not required for self-employed Borrowers filing Schedule C income.

If income used to qualify the Borrower exceeds the two year average of tax returns, an audited P&L or signed quarterly tax return obtained from the IRS is required.

(3) Business Credit Reports

The Mortgagee must obtain a business credit report for all corporations and “S” corporations.

(D) Calculation of Effective Income

The Mortgagee must analyze the Borrower’s tax returns to determine gross Self-Employment Income. Requirements for analyzing self-employment documentation are found in [Analyzing IRS Forms](#).

The Mortgagee must calculate gross Self-Employment Income by using the lesser of:

- the average gross Self- Employment Income earned over the previous two years; or
- the average gross Self-Employment Income earned over the previous one year.

xi. Additional Required Analysis of Stability of Employment Income

(A) Frequent Changes in Employment

If the Borrower has changed employers more than three times in the previous 12-month period, or has changed lines of work, the Mortgagee must take additional steps to verify and document the stability of the Borrower’s Employment Income.

Additional analysis is not required for fields of employment that regularly require a Borrower to work for various employers (such as Temp Companies or Union Trades).

The Mortgagee must obtain:

- transcripts of training and education demonstrating qualification for a new position; or
- employment documentation evidencing continual increases in income and/or benefits.

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(B) Addressing Gaps in Employment

For Borrowers with gaps in employment of six months or more (an extended absence), the Mortgagee may consider the Borrower's current income as Effective Income if it can verify and document that:

- the Borrower has been employed in the current job for at least six months at the time of case number assignment; and
- a two year work history prior to the absence from employment using standard or alternative employment verification.

(C) Addressing Temporary Reduction in Income

For Borrowers with a temporary reduction of income due to a short-term disability or similar temporary leave, the Mortgagee may consider the Borrower's current income as Effective Income, if it can verify and document that:

- the Borrower intends to return to work;
- the Borrower has the right to return to work; and
- the Borrower qualifies for the Mortgage taking into account any reduction of income due to the circumstance.

For Borrowers returning to work before or at the time of the first Mortgage Payment due date, the Mortgagee may use the Borrower's pre-leave income.

For Borrowers returning to work after the first Mortgage Payment due date, the Mortgagee may use the Borrower's current income plus available surplus liquid asset Reserves, above and beyond any required Reserves, as an income supplement up to the amount of the Borrower's pre-leave income. The amount of the monthly income supplement is the total amount of surplus Reserves divided by the number of months between the first payment due date and the Borrower's intended date of return to work.

Required Documentation

The Mortgagee must provide the following documentation for Borrowers on temporary leave:

- a written statement from the Borrower confirming the Borrower's intent to return to work, and the intended date of return;
- documentation generated by current employer confirming the Borrower's eligibility to return to current employer after temporary leave; and
- documentation of sufficient liquid assets, in accordance with [Sources of Funds](#), used to supplement the Borrower's income through intended date of return to work with current employer.

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xii. Other Sources of Effective Income (Manual)

(A) Disability Benefits (Manual)

(1) Definition

Disability Benefits refer to benefits received from the Social Security Administration (SSA), Department of Veterans Affairs (VA), or a private disability insurance provider.

(2) Required Documentation

The Mortgagee must verify and document the Borrower's receipt of benefits from the SSA, VA, or private disability insurance provider. The Mortgagee must obtain documentation that establishes award benefits to the Borrower.

If any disability income is due to expire within three years from the date of mortgage application, that income cannot be used as Effective Income. If the Notice of Award or equivalent document does not have a defined expiration date, the Mortgagee may consider the income effective and reasonably likely to continue. The Mortgagee may not rely upon a pending or current re-evaluation of medical eligibility for benefit payments as evidence that the benefit payment is not reasonably likely to continue.

Under no circumstance may the Mortgagee inquire into or request documentation concerning the nature of the disability or the medical condition of the Borrower.

(a) Social Security Disability (Manual)

For Social Security Disability income, including Supplemental Security Income (SSI), the Mortgagee must obtain a copy of the last Notice of Award letter, or an equivalent document that establishes award benefits to the Borrower, and one of the following documents:

- federal tax returns;
- the most recent bank statement evidencing receipt of income from the SSA;
- a Proof of Income Letter, also known as a "Budget Letter" or "Benefits Letter" that evidences income from the SSA; or
- a copy of the Borrower's [form SSA-1099/1042S](#), *Social Security Benefit Statement*.

(b) VA Disability

For VA disability benefits, the Mortgagee must obtain from the Borrower a copy of the Veteran's last Benefits Letter showing the amount of the assistance, and one of the following documents:

- federal tax returns; or

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- the most recent bank statement evidencing receipt of income from the VA.

If the Benefits Letter does not have a defined expiration date, the Mortgagee may consider the income effective and reasonably likely to continue for at least three years.

(c) Private Disability

For private disability benefits, the Mortgagee must obtain documentation from the private disability insurance provider showing the amount of the assistance and the expiration date of the benefits, if any, and one of the following documents:

- federal tax returns; or
- the most recent bank statement evidencing receipt of income from the insurance provider.

(3) Calculation of Effective Income

The Mortgagee must use the most recent amount of benefits received to calculate Effective Income.

(B) Alimony, Child Support, and Maintenance Income (Manual)

(1) Definition

Alimony, Child Support, and Maintenance Income refers to income received from a former spouse or partner or from a non-custodial parent of the Borrower's minor dependent.

(2) Required Documentation

The Mortgagee must obtain a fully executed copy of the Borrower's final divorce decree, legal separation agreement, court order, or voluntary payment agreement with documented receipt.

When using a final divorce decree, legal separation agreement or court order, the Mortgagee must obtain evidence of receipt using deposits on bank statements; canceled checks; or documentation from the child support agency for the most recent three months that supports the amount used in qualifying.

The Mortgagee must document the voluntary payment agreement with 12 months of canceled checks, deposit slips, or tax returns.

The Mortgagee must provide evidence that the claimed income will continue for at least three years. The Mortgagee may use the front and pertinent pages of the

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divorce decree/settlement agreement and/or court order showing the financial details.

(3) Calculation of Effective Income

When using a final divorce decree, legal separation agreement or court order, if the Borrower has received consistent Alimony, Child Support and Maintenance Income for the most recent three months, the Mortgagee may use the current payment to calculate Effective Income.

When using evidence of voluntary payments, if the Borrower has received consistent Alimony, Child Support and Maintenance Income for the most recent six months, the Mortgagee may use the current payment to calculate Effective Income.

If the Alimony, Child Support and Maintenance Income have not been consistently received for the most recent six months, the Mortgagee must use the average of the income received over the previous two years to calculate Effective Income. If Alimony, Child Support and Maintenance Income have been received for less than two years, the Mortgagee must use the average over the time of receipt.

(C) Military Income (Manual)

(1) Definition

Military Income refers to income received by military personnel during their period of active, Reserve, or National Guard service, including:

- base pay
- Basic Allowance for Housing
- clothing allowances
- flight or hazard pay
- Basic Allowance for Subsistence
- proficiency pay

The Mortgagee may not use education benefits as Effective Income.

(2) Required Documentation

The Mortgagee must obtain a copy of the Borrower's military Leave and Earnings Statement (LES). The Mortgagee must verify the Expiration Term of Service date on the LES. If the Expiration Term of Service date is within the first 12 months of the Mortgage, Military Income may only be considered Effective Income if the Borrower represents their intent to continue military service.

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(3) Calculation of Effective Income

The Mortgagee must use the current amount of Military Income received to calculate Effective Income.

(D) Mortgage Credit Certificates (Manual)

(1) Definition

Mortgage Credit Certificates refer to government Mortgage Payment subsidies other than Section 8 Homeownership Vouchers.

(2) Required Documentation

The Mortgagee must verify and document that the Governmental Entity subsidizes the Borrower's Mortgage Payments either through direct payments or tax rebates.

(3) Calculating Effective Income

Mortgage Credit Certificate income that is not used to directly offset the Mortgage Payment before calculating the qualifying ratios may be included as Effective Income. The Mortgagee must use the current subsidy rate to calculate the Effective Income.

(E) Section 8 Homeownership Vouchers (Manual)

(1) Definition

Section 8 Homeownership Vouchers refer to housing subsidies received under the Housing Choice Voucher homeownership option from a Public Housing Agency (PHA).

(2) Required Documentation

The Mortgagee must verify and document the Borrower's receipt of the Housing Choice Voucher homeownership subsidies. The Mortgagee may consider that this income is reasonably likely to continue for three years.

(3) Calculation of Effective Income

The Mortgagee may only use Section 8 Homeownership Voucher subsidies as Effective Income if it is not used as an offset to the monthly Mortgage Payment. The Mortgagee must use the current subsidy rate to calculate the Effective Income.

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(F) Other Public Assistance (Manual)

(1) Definition

Public Assistance refers to income received from government assistance programs.

(2) Required Documentation

Mortgagees must verify and document the income received from the government agency.

If any Public Assistance income is due to expire within three years from the date of mortgage application, that income cannot be used as Effective Income. If the documentation does not have a defined expiration date, the Mortgagee may consider the income effective and reasonably likely to continue.

(3) Calculation of Effective Income

The Mortgagee must use the current rate of Public Assistance received to calculate Effective Income.

(G) Automobile Allowances (Manual)

(1) Definition

Automobile Allowance refers to the funds provided by the Borrower's employer for automobile related expenses.

(2) Required Documentation

The Mortgagee must verify and document the Automobile Allowance received from the employer for the previous two years.

The Mortgagee must also obtain [IRS Form 2106](#), *Employee Business Expenses*, for the previous two years.

(3) Calculation of Effective Income

The Mortgagee must determine the portion of the allowance that can be considered Effective Income.

The Mortgagee must subtract automobile expenses as shown on IRS Form 2106 from the Automobile Allowance before calculating Effective Income based on the current amount of the allowance received.

If the Borrower uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers

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depreciation may be added back to income. Expenses that must be treated as recurring debt include:

- the Borrower's monthly car payment; and
- any loss resulting from the calculation of the difference between the actual expenditures and the expense account allowance.

Automobile Allowance refers to the amount of the Automobile Allowance that exceeds the Borrower's actual automobile expenditures.

(H) Retirement Income (Manual)

Retirement Income refers to income received from Pensions, 401(k) distributions, and Social Security.

(1) Social Security Income (Manual)

(a) Definition

Social Security Income or Supplemental Security Income (SSI) refers to income received from the SSA other than disability income.

(b) Required Documentation

The Mortgagee must verify and document the Borrower's receipt of income from the SSA and that it is likely to continue for at least a three year period from the date of case number assignment.

For SSI, the Mortgagee must obtain any one of the following documents:

- federal tax returns;
- the most recent bank statement evidencing receipt of income from the SSA;
- a Proof of Income Letter, also known as a "Budget Letter" or "Benefits Letter" that evidences income from the SSA; or
- a copy of the Borrower's [SSA Form-1099/1042S](#), *Social Security Benefit Statement*.

In addition to verification of income, the Mortgagee must document the continuance of this income by obtaining from the Borrower (1) a copy of the last Notice of Award letter which states the SSA's determination on the Borrower's eligibility for SSA income, or (2) equivalent documentation that establishes award benefits to the Borrower (equivalent document). If any income from the SSA is due to expire within three years from the date of case number assignment, that income may not be used for qualifying.

If the Notice of Award or equivalent document does not have a defined expiration date, the Mortgagee must consider the income effective and reasonably likely to continue. The Mortgagee may not request additional

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documentation from the Borrower to demonstrate continuance of Social Security Income.

If the Notice of Award letter or equivalent document specifies a future start date for receipt of income, this income may only be considered effective on the specified start date.

(c) Calculation of Effective Income

The Mortgagee must use the current amount of Social Security Income received to calculate Effective Income.

(2) Pension (Manual)

(a) Definition

Pension refers to income received from the Borrower's former employer(s).

(b) Required Documentation

The Mortgagee must verify and document the Borrower's receipt of periodic payments from the Borrower's Pension and that the payments are likely to continue for at least three years.

The Mortgagee must obtain any one of the following documents:

- federal tax returns;
- the most recent bank statement evidencing receipt of income from the former employer; or
- a copy of the Borrower's Pension/retirement letter from the former employer.

(c) Calculation of Effective Income

The Mortgagee must use the current amount of Pension income received to calculate Effective Income.

(3) Individual Retirement Account and 401(k) (Manual)

(a) Definition

Individual Retirement Account (IRA)/401(k) Income refers to income received from an IRA.

(b) Required Documentation

The Mortgagee must verify and document the Borrower's receipt of recurring IRA/401(k) distribution Income and that it is reasonably likely to continue for three years.

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The Mortgagee must obtain the most recent IRA/401(k) statement and any one of the following documents:

- federal tax returns; or
- the most recent bank statement evidencing receipt of income.

(c) Calculation of Effective Income

For Borrowers with IRA/401(k) Income that has been and will be consistently received, the Mortgagee must use the current amount of IRA Income received to calculate Effective Income. For Borrowers with fluctuating IRA/401(k) Income, the Mortgagee must use the average of the IRA/401(k) Income received over the previous two years to calculate Effective Income. If IRA/401(k) Income has been received for less than two years, the Mortgagee must use the average over the time of receipt.

(I) Rental Income (Manual)

(1) Definition

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

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

(a) Standard

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

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

(b) Required Documentation

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

(i) Limited or No History of Rental Income

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

Two-to Four-Units

The Mortgagee must verify and document the proposed Rental Income by obtaining an appraisal showing fair market rent (use [Fannie Mae Form](#)

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[1025/Freddie Mac Form 72](#), *Small Residential Income Property Appraisal Report*) and the prospective leases if available.

One Unit

The Mortgagee must verify and document the proposed Rental Income by obtaining a [Fannie Mae Form 1004/Freddie Mac Form 70](#), *Uniform Residential Appraisal Report*, [Fannie Mae Form 1007/Freddie Mac Form 1000](#), *Single Family Comparable Rent Schedule*, and Fannie Mae Form 216/[Freddie Mac Form 998](#), *Operating Income Statement*, showing fair market rent and, if available, the prospective lease.

(ii) History of Rental Income

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

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

(c) Calculation of Effective Income

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

(i) Limited or No History of Rental Income

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

- the monthly operating income reported on [Freddie Mac Form 998](#);
or
- 75 percent of the lesser of:
 - fair market rent reported by the Appraiser; or
 - the rent reflected in the lease or other rental agreement.

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(ii) History of Rental Income

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

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

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

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

(a) Standard

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

(b) Required Documentation

(i) Limited or No History of Rental Income

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

Two- to Four-Units

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

One Unit

The Mortgagee must verify and document the proposed Rental Income by obtaining a [Fannie Mae Form 1004/Freddie Mac Form 70](#), *Uniform Residential Appraisal Report*, [Fannie Mae Form 1007](#)/Freddie Mac Form

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1000, *Single Family Comparable Rent Schedule*, and Fannie Mae Form 216/[Freddie Mac Form 998](#), *Operating Income Statement*, showing fair market rent and, if available, the prospective lease.

(ii) History of Rental Income

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

(c) Calculation of Effective Net Rental Income

(i) Limited or No History of Rental Income

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

- the monthly operating income reported on [Freddie Mac Form 998](#), or
- 75 percent of the lesser of:
 - fair market rent reported by the Appraiser; or
 - the rent reflected in the lease or other rental agreement.

(ii) History of Net Rental Income

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

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

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

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

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

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(4) Boarders of the Subject Property (Manual)

(a) Definition

Boarder refers to an individual renting space inside the Borrower's Dwelling Unit.

(b) Standard

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

(c) Required Documentation

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

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

(d) Calculation of Effective Income

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

(J) Investment Income (Manual)

(1) Definition

Investment Income refers to interest and dividend income received from assets such as certificates of deposits, mutual funds, stocks, bonds, money markets, and savings and checking accounts.

(2) Required Documentation

The Mortgagee must verify and document the Borrower's Investment Income by obtaining tax returns for the previous two years and the most recent account statement.

(3) Calculation of Effective Income

The Mortgagee must calculate Investment Income by using the lesser of:

- the average Investment Income earned over the previous two years; or
- the average Investment Income earned over the previous one year.

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The Mortgagee must subtract any of the assets used for the Borrower's required funds to close to purchase the subject Property from the Borrower's liquid assets prior to calculating any interest or dividend income.

(K) Capital Gains and Losses (Manual)

(1) Definition

Capital Gains refer to a profit that results from a disposition of a capital asset, such as a stock, bond or real estate, where the amount realized on the disposition exceeds the purchase price.

Capital Losses refer to a loss that results from a disposition of a capital asset, such as a stock, bond or real estate, where the amount realized on the disposition is less than the purchase price.

(2) Standard

Capital gains or losses must be considered when determining Effective Income, when the individual has a constant turnover of assets resulting in gains or losses.

(3) Required Documentation

Three years' tax returns are required to evaluate an earnings trend. If the trend:

- results in a gain, it may be added as Effective Income; or
- consistently shows a loss, it must be deducted from the total income.

(L) Expected Income (Manual)

(1) Definition

Expected Income refers to income from cost-of-living adjustments, performance raises, a new job, or retirement that has not been, but will be received within 60 Days of mortgage closing.

(2) Standard

The Mortgagee may consider Expected Income as Effective Income except when Expected Income is to be derived from a family-owned business.

(3) Required Documentation

The Mortgagee must verify and document the existence and amount of Expected Income with the employer in writing and that it is guaranteed to begin within 60 Days of mortgage closing. For expected Retirement Income, the Mortgagee must verify the amount and that it is guaranteed to begin within 60 Days of the mortgage closing.

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(4) Calculation of Effective Income

Income is calculated in accordance with the standards for the type of income being received. The Mortgagee must also verify that the Borrower will have sufficient income or cash Reserves to support the Mortgage Payment and any other obligations between mortgage closing and the beginning of the receipt of the income.

(M) Trust Accounts (Manual)

(1) Definition

Trust Income refers to income that is regularly distributed to a Borrower from a trust.

(2) Required Documentation

The Mortgagee must verify and document the existence of the Trust Agreement or other trustee statement. The Mortgagee must also verify and document the frequency, duration, and amount of the distribution by obtaining a bank statement or transaction history from the bank.

The Mortgagee must verify that regular payments will continue for at least the first three years of the mortgage term.

(3) Calculation of Effective Income

The Mortgagee must use the income based on the terms and conditions in the Trust Agreement or other trustee statement to calculate Effective Income.

(N) Annuities or Similar (Manual)

(1) Definition

Annuity Income refers to a fixed sum of money periodically paid to the Borrower from a source other than employment.

(2) Required Documentation

The Mortgagee must verify and document the legal agreement establishing the annuity and guaranteeing the continuation of the annuity for the first three years of the Mortgage. The Mortgagee must also obtain a bank statement or a transaction history from a bank evidencing receipt of the annuity.

(3) Calculation of Effective Income

The Mortgagee must use the current rate of the annuity to calculate Effective Income.

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(O) Notes Receivable Income (Manual)

(1) Definition

Notes Receivable Income refers to income received by the Borrower as payee or holder in due course of a promissory Note or similar credit instrument.

(2) Required Documentation

The Mortgagee must verify and document the existence of the Note. The Mortgagee must also verify and document that payments have been consistently received for the previous 12 months by obtaining tax returns, deposit slips or canceled checks and that such payments are guaranteed to continue for the first three years of the Mortgage.

(3) Calculation of Effective Income

For Borrowers who have been and will be receiving a consistent amount of Notes Receivable Income, the Mortgagee must use the current rate of income to calculate Effective Income. For Borrowers whose Notes Receivable Income fluctuates, the Mortgagee must use the average of the Notes Receivable Income received over the previous year to calculate Effective Income.

(P) Non-Taxable Income (Grossing Up) (Manual)

(1) Definition

Non-Taxable Income refers to types of income not subject to federal taxes, which includes, but is not limited to:

- some portion of Social Security Income;
- some federal government employee Retirement Income;
- Railroad Retirement benefits;
- some state government Retirement Income;
- certain types of disability and Public Assistance payments;
- Child Support;
- military allowances; and
- other income that is documented as being exempt from federal income taxes.

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(2) Required Documentation

The Mortgagee must document and support the amount of income to be Grossed Up for any Non-Taxable Income source and the current tax rate applicable to the Borrower's income that is being Grossed Up.

(3) Calculation of Effective Income

The amount of continuing tax savings attributed to Non-Taxable Income may be added to the Borrower's gross income.

The percentage of Non-Taxable Income that may be added cannot exceed the greater of 15 percent or the appropriate tax rate for the income amount, based on the Borrower's tax rate for the previous year. If the Borrower was not required to file a federal tax return for the previous tax reporting period, the Mortgagee may Gross Up the Non-Taxable Income by 15 percent.

The Mortgagee may not make any additional adjustments or allowances based on the number of the Borrower's dependents.

c. Asset Requirements (Manual)

i. General Asset Requirements (Manual)

The Mortgagee may only consider assets derived from acceptable sources in accordance with the requirements outlined below.

Closing costs, prepaid items and other fees may not be applied towards the Borrower's MRI.

(A) Earnest Money Deposit (Manual)

The Mortgagee must verify and document the deposit amount and source of funds if the amount of the earnest money deposit exceeds 1 percent of the sales price or is excessive based on the Borrower's history of accumulating savings, by obtaining:

- a copy of the Borrower's canceled check;
- certification from the deposit-holder acknowledging receipt of funds; or
- a Verification of Deposit (VOD) or bank statement showing that the average balance was sufficient to cover the amount of the earnest money deposit at the time of the deposit.

If the source of the earnest money deposit was a gift, the Mortgagee must verify that the gift is in compliance with [Gifts \(Personal and Equity\)](#).

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(B) Cash to Close (Manual)

The Mortgagee must document all funds that are used for the purpose of qualifying for or closing a Mortgage, including those to satisfy debt or pay costs outside of closing.

The Mortgagee must verify and document that the Borrower has sufficient funds from an acceptable source to facilitate the closing.

(1) Determining the Amount Needed for Closing

For a purchase transaction, the amount of cash needed by the Borrower to close an FHA-insured Mortgage is the difference between the total cost to acquire the Property and the total mortgage amount.

For a refinance transaction, the amount of cash needed by the Borrower to close an FHA-insured Mortgage is the difference between the total payoff requirements of the Mortgage being refinanced and the total mortgage amount.

(2) Mortgagee Responsibility for Estimating Settlement Requirements

In addition to the MRI, additional Borrower expenses must be included in the total amount of cash that the Borrower must provide at mortgage settlement.

(a) Origination Fees and Other Closing Costs

The Mortgagee or sponsored TPO may charge a reasonable origination fee.

The Mortgagee or sponsored TPO may charge and collect from Borrowers those customary and reasonable closing costs necessary to close the Mortgage. Charges may not exceed the actual costs.

The Mortgagee must comply with HUD's Qualified Mortgage Rule at [24 CFR § 203.19](#).

(b) Discount Points

Discount Points refer to a charge from the Mortgagee for the interest rate chosen. They are paid by the Borrower and become part of the total cash required to close.

(c) Types of Prepaid Items (Including Per Diem Interest)

Prepaid items may include flood and hazard insurance premiums, MIP, real estate taxes, and per diem interest. They must comply with the requirements of the [CFPB](#).

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(d) Non-Realty or Personal Property

Non-Realty or Personal Property items (chattel) that the Borrower agrees to pay for separately, including the amount subtracted from the sales price when determining the maximum Mortgage, are included in the total cash requirements for the Mortgage.

(e) Upfront Mortgage Insurance Premium Amounts

Any UFMIP amounts paid in cash are added to the total cash settlement requirements. The UFMIP must be entirely financed into the Mortgage or paid entirely in cash. However, if the UFMIP is financed into the Mortgage, the entire amount is to be financed except for any amount less than \$1.00.

(f) Real Estate Agent Fees

If a Borrower is represented by a real estate agent and must pay any fee directly to the agent, that expense must be included in the total of the Borrower's settlement requirements.

(g) Repairs and Improvements

Repairs and improvements, or any portion paid by the Borrower that cannot be financed into the Mortgage, are part of the Borrower's total cash requirements.

(h) Premium Pricing on FHA-Insured Mortgages

Premium Pricing refers to a credit from a Mortgagee for the interest rate chosen.

Premium Pricing may be used to pay a Borrower's actual closing costs and/or prepaid items. Closing costs paid in this manner do not need to be included as part of the Interested Party limitation.

The funds derived from a premium priced Mortgage:

- must be disclosed in accordance with RESPA;
- must be used to reduce the principal balance if the credit amount exceeds the actual dollar amount for closing costs and prepaid expenses; and
- may not be used for payment of debts, collection accounts, escrow shortages or missed Mortgage Payments, or Judgments.

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(i) Interested Party Contributions on the Closing Disclosure

The Mortgagee may apply Interested Party credits to the origination fees, other closing costs and discount points including any items Paid Outside Closing (POC).

The refund of the Borrower's POCs may be used toward the Borrower's MRI if the Mortgagee documents that the POCs were paid with the Borrower's own funds.

The Mortgagee must identify the total Interested Party credits on the front page of the Closing Disclosure or similar legal document or in an addendum. The Mortgagee must identify each item paid by Interested Party Contributions.

(j) Real Estate Tax Credits

Where real estate taxes are paid in arrears, the seller's real estate tax credit may be used to meet the MRI, if the Mortgagee documents that the Borrower had sufficient assets to meet the MRI and the Borrower paid closing costs at the time of underwriting.

This permits the Borrower to bring a portion of their MRI to the closing and combine that portion with the real estate tax credit for their total MRI.

(C) Reserves (Manual)

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

Reserves do not include:

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

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

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

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

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

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ii. Source Requirements for the Borrower's Minimum Required Investment (Manual)

(A) Definition

Minimum Required Investment (MRI) refers to the Borrower's contribution in cash or its equivalent required by Section 203(b)(9) of the National Housing Act, which represents at least 3.5 percent of the Adjusted Value of the Property.

(B) Standard

The Mortgagee may only permit the Borrower's MRI to be provided by a source permissible under Section 203(b)(9)(C) of the National Housing Act, which means the funds for the Borrower's MRI must not come from:

- (1) the seller of the Property;
- (2) any other person or Entity who financially benefits from the transaction (directly or indirectly); or
- (3) anyone who is or will be reimbursed, directly or indirectly, by any party included in (1) or (2) above.

While additional funds to close may be provided by one of these sources if permitted under the relevant source of funds requirements above, none of the Borrower's MRI may come from these sources. The Mortgagee must document permissible sources for the full MRI in accordance with special requirements noted above.

Additionally, in accordance with [Prohibited Sources of Minimum Cash Investment Under the National Housing Act - Interpretive Rule](#), HUD does not interpret Section 203(b)(9)(C) of the National Housing Act to prohibit Governmental Entities, when acting in their governmental capacity, from providing the Borrower's MRI where the Governmental Entity is originating the insured Mortgage through one of its homeownership programs.

(C) Required Documentation

Where the Borrower's MRI is provided by someone other than the Borrower, the Mortgagee must also obtain documentation to support the permissible nature of the source of those funds.

To establish that the Governmental Entity provided the Borrower's MRI in a manner consistent with HUD's Interpretive Rule, the Mortgagee must document that the Governmental Entity incurred prior to or at closing an enforceable legal liability or obligation to fund the Borrower's MRI. It is not sufficient to document that the Governmental Entity has agreed to reimburse the Mortgagee for the use of funds legally belonging to the Mortgagee to fund the Borrower's MRI.

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The Mortgagee must obtain:

- a canceled check, evidence of wire transfer or other draw request showing that prior to or at the time of closing the Governmental Entity had authorized a draw of the funds provided towards the Borrower's MRI from the Governmental Entity's account; or
- a letter from the Governmental Entity, signed by an authorized official, establishing that the funds provided towards the Borrower's MRI were funds legally belonging to the Governmental Entity, when acting in their governmental capacity, at or before closing.

Where a letter from the Governmental Entity is submitted, the precise language of the letter may vary, but must demonstrate that the funds provided for the Borrower's MRI legally belonged to the Governmental Entity at or before closing, by stating, for example:

- the Governmental Entity has, at or before closing, incurred a legally enforceable liability as a result of its agreement to provide the funds towards the Borrower's MRI;
- the Governmental Entity has, at or before closing, incurred a legally enforceable obligation to provide the funds towards the Borrower's MRI; or
- the Governmental Entity has, at or before closing, authorized a draw on its account to provide the funds towards the Borrower's MRI.

While the Mortgagee is not required to document the actual transfer of funds in satisfaction of the obligation or liability, the failure of the Governmental Entity to satisfy the obligation or liability may result in a determination that the funds were provided by a prohibited source.

iii. Sources of Funds (Manual)

The Mortgagee must verify liquid assets for cash to close and Reserves as indicated.

(A) Checking and Savings Accounts (Manual)

(1) Definition

Checking and Savings Accounts refer to funds from Borrower-held accounts in a financial institution that allows for withdrawals and deposits.

(2) Standard

The Mortgagee must verify and document the existence of and amounts in the Borrower's checking and savings accounts.

For recently opened accounts and recent individual deposits of more than 1 percent of the Adjusted Value, the Mortgagee must obtain documentation of the deposits. The Mortgagee must also verify that no debts were incurred to obtain part, or all, of the MRI.

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(3) Required Documentation

If the Borrower does not hold the deposit account solely, all non-Borrower parties on the account must provide a written statement that the Borrower has full access and use of the funds.

(a) Traditional Documentation

The Mortgagee must obtain a written VOD and the Borrower's most recent statement for each account.

(b) Alternative Documentation

If a VOD is not obtained, a statement showing the previous month's ending balance for the most recent month is required. If the previous month's balance is not shown, the Mortgagee must obtain statement(s) for the most recent two months.

(B) Cash on Hand (Manual)

(1) Definition

Cash on Hand refers to cash held by the Borrower outside of a financial institution.

(2) Standard

The Mortgagee must verify that the Borrower's Cash on Hand is deposited in a financial institution or held by the escrow/title company.

(3) Required Documentation

The Mortgagee must verify and document the Borrower's Cash on Hand by obtaining an explanation from the Borrower describing how the funds were accumulated and the amount of time it took to accumulate the funds.

The Mortgagee must also determine the reasonableness of the accumulation based on the time period during which the funds were saved and the Borrower's:

- income stream;
- spending habits;
- documented expenses; and
- history of using financial institutions.

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(C) Retirement Accounts (Manual)

(1) Definition

Retirement Accounts refer to assets accumulated by the Borrower for the purpose of retirement.

(2) Standard

The Mortgagee may include up to 60 percent of the value of assets, less any existing loans, from the Borrower's retirement accounts, such as IRAs, thrift savings plans, 401(k) plan, and Keogh accounts, unless the Borrower provides conclusive evidence that a higher percentage may be withdrawn after subtracting any federal income tax and withdrawal penalties.

The portion of the assets not used to meet closing requirements, after adjusting for taxes and penalties, may be counted as Reserves.

(3) Required Documentation

The Mortgagee must obtain the most recent monthly or quarterly statement to verify and document the existence and amounts in the Borrower's retirement accounts, the Borrower's eligibility for withdrawals, and the terms and conditions for withdrawal from any retirement account.

If any portion of the asset is required for funds to close, evidence of liquidation is required.

(D) Stocks and Bonds (Manual)

(1) Definition

Stocks and Bonds are investment assets accumulated by the Borrower.

(2) Standard

The Mortgagee must determine the value of the stocks and bonds from the most recent monthly or quarterly statement.

If the stocks and bonds are not held in a brokerage account, the Mortgagee must determine the current value of the stocks and bonds through third party verification. Government-issued savings bonds are valued at the original purchase price, unless the Mortgagee verifies and documents that the bonds are eligible for redemption when cash to close is calculated.

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(3) Required Documentation

The Mortgagee must verify and document the existence of the Borrower's stocks and bonds by obtaining brokerage statement(s) for each account for the most recent two months. Evidence of liquidation is not required.

For stocks and bonds not held in a brokerage account the Mortgagee must obtain a copy of each stock or bond certificate.

(E) Private Savings Clubs (Manual)

(1) Definition

Private Savings Club refers to a non-traditional method of saving by making deposits into a member-managed resource pool.

(2) Standard

The Mortgagee may consider Private Savings Club funds that are distributed to and received by the Borrower as an acceptable source of funds.

The Mortgagee must verify and document the establishment and duration of the club, and the Borrower's receipt of funds from the club. The Mortgagee must also determine that the received funds were reasonably accumulated, and not borrowed.

(3) Required Documentation

The Mortgagee must obtain the club's account ledgers and receipts, and a verification from the club treasurer that the club is still active.

(F) Gifts (Personal and Equity) (Manual)

(1) Definition

Gifts refer to the contributions of cash or equity with no expectation of repayment.

(2) Standards for Gifts

(a) Acceptable Sources of Gifts Funds

Gifts may be provided by:

- the Borrower's Family Member;
- the Borrower's employer or labor union;
- a close friend with a clearly defined and documented interest in the Borrower;

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- a charitable organization;
- a governmental agency or public Entity that has a program providing homeownership assistance to:
 - low or moderate income families; or
 - first-time homebuyers.

Any gift of the Borrower's MRI must also comply with the additional requirements set forth in [Source Requirements for the Borrower's MRI](#).

(b) Reserves

Surplus gift funds may not be considered as cash Reserves.

(c) Donor's Source of Funds

Cash on Hand is not an acceptable source of donor gift funds.

(3) Required Documentation

The Mortgagee must obtain a gift letter signed and dated by the donor and Borrower that includes the following:

- the donor's name, address, telephone number;
- the donor's relationship to the Borrower;
- the dollar amount of the gift; and
- a statement that no repayment is required.

Documenting the Transfer of Gifts

The Mortgagee must verify and document the transfer of gift funds from the donor to the Borrower in accordance with the requirements below.

- a. If the gift funds have been verified in the Borrower's account, obtain the donor's bank statement showing the withdrawal and evidence of the deposit into the Borrower's account.
- b. If the gift funds are not verified in the Borrower's account, obtain the certified check or money order or cashier's check or wire transfer or other official check, and a bank statement showing the withdrawal from the donor's account.

If the gift funds are paid directly to the settlement agent, the Mortgagee must verify that the settlement agent received the funds from the donor for the amount of the gift, and that the funds were from an acceptable source.

If the gift funds are being borrowed by the donor and documentation from the bank or other savings account is not available, the Mortgagee must have the donor

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provide written evidence that the funds were borrowed from an acceptable source, not from a party to the transaction.

The Mortgagee and its Affiliates are prohibited from providing the loan of gift funds to the donor unless the terms of the loan are equivalent to those available to the general public.

Regardless of when gift funds are made available to a Borrower, the Mortgagee must be able to make a reasonable determination that the gift funds were not provided by an unacceptable source.

(4) Standards for Gifts of Equity

(a) Who May Provide Gifts of Equity

Only Family Members may provide equity credit as a gift on Property being sold to other Family Members.

(b) Required Documentation

The Mortgagee must obtain a gift letter signed and dated by the donor and Borrower that includes the following:

- the donor's name, address, telephone number;
- the donor's relationship to the Borrower;
- the dollar amount of the gift; and
- a statement that no repayment is required.

(G)Interested Party Contributions (Manual)

(1) Definition

Interested Parties refer to sellers, real estate agents, builders, developers or other parties with an interest in the transaction.

Interested Party Contribution refers to a payment by an Interested Party, or combination of parties, toward the Borrower's origination fees, other closing costs and discount points.

(2) Standard

Interested Parties may contribute up to 6 percent of the sales price toward the Borrower's origination fees, other closing costs and discount points. The 6 percent limit also includes:

- Interested Party payment for permanent and temporary interest rate buydowns, and other payment supplements;
- payments of mortgage interest for fixed rate Mortgages;

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- Mortgage Payment protection insurance; and
- payment of the UFMIP.

Interested Party Contributions that exceed actual origination fees, other closing costs, and discount points are considered an inducement to purchase. Interested Party Contributions exceeding 6 percent are considered an inducement to purchase.

Interested Party Contributions may not be used for the Borrower's MRI.

Payment of real estate agent commissions or fees, typically paid by the seller under local or state law, or local custom, is not considered an Interested Party Contribution. The satisfaction of a PACE lien or obligation against the Property by the property owner is not considered an Interested Party Contribution.

(3) Required Documentation

The Mortgagee must document the total Interested Party Contributions on form [HUD-92900-LT](#), Closing Disclosure or similar legal document, and the sales contract.

(H) Inducements to Purchase (Manual)

Inducements to Purchase refer to certain expenses paid by the seller and/or another Interested Party on behalf of the Borrower and result in a dollar-for-dollar reduction to the purchase price when computing the Adjusted Value of the Property before applying the appropriate Loan-to-Value (LTV) percentage.

These inducements include, but are not limited to:

- contributions exceeding 6 percent of the purchase price;
- contributions exceeding the origination fees, other closing costs and discount points;
- decorating allowances;
- repair allowances;
- excess rent credit;
- moving costs;
- paying off consumer debt;
- Personal Property;
- sales commission on the Borrower's present residence; and
- below-market rent, except for Borrowers who meet the Identity-of-Interest exception for Family Members.

(1) Personal Property (Manual)

Replacement of existing Personal Property items listed below are not considered an inducement to purchase, provided the replacement is made prior to settlement