CHAPTER 11: RATIO ANALYSIS

11.1 INTRODUCTION

Ratios are used to determine whether the borrower's repayment income can reasonably be expected to meet the anticipated monthly housing expense and total monthly obligations involved in homeownership. The Agency has established standards for principal, interest, taxes and insurance (PITI) and total debt (TD) ratios; however, there is flexibility in applying these standards when valid compensating factors are present.

11.2 THE RATIOS

Ratios are calculated by utilizing the repayment income, as determined by the lender in Chapter 9 Section 2 of this Handbook. To qualify for a guarantee, borrowers must meet the Agency's standards for both the PITI and TD ratios.

A. The PITI Ratio

Applicants are considered to have repayment ability if their proposed monthly housing expense does not exceed 29 percent of their repayment income. Monthly housing expenses include the following:

- Principal and interest payment on the mortgage;
- Hazard insurance premiums, whether escrowed or not;
- Real estate taxes, whether escrowed or not;
- Monthly escrow required for annual fee;
- Homeowners association dues and regular assessments
- Flood insurance premiums, whether escrowed or not; and
- Special assessments.

B. The Total Debt Ratio

Applicants are considered to have repayment ability when their total debts do not exceed 41 percent of their repayment income.

Total debt includes monthly housing expense PITI plus any other monthly credit obligations incurred by the applicant.

Obligations for child care, voluntary contributions to retirements such as a 401K, and open accounts with zero balance, are not considered a debt.

The lender must document an applicant's debt through various records including a credit report, direct or third-party verifications, court documents, and verification of deposits for loans. All applicant open debts/accounts (including collection accounts, and judgments) incurred through the note date must be included in the total debt calculation and captured under liabilities on the application. Monthly obligation expenses include:

- PITI.
- Long-term obligations with more than ten months repayment remaining on the credit report presented at underwriting. This may include all installment loans, alimony, child support or separate maintenance payments, student loans and other continuing obligations.
- Revolving accounts. The minimum monthly payment is required for all revolving credit card debts. If the credit report shows an outstanding balance, but no specific minimum monthly payment, the payment will be calculated 5 percent of the balance as reported on the credit report. If the lender obtains a copy of the current statement reflecting the actual monthly payment, that amount must be used for qualifying purposes. The lender must retain this documentation in their permanent loan file. Revolving accounts with no outstanding balance do not require an estimated payment to be included in the debt ratio. Revolving accounts that will be paid in full prior to loan closing are not required to be closed.
- 30-Day Accounts. A 30-day account is a credit arrangement requiring the applicant to pay off the full outstanding balance on the account every month. The lender may utilize the credit report to document the applicant has paid the outstanding balance for the previous 12 months. 30-day accounts that are paid monthly in full are not included in the total debt ratio. If the credit report reflects any late payments in the last 12 months, a long-term monthly payment will be included. The lender will utilize 5% of the outstanding balance as the applicant's monthly debt.
- Child support, alimony, garnishments. Applicants obligated to pay child support, alimony, garnishments, or other court ordered debts must have the payment included in the total debt ratio. If the applicant has a release of

liability from the court/creditor, and acceptable evidence is obtained, the debt can be excluded. Lenders will utilize select pages from the applicable agreement/court order to document the required monthly payment due and the duration of the debt. For GUS transactions, the lender will manually enter the obligations on the “Additional Expenses” on the “Assets and Liabilities” page. A manual entry of obligation does not require an underwriting recommendation of “Accept” to be downgraded to a “Refer.” Lenders will ensure repayment agreements are current.

- Child care expenses. Child care expenses are not required to be considered as a recurring liability when calculating the total debt ratio.

- Student loans. Lenders must include the payment as follows:

  - **Fixed payment loans**: A permanent amortized, fixed payment may be used in the debt ratio when the lender retains documentation to verify the payment is fixed, the interest rate is fixed, and the repayment term is fixed.

  - **Non-Fixed payment loans**: Payments for deferred loans, Income Based Repayment (IBR), Graduated, Adjustable, and other types of repayment agreements which are not fixed cannot be used in the total debt ratio calculation. One percent of the loan balance reflected on the credit report must be used as the monthly payment. No additional documentation is required.

- Previous mortgage. Previous mortgage liabilities disposed of through a sale, trade or transfer without a release of liability will be included in the total debt ratio unless evidence can be obtained to confirm the remaining party/new owner has successfully made the payment for the previous 12 months prior to loan application. Documentation to be obtained by the lender includes:

  - In the case of a divorce, the lender will obtain a copy of the divorce decree to document the remaining party/new owner responsible to pay all mortgage debts from the effective date of the decree forward. If the loan was assumed, sold or traded without a release of liability, a copy of the assumption agreement (as applicable) and deed showing transfer of title out of the applicant’s name will be obtained by the lender and retained in the lender’s permanent file. And:

- Documented evidence the remaining party/new owner has been making regular payments during the previous 12 months with no history of delinquent payment on the loan during that time. Evidence may be reported through the credit report or the lender may verify from the servicer of the assumed loan, a payment history showing that the mortgage has been current during the previous 12 months.

- Co-signed obligations (Also known as co-borrower, joint obligator or guarantor). Co-signed debts must be considered in the total debt ratio unless the applicant provides evidence another obligor has made the payment on time in the previous 12 months prior to loan application. Acceptable evidence that demonstrates the remaining co-obligor's history of making regular payments during the previous 12 months include canceled checks, money order receipts and/or bank statements of the co-obligor. Late payments reported in the previous 12 months prior to application will require the monthly liability to be included in the long-term repayment ratio of the applicant. Debts identified as "individual" on a credit report will always be considered in the debt ratio regardless of what party is making the monthly payment (as an example, parents making car payments on behalf of applicant and the loan is in the applicant's name). If the applicant can provide conclusive evidence from the debt holder that there is no possibility that the debt holder will pursue debt collection against the applicant should the other party default, the 12 month history is not required.

- Business debts. Business debts (for example – car loan) reported on the applicant's personal credit report may be excluded from the debt ratio if the debt is paid through a business account. An example of acceptable evidence the debt is paid through a business account includes canceled business checks or bank statements for the previous 12 months.

- 401(k) loans/personal asset loans. Loans pledging personal assets, such as a 401(k) account, retirement funds, savings account or other liquid assets are not considered in the total debt ratio.

- Debts of a non-purchasing spouse (NPS). For applicants who reside or are purchasing in a community property state, the debts of the NPS must be included in the applicant's total debt ratio unless specifically excluded by state law.

- Collection accounts. Collection accounts, as outlined in Paragraph 10.9 of Chapter 10 of this Handbook will be included in the total debt ratio.

- Judgment accounts. Judgment accounts with a repayment plan already established and a history of consistent repayment will be included as a long-term obligation. It may be excluded from the total debt ratio if less than 10 months of the repayment plan remains and the lender determines the debt does not have a significant impact on the repayment of the loan. Significant impact calculations are described in the short term obligations section. A letter from the creditor or evidence on the credit report is required to validate the payment arrangements and payment history. Refer to Chapter 10, Section 10.10 for additional guidance on judgments.

- Charge-off accounts. Charge-off accounts are debts written off and are not required to be included in the applicant's total debt ratio.

- Automobile Allowances and Expense Account Payments. The amount of actual expenditures exceeding the amount of automobile allowance or expense account payments will be treated as recurring debt. Lenders will utilize IRS Form 2106, *Employee Business Expenses*, for the previous two years and employer verification that the payments will continue as documentation to support the calculation. The applicant's monthly car payment will be treated as recurring debt and will not be offset by any car allowance.

- Rental loss. Negative net rental income will be treated as a recurring liability and included in the total debt ratio.

- Short-term obligations that have a significant impact on repayment ability must be included in the total debt ratio. A significant impact on repayment is defined as 5% or greater of the monthly repayment income of the applicant(s). Installment debt can be paid down to a repayment balance of 10 months or less; however underwriters must include any debt that in their underwriting analysis is considered a significant impact to the applicant's ability to repay the debt.

- Balloon/deferred payments and payments that will come due in the next 24 months, including personal loans with deferred installments and balloon payments. *Additional guidance surrounding student loan repayment is provided earlier in this section and not applicable under this subject*. If the actual payment on a deferred loan is unknown, the lender should estimate the monthly payments using 5% of the outstanding balance.

11.3 DEBT RATIO WAIVERS AND COMPENSATING FACTORS

An applicant's PITI ratio may exceed 29 percent and the Total Debt ratio may exceed 41 percent if the lender determines that strong compensating factors demonstrate that the household has higher repayment ability.

A. Debt ratio waivers for purchase transactions

Manually underwritten loans – purchase transactions. Agency approval of a lender's request for debt ratio waiver may be granted if the following conditions are met:

1. Acceptable ratio thresholds are met:

    a. The PITI ratio is greater than 29 percent, but less than or equal to 32 percent, accompanied by a TD ratio not exceeding 44 percent; or

    b. The TD ratio is greater than 41 percent, but less than or equal to 44 percent, accompanied by a PITI ratio not exceeding 32 percent;

    And:

2. The credit score of all applicant(s) is 680 or greater;

    And:

3. At least one of the acceptable compensating factors listed below is identified and supporting documentation is provided to the Agency.

Acceptable Compensating Factors and Supporting Documentation:

- The proposed PITI is equal to or less than the applicant's current verified housing expense for the 12 month period preceding loan application. Verification of housing expenses may be documented on a verification of rent (VOR) or credit report as noted in Chapter 10, 10.13. The VOR or credit report must include the actual payment amount due and report no late payments or delinquency for the previous 12 months. Rent or mortgage payment histories from a family member will not be considered unless 12 months of canceled checks, money order receipts, or electronic payment confirmations are provided. A history of less than 12 months will not be considered an acceptable compensating factor.

- Accumulated savings or cash reserves available post loan closing are equal to or greater than 3 months of PITI payments. A verification of deposit (VOD) or two most recent consecutive bank statements document the average balance held by the applicant are required as noted in Chapter 9, 9.3. Cash on hand is not eligible for consideration as a compensating factor.

- The applicant(s) (all employed applicants) has been continuously employed with their current primary employer for a minimum of 2 years. A "Request for Verification of Employment" (VOE) (Form RD 1910-5, comparable HUD/FHA/VA or Fannie Mae form, or other equivalent), or VOEs prepared by an employment verification service (e.g., The Work Number.) must be provided. This compensating factor is not applicable for self-employed applicants.

Debt Ratio Waiver Request and Agency Approval*:*

Debt ratio waivers must be requested and documented by the approved lender. The lender requests Agency concurrence with the debt ratio waiver by submitting a signed underwriting analysis that cites one or more of the above acceptable compensating factors. Lenders may utilize Fannie Mae 1008 / Freddie Mac 1077, "Uniform Underwriting and Transmittal Summary," or similar form. Evidence of the compensating factor, such as a VOR, VOD, and/or VOE, must be submitted to the Agency for approval.

GUS underwritten loans receiving an "Accept." GUS files that receive an "Accept" underwriting recommendation or an "Accept" underwriting recommendation that requires a "Full Documentation" loan submission as part of a quality control message on the GUS Underwriting and Findings Report do not require debt ratio waiver requests.

B. Debt ratio waivers for refinance transactions

For manually underwritten Non-Streamlined and Streamlined refinance loans, the lender must thoroughly document the compensating factors that justify a debt ratio waiver. Streamlined-assist refinance transactions do not require debt ratio waivers. Debt ratio waivers can be approved when acceptable compensating factors are present. The following are examples of acceptable compensating factors:

- Credit score of 680 or higher. Credit scores of 680 and higher can be documented as a standalone compensating factor for a debt ratio waiver request, if no additional risk layers are present (e.g., adverse credit, or payment shock, etc.).

- The borrower(s) has successfully demonstrated the ability to pay housing expenses equal to or greater than the new proposed monthly housing expense for the past 12 months.

- The borrower(s) has demonstrated a conservative attitude toward the use of credit.

- Cash reserves post-closing. The borrower(s) has demonstrated an ability to accumulate savings comparable to the difference between current housing costs and projected costs. The use of retirement accounts as compensating factors and as cash reserves is limited to 60% of the vested amount of the retirement asset to offset potential withdrawals by the applicant(s). Retirement accounts that restrict withdrawals to circumstances involving the borrower's employment separation, retirement or death should not be considered as a compensating factor or as cash reserves.

- Continuous employment with the current primary employer.

Written approval of the debt ratio waiver request by the Agency is represented if a Conditional Commitment for Loan Note Guarantee is issued.

GUS underwritten loans receiving an "Accept." The debt ratio waiver requirements in this Paragraph do not apply to GUS files that receive an "Accept" underwriting recommendation or an "Accept" underwriting recommendation that requires a "Full Documentation" loan submission as part of a quality control message on the GUS Underwriting and Findings Report.

11.4 MORTGAGE CREDIT CERTIFICATES

Authorized State or local housing finance agencies may issue a mortgage credit certificate that provides a Federal income tax credit to a qualified first-time homebuyer and/or low- or moderate-income homebuyer. Lenders may consider the monthly amount of the tax credit available to the borrower as a deduction to the proposed monthly PITI payment.

Lenders using the tax credit to qualify the applicant for the loan must determine the amount of the mortgage credit available. Loan files must contain copies of the mortgage credit certificate, a copy of the lender's calculation of the adjustment to income, and a copy of the IRS Form W-4 that was given to the borrower's employer. See Chapter 9, Section 9.11A of this Handbook for additional information regarding mortgage credit certificates.

11.5 FUNDED BUYDOWN ACCOUNTS

Funded buydown accounts are designed to temporarily reduce the borrower's monthly payment during the initial years of the loan. Buydown funds may come from the seller, lender or other interested third party. The borrower is not permitted to fund the escrow account and must not be required to repay the funds. Lenders should not use funded buydowns to qualify a borrower who would not otherwise qualify for a mortgage.

Funded buydown accounts must meet the following requirements:

- The mortgage loan must be underwritten at the note rate;
- Buydown funds may come from the seller, lender or other third party;
- Buydown funds may not come from the borrower;
- A buydown rate will not reduce the interest rate more than two percent below the note rate;
- The assistance may not result in more than a one percent annual increase in the interest rate and the increase may only occur once a year;
- The borrower must agree in writing that the buydown funds will be placed in an escrow and paid directly to the lender each month to reduce the monthly mortgage payment;
- The buydown account must be fully funded at origination; and
- The funds must be placed in an escrow account with a financial institution supervised by a Federal or state agency.

A copy of the escrow agreement, signed by the borrower and the provider of the funds, must be retained in the lender's loan file. Additional information regarding a temporary interest rate buydown can be found at Chapter 9, Paragraph 9.11 B. of this Handbook.

11.6 SECTION 8 HOMEOWNERSHIP VOUCHERS

Section 8 Homeownership Vouchers may be used for qualifying applicants. This income is not included in Annual Income. For repayment income purposes, the monthly subsidy from the Section 8 Homeownership Vouchers may be treated in either of the ways described below.

A. Repayment income

When the subsidy is paid directly to the applicant, it must be added to monthly repayment income. Since the subsidy is non-taxable, it may be "grossed up" by 25 percent. This is the only option to include the Section 8 Homeownership Voucher when lenders utilize GUS for their underwriting recommendation.

B. Offset to Principal, Interest, Taxes and Insurance (PITI)

When the subsidy is paid directly to the servicing lender, the monthly homeownership assistance payment may be deducted from the proposed PITI prior to calculating qualifying ratios.

11.7 OBLIGATIONS NOT INCLUDED IN DEBT-TO-INCOME RATIOS

Obligations not considered or included in total debt-to-income ratio calculations include:

- Medical collections;
- Federal, state, and local taxes;
- Federal Insurance Contribution Act (FICA) contributions;
- Other retirement contributions such as 401(k) accounts, including the repayment of loans secured by 401(k) funds;
- Automatic deductions to savings accounts, mutual funds, stocks, bonds, certificates of deposit, including the repayment of loans secured by such funds;
- Collateralized loans secured by depository accounts;
- Utilities
- Insurance, other than property insurance

- Commuting costs;
- Union dues;
- Open accounts with zero balances;
- Child care; and
- Voluntary deductions.