

CHAPTER 11: RATIO ANALYSIS

11.1 INTRODUCTION

Ratio calculations are used to determine if the applicant'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 to apply 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 but are not limited to:

- 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.

The total debt ratio includes monthly housing expense (PITI) plus other monthly credit or debt obligations incurred by the applicant.

The lender must document an applicant's debt through various records including but limited to: a credit report, direct or third-party verifications, court documents, verification of deposits, electronic verifications, etc. All applicant open debts/accounts (including non-medical collection accounts and judgments) incurred through the note date must be included in the total debt calculation and documented in GUS and on the loan application as applicable. The following obligation expenses must be included in the monthly debts.

PITI

- Principal, interest, real estate taxes, hazard insurance, monthly portion of the annual fee, HOA fees, special assessments, etc.

Installment accounts

- Accounts that will be paid in full through a specified number of fixed payments such as auto, personal, secured/unsecured, etc. must have the monthly payment included.
- Installment debt may be paid down to ten months or less of remaining debt.
- If ten or less months of repayment remains per the credit report, creditor verification, etc., the monthly debt may be excluded if the payment does not exceed five percent of the monthly repayment income.

Revolving accounts

- Credit cards, lines of credit, secured/unsecured, etc. must include the minimum monthly payment documented on the credit report or other creditor verification in the total debts.
- If the credit report shows an outstanding balance, but no minimum monthly payment, the payment must be calculated as five percent of the balance reported on the credit report.

- The lender may obtain a current account statement or creditor verification to document the actual monthly payment and include that amount in the monthly debts.
- Revolving accounts with no outstanding balance on the credit report do not require an estimated payment to be included in the debt ratio.
- USDA will not require a revolving account 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 late payments in the last 12 months, the lender must include five percent of the outstanding balance in the monthly debts.

Court Ordered Debts: Child support, alimony, garnishments, etc.

- Court ordered debts must have the payment included in the total debt ratio unless the applicant has a release of liability from the court/creditor and acceptable evidence is documented.
- Lenders will utilize select pages from the applicable agreement/court order to document the required monthly payment due and the duration of the debt.
- Court ordered debts with ten or less payments remaining may be excluded if the payment does not exceed five percent of the monthly repayment income.
- For GUS transactions, the lender will manually enter the obligation(s) as a monthly liability. A manual entry of this monthly obligation does not require an underwriting recommendation of “Accept” to be downgraded to a “Refer.”
- Lenders must confirm repayment agreements are current. Refer to Chapter 10 for court ordered debt guidance and program eligibility.

Child care expenses

- Child care expenses are not required to be included in the monthly debt ratio.

Student loans

Lenders must include the required payment as applicable:

- 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. The fixed payment will fully amortize/pay in full the debt at the end of the term.
- Non-Fixed payment loans: Payments for deferred loans, Income Based Repayment (IBR), Income Contingent (IC), Graduated, Adjustable, and other types of repayment agreements which are not fixed must use the greater of the following:
 1. One half (.50) percent of the outstanding loan balance documented on the credit report or creditor verification, or
 2. The current documented payment under the approved repayment plan with the creditor.
- Student loans in the applicant's name alone but paid by another party remain the legal responsibility of the applicant. The applicable payment must be included in the monthly debts.
- Student loans in a "forgiveness" plan/program remain the legal responsibility of the applicant until they are released of liability from the creditor. The applicable payment must be included in the monthly debts.

Mortgages: Rental Property

- A retained dwelling that has been rented for 24 months or longer prior to loan application may have the mortgage obligation omitted when the applicant provides documentation to support the lease history.
- If the rent received does not cover all expenses (principal, interest, real estate taxes, hazard insurance, HOA fees, assessments, etc.), the remaining balance must be included in the monthly debts.

- The manual entry of a rental income loss to the monthly debts in GUS will not require an Accept loan file to be downgraded to a Refer.
- If the credit report reflects late mortgage payments on the rental dwelling in the 12 months prior to loan application, the full mortgage liability and all associated costs must be included in the monthly debts.
- Refer to Chapter 9 for rental income guidance.

Mortgages: No Release of Liability

- Mortgage liabilities disposed of through a sale, trade or transfer without a release of liability (i.e., borrower remains on the promissory note) must 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.
- Evidence may be reported through the credit report or verification from the creditor/servicer to document the payment history has been current for the 12 months prior to loan application.
- If there are late payments in the previous 12 months prior to loan application, the full mortgage obligation must be included in the monthly debt.

Mortgages: Divorce

- In the case of a divorce, the lender must obtain a copy of the legal separation agreement or divorce decree to document the remaining party/new owner responsible to pay all mortgage debts from the effective date of the decree forward.
- To exclude the mortgage debt, the lender must document the previous 12 months have been paid as agreed prior to loan application through the credit report or verification from the creditor/servicer.
- If there are late payments in the previous 12 months prior to loan application, the full mortgage obligation must be included in the monthly debts.

Co-signed obligations

- Co-signed debts refer to a debt where the applicant may be a co-borrower, joint obligor, co-signer, guarantor, etc.
- Co-signed debts must be included in the monthly debts unless the applicant provides evidence another obligor (party to the debt) has successfully made the payment for the previous 12 months prior to loan application.
- Acceptable evidence includes but not is limited to: 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 monthly debts.
- If the applicant can provide conclusive evidence from the creditor that they will not pursue debt collection against the applicant should the other party default, the 12-month payment history of the additional party is not required.
- Debts identified as “individual” on a credit report must be included in the debt ratio regardless of who is making the monthly payment (e.g. parents paying car payments on behalf of applicant and the loan is solely in the applicant’s name).

Business debts

- Business debts (e.g. car loan) reported on the applicant’s personal credit report may be excluded from the monthly debt if there is evidence the debt is paid through a business account.
- Acceptable evidence includes canceled checks or bank statements from a business account 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 do not require a payment to be included in the monthly debts.

Debts of a non-purchasing spouse (NPS)

- Applicants who currently reside or are purchasing in a community property state must include the debts of the NPS unless specifically excluded by state law.

- Approved lenders are responsible to confirm state laws are met.

Collection accounts

- Refer to Chapter 10 for collection account guidance.

Judgment accounts

- Refer to Chapter 10 for Federal and non-Federal judgment guidance.

Charge-off accounts

- Charge-off accounts are not required to have a payment included in the monthly debts. Refer to Chapter 10 for charge-off account guidance.

Automobile allowances and expense account payments

- An automobile or allowance will not cancel out a monthly debt for an automobile or expense loan/debt.
- The full monthly payment(s) due must be included in the monthly debt.
- Refer to Chapter 9 for automobile and expense allowance income guidance.

Balloon/deferred payments.

- Deferred debts and balloon debts that will require payment in full upon their due date must have a payment included in the monthly debts.
- If the actual payment on a deferred/balloon loan is unknown, the lender may obtain documentation from the creditor to establish a monthly payment that will be due on a documented payment date or they must use five percent of the outstanding balance on the credit report or creditor verification.

Tax repayment agreements

- Include Federal or State income tax repayment plan payments in the monthly debt.
- If ten or less months of repayment remains per the plan, the monthly debt may be excluded if the payment does not exceed five percent of the monthly repayment income.

- Refer to Chapter 10 for Federal Income Tax agreement eligibility.

Lease payments

- Auto, solar, energy, and additional lease payments must have the payment included in the monthly debt regardless of months remaining to pay on the contract.

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. Purchase Transactions: Debt ratio waivers

GUS Accept loans:

GUS files that receive an Accept or Accept Full Documentation underwriting recommendation do not require debt ratio waivers.

GUS Refer, Refer with Caution, and manually underwritten loans without GUS assistance:

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 maximum PITI ratio cannot exceed 32 percent, and
 - b. The maximum TD ratio cannot exceed 44 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. The VOR or credit report must include the actual payment 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 three months of PITI payments. A verification of deposit (VOD) or two most recent consecutive bank statements to document the average balance held by the applicant are required as noted in Chapter 9. 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 two years. A "Request for Verification of Employment" (VOE) (*Form RD 1910-5*, comparable HUD/FHA/VA or Fannie Mae form, or other equivalent), or a VOE prepared by an employment verification service (e.g., The Work Number.) must be provided. Applicants that have received Social Security benefits or retirement income for two years may utilize this compensating factor with documentation to support the history of receipt of benefits. 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.

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

B. Refinance Transactions: Debt ratio waivers

GUS Accept loans:

GUS files that receive an Accept or Accept Full Documentation underwriting recommendation do not require debt ratio waivers.

GUS Refer, Refer with Caution, and manually underwritten loans without GUS assistance:

- Streamlined-assist refinance loans do not require debt ratio calculations, and therefore no debt ratio waiver.
- Debt ratios for refinance loans are not limited to the maximum purchase debt ratio thresholds.
- Non-Streamlined and Streamlined refinance loans require the lender to document the compensating factors that justify a debt ratio waiver.

The following are examples of acceptable compensating factors for debt ratio waiver requests:

- Credit score of 680 or higher for each applicant.
- 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.
- Accumulated savings or cash reserves available post-closing are equal to or greater than three months of the proposed PITI payment. Cash on hand is not eligible for consideration as a compensating factor.
- 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.

11.4 MORTGAGE CREDIT CERTIFICATES

Authorized State or local housing finance agencies may issue a mortgage credit certificate (MCC) that provides a Federal income tax credit to a qualified first-time homebuyer and/or low- or moderate-income homebuyer. Refer to Chapter 9 for MCC guidance and GUS data entry.

11.5 FUNDED BUYDOWN ACCOUNTS

Funded buydown accounts are designed to reduce the borrower's monthly payment during the initial years (temporary buydown) or the full life (permanent buydown) of the loan. Permanent buydowns are fully funded and paid for at loan closing. The interest rate is fixed and will not change for the life of the loan. Temporary buydowns are eligible when the applicable guidelines are met.

Temporary buydown account requirements:

- The mortgage loan must be underwritten at the full note rate;
- Buydown funds may come from the seller, lender or other third party;
- Buydown funds may not come from the borrower;
- The buydown must not reduce the interest rate more than two percent below the full note rate;
- The assistance may increase no more than one percent annually;
- The borrower must agree in writing that the temporary 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.

11.6 SECTION 8 HOMEOWNERSHIP VOUCHERS

Section 8 Homeownership Vouchers may be used for qualifying applicants. Refer to Chapter 9 for voucher guidance and GUS data entry.

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.