

**MANUAL UNDERWRITING ML
2014-02: EFFECTIVE CASE NUMBERS
ISSUED 4/21/14 AND LATER**

AUGUST 1, 2015



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OVERVIEW



- ✓ FHA has established new requirements for manually underwritten loans with case numbers assigned (or re-assigned) 4/21/14 and later:
 - With this change, DE Underwriter “discretion” has been eliminated for manually underwritten loans where ratios exceed 31%/43%
 - New specific revised compensating factors required when ratios exceed 31%/43% on a manual underwrite
 - New minimum reserve requirement for all manually underwritten loans regardless of ratios

These new requirements do NOT apply if the DTI does not exceed 31%/43% or to non-credit qualifying Streamline refinance transactions

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DEFINITION OF MANUAL UNDERWRITE



- ✓ FHA loans require manual underwriting when:
 - “Approve/Eligible” received but underwriter downgrades to manual due to additional information not considered in the DU decision, or
 - “Refer/Eligible” received, or
 - Borrowers with no FICO score

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SUMMARY OF MANUAL UNDERWRITE CHANGES



- ✓ Max qualifying ratios based upon minimum credit score
- ✓ New minimum required cash reserves by property type per FHA (regardless of ratios):
 - 1-2 units: 1 month (change)
 - 3-4 units: 3 months (existing policy)
 - The following cannot be considered as reserves:
 - Cash back from cash-out refinance
 - Incidental cash back from rate/term refinance
 - Gift funds or borrowed funds
 - Equity in other property
- ✓ New specific compensating factors required if exceed FHA standard ratios of 31%/43%

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DETERMINING “DECISION CREDIT SCORE”



- ✓ Individual Borrower
 - 3 scores-use middle score
 - 2 scores-use lowest score
- ✓ Multiple Borrowers - All with Credit Scores
 - Determine each borrower’s score (see above) and then select the lowest for all borrowers
 - Ex: Borrower 1 -620, 641, 657 will use 641
 - Ex: Borrower 2- 619, 630, 632 will use 630
 - “Minimum Decision Score” for loan is 630
- ✓ Multiple Borrowers- One or More with No Score
 - Select the lowest score of all borrowers that do have credit scores
 - Ex: Borrower 1 has middle score 641
 - Ex: Borrower 2 has middle score 630
 - Ex: Borrower 3 has no score
 - “Minimum Decision Score” for loan is 630

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BORROWERS WITHOUT FICO SCORE: REMINDER



- ✓ Loans where not all borrowers have a FICO score are subject to the following current policy:
 - Determine if a “primary borrower” exists. If a primary borrower exists (meets all of the requirements below) the loan may proceed without additional documentation. A primary borrower is defined as:
 - The individual who will be occupying the property, and
 - Has more than 50% of the qualifying income, and
 - Meets the minimum tradeline requirements (3 tradelines, each with 12 month history and 1 of the 3 must have been active within the past 24 months)
 - If a “primary borrower” cannot be established (no borrower meets all of the above criteria), non-traditional /insufficient requirements must be followed (see next slide)

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NON-TRADITIONAL/INSUFFICIENT CREDIT REMINDER



- ✓ Borrowers with non-traditional or insufficient credit cannot exceed 31%/43%
 - 31%/43% cannot be exceeded even with compensating factors
- ✓ Insufficient Credit Borrower: A Borrower with NO FICO SCORE and CANNOT develop acceptable alternative credit (Group 1 and Group 2 requirements)
 - Cannot use Non-Occupant Co-Borrower income to qualify
- ✓ Non-Traditional Credit Borrower: Borrower with NO FICO SCORE but CAN develop acceptable alternative credit (Group 1 and Group 2 requirements)
 - Can use Non-Occupant Co-Borrower income to qualify

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GROUP 1 AND GROUP 2 CREDIT REQUIREMENTS



- ✓ See [ML 2008-11](#) for complete details of Group 1 and Group 2 credit requirements:

Group 1

- ✓ Rental Housing Payment
 - Subject to independent verification
- ✓ Utility Company References
 - Not included in housing payments

Group 2

- ✓ Insurance Coverage (not payroll deducted)
- ✓ Child Care Providers
- ✓ Retail Stores
- ✓ Medical Bills (not covered by insurance)
- ✓ Internet/Cell Phone Bills
- ✓ 12 Month History of Regular Savings Deposits
- ✓ Auto Leases
- ✓ Personal Loan Payments

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ACCEPTABLE COMPENSATING FACTORS



- ✓ Loans exceeding standard FHA ratios of 31%/43% can use the following five acceptable compensating factors:
 - Reserves that exceed the minimum
 - 1-2 units: 3 months
 - 3-4 units: 6 months
 - ✓ Minimal increase in housing
 - ✓ No discretionary debt
 - ✓ Additional income not used to qualify the loan
 - ✓ VA residual income

Depending on the ratios, more than 1 compensating factor may be required

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ELIGIBILITY TO EXCEED 31%/43% DTI



✓ Maximum eligible DTI is determined based on the compensating factors used

Credit Score/ Compensating Factor(s)	Maximum DTI	Requirements
620+ No Compensating Factor	31%/43%	<ul style="list-style-type: none"> ✓ Max DTI cannot be exceeded per HUD new requirements, underwriter discretion no longer allowed ✓ Must meet HUDs new manual underwriting cash reserve requirement <ul style="list-style-type: none"> • 1-2 units: Minimum 1 month reserves • 3-4 units: Minimum 3 months reserves
620+ and One Compensating Factor	37%/47%	<p>Compensating factor must be one of the following:</p> <ul style="list-style-type: none"> ✓ Additional cash reserves <ul style="list-style-type: none"> • 1-2 units: Minimum 3 month reserves • 3-4 units: Minimum 6 months reserves ✓ Additional cash reserves ✓ Residual income* ✓ Additional income not used for qualification*
620+ and Two Compensating Factors	40%/50%	<p>Compensating factor must be two of the following:</p> <ul style="list-style-type: none"> ✓ Additional cash reserves <ul style="list-style-type: none"> • 1-2 units: Minimum 3 month reserves • 3-4 units: Minimum 6 months reserves ✓ Additional cash reserves ✓ Residual income* ✓ Additional income not used for qualification*
620+ and No Discretionary Debt	40%/40%	<ul style="list-style-type: none"> ✓ All requirements under the “No Discretionary Debt” topic must be met ✓ Must meet manual underwriting cash reserve requirement <ul style="list-style-type: none"> • 1-2 units: Minimum 1 month reserves • 3-4 units: Minimum 3 months reserves

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COMPENSATING FACTOR: RESERVES THAT EXCEED THE MINIMUM



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- ✓ Additional reserves above and beyond the 1 or 3 month requirement , based on property type, may be used as a compensating factor for ratios that exceed 31%/43%
- ✓ 1-2 Unit Properties
 - Standard ratios exceed 31%/43%: 3 months PITI can be used as compensating factor
- ✓ 3-4 Unit Properties
 - Standard ratios exceed 31%/43%: 6 months PITI can be used as a compensating factor

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COMPENSATING FACTOR: MINIMAL HOUSING INCREASE



- ✓ New monthly housing payment does not exceed current housing payment by the lesser of:
 - \$100, or
 - 5% of the current housing payment and
- ✓ Borrower must have a documented 12 month housing history with no more than 1 X 30
 - Cash-out refinance: require 0 X 30 last 12 month

See Program Matrices for documentation requirements

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COMPENSATING FACTOR: NO DISCRETIONARY DEBT



- ✓ The only open account with an outstanding balance that is not paid off monthly is the borrower's mortgage, and
- ✓ The borrower's credit report indicates established trade lines for at least 6 months (authorized user accounts not eligible), and
- ✓ The borrower has paid any account balances in full for past 6 months

See Program Matrices for documentation requirements

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COMPENSATING FACTOR: ADDITIONAL INCOME



- ✓ The following income is eligible if not used to qualify:
 - Bonus, OT, Part Time/Seasonal
- ✓ Income above can only be used if borrower can document receipt for minimum of 1 year but < 2 years and likelihood of continuance
- ✓ May be used as the only compensating factor if DTI will not exceed 37%/47%
- ✓ May be used with an additional compensating factor if DTI exceeds 37%/47%, but is not more than 40%/50%
- ✓ Only income from borrower on Note can be used
 - Cannot use non-borrowing spouse or other parties not on note for this criteria

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COMPENSATING FACTOR: VA RESIDUAL INCOME



- ✓ FHA is adopting VA guidelines on residual income when residual income is used as a compensating factor
- ✓ Residual income is based on loan amount, family size, and region loan located in
 - All occupying borrower household members counted without regard to nature of relationship and without regard to whether they are on the subject Note

Exception: “Self-sufficient” household members who fully support themselves with verifiable income and that income was not used for qualifying may be excluded from count.

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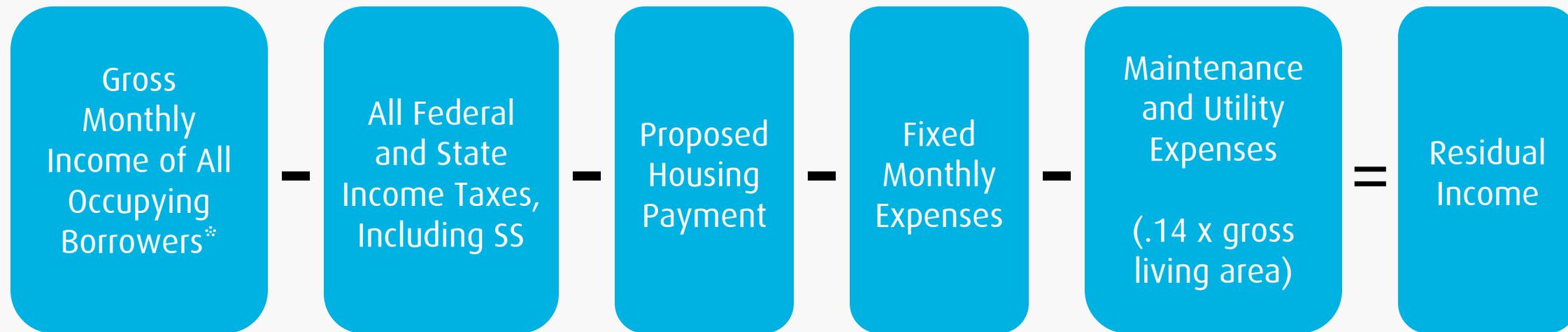
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HOW TO CALCULATE VA RESIDUAL INCOME (WHEN USED AS COMPENSATING FACTOR)



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- ✓ Child care expenses only considered if disclosed or on tax returns

REMINDER: Non-taxable income cannot be “grossed up” when calculating residual income

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VA RESIDUAL INCOME BY REGION (FOR COMPENSATING FACTOR)



Loan Amounts ≤ 79,999				
Family Size	Northeast	Midwest	South	West
1	\$390	\$382	\$382	\$425
2	\$654	\$641	\$641	\$713
3	\$788	\$772	\$772	\$859
4	\$888	\$868	\$868	\$967
5	\$921	\$902	\$902	\$1,004
Over 5	Add \$75.00 for each additional family member up to 7.			

Loan Amounts ≥ 80,000				
Family Size	Northeast	Midwest	South	West
1	\$450	\$441	\$441	\$491
2	\$755	\$738	\$738	\$823
3	\$909	\$889	\$889	\$990
4	\$1,025	\$1,003	\$1,003	\$1,117
5	\$1,052	\$1,039	\$1,039	\$1,158
Over 5	Add \$80.00 for each additional family member up to 7.			

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VA RESIDUAL INCOME: STATES INCLUDED IN REGIONS (FOR COMPENSATING FACTOR)



Geographic Regions as Identified by VA			
Northeast	Connecticut Maine Massachusetts	New Hampshire New Jersey New York	Pennsylvania Rhode Island Vermont
Midwest	Illinois Indiana Iowa Kansas	Michigan Minnesota Missouri Nebraska	North Dakota Ohio South Dakota Wisconsin
South	Alabama Arkansas Delaware District of Columbia Florida Georgia	Kentucky Louisiana Maryland Mississippi North Carolina Oklahoma	Puerto Rico South Carolina Tennessee Texas Virginia West Virginia
West	Alaska Arizona California Colorado	Hawaii Idaho Montana Nevada	New Mexico Oregon Utah Washington Wyoming

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RESIDUAL INCOME CALCULATION EXAMPLE (FOR COMPENSATING FACTOR)



- ✓ \$260,000 Purchase Price
- ✓ \$250,000 Loan Amount
- ✓ Family of 4
- ✓ 2 Incomes
- ✓ California Property

Note: Taxes are taken from paystubs

*Refer to Residual Income Chart by Region

Gross Monthly Income	
Borrower	\$3,500
Spouse	\$2,500
Total Income	\$6,000
Monthly Taxes	
Federal	\$359
State	\$37
Social Security	\$372
Medicare	\$87
Total Taxes	\$855
Monthly Housing Expense	
P&I Payment	\$1,192
Property Taxes	\$272
Homeowners Insurance	\$73
Total Housing Expense	\$1,537

Fixed Monthly Expenses	
Car Loans/Leases	\$400
Revolving Charge Accounts	\$100
Childcare Expenses	\$500
Total Fixed Expenses	\$1,000
Monthly Maintenance & Utilities	
Total Square Footage	1800
Square Footage X.14	\$252
Total Maintenance & Utilities	\$252
Residual Income	
Required by Region	\$1,117
Total Housing Expense	\$2,356

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SUMMARY



- ✓ All manually underwritten files will require reserves of either 1 month for 1 - 2 unit properties or 3 months for 3 - 4 unit properties, regardless of the ratios
- ✓ All manually underwritten files that exceed FHA standard ratios (31.00% / 43.00%) now require specific compensating factors

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✓ SCENARIO ONE:

- “Refer/Eligible” SFR with ratios 28.50% / 40.00%. The loan will require 1 month reserves as it is a manual underwrite. The loan does not require any additional compensating factors as the standard FHA ratios of 31.00% / 43.00% are not exceeded

✓ SCENARIO TWO:

- “Refer/Eligible” SFR with ratios 32.00% / 41.00%. Since the housing ratio exceeds the 31.00% standard, the file must meet specific compensating factors. The compensating factors are in addition to the minimum 1 month reserve requirement which must also be met (manual underwrite)

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SCENARIOS (CONTINUED)



✓ SCENARIO THREE:

- “Approve/Eligible” SFR with ratios 32.00% / 41.00% and did not require manual downgrade. Since this is not a manually underwritten loan, specific compensating factors and the 1 month reserve do not apply
- In this same scenario, if the Underwriter required a manual downgrade due to a foreclosure Total Scorecard did not identify, the loan would then require the minimum of 1 month reserves and specific compensating factors

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IMPORTANT REMINDERS



- ✓ Determine the minimum decision credit score
- ✓ Determine if ratios exceed FHA standards of 31%/43%
- ✓ Calculate the number of months of allowable reserves to ensure new minimum reserves met on all manual underwrites
- ✓ Determine if allowable compensating factors exist
- ✓ Review guidelines in detail for required documentation for compensating factors

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AVAILABLE RESOURCES



- ✓ FHA Manual Underwriting DTI Exceeds 31%/43% Quick Reference Guide – on Website under Forms & Resources Tab
- ✓ Announcement 2014-29
- ✓ FHA ML 2014-02
- ✓ FHA Residual Income Worksheet
- ✓ Program Matrices

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