Chapter 5

Government Loan Programs

Learn Mortgage

Chapter Objectives

- Identify basic qualifying standards for FHA-insured loans
- Define the use of upfront mortgage insurance premiums
- Recognize different FHA loan programs
- Identify basic qualifying standards for VA-guaranteed loans
- Define eligibility and entitlement for veterans
- Recognize different USDA loan programs

FHA-Insured Loans

- **Federal Housing Administration**
  - Insures loans for single and multi-family homes
  - FHA insures loans for anyone who is a U.S. citizen, permanent resident or non-permanent resident with a qualifying work visa; must meet lending guidelines
  - Part of the Department of HUD; has oversight of FHA loan programs
- **Approved Lenders**
  - Must be approved as FHA Direct Endorsement Lender
- **HUD Homeownership Centers**
  - Process FHA loans

5.1 Knowledge Check

If potential borrowers meet the lending guidelines, who can qualify for an FHA-insured loan?

A. all non-permanent residents
B. non-permanent residents with a qualifying work visa
C. permanent residents
D. U.S. citizens

FHA Loan Underwriting Standards

- **Limited Denial of Participation List**
  - Persons/companies that do not comply with HUD program standards
  - Check list before processing FHA loan application
- **4 Cs of Underwriting**
  - Allows for some credit issues; court-ordered judgements must be paid
  - No student loan or federal debt defaults
  - CAIVSR; database of delinquent federal debtors
  - No income requirements; more liberal housing expense and LTV ratios

FHA Loan Underwriting Standards

- **FHA Underwriting Guidance**
  - FHA Single Family Housing Policy Handbook
  - Mortgagee Letters
- **FHA TOTAL Mortgage Scorecard**
  - Developed by HUD
  - Evaluate creditworthiness: Credit score; monthly housing expense, reserves, LTV, loan term
  - Approves or refers; does not deny
  - Refers must be manually underwritten

5.2 Knowledge Check

Which of the following is NOT one of FHA's "4 C's of Underwriting"?

A. capacity to repay

B. cash

C. credit history

D. current interest rate

FHA Loan Underwriting Standards

- **Housing Expense Ratio**
  - Relationship of total monthly housing expense to income; includes PITI
  - Must not exceed 31%
  - Example: $3,200 income x .31 = $992 max housing expense
- **Total Debt-to-Income Ratio**
  - Relationship between total monthly debt obligation to income; given primary consideration by TOTAL
  - Must not exceed 43%

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FHA Loan Underwriting Standards

- **Maximum Ratios for Manually Underwritten**

Borrower Credit Score	Maximum Front-End and Maximum Back-End Ratio
No credit score or credit scores below 580	May not exceed the standard 31%/43% ratios
Credit scores of 580 or higher with one compensating factor	May be approved for ratios as high as 37%/47%
Credit scores of 580 or higher with two compensating factors	May be approved for ratios as high as 40%/50%

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FHA Loan Underwriting Standards

For a manually underwritten loan, if a loan applicant exceeds either or both of the 31% / 43% ratios, the lender must document **compensating factors**.

Compensating Factor	Comments
Energy Efficient Homes	For mortgages on new construction, the borrower is eligible for the EEH stretch ratios when the property meets or exceeds the higher of: • The 2006 International Energy Conservation Code • Any successor energy code standard that has been adopted by HUD for its minimum property standard • The applicable IECC year used by the state or local building code For mortgages on existing construction, the borrower is eligible for the EEH stretch ratios when the property meets either of the following conditions: • Homes that currently score a "6" or higher on the Home Energy Score scale • Homes where documented cost-effective energy improvements, as identified in the Home Energy Score Report, would increase a home's score to a "6" or higher are completed prior to closing, or in association with FHA's 203(k), Weatherization, EEM or Solar and Wind programs.

FHA Loan Underwriting Standards

Compensating Factor	Comments
Verified and Documented Cash Reserves	Subject to the following requirements. • Reserves are equal to or exceed three total monthly mortgage payments (one and two units) • Reserves are equal to or exceed six total monthly mortgage payments (three and four units) Reserves are calculated as the borrower's total assets as described in asset requirements less: • The total funds required to close the mortgage • Gifts • Borrowed funds • Cash received at closing in a cash-out refinance transaction or incidental cash received at closing in the mortgage transaction
Minimal Increase in Housing Payment	Subject to the following requirements: • The new total monthly mortgage payment does not exceed the current total monthly housing payment by more than $100 or 5 percent, whichever is less; and • There is a documented 12-month housing payment history with no more than one 30-day late payment. In cash-out transactions all payments on the mortgage being refinanced must have been made within the month due for the previous 12 months. • If the borrower has no current housing payment mortgagees may not cite this compensating factor.

FHA Loan Underwriting Standards

No Discretionary Debt	Subject to the following requirements: • The borrower's housing payment is the only open account with an outstanding balance that is not paid off monthly, • The credit report shows established credit lines in the borrower's name open for at least six months, and • The borrower can document that these accounts have been paid off in full monthly for at least the past six months. Borrowers who have no established credit other than their housing payment, no other credit lines in their own name open for at least six months, or who cannot document that all other accounts are paid off in full monthly for at least the past six months, do not qualify under this criterion. Credit lines not in the borrower's name but for which they are an authorized user do not qualify under this criterion.
Significant Additional Income Not Reflected in Effective Income	Subject to the following: • The mortgagee must verify and document that the borrower has received this income for at least one year, and it will likely continue; and • The income, if it were included in gross effective income, is sufficient to reduce the qualifying ratios to not more than 37/47. Income from non-borrowing spouses or other parties not obligated for the mortgage may not be counted under this criterion. This compensating factor may be cited only in conjunction with another compensating factor when qualifying ratios exceed 37/47 but are not more than 40/50.

FHA Loan Underwriting Standards

Compensating Factor	Comments
Residual Income	Residual income may be cited as a compensating factor provided it can be documented and is at least equal to the applicable amounts for household size and geographic region found on the Table of Residual Incomes By Region in the VA Lenders Handbook (VA Pamphlet 26-7, Chapter 4.9 b, e). The mortgagee must count all members of the household of the occupying borrower without regard to the nature of their relationship and without regard to whether they are joining on title or the note to determine "family size." The mortgagee may omit any individuals from "family size" who are fully supported from a source of verified income which is not included in effective income in the mortgage analysis.

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FHA Loans Property Guidelines

- **Eligibility of the Property**
- **Condition of the Property**
- **Maximum Mortgage Amount Permitted**
- **Occupancy**

FHA Loans Property Guidelines

- **Eligibility of the Property**
  - One- to four-family dwellings including: Detached or semi-detached dwellings, row houses, multiplex dwellings, individual condominium units (approved), and some manufactured housing
  - Utilities and other facilities that are to be independent of each other
    - Continuing supply of safe, potable water
    - Sanitary facilities and safe method of sewage disposal
    - Heating adequate for health and comfort
    - Domestic hot water
    - Conventional electrical source for lighting and equipment

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FHA Loans Property Guidelines

- **Property Conditions**
  - Must be free of health and safety hazards
  - Conditions that would require further inspection or testing
    - Infestation/evidence of termites
    - Inadequate plumbing, heating, or electrical systems
    - Structural failure in framing members
    - Leaking or worn-out roofs
    - Cracked masonry or foundation damage
    - Drainage problems
  - Lenders determine repairs to be made; required for safety, security, and structural integrity

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FHA Loans Property Guidelines

- **Occupancy**
  - Borrowers with FHA loans must:
    - Establish occupancy of the property as principal residence **within 60 days** of signing security instrument
    - Live in the house for **at least 1 year**

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FHA Loans Property Guidelines

- **Maximum Mortgage Amount**
  - Boundaries may be based on county, zip code, or metropolitan statistical areas
  - Loan amounts reviewed every 3 years
  - For example, the 2022 limits for most single-family homes start at $420,680 and go up to $970,800
  - High cost area limits are subject to a ceiling based on a percent of the Freddie Mac loan limits

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Other FHA Loan Regulations

- **Required Minimum Investment**
  - Must meet minimum investment of 3.5% of the home's purchase price or appraised value, whichever is less
  - 580 or > credit score = maximum financing
  - 500-579 credit score = 90% LTV
  - < 500 credit score = not eligible
  - Nontraditional or insufficient credit = special underwriting guidance
  - Mortgage insurance for Disaster Victims and 500 or > credit score = 100% financing with no down payment

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Other FHA Loan Regulations

- **Gifts**
  - Entire minimum investments can be non-repayable gifts
  - Gift donor may not be a person or entity with an interest in the sale of the property; considered inducement; must be subtracted from the sales price
  - Lender must document borrower gifts through a **gift letter**, including:
    - Donor and borrower signatures
    - Donor's name, relationship, and contact information
    - Dollar amount of gift and that no repayment is required

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Other FHA Loan Regulations

- **Secondary Financing**
  - FHA will insure first mortgage transactions that include secondary financing, with certain restrictions
  - May insure mortgages originated as part of the homeownership programs when government entities provide minimum cash investment funds
  - May refuse to insure the first mortgage if there is any secondary financing that does not serve the needs of the intended borrower

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Other FHA Loan Regulations

- **Seller/Third-Party Contribution**
  - May contribute **up to 6%** of the *lesser of* property's sales price or appraised value toward closing costs
    - Third-party payment for permanent and temporary interest rate buydowns
    - Payments of mortgage interest for fixed-rate mortgages
    - Mortgage payment protection insurance
    - Payment of upfront mortgage insurance premium
  - Cannot reduce required minimum investment
  - Contributions over 6% are inducements to purchase

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Other FHA Loan Regulations

- **Loan Assumption**
  - Made prior to 12/15/89 = fully assumable
  - Made on or after 12/15/89 = may include alienation clause
  - Borrower only release from liability if FHA agrees to assumption
- **Prepayment Penalties**
  - Prohibited per HUD regulations
  - Mortgagee who is receiving a full and final payment may charge interest only through the date of receipt of the payoff funds

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Other FHA Loan Regulations

- **Mortgage Insurance Premium**
  - Required for all FHA loans regardless of down payment
- **Upfront Mortgage Insurance Premium (UFMIP)**
  - Required initial premium
  - 1.75% of loan amount
- **Mortgage Insurance Premium (MIP)**
  - Assessed annually
  - Based on annual average outstanding loan balance divided by 12
  - Reflects the type of loan and loan-to-value

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Mortgage Insurance Premium

Annual MIP			
Base Loan Amount	LTV	MIP (bps)	Duration
Mortgage Term of More Than 15 Years			
≤ $625,500	≤ 90.00%	80 bps	11 years
≤ $625,500	> 90.00% but ≤ 95.00%	80 bps	Mortgage term
≤ $625,500	> 95.00%	85 bps	Mortgage term
> $625,500	≤ 90.00%	100 bps	11 years
> $625,550	> 90.00% but ≤ 95.00%	100 bps	Mortgage term
> $625,550	> 95.00%	105 bps	Mortgage term
Mortgage Term of Less Than or Equal to 15 Years			
≤ $625,500	≤ 90.00%	45 bps	11 years
≤ $625,500	> 90.00%	70 bps	Mortgage term
> $625,500	≤ 78.00%	45 bps	11 years
> $625,500	78.01 - 90.00%	70 bps	11 years
> $625,500	> 90.00%	95 bps	Mortgage term

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Other FHA Loan Regulations

- **Mortgage Insurance Premium**
  - **Financing** - UFMIP paid at closing must be in all cash or all the premiums must be financed
  - **Cancelation**
    - Made after 01/01/01 – LTV automatically cancelled 78% LTV of the original value
    - After 06/03/13 – Annual MIP collected for maximum duration
- **Keep Informed of Changes – Mortgagee Letters**

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5.3A Apply Your Knowledge

Mary wants an FHA loan to buy a house. She would have these monthly expenses:

\$536.82	Principal and Interest (\$100,000 at 5% for 360 months)
\$ 53.00	Property Taxes
\$ 25.00	Homeowners Insurance
\$ 95.83	MIP (FHA Mortgage Insurance Premium based on 96% LTV)
+\$ 90.00	Homeowners Association Dues
\$800.65	Total Housing Expense (PITI)

What should Mary's required stable monthly gross income be to qualify for this loan? **\$2,582.74**

$$\$800.65 \div .31 = \$2,582.74$$

5.3B Apply Your Knowledge

Mary wants an FHA loan to buy a house. She would have these monthly expenses:

$ 800.65	Housing Expense (from previous example)
$ 192.65	Auto Payment
+$ 40.00	Revolving Credit Account
$1,033.30	Total Debt

Based on her total debt, what should Mary's required minimum monthly income be to qualify for this loan using the debt-to-income ratio? $2,403.02

$1,033.30 ÷ 0.43 = $2,403.02

$800.65 ÷.31 = $2,582.74 Must qualify under both ratios. **$2,582.74** is income required

VA-Guaranteed Loans

- **Department of Veterans Affair**
  - Guarantees, through federal government, VA loans
  - Purpose is to meet the housing needs for eligible veterans or those currently serving in the U.S. Armed Forces for purchase of owner-occupied single-family homes or multi-family dwellings up to four units if veteran occupies
- **Automatic Endorsers**
  - Close VA-guaranteed loans without prior approval
  - Responsible for supervising mortgage process

VA-Guaranteed Loans - Eligibility

- **Eligibility**
  - Primary requirement = Borrower's military eligibility based on length of continuous active service and other service factors
  - Spouses of veterans who died while on active duty or from service-related disabilities and did not remarry before reaching age 57 or before December 16, 2003
  - Spouses of persons MIA or a POW
  - Same standards for married couple regardless of sex of spouses

VA Lenders Handbook (Pamphlet 26-7)

VA-Guaranteed Loans - Eligibility

- **Certificate of Eligibility**
  - Issued by VA; lenders apply online
- **Borrower Documentation for COE**
  - Discharged veteran who served in Armed Forces: DD-214 to identify character of service and discharge reason
  - Discharged members of Army or ANG never activated: NGB Form 22 or NGB Form 23 and proof of character of service
  - Active-duty personnel or still members of the Reserve/Guard: A signed statement of service

VA Lenders Handbook (Pamphlet 26-7)

5.4 Knowledge Check

1. **Before closing, the VA requires the lender to confirm the veteran qualifies for a loan with a Certificate of Eligibility.**

   A. true

   B. false

5.4 Knowledge Check

2. What two items must accompany every application for a VA-guaranteed mortgage?

A. Bonus Entitlement Letter from VA

B. Current Certificate of Eligibility

C. Current Certificate of Reasonable Value

D. DD214, NGB22/23 or Statement of Service

VA-Guaranteed Loans - Eligibility

- **Maximum Loan Limit**
  - Guarantee for default limited to 25% of purchase price or established reasonable value, whichever is less
- **Maximum Guaranty Amount**
  - Known as entitlement; guarantee in the event of default
  - Full entitlement = no county loan limits or down payment
  - Less than full entitlement = maximum guaranty will be the lesser of 25% of the loan amount or 25% of the county loan limit minus previous entitlement used and not restored
- **Down Payment Requirement**
  - Generally none if have full entitlement; may be required if < full entitlement or purchase price > reasonable value

VA Lenders Handbook (Pamphlet 26-7)

Case in Point—Example 1

Assume each veteran is buying a home in a county where the current conforming loan limit for a single-family home is $467,200, making the maximum guaranty **$161,800** when county loan limits apply.

Example 1: Veteran Bob has *full entitlement* available. He is purchasing a home for $350,000 and is seeking 100% financing.

Since Bob has his entire entitlement available, his guaranty is unlimited and no analysis needs to be completed. He can purchase this house without a down payment as long as purchase price does not exceed reasonable value of property.

Case in Point—Example 2

Example 2: Veteran Ann wants to buy a house for $550,000 at 100% financing. She has already used $29,500 of entitlement which has not been restored.

$161,800	Maximum Entitlement
–$29,500	Entitlement Used (not restored)
$132,300	Available Entitlement
$550,000	Purchase Price/Potential Loan Amount
x .25	
$137,500	Maximum Guaranty Required

Ann has $132,300 of her entitlement available to buy this house and needs a $5,200 as a down payment

5.5 Apply Your Knowledge

Assume borrower Jackie used $50,000 of entitlement on a prior VA-guaranteed home loan, which was not restored. She now wants to purchase another home with a loan amount of $500,000 in an area with a county limit of $647,200. What is the amount of the maximum guaranty for this loan?

The maximum guaranty is $111,800.

VA-Guaranteed Loans - Qualifications

- **Housing Expense Ratio**
  - Not usually considered
- **Total Debt-to-Income Ratio**
  - More latitude than conventional
  - Total DTI not to exceed 41%
  - Tax-free income may be grossed up; no more than 25%
- **Residual Income**
  - Appropriate cash flow required
  - Net income minus expense and reoccurring debts and obligations = cash flow remaining for family support
  - Uses net income and considers size of family
  - See VA Residual Income Calculation Worksheet

VA Lenders Handbook (Pamphlet 26-7)

VA-Guaranteed Loans - Property

- **Property Eligibility**
  - Existing homes, previously owner-occupied *or* had all onsite and offsite improvements completed for 1 year or more
  - Newly completed properties if
    - 1 year VA builder's warranty,
    - HUD-acceptable 10-yr insured protection plan, or
    - Built by veteran for own occupancy
  - Some manufactured homes

VA Lenders Handbook (Pamphlet 26-7)

VA-Guaranteed Loans - Property

- **Establishing Reasonable Value**
  - Appraisal must be reviewed by VA-authorized staff reviewer (SAR) or staff appraiser
  - Issue Notice of Value or Certificate of Reasonable Value
  - Loan amount cannot exceed establish reasonable value
- **Occupancy**
  - Must personally live in the property as home, or
  - Intend to use as home within a reasonable time; generally within 60 days after loan closing

VA Lenders Handbook (Pamphlet 26-7)

VA-Guaranteed Loans - Terms

- **Variable Funding Fee**
  - Must pay a non-refundable one-time variable funding fee at closing
  - Waived for disabled veterans and surviving spouses of veterans who died in service

Down Payment	First Time Use	Subsequent Use
< 5%	2.3%	3.60%
5% or more	1.65%	1.65%
10% or more	1.40%	1.40%

VA Lenders Handbook (Pamphlet 26-7)

VA-Guaranteed Loans - Terms

- **Closing Costs**
  - Veteran may pay any and all of the following:
    - Appraisal/compliance inspections
    - Recording fees
    - Credit report
    - Prepaid items
    - Hazard insurance
    - Flood zone determination
    - Survey
    - Title examination insurance
    - Special mailing fees
    - Mortgage Electronic Registration System fee
  - Veteran cannot be charged for the following fees:
    - Attorney's fees
    - Brokerage fees
    - Prepayment penalties
    - Builder's inspection fees
  - Lender may also charge a **flat fee**, up to 1% of the loan amount, to cover the lender's costs

VA Lenders Handbook (Pamphlet 26-7)

VA-Guaranteed Loans - Terms

- **Seller Concessions Subject to a 4% Limit**
  - Payment of the buyer's VA funding fee
  - Prepayment of buyer's property taxes and insurance
  - Gifts (such as a television or microwave oven)
  - Payment of extra points to provide permanent interest rate buydowns
  - Provision of escrowed funds to provide temporary interest rate buydowns
- **Not Considered as Seller Concessions**
  - Payment of the buyer's closing costs
  - Payment of points as appropriate to the market

VA Lenders Handbook (Pamphlet 26-7)

VA-Guaranteed Loans - Terms

- **Secondary Financing**
  - Permitted simultaneously with a VA-guaranteed first loan for a variety of purposes
- **Loan Assumption**
  - Must be approved by Department of Veteran Affairs
  - With assumption, entitlement can be restored if specific conditions are met
- **Prepayment Penalties**
  - Prohibited

VA Lenders Handbook (Pamphlet 26-7)

USDA Rural Development Programs

- **USDA's Rural Development Agency**
  - Provides financial support to low-income homebuyers in rural communities
  - "Rural" can include small towns up to 35,000 people
  - Loan officers need to verify whether the property is located in a designated area for specific programs

http://eligibility.sc.egov.usda.gov/eligibility/welcomeAction.do

USDA Rural Development Programs

- **Section 502 Loans**
  - Guarantees loans made by approved private lenders, or
  - Makes direct loans if no local lender is available
- **Section 502 Loan Allowable Purposes**
  - Purchase an existing home
  - Construct a new home
  - Renovate or repair an existing home
  - Relocate an existing home
  - Purchase and prepare a site for a home, including sewage and water facilities

http://eligibility.sc.egov.usda.gov/eligibility/welcomeAction.do

USDA Rural Development Programs

- **Section 502 Direct Loan**
  - **Applicant Requirements**
    - Be without decent, safe, and sanitary housing
    - Be unable to obtain loan can be expected to meet
    - Agree to occupy the property as primary residence
    - Have the legal capacity to incur a loan obligation
    - Meet citizenship or eligible noncitizen requirements
    - Not be suspended or debarred from federal programs
  - **Property Requirements**
    - Generally be 2,000 square feet or less
    - Not have market value > applicable area loan limit
    - Not have in-ground swimming pools
    - Not be designed for income producing activities

http://eligibility.sc.egov.usda.gov/eligibility/welcomeAction.do

USDA Rural Development Programs

- **Section 502 Guaranteed Loan**
  - **Applicant Requirements**
    - Meet income-eligibility (not > 115%)
    - Agree to occupy as primary residence
    - U.S. Citizen, U.S. non-citizen national or Qualified Alien
  - **Property Requirements**
    - Located within an eligible rural area
    - Single-family dwelling
    - Meet HUD 4000.1 minimum standards.
    - No set maximum purchase price
    - No set acreage limits; acreage amount must be common for the area
    - No seasoning requirements ("flipped" properties allowed).

http://eligibility.sc.egov.usda.gov/eligibility/welcomeAction.do

USDA Rural Development Programs

- **Section 502 Loan Income Requirements**
  - – Applicants must meet income requirements based on the area median income (AMI)
  - – May have an income of up to 115% of AMI
- **Section 502 Loan Financing**
  - – May receive 100% financing, based on appraised value or acquisition cost, whichever is less
  - – USDA Mortgage insurance rates:
    - 1.00% upfront fee paid at closing, based on the loan size
    - 0.35% annual fee, based on the remaining principal balance

http://eligibility.sc.egov.usda.gov/eligibility/welcomeAction.do

Chapter 5

Chapter Quiz

Chapter 5 Quiz

1. **An eligible borrower applies for an FHA loan on a house with an appraised value of $100,000 and a purchase price of $96,000. What is the required minimum investment?**
   A. $3,000
   B. $3,360
   C. $3,500
   D. $4,800

Chapter 5 Quiz

2. **An upfront mortgage insurance premium is required**
   A. for all FHA loans.
   B. only when the buyer cannot pay the required down payment in cash.
   C. only when the LTV exceeds 80%.
   D. only when the LTV exceeds 90%.

Chapter 5 Quiz

3. **To qualify for an FHA loan, a borrower should have a maximum housing expense ratio of _____and a total debt-to-income ratio of _____.**
   A. 28%; 36%
   B. 29%; 36%
   C. 29%; 41%
   D. 31%; 43%

Chapter 5 Quiz

4. A residual income calculation shows the

A. amount of cash flow available for maintenance and utilities.

B. cash flow remaining for family support.

C. funds remaining for the proposed PITI payment.

D. true composite debt-to-income ratio.

Chapter 5 Quiz

5. **FHA-insured loans are funded by**
   A. approved lenders.
   B. the FDIC.
   C. the FHA.
   D. HUD.

Chapter 5 Quiz

6. **The annual area median income for a county is $50,000. Using USDA-guaranteed financing, what is the maximum amount of gross annual income that the borrower can earn and still qualify?**
    A. $50,000
    B. $55,000
    C. $57,500
    D. $62,500

Chapter 5 Quiz

7. **What is the maximum flat fee that a lender may charge for origination on a VA loan?**
   A. 1%
   B. 2%
   C. 3.5%
   D. There is no limit; the fee is negotiable.

Chapter 5 Quiz

8. Full VA entitlement can generally be restored to a veteran

A. if any disabled veteran assumes the loan.

B. if an eligible veteran substitutes his entitlement for the seller's.

C. under no circumstances.

D. when the loan is paid down to below 50% LTV.