

Required Elements for Homebuyer Underwriting Policies

Introduction: The 2013 HOME Final Rule, published on July 24, 2013, introduced several requirements related to the use of HOME funding to assist low income homebuyers. In particular, the HOME Rule requires PJs to establish Homebuyer Program Policies addressing buyer underwriting, responsible lending, and subordination of HOME liens to future refinancing. Other Rule changes also explicitly require PJs to consider cost reasonableness of all HOME projects and establish a requirement that all buyers of HOME-assisted units receive housing counseling. Pending publication of a CPD notice covering these requirements in more detail, this document has been developed to help PJs in developing their Homebuyer Program Policies.

Required Elements for PJ Policies: The 2013 HOME Final rule does not establish specific underwriting or financial metrics that PJs must use to fully and carefully underwrite HOME-assisted homebuyers, prevent predatory lending, and ensure that homeownership is affordable and sustainable over the long term. Instead, the 2013 HOME Final Rule provides PJs with the discretion to determine the appropriate thresholds and limits in the context of their local markets and populations served. However, PJs must ensure that their local policies and procedures include elements addressing each of the following items:

- Purchase price,¹ including:
 - Reasonableness of purchase price and how PJ will document. Per §92.250(b)(1) PJ must determine all project costs² are reasonable.
 - Applicability of HOME Maximum Purchase Price limits in §92.254(a)(2)(iii)
- Appropriate amount of homeownership assistance (including downpayment, closing cost, and direct financing of purchase) [§92.254(f)(1)]. In practice, PJ must establish expectations about the primary mortgage loan the buyer must receive, including:
 - How income will be defined for underwriting purposes³
 - Maximum housing payment (i.e. front-end ratio) requirement, inclusive of principal, interest, taxes, insurance, mortgage insurance, and association fees (as applicable)
 - Maximum total debt payments inclusive of housing and consumer debt (i.e. back-end ratio), and definition of what debt payments will be included in the ratio evaluation
 - Consideration of buyer assets, including:
 - How the PJ will define assets for purposes of underwriting⁴
 - The minimum required cash contribution from the buyer toward the purchase
 - The PJ's local "asset limit" (e.g. requiring that a buyer use any cash assets available above a given "ceiling" toward the purchase of the home before receiving HOME assistance)
 - Minimum buyer cash reserves following purchase (e.g. following purchase the buyer must have X times the monthly PITI payment in liquid assets available)
 - Maximum HOME assistance available

¹ When PJs provide HOME funds to develop units for sale to low income households, they must establish the sales price or the process by which the sales price will be established in the written agreement with the developer [§92.504(c)(3)(ii)(B)]. That issue will be addressed in other HUD guidance, but even when HOME is used only for direct buyer assistance (e.g. DPA) to assist a private purchase, the purchase price must be reasonable.

² Reasonableness of closing costs and prepaid expenses is addressed in responsible lending provisions below

³ For example, a PJ using the Part 5 definition for eligibility purposes might exclude child support attributable to a 17-year-old child from the evaluation of income available to afford the mortgage since that income source will not be readily available soon after the purchase. A PJ using the 1040 definition, which does not count child support for income eligibility, might still consider that income towards a buyer's ability to make the payment if it can be expected to last for some time.

⁴ For example, under Part 5 a 401(k) retirement account is an asset, but the PJ might exclude tax-preferred retirement, educational, or health savings accounts when evaluating what a buyer must contribute toward the purchase.

- Monthly expenses that may limit a buyer's ability to sustain housing or justify additional assistance within local limits
 - List or definition of nondiscretionary, fixed, recurring monthly expenses that may significantly affect ability to manage housing/debt payments that the PJ will consider in underwriting
 - How the selected monthly expenses will affect assistance levels (e.g. allowance for lower debt ratios within max. assistance level; specific benchmarks/standard for limit on fixed monthly expenses to ensure housing sustainability)

- Responsible lending standards to ensure buyer's primary mortgage does not contain predatory or risky features that threaten the sustainability of homeownership [*§92.254(f)(2)*]. Topics should include:
 - Whether PJ will require fixed rate or will allow adjustable rate loans under some circumstances
 - Maximum interest rate, likely defined by reference to FFIEC or Freddie Mac surveys
 - Minimum and maximum loan terms (i.e. restrict to 30 year loans or allow shorter/longer terms?)
 - Reasonableness of closing costs, especially origination fees, points, and other lender charges
 - Other potentially risky/irresponsible loan features such as balloon payments, prepayment penalties, single-premium credit life insurance, loans without tax/insurance escrows, etc.

- Treatment of subordination requests [*§92.254(f)(3)*]. Topics should include:
 - Conditions under which the PJ will subordinate its HOME lien to allow refinancing of primary mortgage or new debt (i.e. will PJ only allow rate/term refinancing or will PJ allow cash out for approved purposes)
 - If allowed, limits on equity that may be taken as cash out (e.g. maximum combined loan to value ratio following refinance)
 - How responsible lending standards will apply to the new loan
 - If refinancing allowed, how PJ will apply underwriting standards to ensure new loan is sustainable

- Standards for required housing counseling [*§92.254(a)(3)*]:
 - In December 2016, HUD published the Final Rule for Housing Counseling Certification which applies to homeownership counseling required by the HOME program. That rule, the final effective date of which is August 1, 2020, requires that HOME-assisted buyers receive counseling from HUD certified counselors employed by HUD Approved Housing Counseling Agencies. The rule also standardizes the content requirements for counseling. Until then, PJs continue to have the flexibility to determine in their local policies and procedures:
 - Qualifications for counseling provider (including entity and individual)
 - Content of counseling curriculum, acceptable delivery mechanisms (i.e. one-on-one, individual, in-person, remote, etc.), and duration (e.g. number of hours)
 - Timing of counseling (e.g. how long is a counseling certificate good—1 yr, 2 yrs, etc.?)
 - PJs should also consider how counseling will be paid. Options may include:
 - Donated counseling can count toward HOME match [*§92.220(a)(11)*];
 - Counseling can be charged as project soft cost [*§92.206(d)(6)*];
 - Counseling can be charged to administration [*§92.207(b)*]; or
 - Reasonable counseling fees can be charged to the buyer [*§92.214(b)(1)(iii)*]

PJ Procedures: PJs are expected to have written policies and procedures. In addition to the policy elements above, a PJ's procedures should identify the process for applying its underwriting standards, the staff responsible, and the documentation that will be collected, reviewed, and maintained in project files.

Additional HUD Guidance & Updates: HUD will release additional guidance to HOME PJs through CPD Notices, training, and other means. PJs should track the release of new guidance from HUD which may more formally incorporate this list of minimum policy elements, add to or further refine it, or otherwise modify it as appropriate.