

CHAPTER 5. VERIFYING INFORMATION ON PROSPECTIVE BORROWER'S
FINANCES AND PROPERTIES

5-1. INTRODUCTION. At this stage in the Section 312 Loan review process, the information obtained from the prospective borrower in the initial screening process must be verified by the Local Processing Agency to help determine whether the borrower is an acceptable credit risk. Specifically, the LPA must verify or obtain the following: (1) the prospective borrower's credit history; (2) the status of all mortgages and liens on the property; (3) the prospective borrower's income; (4) the prospective borrower's liquid assets; (5) the prospective borrower's employment; (6) the prospective borrower's legal status (for partnerships or corporations); (7) the title to the property; and (8) the appraised value of the property. These are each discussed individually below, following a discussion of general requirements for verification.

5-2. GENERAL REQUIREMENTS FOR VERIFICATION

- a. Verification Required for all Borrowers. LPA's must obtain all the applicable verifications included in this Chapter for each prospective borrower of Section 312 Loan funds, including all co-owners of the property.
- b. Verifications Required for Co-Signers. In the event that an individual or individuals are required to co-sign or guarantee a Section 312 Loan in order to support a finding of acceptable risk in a particular case in accordance with the requirements in Chapter 7, all information required by this Chapter to be verified for an individual borrower must be obtained for the co-signer or guarantor. This includes verifications of the co-signer's or guarantor's credit history, income, liquid assets, and employment stability.
- c. Record of Verifications. The LPA must include all verifications as part of the loan file, including written verifications and/or copies of documentation, such as pay stubs, etc. Where verifications are made in person or by telephone, a record of the date of call, name of individual contacted, and name of the LPA staff who verified the information must be included in the file.
- d. Order of Conducting Verifications. LPA's may conduct verifications in whatever order works best for them. LPA's are encouraged to conduct the verifications that are least expensive and easiest first, such as verifications of employment, income, deposit and credit reports. In that way, if serious problems arise and the prospective borrower needs to be disqualified, more expensive verifications can be avoided.

- e. Covering Costs Associated With Verification. The fees associated

with verifying credit, income employment, appraisals and title evidence from outside companies are eligible loan costs so long as the fees are reasonable and customary. LPA's may advance CDBG funds or local funds to pay for these verifications, and be reimbursed from Section 312 funds at loan settlement. (All advances of CDBG funds must be done in accordance with the applicable CDBG statutes and regulations.) The LPA may not use Section 312 funds or require the borrower to pay for verification work done by LPA's, but these costs may be eligible CDBG rehabilitation delivery services under 24 CFR 570.202(b)(9). If the loan is subsequently rejected by the LPA or HUD, or if the loan is cancelled in accordance with Truth-in-Lending procedures, Section 312 funds may not be used to pay for verifications conducted by outside companies. In such cases, the LPA may absorb these verification costs, such as with CDBG funds (if done in accordance with CDBG statutes and regulations) or the applicants must pay for these costs themselves. (See Chapter 3 for additional information on eligible uses for Section 312 Loans.)

- f. The Role of LPA, HUD Field Office and HUD Headquarters in Conducting Verifications. The applicable verifications detailed in this Chapter must be conducted or obtained by LPA's for all Section 312 applications, except for loan assumptions. For loan assumptions, LPA's may choose to conduct or obtain the verification themselves, or they may request the Master Servicer to do so. LPA's are responsible for conducting or obtaining verifications (except for assumptions, as indicated above) whether or not the LPA has Local Loan Approval Authority, and whether or not the Section 312 Loan exceeds \$200,000. If the Section 312 Loan exceeds \$200,000, the LPA must underwrite and make a recommendation on the loan to the HUD Field Office and the HUD Headquarters Office of Urban Rehabilitation, in accordance with the requirements detailed in Paragraph 7-4 of this Handbook.
- g. Special Requirements for Partnerships and Corporations. See Paragraph 5-3-c for requirements concerning credit checks, Paragraph 5-4-f for financial statement requirements, and Paragraph 5-8 for requirements concerning the verification of the entity's legal status.

5-3. VERIFYING CREDIT HISTORY -- THE CREDIT REPORT

- a. General Requirements. A credit report must be obtained from a reputable, independent, credit reporting agency on each borrower signing the promissory note and security instrument, whether as borrower, guarantor, co-signer, or surety.

The credit report must show terms, balances and ratings on outstanding debts; must list and describe other debts with balances

and/or court records for liens, suits, foreclosures, garnishments, divorce decrees, bankruptcies or judgments for a period of seven years. All accounts listed in the credit report with a balance due must be accounted for on the loan application.

- b. LPA's must check the following on the credit report:
- (1) Payment history, looking specifically for a recurring history of making payments on revolving or installment debts that are more than 30 days late;
 - (2) Legal actions, including liens, judgments, bankruptcies, garnishments, suits, foreclosures and divorce decrees;
 - (3) Current and previous addresses, which serves as a verification and shows some degree of stability;
 - (4) Phone number, which shows some degree of stability;
 - (5) Outstanding debt, which give LPA's insight as to whether the borrower is overextended;
 - (6) Spouse's name and social security number, which verifies information received from the borrower;
 - (7) Current and, if with current employer less than two years, recent employment, which will verify information received from the borrower.
- c. Additional Requirements for Partnerships, Corporations and Sole Proprietorships. If the prospective borrower is a partnership, including general and limited partnerships, a credit report must be obtained for each general partner. As to limited partnerships and limited partners, since each partner is required to personally sign the note and the mortgage and must assume personal liability for the full amount of the loan, LPA's must obtain a credit report from as many limited partners as necessary to determine whether the partnership is an acceptable risk, pursuant to Paragraph 7-6 of this Handbook. (This may or may not include all limited partners.) In addition, a commercial credit report must be obtained for the partnership. If the prospective borrower is a corporation, LPA's must obtain a Dun and Bradstreet or equivalent report, if one is readily available. (The LPA or HUD may contact the Master Servicer to obtain a copy of the Dun and Bradstreet Report, if one is available.) A credit report must also be obtained for each principal officer or stockholder owning more than 10% of the stock of the corporation. For sole proprietorships, a personal credit report must be obtained for the sole proprietor, and a commercial credit report must be obtained for the business.

- d. Cost of Credit Report. A reasonable fee, not to exceed the cost

of the credit report, may be charged to the borrower and may be included in the Section 312 Loan.

5-4. VERIFYING MORTGAGE AND LIEN STATUS

- a. Required Documentation. Written evidence of the present status of all mortgages and liens on the property must be obtained. This must include a written statement that all liens superior to the Section 312 Loan are current at the time the Section 312 Loan is closed. A letter from the mortgagee or a completed Mortgage Verification Form (See Exhibit 5-1 for a sample Request for Verification of Mortgage or Deed of Trust) are acceptable types of verifications. The LPA must also obtain a copy of the legal documents (note and mortgage or deed of trust) evidencing all prior liens on the property for review by LPA counsel. This must be done to identify any existing real estate tax and insurance escrows and their expected date of termination. It must also be done to determine the terms of any future payments that may vary, such as adjustable rate mortgages and/or balloon payment notes, or the possibility that prior liens may secure additional advances that would also be prior to the Section 312 Loan (i.e., an open-end mortgage). This examination of prior liens should be done in conjunction with doing the title search, discussed in Paragraph 5-9 of this Handbook.
- b. Requirements for Balloon Notes or Mortgages. A Section 312 Loan may be made to a borrower who has a balloon note secured by the property only if one of the following conditions are met:
 - (1) the balloon will be junior to the Section 312 lien and is scheduled to come due after the expected completion of construction on the Section 312 project, OR
 - (2) the balloon will be senior to the Section 312 Loan, it was made prior to the submission of the Section 312 application to the LPA, and the balloon payment is scheduled to come due at least five years from the expected date of settlement the Section 312 Loan, OR
 - (3) the balloon will be senior to the Section 312 Loan, it will be made after the submission of the Section 312 application to the LPA, and the balloon payment is scheduled to come due at least ten years from the expected date of settlement of the Section 312 Loan.
- c. Open-Ended Mortgages. An open-ended mortgage or note permits the borrower to add new advances to the lien. For open-ended mortgages prior to (i.e., more senior than) a Section 312 Loan, the LPA must

consider the amount of the lien to be the full amount that could be advanced (even if not yet advanced), unless the open-ended

mortgage lender agrees in a recorded instrument to subordinate any future advances to the Section 312 Loan.

5-5. VERIFYING INCOME. All significant sources of income and earnings that will be used to determine whether the prospective borrower is an acceptable credit risk must be verified. LPA's must use one or more of the following means of verifying the prospective borrower's recent income.

- a. Completed Form HUD 92004-G. A completed Request for Verification of Employment Form, HUD 92004-G (See Exhibit 5-2 for a sample), or another acceptable verification of employment form designed by the locality which includes all the information on the HUD form, is the best means of verifying income. However, the verification of employment form must be mailed by the LPA to the employer and by the employer back to the LPA; these forms may not be hand-carried by prospective borrowers.
- b. Previous Year's Income Tax Return (1040). The Federal Income Tax Form (such as the IRS 1040 Form), signed by the borrower and filed with the IRS, generally is acceptable as a sole source of income verification if the borrower is applying for Section 312 funds in the early part of the year. The IRS tax forms are the most accurate source of income verification for borrowers with irregular incomes or with updated information for the current year. These forms are required for all self-employed borrowers. During the last six months of the calendar year, the Federal tax forms should be supplemented with recent income documentation, such as one or more pay stubs or a telephone call to the employer. This will help ensure that the borrower's income has not changed significantly since the Federal tax form was prepared.
- c. Salary Pay Stub. When the income needed to support the loan is solely from salary, the salary pay stubs may be used as the sole or primary source of income verification. These salary stubs must be for a recent, continuous two-month period. When the salary pay stub documentation supplements another verification source, such as the previous year's W-2 form(s), one typical pay stub may suffice to verify the current salary.
- d. Previous Year's W-2 Form(s). Like the Federal tax form, the previous year's W-2 form(s) for all employment income is generally an acceptable sole source of income verification, but only if the borrower is applying for Section 312 funds in the early part of the year.

- e. Pension, Disability, Social Security or Social Services Benefits. Acceptable methods of verifying such income include any one or more of the following, which are listed in order of preference:
 - (1) Requesting information from the Social Security Administration Office which services the locality. In order to receive prompt service, it is best to send the request to

the attention of a particular individual;

- (2) A copy of the award letter;
 - (3) A photocopy of a regular benefit check, if the prospective borrower can bring the check to the LPA Office for photocopying. Any such photocopy must clearly be marked "void";
 - (4) Visual verification of the benefit check or award letter, so long as a written statement by the LPA is included in the borrower's file certifying that the check or award letter was visually verified. This is particularly appropriate when the borrower is elderly or home-bound. If possible, a photocopy of the check, marked "void", or the award letter should be obtained.
- f. Currently Dated Balance Sheet and Statement of Operations. Where the principal source of income is from the borrower's business, whether owned individually or by a corporation or partnership, or where the borrower itself is a corporation, partnership or other legal entity, the LPA must obtain audited financial statements for the entity prepared by an accountant, including a currently dated balance sheet and statement of operations, or a signed copy of the legal entity's most recent tax return filed with the IRS. For partnerships, the LPA must also obtain this same information from all general partners. For limited partnerships, the LPA must also obtain this same information from as many limited partners as necessary to determine whether the partnership is an acceptable risk, pursuant to Paragraph 7-6 of this Handbook. (This may or may not include all limited partners.) (See Paragraph 7-6 of this Handbook for additional information on underwriting loans to partnerships and corporations.)
- g. Separation or Divorce Settlement Statement. A separation or divorce settlement statement for alimony or child support payments is necessary if reliance on that income will be used to determine the borrower's ability to repay the loan. This statement must be supplemented by some evidence of regular payment of the alimony or child support payments.
- h. Verifying Other Income. The LPA must either use the previous year's Federal income tax return or the sources listed below to verify the following types of other income:

8/13/86

5-6

7375.01 REV-2

- (1) Income and Expenses from Investment Properties -- verifiable with signed leases for income, cancelled checks or copies of receipts marked paid for expenses, audited profit/loss statements or other statements from leasing agents;
- (2) Interest or Dividends from Stocks, Bonds, or other Financial Institutions -- verifiable with statements from the broker or financial institution;

- (3) Payments of Principal or Interest on Notes or Mortgages -- verifiable with copies of the legal instrument;
- (4) Overtime, Bonuses or Commissions -- verifiable with statements from the employer;
- (5) Regular Contributions or Payments from Others, including funds contributed by other family members regardless of whether they live in the same dwelling as the prospective borrower -- verifiable with cancelled checks written by the payor, bank statements showing deposits in the prospective borrower's account, or a written agreement concerning the contribution or payment.

5-6. VERIFYING LIQUID ASSETS. The LPA must verify the prospective borrower's liquid assets, if these liquid assets are needed for the rehabilitation project. For instance, a prospective borrower who plans to use cash to complete the rehabilitation work must demonstrate that those funds are available, or an investor-owner of a multifamily project must demonstrate that he or she has sufficient cash to cover operating expenses and debt service during the rent-up period immediately following the completion of the rehabilitation.

The liquid assets may be cash on deposit, cash on hand, cash surrender value of life insurance, proceeds from the sale of marketable securities or other assets, gifts of cash, or cash equivalents.

Cash on deposit must be verified with a Request for Verification of Deposit Form (HUD 92004-F, included as Exhibit 5-3), or a form designed by the LPA which includes all the information on the HUD form. All other liquid assets must also be verified.

5-7. VERIFYING EMPLOYMENT STABILITY. The LPA must verify the prospective borrower's employment record for at least the previous two-year period. If the borrower has been employed by his or her present employer for less than two years, the previous employment must be verified. If the borrower has been employed by the current employer for less than six months, or if prospects for continued employment with the current employer may be questionable, the LPA must verify the borrower's

prospects for continued employment. This can be accomplished by a telephone call to the employer (which must be documented in the file), a completed Request for Verification of Employment Form mailed by the employer to the LPA (either HUD Form 92004-G, a sample of which is included as Exhibit 5-2, or a locally designed verification form), or a letter mailed from the employer on letterhead stationery. If there have been periods of unemployment over the previous two years, the prospective borrower must adequately explain the reasons.

5-8. VERIFYING LEGAL STATUS OF PARTNERSHIPS OR CORPORATIONS. The LPA counsel (i.e., a qualified attorney retained by the LPA or the local

government's attorney) must review the partnership agreement or corporate by-laws and resolutions to ensure that they duly authorize the entity to engage in real estate activity and to enter into debt. The LPA must also ensure that the entity has all required licenses and has filed all necessary reports to do business in the state and locality.

5-9. VERIFYING TITLE

- a. Introduction. The LPA is responsible for reviewing the title evidence prior to loan approval and updated title evidence at loan settlement. The title evidence must show that the borrower has a good and marketable title to the property (except as noted in Paragraph 5-9-e) being used for security as of the date of settlement, except for issues related to refinancing which must be resolved by the recordation date of HUD's security instrument, subject only to such liens and encumbrances as are approved by the Approving Officer as part of the determination of acceptable risk. Any prior and subordinate encumbrances must be specifically listed in the Section 312 Loan application.
- b. Acceptable Types of Title Evidence. The following types of title evidence are acceptable to HUD:
 - (1) Mortgagee's Title Policy. A mortgagee's policy of title insurance issued by a title company, duly authorized by law and qualified to issue such policies.
 - (2) Abstract, Legal Opinion and/or Attorney's Certificate of Title. An abstract of title prepared by a company or individual engaged in the business of preparing abstracts of title, accompanied by a legal opinion as to the quality of such title, and/or an Attorney's Certificate of Title, each of which must be signed by an attorney-at-law experienced in examination of titles.
 - (3) Torrens or Similar Certificate. A Torrens or similar certificate of registered title, where available.

8/13/86

5-8

7375.01 REV-2

- c. Securing Title Evidence. The LPA is encouraged to contract with an outside firm or attorney to secure title evidence. However, the LPA also may prepare title evidence "in-house", provided that the person performing this function meets the criteria listed below in Paragraph 5-9-d, and any additional professional requirements for preparing the type of title evidence required. In cases where the LPA contracts for service, it must secure the type of title evidence that is customary for the locality from a firm that meets the criteria listed below in Paragraph 5-9-d.
- d. Eligibility Criteria for Preparing Title Evidence. Parties selected to prepare title evidence, whether private individuals or businesses or LPA staff, must meet the following minimum criteria:

- (1) Experience in performing title-related work;
 - (2) Proper education, academic and/or professional degrees, licensing and/or certification, where applicable;
 - (3) Competitive costs for services (for non-LPA staff);
 - (4) Necessary insurance, such as Errors and Omissions coverage, where applicable;
 - (5) Reliability and expeditious service;
 - (6) Equal opportunity considerations; and
 - (7) Must not be on HUD's suspended or debarred list.
- e. Borrowers Who Are Not Fee Simple Title Holders. Whenever loans are made to land sales contract purchasers, the requirements of this Paragraph as to title evidence are applicable to the title of the seller under the land sales contract. (See Paragraph 4-4-b and 4-4-c of this Handbook for eligibility criteria for borrowers who are contract purchasers.) When Section 312 Loans are made to Urban Homesteaders meeting the requirements of the Urban Homesteading regulations (as detailed in Paragraph 12-16), title evidence documenting the conditional title of the homesteader with the possibility of reverter in the local Urban Homesteading agency (or equivalent conditional transfer arrangement) is acceptable.

5-10.CONDUCTING PROPERTY APPRAISALS

a. General Requirements

- (1) Properties for Which Appraisals are Required. In order to ensure that Section 312 Rehabilitation Loans are properly underwritten and secured, appraisals are required for all

5-9

8/13/86

7375.01 REV-2

properties for which Section 312 Loans are made, with the following exception: Appraisals are not required for loans for single-family properties of \$33,500 or less if the most recently assessed value of the property, as determined by the locality's property tax assessor prior to loan approval, is sufficient to meet the loan-to-value ratio requirements detailed in Paragraph 7-5-c of this Handbook.

- (2) When Appraisals Must be Conducted. When an appraisal is conducted, it must be completed prior to underwriting and approving the loan.
- (3) What Appraisals Must Include
 - (a) Requirements for All Loans. All appraisals must include an estimate of what the fair market value of the

property will be after the proposed rehabilitation is completed because that is what is used in the final underwriting process, as detailed in Chapter 7. LPA's may provide appraisers with a work write-up prior to the appraisal to assist in evaluating the after-rehabilitation value of the property, or the appraisal may be done without this information to help the LPA determine the appropriate level of rehabilitation, given property values in the surrounding area. In any event, all appraisals must include a summary of proposed work included in the appraised value.

- (b) Additional Requirements for Investor-Owners. Appraisals for loans to investor-owners must also include the as-is value of the property since this figure is needed to determine the borrower's equity in the property both before and after rehabilitation. (See Paragraph 7-6-b-(2) for additional details on determining the borrower's financial interest in the property.) In addition, the as-is value of the property is also needed for borrowers who must comply with the requirements of the Rent Regulatory Agreement (who are detailed in Paragraph 9-2-c of this Handbook), since this figure is used when calculating return on equity.

b. Acceptable Appraisers

- (1) Single-family Loans of \$33,500 or Less. When obtaining an appraisal for these loans, the LPA may select either an outside, qualified fee appraiser or they may utilize a local staff member who meets the minimum qualifications for appraisers. In either case, the appraiser must meet the qualifications listed in Paragraph 5-10-c of this Handbook. The LPA can obtain recommendations about qualified fee appraisers from the Rehabilitation Management Specialist in their HUD Field Office.

8/13/86

5-10

7375.01 REV-2

- (2) All Other Loans. For all Section 312 Loans other than single-family loans of \$33,500 or less, the appraisal must be prepared by an outside professional fee appraiser who meets the qualifications listed in Paragraph 5-10-c of this Handbook.
- c. Minimum Qualifications for Appraisers. Individuals or firms authorized to perform appraisals for Section 312 Loans of \$33,500 or less, including the LPA, must meet the following minimum qualifications:
- (1) A general reputation among users of appraisals for producing satisfactory real estate appraisal work;
 - (2) Experience in performing staff appraisals while in the

employment of an appraisal firm, or a bank, insurance company, real estate sales or development company, or other organization which utilizes real estate appraisals in its business operations;

- (3) An educational background in appraisal that includes, but is not limited to, college level courses in appraisal and general real estate, training sponsored by appraisal organizations, and/or HUD sponsored appraisal training;
- (4) Experience doing appraisals in the types of neighborhoods and types of properties encountered in the locality's Section 312 efforts;
- (5) Demonstrated experience appraising the after-rehab value of urban properties is preferred, as is experience on the type of property for which the appraisal is needed (i.e., appraisers should have experience appraising multifamily properties if they are conducting multifamily property appraisals for the Section 312 program).

d. Additional Requirements for Fee Appraisers. Fee appraisers, which are required for all Section 312 Loans other than single-family loans of \$33,500 or less, must meet all the requirements detailed in Paragraph 5-10-c of this Handbook, and must meet the following additional qualifications:

- (1) A fee appraiser must be an active member of a nationally recognized appraisal organization, such as the American Institute of Real Estate Appraisers or the American Society of Appraisers.
- (2) The fee appraiser must include a statement on the appraisal stating, "The appraiser has no interest in the property appraised, or in any contract for the rehabilitation

thereof, or in any business relationship with the prospective borrower or members of his or her family, other than the appraisal fee."

e. LPA Requirements Concerning the Selection of Fee Appraisers

- (1) The LPA must select fee appraisers in accordance with all applicable equal opportunity requirements.
- (2) The LPA must insure that the fees are reasonable and competitive for the locality.
- (3) The LPA must maintain on file the names, qualifications, and fee structures of fee appraisers used in the Section 312 Program and the property addresses and dates when their

services were used.

- f. Acceptable Appraisal Format. Demonstration type appraisals are required. This means that all data sources, sequence, and analysis of pertinent facts and value conclusions must be documented and justified. A sample format -- The Federal Home Loan Mortgage Corporation's Home Improvement and Energy Loan Property Analysis Report, FHLMC Form 704 -- is included as Exhibit 5-4 as a suggested basic format for appraisals on owner-occupied properties with one-to-four units. Appraisals of multifamily, non-residential and mixed-use properties must be in a narrative format, must include stream-of-income, replacement and comparable analyses, and must be prepared in a manner which is consistent with local appraisal practices.

8/13/86

5-12