# Section F. Borrower Qualifying Ratios

## Overview

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1. General Information on Borrower Qualifying

**Introduction**

This topic contains general information on qualifying a borrower, including

- lender responsibility when qualifying a borrower, and
- the importance of careful underwriting analysis.

**Change Date**

March 1, 2011

**4155.1 4.F.1.a**

**Lender Responsibility When Qualifying a Borrower**

The lender is responsible for adequately analyzing the probability that a borrower will be able to repay the mortgage obligation according to the terms of the loan.

This responsibility includes using qualifying ratios and compensating factors when qualifying a borrower. Qualifying ratios can be exceeded when significant compensating factors exist.

**4155.1 4.F.1.b**

**Importance of Careful Underwriting Analysis**

Underwriting requires a careful analysis of many aspects of the mortgage.

Each loan is a separate and unique transaction, and there may be multiple factors that demonstrate a borrower’s ability and willingness to make timely mortgage payments.

Simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting. When qualifying a borrower, it is important to avoid the danger of “layering flexibilities” when assessing the mortgage insurance risk.
2. Qualifying Ratios

Introduction

This topic contains information on determining ratios to qualify a borrower, including:

- general information about qualifying ratios
- mortgage payment expense to effective income ratio
- total fixed payments to effective income ratio, and
- estimating real estate taxes when determining qualifying ratios.

Change Date

March 1, 2011

4155.1 4.F.2.a
General Information About Qualifying Ratios

Qualifying ratios are used to determine if the borrower can reasonably be expected to meet the expenses involved in home ownership, and provide for his/her family. In order to make this determination, the lender must calculate:

- the Mortgage Payment Expense to Effective Income ratio, as described in HUD 4155.1 4.F.2.b, and
- the Total Fixed Payment to Effective Income ratio, as described in HUD 4155.1 4.F.2.c.

Note: The underwriter must calculate the qualifying ratios for entry into the Automated Underwriting System (AUS) in order to be evaluated by the Technology Open To Approved Lenders (TOTAL) Scorecard.
2. Qualifying Ratios, Continued

4155.1 4.F.2.b
Mortgage Payment Expense to Effective Income Ratio

The relationship of the mortgage payment to income is considered acceptable if the total mortgage payment does not exceed 31% of the gross effective income.

A ratio exceeding 31% may be acceptable only if significant compensating factors, as discussed in HUD 4155.1 4.F.3, are documented and recorded on Form HUD-92900-LT, FHA Loan Underwriting and Transmittal Summary.

For those borrowers who qualify under FHA’s Energy Efficient Homes (EEH), the ratio is set at 33%.

Note: The total mortgage payment includes
• principal and interest
• escrow deposits for real estate taxes
• hazard insurance
• mortgage insurance premium
• homeowners’ association dues
• ground rent
• special assessments, and
• payments for any acceptable secondary financing.

4155.1 4.F.2.c
Total Fixed Payments to Effective Income Ratio

The relationship of total obligations to income is considered acceptable if the total mortgage payment and all recurring monthly obligations do not exceed 43% of the gross effective income.

A ratio exceeding 43% may be acceptable only if significant compensating factors, as discussed in HUD 4155.1 4.F.3, are documented and recorded on Form HUD-92900-LT, FHA Loan Underwriting and Transmittal Summary. For those borrowers who qualify under FHA’s EEH, the ratio is set at 45%.

Continued on next page
2. Qualifying Ratios, Continued

For real estate taxes, lenders must use accurate estimates of monthly property tax escrows when qualifying borrowers. In new construction cases, property tax estimates must be based on the land and completed improvements, not just on the land value.

Reference: For information on projecting and collecting real estate tax payments, see HUD 4155.2 6.A.1.i.
3. Compensating Factors

Introduction
This topic contains information on using compensating factors to qualify a borrower, including

- documenting compensating factors, and
- compensating factors benchmark guidelines.

Change Date
March 1, 2011

4155.1 4.F.3.a Documenting Compensating Factors
Compensating factors used to justify approval of mortgage loans with ratios that exceed benchmark guidelines must be recorded on the Underwriter Comments section of Form HUD-92900-LT, FHA Loan Underwriting, and Transmittal Summary. Any compensating factor used to justify mortgage approval must also be supported by documentation.

TOTAL Scorecard Accept Recommendation
The Technology Open To Approved Lenders (TOTAL) Scorecard Accept recommendation does not require documented compensating factors, even if qualifying ratios have exceeded FHA benchmark guidelines.

Reference: For more information on the TOTAL Scorecard recommendations, see the TOTAL Mortgage Scorecard User Guide.

4155.1 4.F.3.b Compensating Factors Benchmark Guidelines
The table below describes the compensating factors that may be used to justify approval of mortgage loans with ratios that exceed FHA benchmark guidelines.

<table>
<thead>
<tr>
<th>Compensating Factor</th>
<th>Guideline Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing Expense Payments</td>
<td>The borrower has successfully demonstrated the ability to pay housing expenses greater than or equal to the proposed monthly housing expenses for the new mortgage over the past 12-24 months.</td>
</tr>
</tbody>
</table>

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3. **Compensating Factors, Continued**

4155.1 4.F.3.b **Compensating Factors Benchmark Guidelines** (continued)

<table>
<thead>
<tr>
<th>Compensating Factor</th>
<th>Guideline Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Down Payment</td>
<td>The borrower makes a large down payment of 10% or higher toward the purchase of the property.</td>
</tr>
</tbody>
</table>
| Accumulated Savings                         | The borrower has demonstrated  
• an ability to accumulate savings, and  
• a conservative attitude toward using credit.                                                                                                     |
| Previous Credit History                     | A borrower’s previous credit history shows that he/she has the ability to devote a greater portion of income to housing expenses.                     |
| Compensation or Income Not Reflected in Effective Income | The borrower receives documented compensation or income that is not reflected in effective income, but directly affects his/her ability to pay the mortgage.  
This type of income includes food stamps and similar public benefits. |
| Minimal Housing Expense Increase            | There is only a minimal increase in the borrower’s housing expense.                                                                                   |

*Continued on next page*
3. **Compensating Factors**, Continued

4155.1 4.F.3.b **Compensating Factors Benchmark Guidelines** (continued)

<table>
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3. **Compensating Factors**, Continued

### 4155.1 4.F.3.b Compensating Factors Benchmark Guidelines (continued)

<table>
<thead>
<tr>
<th>Compensating Factor</th>
<th>Guideline Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Substantial Non-Taxable Income</td>
<td>The borrower has substantial non-taxable income.</td>
</tr>
<tr>
<td></td>
<td>Note: This applies if no adjustment was previously made when computing ratios.</td>
</tr>
<tr>
<td>Potential for Increased Earnings</td>
<td>The borrower has a potential for increased earnings, as indicated by job training or education in his/her profession.</td>
</tr>
<tr>
<td>Primary Wage-Earner Relocation</td>
<td>The home is being purchased because the primary wage-earner is relocating, and the secondary wage-earner</td>
</tr>
<tr>
<td></td>
<td>• has an established employment history</td>
</tr>
<tr>
<td></td>
<td>• is expected to return to work, and</td>
</tr>
<tr>
<td></td>
<td>• has reasonable prospects for securing employment in a similar occupation in the new area.</td>
</tr>
<tr>
<td></td>
<td>Note: The underwriter must document the availability of the potential employment.</td>
</tr>
</tbody>
</table>