

# City of Madison Community Development Division Underwriting Guidelines



Community Development Division  
Department of Planning and Community and Economic  
Development  
215 Martin Luther King Jr. Boulevard, Room 225  
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## April 2012

The City of Madison CDBG Committee has approved these underwriting guidelines for use by the Community Development Block Grant Office assisted non-profits and ADDI program.

## PREFACE

The City of Madison Community Development Division Underwriting Guidelines includes the program requirements approved by the City of Madison CDBG Committee.

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NOTE: These requirements and the forms necessary to administer this program are subject to change. Agencies will be updated as changes occur.

## Introduction

The City of Madison Community Development Division promotes and facilitates homeownership opportunities for lower income households. One method the CD Division uses to achieve this goal is to fund various non-profit programs to develop affordable housing for re-sale to income eligible homebuyers. Another method is to provide down payment assistance through the American Dream Down payment Initiative (ADDI). The funding to support these efforts comes from the Federal Department of Housing and Urban Development in HOME and CDBG funds. The CD Division may also use City or other federal funds.

The non-profits and the ADDI program provide the CD Division assistance to the homebuyer in the form of a long-term deferred loan, generally as a 2<sup>nd</sup> mortgage. ~~The CD Division will generally follow WHEDA underwriting guidelines unless otherwise stated in this document.~~ Agencies administering CD Division funds should contact the CD Division if clarification is needed on a specific item. The loan terms for each type of funding are as follows:

## HOME, CDBG and ADDI Funds

The homebuyer must accept the following conditions when accepting HOME, CDBG and ADDI funds:

- The homebuyer must repay the loan when the property is sold, transferred or ceases to be the primary residence of the homebuyer.
- Repayment of the loan includes the initial loan amount plus a one-time loan fee which is to be determined by the staff each year. For 2012 the loan fee is 2.5% for loans under \$10,000 and 5% for all loans greater than \$10,000.

## Other CD Division Administered Funds

Other CD Division funds may have similar, other, or additional requirements, which shall be articulated in the contract between the CD Division and the administering non-profit agency.

To ensure that all homebuyer assistance loans from the CD Division are processed in a similar manner and are subject to the same conditions, the CDBG Committee has established these underwriting guidelines. These requirements must be followed by all agencies providing CD Division funds to homebuyers.

## ELIGIBILITY REQUIREMENTS

### Homebuyer Eligibility

The homebuyer must meet the following requirements:

- Have a household gross annual income that does not exceed **80% of the area median income** limits as published annually by HUD.

### 2012 INCOME LIMITS BY FAMILY SIZE

Household Size	Gross Annual Income Levels
1	\$45,500
2	\$52,000
3	\$58,500
4	\$65,000
5	\$70,200
6	\$75,400
7	\$80,600
8	\$85,800

Gross annual income includes income from the following sources: wages, overtime, commissions, bonuses, profit sharing, tips, business income, child support, interest and dividends from funds retained after the closing, and other types of periodic payments which are anticipated for the 12 month period commencing with the date of the request. Gross annual income is based on the HUD 24 CFR Part 5 definition of annual income.

### Education

Complete an approved first-time homebuyer education course or a homebuyer study guide if the buyer has not owned a home within the past three years. A training certificate must be submitted to the non-profit agency providing the pass through loan or the CD Division for an ADDI loan prior to the closing. Homebuyer's certificate must be dated no more than 18 months prior to receipt of the loan.

### Citizenship

Be a documented United States citizen or eligible alien.

### Mortgage Qualification

Qualify for a first mortgage that does not exceed WHEDA's prevailing market rate by more than 2% and has an amortization period of 30 years. Thirty year amortization scheduled can be waived for borrowers with a disability on a case-by-case basis.

### Child Support/Maintenance

Arrearages for child support, birthing, maintenance or other expenses owed to the state must be paid in full prior to closing.

### Ownership of Other Property

The subject property must be owner-occupied and the borrower may not have ownership interest in any other real estate at the time of closing. The borrower must take occupancy within 60 days of acquisition of the property.

For An ADDI loan, the borrower must be a first-time homebuyer, a displaced homemaker or a single parent.

- HUD Definitions:
  - A **first-time homebuyer** is defined as any individual listed on the deed, mortgage and note who has not owned a home during the three-year period prior to purchase of a home with Madison American Dream Downpayment Assistance. For married couples, if only one individual is listed on the deed, mortgage and note, HUD requires that both individuals qualify as first time homebuyers as defined above.
  - A **displaced homemaker** is defined as an adult who has not worked full-time full-year in the labor force for a number of years but has, during such years, worked primarily without compensation to care for the home and family and is unemployed or underemployed and is experiencing difficulty in obtaining or upgrading employment.
  - A **single parent** is defined as an individual who is unmarried or legally separated from a spouse and has one or more minor children for whom the individual has custody or joint custody, or is pregnant.

## Income

### Required Employment Documentation

Provide 3 months worth of paystubs or Verification of Employment and 1 month of paystubs. If the borrower has been on their present job for less than 1 year, a full written Verification of Employment (VOE) is required.

### Current Employment Documentation

Documentation for current employment must include:

- Wage rate
- Average hours and overtime hours worked per week
- Year-to-date earnings
- Date of employment
- Frequency of payment
- Previous year earnings

### Other Income documentation:

- Current Social Security Award Letter
- One year history of child support verified through the Department of Workforce Development
- Pension Letter
- A disability benefits statement from the benefits payer

### Tax Transcripts

IRS transcripts and W-2s for the last year will be required for all individuals who intend to occupy the property. Transcripts will be reviewed for compliance income, self employed activity, unreimbursed employee expenses, and income from assets.

### Self Employed Borrower

For individuals participating in partnerships and/or corporations provide copies of the business tax returns for the last 2 years in addition to the personal tax returns from the last 2 years.

**Compliance Income**

Compliance income is the anticipated income of anyone age 18 or older who intends to occupy the property, regardless of their relationship to the borrower. This may include adult children, parents, aunts, uncles, grandparents, partners, companions, etc.

Compliance income is generally calculated by projecting forward the current gross income by 12 months.

**Inclusions:**

- Earned income of all occupants over the age of 18
- Unearned income of all occupants under the age of 18
- Social Security Income (SSI)
- Child support
- Alimony
- Pension/retirement
- Disability
- Public Assistance
- Interest and dividend income on funds retained after closing
- Self employment income (adding back depreciation, depletion, meals and entertainment, and business use of home). If a business is operated at a loss.

**Exclusions:**

- Earned income for all occupants under the age of 18
- Foster care income
- Food stamps
- Non-recurring payments from:
- Inheritances
- Insurance settlements
- Lottery winnings
- Gambling winnings
- Capital gains
- Settlements for personal loss

**Qualifying Income**

Qualifying income is the verified, stable income of the borrower and is used to calculate ratios.

**Overtime**

Overtime income must show a history of at least 24 months with the current employer.

**Commission, Bonus, Tip, and Profit Sharing**

Commission, bonus, tip, and profit sharing income must show a history of at least 24 months with the current employer.

**Non-taxable Income (Child Support, SSI)**

Non-taxable income is adjusted upward 125%. This source of income should be expected to continue for the next 3 years.

Child support and alimony must be documented with a 12 month history from the Department of Workforce Development.

Social Security, pension/retirement, and public assistance must be verified with a current award letter.

Disability income must be verified with a copy of the disability policy or benefits statement and a statement from the benefits payer.

### **Second Job**

Second job (part-time or full-time) income requires a 24 month history and a strong likelihood of continuation.

### **Military Income**

For full time military personnel, use base pay plus additional pay (hazard pay, ratios, clothing allowance, etc) if the additional pay is likely to be received in the future.

Reserve pay may be used as qualifying income if it can be verified as having been uninterrupted for the previous 2 years and has a strong likelihood of continuation.

### **Seasonal and Unemployment**

Seasonal employment and unemployment compensation may be considered if there is a minimum 2 year history with the same employer.

### **Unreimbursed Employee Expense**

Calculate a 24 month average of Unreimbursed Employee Expenses on the borrower's personal tax returns and reduce monthly qualifying income. If the expenses are auto lease or auto loan related, count the monthly payment as a debt.

### **Self Employment, Corporation, Partnership, and S Corporation Income**

Average the net income from the prior two years personal and business tax returns. If the income for the most recent year shows a substantial decline, the income from that year will be used. A sharp decline in the most recent year will be closely reviewed to determine if the business has the ability to support the borrower's debt obligations.

### **Business Operated at a Loss**

Negative cash flow from a business reduces other qualifying income. If the business is operated at a loss, such loss may not be used to offset income generated from other sources when determining compliance with income limits.

### **Boarder Income**

If the loan-to-value is 90% or less, monthly rental income received from roommates may be added to the applicant's other income before ratio analysis.

Rental income can be considered as acceptable stable income, in an amount up to 30% of total gross income that is used to qualify the borrower for the mortgage if:

- The individual has lived with borrower for 12 months
- Boarder can prove history of shared residency
- Boarder can provide a history of rental payments for 12 months via copies of canceled checks

### **Down Payment from Borrower's Funds**

#### **Cash on Deposit**

Funds must be invested in the borrower's account at least 2 months prior to the loan application date. Verify the source of any large increases.

#### **Gifts**

An acceptable gift donor may be a spouse, parent, sibling, child, grandparent, aunt, uncle, cousin, domestic partner or fiancé who has lived with the borrower for the last 12 months.

Verify and document the gift using a Gift Affidavit form.

All gift funds must be verified and received by the borrower prior to the closing.

For funds verification, the following is required:

- Copy of gift check (or withdrawal documentation) to borrower showing the donor as the remitter.
- Copy of borrower's deposit receipt or a bank statement that shows the deposit.

### **Earnest Money**

Provide a copy of the cancelled earnest money check.

### **Retirement Funds**

The net withdrawal amount, after any penalties, may be an acceptable source of down payment. Use 60% of the vested balance when calculating available cash to close and reserve funds if the withdrawal has not yet occurred.

### **Sale of Personal Asset**

The purchaser of the asset cannot be an interested party in the sales transaction. Provide the following:

- Proof of ownership
- Fair market value of the item sold
- Bill of sale or copy of the transferred title
- Receipt of funds

### **Tax Refund**

Satisfactory documentation includes:

- Copies of the refund checks
- Proof of deposit in the borrower's account
- Copy of the borrower's tax return

### **Borrowed Funds**

The loan must be fully secured by the borrower's own asset, repayable on a monthly installment basis, and fully amortized. Provide the following:

- Copy of the fully executed note
- Receipt of funds
- Proof of ownership
- Verification of asset value.

The term of the loan must be reasonable based on the life of the asset.

### **Cash at Home**

Cash at home generally is not an acceptable source of down payment.

Exceptions may be made if the borrower has no history of using:

- Checking accounts
- Savings accounts
- Loans



- Credit cards

Funds must be deposited and verified prior to closing.

### **Repayment of Debt**

Funds received from repayment of loans to family and friends must be verified and reconciled with the borrower's ability to have made such loans.

### **Stacking of Funds**

Combining funds from more than one down payment and closing cost loan program will be allowed however the Community Development Division loan must remain the second lien position. Exceptions will be allowed for the Madison American Dream funds to be the third mortgage when used in conjunction with other Community Development funds. These funds can be stacked with the City of Madison Home-Buy funds.

### **Total Assistance Limits**

The maximum amount of funds available from all City of Madison sources may not exceed the maximum amount of assistance per unit listed in the annual "Community Development Program Goals and Priorities" For 2012, the Community Development Division maximum assistance from all funding sources for any property is \$54,000. For properties that are accessible or require lead paint remediation, the limit is \$60,000.

## **Credit**

### **Credit Report**

Obtain a triple-merged credit report for all borrowers, including a non-applicant spouse, if applicable.

### **Length of Credit History**

The borrower's credit report must have 2 years of active credit history with a minimum of three 12-month trade lines. Applications with insufficient trade lines (thin credit file) may be supplemented with alternative credit references. See the Non-Traditional Credit section for acceptable sources.

### **Analysis of Credit Report**

Credit history within the past 12 months will be a strong factor in the underwriting decision. Borrowers should exhibit no late payments, judgments or new collections within the past 12 months. Late payments within 13-24 months will be evaluated on a case-by-case basis.

### **Collections & Charge-Offs**

Medical collections cannot exceed an aggregate total of \$5,000 and must have a payment plan established.

Non-medical collections and charge-offs must be paid-in-full.

### **Judgments, Tax Liens**

Must be paid-in-full prior to closing. Provide a recorded satisfaction.

### **Derogatory Accounts, Foreclosures, Bankruptcy's, etc.**

## **Bankruptcy Chapter 7**

Document 4 years of re-established good credit after the discharge of the bankruptcy. Provide a complete copy of the discharge paper including all schedules. Provide a written explanation for the bankruptcy.

### **Bankruptcy Chapter 13**

Document 2 years of re-established good credit after the discharge of the bankruptcy. Provide a complete copy of the discharge paper including all schedules. Provide a written explanation for the bankruptcy.

### **Non-Traditional Credit**

Alternative credit references are acceptable when sufficient traditional sources are not available. Document 3 sources of alternative credit references each having at least a 12 month history of being paid on time.

Required credit references for non –traditional credit borrowers are:

- Verification of Rent – verification from someone other than a professional management company should be verified with copies of 12 months cancelled checks. If cancelled checks are unavailable, check public landlord-tenant records for court filings, judgments, or evictions. No history of delinquency within the past 24 months (or since inception, if less than 24 months).
- A utility (i.e. gas, electric)

Examples of other forms of alternative credit references are:

- Auto insurance premiums paid monthly
- Telephone or cell phone payments
- Cable payments

Only one 30-day delinquency is allowed within the last 12 months. No collections or judgments (other than medical) filed within the past 24 months. Judgments must be paid in full.

Provide 12 months of cancelled checks or 12 months of payment history. Bank statements do not, by themselves, validate payments, but can be used to supplement other sources.

Alternative credit references must include all of the following:

Alternative credit references must include all of the following:

- Creditor's name
- Name of person providing the reference
- Date account was opened
- Amount of highest credit
- Current status of the account
- Required payment amount
- Unpaid balance
- Payment history

### **Undisclosed Debt**

Document any discrepancies between the credit report and information disclosed in the application or elsewhere. All debts must be documented and the payments will be included in the ratios.

## Disputed Accounts

Any disputed account noted on the credit report must be remedied prior to loan approval.

## Guarantors/Co-Signers

Guarantors and co-signers are allowed only for credit purposes. The borrower must be able to support the monthly housing payment within the programs ratio guidelines without the support of the co-signers income.

## Down Payment Requirement

There is no cash down payment required.

## Maximum Loan-to-Value

The total of the of the first mortgage plus the city funded mortgage and any other loans collateralized by the property, shall not exceed **100% loan to value** based on the purchase price of the property or the appraised value which ever amount is less.

## Debt Analysis

### Combined Qualifying Ratio

The accepted combined housing and total debt to income ratio is **36%**. An expanded combined ratio of **40%** may be allowed with strong compensating factors such as good savings history, history of comparable rent expense, excellent credit history, good rent history and stable employment. The Community Development Supervisor or designee will approve loan requests with a combined ratio **below 30%** on a case-by-case basis.

### Housing Payment

The monthly payment includes principal and interest, taxes, hazard insurance, condo fees, flood insurance and mortgage insurance premium, if applicable. Homebuyers must escrow the property taxes and have homeowner insurance as a condition of the first mortgage.

### Revolving Accounts

CDD reserves the right to use 3% of the outstanding balance of a revolving account for the monthly payment if the 3% payment is higher than what appears on the credit report.

Use 5% of the balance if no payment amount is listed on the credit report.

Payment in full of revolving debt to obtain satisfactory qualifying ratios is not allowed.

### Installment Debt

Include all installment debt with a remaining term of 10 months or more. Principal buy down of installment debt to reach a remaining term of 10 months is acceptable.

Installment debts with fewer than 10 months remaining are generally excluded. However, debts with less than 10 months must be counted if the amount of the debt affects the borrower's ability to pay the mortgage payments immediately after closing.

Lease payments are always included in ratios.

**Authorized User Accounts**

Do not count authorized user accounts as a credit reference unless the borrowers can provide cancelled checks to verify they have been making the payments for at least 12 months. If the borrowers have been making the payments, include the monthly payment in the borrowers' debt ratio.

If the borrower is an authorized user of a trade line that belongs to a non-applicant spouse the lender must include the monthly payment when calculating the borrower's debt ratio.

**Non-applicant Spouse Debt**

All open and active accounts will be included in ratios.

The borrower will not be held responsible for payment of collections and judgments incurred by a non-applicant spouse prior to the documented date of the marriage.

**Child Support and Maintenance**

Include all child support obligations with a remaining term of 10 months or more.

All child support, birthing expenses, and maintenance arrearages must be paid prior to closing.

**Student Loans**

Payments for deferred loans (student loans) must be included in the borrower's total debt ratio. The payment must be based on standard amortization of the loan.

If no payment is listed on the credit report the monthly payment may be calculated based on 2% of the balance of the student loan in lieu of obtaining documentation of the monthly payment. If documentation is provided by the borrower or obtained by the lender that indicates the actual monthly payment, that figure must be used.

**Business Debt**

Obtain 12 months of cancelled checks to verify the obligation was paid with company funds. If delinquencies have occurred in the past 12 months, include the debt as part of the borrower's individual obligations.

**Co-Signature Debt**

A borrower's co-signed obligation is not considered debt if the borrower can provide documentation that the last 12 months of payments have been paid by the primary debtor.

**Property Eligibility****Principal Residence**

The property must be the borrower's principal residence. The borrower must occupy the subject property within 60 days of loan closing.

**Location**

The property must be a single family attached or detached dwelling, a condominium or part of a duplex located in the City of Madison.

**Purchase Price**

For 2012, HUD has established the maximum value of the home being purchased using assistance from CD Division as equal to or less than \$223,250.

**Property Types****Eligible Properties**

- Existing single family dwelling
- Condominium
- Zero lot line duplex

### **Ineligible Properties**

The following types of properties are not acceptable:

- Commercially used properties
- Time share units
- Earth homes
- Dome homes
- Geothermal homes
- Log homes

### **Offer to Purchase**

Provide a copy of the complete and fully executed contract including all addendums, counters, amendments, and notices.

### **Voluntary Acquisition Form**

It will be the responsibility of the homebuyer to submit a Voluntary Acquisition Form with the Offer to Purchase to the seller. This form is used to satisfy the requirements of the Uniform Relocation Assistance and Real Property Acquisition Policies Act (URA). Neither the City of Madison nor the homebuyers have the right to acquire the property by eminent domain.

### **Appraisal**

Be marketed and sold for no more than their appraised value at the time of sale, as verified by an independent appraisal obtained by the first mortgage lender.

Appraisal requirements are as follows:

- Obtained in compliance with the Appraiser Independence Requirements
- Compliant with Uniform Appraisal Dataset requirements
- An interior & exterior review by a licensed appraiser
- Based on the “as is” value of the property
- Appraiser must confirm they were provided with a complete copy of the Offer to Purchase and verify Interested Party Contributions (IPCs), if applicable

The following exhibits must accompany the appraisal:

- Exterior building sketch with dimensions
- Street map that shows the location of the property and comparables
- Original photographs showing the front, back, and street scene of the subject property and the front of each comparable
- Interior photographs of the kitchen, all bathrooms, main living area, examples of physical deterioration, examples of recent updates

### **Condition of Property**

Be safe and sanitary, as verified by a City of Madison Minimum Housing and Property Maintenance Code inspection report.

### **Property Inspections**

#### **Home Inspection**

The property must meet the City of Madison Minimum Housing and Property Maintenance Code requirements before CD Division assistance will be provided. The City of Madison contracted

inspector will provide all inspections. For newly constructed properties, a certificate of occupancy will be accepted in lieu of Madison Minimum Housing and Property Maintenance Code inspection. The CD Division will grant the inspection fee to the homebuyer. The inspection will be scheduled once it is determined that the homebuyer qualifies for the program.

### **Lead Based Paint Inspection**

Lead based paint inspection will be conducted on all homes built prior to 1978 in accordance with the Lead-Based Paint Poisoning Prevention Act 42 USC 3535 (d), 4821 and 4851, and its implementing regulations in 24 CFR 35, as well as State of Wisconsin Code HFS 163 and City of Madison MGO 7.49. The City of Madison contracted inspector will provide the lead based paint inspection and clearance test for the property.

The CD Division will grant the lead based paint inspection and clearance test fees to the homebuyer. The inspection will be scheduled once it is determined that the homebuyer qualifies for the program.

If the property does not pass inspection after the first clearance test, the contractor performing the lead paint stability work will be responsible for the payment of any additional tests.

### **Environmental Review**

The property must pass an environmental review conducted by the City of Madison Community Development Division staff.

### **Loan Repayment**

The mortgage will require a repayment equal to the amount of Madison American Dream Down payment funds invested plus a loan fee which will be determined by CDBG Committee annually. For 2012 the loan fee is 2.5% for loans under \$10,000 and 5% for loans \$10,001 and more. The repayment is due and payable to the City of Madison at the time the property is sold, transferred or ceases to be the primary residence of the homebuyer. Loan repayment must be completed in full. Partial payments will not be accepted. Complete loan payments can be made prior to the property being sold, transferred or ceases to be the primary residence of the homebuyer.

#### **Example:**

Home purchase price	\$150,000
Madison American Dream loan assistance	\$9,000
Community Development Loan fee for 2011	2.5%
Loan Repayment	\$9,288

#### **Example:**

Home purchase price	\$150,000
CD Division loan assistance	\$25,000
Community Development Loan Fee for 2011	5%
Loan Repayment	\$26,250

### **Loan Repayment for Contracts Prior to 2011**

The mortgage will require a repayment equal to the amount of CD Division funds invested or the percent of appraised value that the CD Division funds represent in the value of the property, whichever amount is greater. The repayment is due and payable to the City of Madison at the time the property is sold, transferred or ceases to be the primary residence of the homebuyer. Loan repayment must be completed in full. Partial payments will not be accepted. Complete loan

payments can be made prior to the property being sold, transferred or ceases to be the primary residence of the homebuyer. In this case, the homebuyer will be responsible for the cost of an appraisal that is acceptable to the City of Madison. Appraisals no more than 6 months old will be used to determine the loan repayment amount.

**Example:**

Home purchase price	\$150,000
CDBG Office loan assistance	\$25,000
Percentage of CDBG Office funds invested	17%
Home appraisal at the time the homebuyer sells or pays off the loan	\$175,000
Loan repayment equals 17% of the appraised value	\$29,750

**Loan Subordination**

The CD Division will subordinate the second mortgage loan according to the terms of the Community Development Division Homeowner Loan Subordination Policy.

**Non-discrimination**

CD Division funds will be made available to all persons without regard to race, national origin or ancestry, color, religion, sex, age, handicap/disability, marital status, source of income, arrest record or conviction record, less than honorable discharge, physical appearance, sexual orientation, political beliefs, familial status, or student status or the fact that such a person is a member of a domestic partnership as determined in MGO 30.03. The loans will be granted based on the homebuyer eligibility and the availability of funds.

**Privacy Concerns**

Homebuyer information obtained by the Community Development Division will determine eligibility for a CD Division loan according to these underwriting standards. Certain information will not be disclosed outside the CD Division without consent except to the person or company verifying the information including, but not limited to, the employer, bank, lender, and any other credit reference as needed to verify other credit information and as permitted by law.

**Appeals Process for Denial of a Madison American Dream Down-payment Loan**

The homebuyer may appeal any denial of a loan to the CDBG Committee at their next regularly scheduled Committee meeting following the denial of a loan. The decision from the CDBG Committee will be final.