37.16: Monthly debt payment-to-income ratio (03/16/03)

The monthly debt payment is the sum of the monthly charges for the following:

1. Monthly housing expense (see Section 37.15)

2. Payments on all installment debts with more than 10 months of payments remaining, including debts that are in a period of either deferment or forbearance. If the credit report does not contain a required monthly payment, the monthly payment used must be based on documentation in the file

3. Alimony, child support or maintenance payments with more than 10 months of payments remaining

4. Monthly payments on revolving or open-end accounts, regardless of the balance. In the absence of a stated payment, five percent of the outstanding balance will be considered to be the required monthly payment.

5. Car lease payments, regardless of the number of payments remaining

6. Aggregate negative net rental income from all Investment Properties owned

7. Monthly Mortgage payment for second home (principal, interest, taxes and insurance and, when applicable, leasehold payments, homeowner association dues, condominium maintenance fees, etc.)

The credit report may show that an installment debt is in a period of deferment or forbearance. Examples of installment debts with deferred payments include:

- Debts on furniture, household items and automobiles on which the initial payment is delayed for a period of time as part of a promotional campaign by the merchant

- Student loans on which the repayment period has not yet started because the Borrower is still in school or payment has been suspended for a period of time with the approval of the creditor

When payments on an installment debt are not given on the credit report or are listed as deferred, the Seller must obtain documentation to support the payment amount included in the monthly debt payment. Examples of documentation of the required payment amount include:

- A direct verification obtained from the creditor

- A copy of the installment loan agreement obtained from the Borrower, or

- If payments are currently deferred, the payment amount that will be required once the deferment or forbearance period has ended, as stated in a copy of a financial institution's student loan certification or the installment loan agreement

Payments on installment debts secured by financial assets in which repayment may be obtained by liquidating the asset, may be excluded from the monthly debt payment-to-income ratio for qualifying purposes, regardless of the payment amount or number of payments remaining. The loan secured by the financial asset must have been made by a financial institution. The Seller may only consider the assets in the account that exceed the loan balance to be available to the Borrower.

The Borrower's previous housing payment and the payments on short term financing secured by the sale of the Borrower's previous residence (commonly known as a bridge loan) may be excluded from the monthly debt payment-to-income ratio when the Mortgage file contains the following documentation:

- The Borrower's executed noncontingent sales contract for the previous residence and

- A lender's commitment to the buyer of the previous residence (if the executed sales contract includes a financing contingency) and

- Evidence of reserves of six months' payments covering any liens on the previous residence, or
- Executed buyout agreement that is part of an employer relocation plan where the employer/relocation company takes responsibility for the outstanding Mortgage(s)

Refer to Section 37.17 for special requirements pertaining to contingent liabilities.

If all or any portion of the proceeds of the Mortgage are being used to pay off or pay down existing debts in order to qualify for the Mortgage, the Seller must document such payoff in the Mortgage file. Canceled checks, paid receipts and/or a copy of the HUD-1 form or other closing statement may be used to document the repayment. A Borrower who increases debt and then periodically uses refinance or debt consolidation to reduce payments to a manageable level presents a higher risk and the qualifying ratios should be close to guidelines.

Evaluating debt ratios

Loan Prospector calculates and evaluates the Borrower's qualifying ratios. For Accept Mortgages and A-minus Mortgages, Loan Prospector has determined that the Borrower's qualifying ratios are acceptable.

For Manually Underwritten Mortgages, the Seller must evaluate the Borrower's ability to pay the monthly housing expense and other obligations. As a guideline, the monthly debt payment-to-income ratio should not be greater than 33 percent to 36 percent of the Borrower's stable monthly income.

Higher qualifying ratios may be appropriate in some cases. Examples of conditions that could justify a higher housing expense-to-income or debt payment-to-income ratio are:

1. An energy-efficient property that reduces energy costs (See Section 37.15)
2. The Borrower's probability for increased earnings based on education, job training or time employed or practiced in a profession
3. Rent paid by Related Persons living in the house
4. The existence of verified income that is not included within the definition of "stable monthly income" in Section 37.13 when there is an expectation that future expenses will be lower (such as child-support income that is scheduled to cease in one year when a child becomes an adult. In this case, the expectation would be that either future household expenses will be lower or that additional income will be provided by the new adult.)
5. The Borrower's demonstrated ability to carry a higher housing expense or higher debt level while maintaining a good credit history

In addition, the examples listed below may be used to justify higher qualifying ratios for Non-Loan Prospector Mortgages. These examples and those precluded in Section 37.1 may not be used to justify higher qualifying ratios for Caution Mortgages because they have already been considered by Loan Prospector.

1. The Borrower's verified liquid assets being substantial enough to evidence an ability to repay the Mortgage regardless of income
2. A large downpayment on the purchase of the property
3. The demonstrated ability of the Borrower to maintain a good credit history, accumulate savings and maintain a nonhousing debt-free position
4. The Borrower's strong Credit Score (for example, a 720 or higher FICO score) and the Seller's confirmation that the Borrower's credit reputation is excellent

For any Manually Underwritten Mortgage for which either of the ratio guidelines is exceeded, the Seller must prepare and retain in the Mortgage file a written explanation justifying its underwriting decision.

For Accept Mortgages and A-minus Mortgages with a nonoccupying Borrower, the Seller is not required to calculate or evaluate the occupant Borrower's monthly debt payment-to-income ratio. For Manually Underwritten Mortgages with a nonoccupying Borrower, the occupant Borrower's monthly debt payment-to-income ratio should not exceed 43 percent of the occupant Borrower's stable monthly income.

For all Manually Underwritten Mortgages, the Borrower's monthly debt payment-to-income ratio must not exceed 50 percent of the Borrower's stable monthly income. If the Borrower's monthly debt payment-to-income ratio exceeds 50 percent, Freddie Mac will assume the Borrower's capacity to repay is not acceptable unless the Seller documents that the Borrower has been carrying an equivalent monthly debt payment-to-income ratio for at least one year while maintaining an acceptable credit history. If the information in the Mortgage file does not readily reflect this, the Seller must describe on the Form 1077 or an equivalent document how this determination was made.