



FHA Compensating Factors for Manual Underwriting

The maximum DTI applicable to manually underwritten Mortgages are summarized below. Borrowers with no credit score may not include any income from a Non-Occupant Co-Borrower.

Ratios up to 31/43 (and all Manual Underwrites) require reserves of at least one month.

Ratios up to 37/47 require One of the following:

- Verified and documented cash Reserves;
- Minimal increase in housing payment; or
- Residual income.

Ratios up to 40/40 can be acceptable with No Discretionary Debt

Ratios up to 40/50 require Two of the following:

- Verified and documented cash Reserves;
- Minimal increase in housing payment;
- Significant additional income not reflected in Effective Income; and/or
- Residual income.

The following describes the compensating factors and required documentation that may be used to justify approval of manually underwritten Mortgages with qualifying ratios described above.

Verified and Documented Cash Reserves:

- Reserves equal or exceed three total monthly Mortgage payments (1 or 2 units) or,
- Reserves equal or exceed six total monthly Mortgage payments (3 or 4 units)

Reserves are verified documented assets less the following:

- Funds required to close the Mortgage;
- Gifts;
- Borrowed funds; and
- Cash received at closing of a refinance including incidental cash-out.

Minimal Increase in Housing Payment:

- The new payment does not exceed the current by more than \$100 or 5%, whichever is less; and
- Documented 12-month history with no more than one 30 day late (cash-out refi all payments on the mortgage being refinanced must have been made within the month due for the previous 12 months)
- If the Borrower has no current housing payment this may not be cited as a compensating factor.

No Discretionary Debt:

- **The Borrower's housing payment is the only open account with an outstanding balance that is not paid off monthly;**
- **The credit report shows established credit lines in the Borrower's name open for at least six months; and**
- **The Borrower can document that these accounts have been paid off in full monthly for at least the past six months.**

Significant Additional Income Not Reflected in Effective Income:

- **The Borrower has documented income that has been received for at least one year, and is likely to continue; and**
- **The income, if it were included in gross Effective Income, is sufficient to reduce the qualifying ratios to not more than 37/47.**

Income from non-borrowing spouses or other parties not obligated on the Mortgage may not be counted under this criterion. This compensating factor may be cited only in conjunction with another compensating factor when qualifying ratios exceed 37/47 but are not more than 40/50.

Residual Income:

To use Residual Income as a compensating factor, count all members of the household of the occupying borrower without regard to the nature of their relationship, and without regard to whether they are joining on title or the Note to determine "Family Size" below. Exception exists if any individuals are fully supported by a separate source of income not included in the Effective Income. These individuals must voluntarily provide sufficient documentation to verify their income to qualify for this exception.

The amount of Residual Income must be at least equal to the amount used by The Department of Veteran Affairs for household size and geographic region. This can be found in the VA Lender Handbook Chapter 4.9 b and e, (or) it is available in Encompass: Forms Tab - VA Management - Qualification Tab. Complete the Family (household) Size and Country Region then click "Get Residual Income"

Residual Income is calculated using total Effective Income of all occupying Borrowers less:

- **Taxes: All State, Federal, municipal or other income taxes, retirement or Social Security (if available, use federal and state tax returns from the most recent year to document. If tax returns are not available, use current pay stubs)**
- **The total fixed payment**
- **Estimated maintenance and utilities (multiply gross living area by VA factor which is currently .14 per square foot)**
- **Job related expenses (e.g., child care); and**
- **The amount of the Gross Up of any Non-Taxable Income.**