RESIDUAL INCOME SHORTFALL – USING COMPENSATING FACTORS

When a borrower fails the residual income test (RIT), a partially funded LESA is required. However, according to HUD guidelines, the lender may consider one or more of the following compensating factors in order to avoid having to place a partially funded LESA on the HECM

Guidelines for each factor must be met. These are to be used ONLY when the borrower fails the Residual Income Test.

Compensating Factors That Can Be Used When Income is Less Than 80% of the Required Amount

1. **Using income from an Eligible Non-Borrowing Spouse:**
   - **Documented** income from an **eligible NBS** that would result in a combined income equaling or exceeding the applicable amount required to pass the residual income test (RIT)

   Remember that credit will need to be pulled for the NBS. Derogatory items pertaining specifically to the NBS will not affect the borrower, however the expenses will affect the amount of residual income to be used for the NBS.

   The NBS must be eligible. Meaning, they must currently live in the subject property OR be in a temporary healthcare institution for less than 12 consecutive months; documentation will be required to support this and must show a return date.

2. **Borrower has documented overtime, bonus, part-time or seasonal income that will allow them to pass the RIT and meets the following requirements:**
   - The borrower has received the income for **at least six months;** and
   - **It will continue**

3. The borrower **will begin receiving pension or Social Security income within the next 12 months** and the amount specified in the award letter would result in a total residual income required to pass the RIT.
   Award letter must show that bwr will start receiving Social Security within 12 months

4. **Using HECM proceeds as an asset to increase income:**
   - An increase in monthly income from **dissipating all available HECM proceeds** that would result in a total residual income required to pass the RIT. **All proceeds available to the borrower at closing (regardless of first or second year) can be used as a dissipated asset.**

   For example: Let's say the borrower will have access to $40,000 in proceeds. If that $40,000 was entered into Reverse Vision as a non-taxable asset and the income was increased enough to allow the borrower to pass the RIT, then this would be a compensating factor.

   Remember to remove the HECM proceeds from the "asset" section in Reverse Vision after the amount of monthly income is calculated.

Compensating Factors That Can be Used ONLY When Income is 80% or More of Required Amount

1. **The borrower meets ALL of the following:**

   - ***Borrower has* paid their own property charges directly for at least the last 24 months without incurring penalties** (i.e. they were not paid by a mortgage lender from an escrow account)
   - ***Current income is not less than income received during the previous 24 months***

   If the borrower has been on time with the property charge payments but was paying through an escrow account, this particular compensating factor cannot be used

   The borrower has documented assets equivalent to the anticipated property charge payments for the life expectancy of the borrower that were not dissipated or considered in the residual income calculation.

   For example: if the total LESA (fully-funded) amount equals $60,000 and the borrower has a 401 K of $80,000; this would show that the borrower has the "capacity" to pay their property taxes and insurance and therefore, would be a compensating factor.

   Taxable assets will be assessed a 15% tax and the net amount will be evaluated to see if proceeds are enough to cover the LESA.

2. **Using HECM proceeds as "capacity" to pay off debt:**

   - **HECM proceeds available that have not been dissipated as assets (i.e., See comp factor No. 4) and after including any required set-asides** that are sufficient to pay off outstanding obligations; such as revolving and installment debt, that would reduce their monthly payments and result in a total residual income required to pass the RIT. **All proceeds available to the borrower at closing (regardless of first or second year) can be used to hypothetically payoff debt.**

   For example: The borrower has $20,000 available at closing, and a credit card of S 10,000 with a $300 monthly payment, is causing a residual income shortfall. The $20,000 would hypothetically be enough to pay off the credit card debt and allow the borrower to pass the RIT. This would be a compensating factor.

   It is not required or allowed to pay off consumer debt (unless affecting title) through the HECM loan, even if this compensation factor is used.

3. **Access to other credit:**

   - **The borrower has access to revolving credit that provide financial liquidity that would enhance their ability to endure a financial hardship.**

   The credit lines (other than their mortgage) must meet the following guidelines:
   - Credit lines must be in the borrower's name (being an authorized user does not qualify)
   - Must be open for at least six months
   - Must have been paid off in full every month for at least the last six months