Guidance on Qualification Criteria

for Short-Term Lease-Purchase NSP Programs




About this Tool

Description:

This guidance document on qualification criteria for short-term lease-purchase NSP programs is intended to provide a list of possible criteria that NSP grantees, sub recipients and developers can use in selecting potential lease-purchasers for their lease-purchase program. It is intended to be used with the following companion documents: “Sample Lease Purchase Developers Agreement,” “Sample Residential Lease with Option to Purchase,” “Sample Residential Lease with Option to Purchase, Annotated,“ “Sample Lease-Purchase Financial Pro Forma,” and “Sample Lease-Purchase Policies and Procedures Manual.”

How to Adapt this Document:

This document provides options developers can choose to tailor the model to their programs. It is not intended to be used as-is. NSP grantees should determine if the underlying program design is suitable

Source of Document:

Substantial portions of this document come from manuals used by Training and Development Associates in providing training and technical assistance..

Disclaimer:

This document is not an official HUD document and has not been reviewed by HUD counsel. It is provided for informational purposes only. Any binding agreement should be reviewed by attorneys for the parties to the agreement and must conform to state and local laws.

This resource is part of the NSP Toolkits. Additional toolkit resources may be found at www.hud.gov/nspta

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A framework is needed for predicting the lease-purchaser's readiness to purchase and be mortgage-ready within the lease term. Lease-purchase candidates are not simply all those who are interested in homeownership but not mortgage-ready. A floor needs to be established to distinguish those candidates who have a high probability of success from those where little probability exists. This level of probability depends on what level of risk the lease- purchase program sponsor is willing to absorb.

In contrast to criteria for homeownership underwriting, lease purchase does not have a national, standardized set of criteria. Moreover, determining risk has to be individualized for each lease-purchase program because of so many local variations in market, financing, sponsor capacity, and length of the leasing period. Therefore, each lease-purchase sponsor will need to develop their own set of criteria and refine and adjust them over time as the market and conditions shift. Furthermore, it is important to keep in mind that no matter how solid the set of criteria, success for lease-purchase units is not assured. The highest success rate in the country is reported to be no higher than 95%. Finally, the bar for various criteria should not be set so high as to eliminate deserving candidates or those who have the ability to purchase outright.

The following is a list of various factors that should be considered in developing a list of criteria. It is important to select criteria that can be measured objectively so that the same standard can be understood and utilized by everyone involved in the implementation of the program. While certain bars can be set for each criterion, it is important to allow for exceptions given individual circumstances. However, any exception would need to be justified. Front-line underwriters would have to justify exceptions and have approval by the manager before exceptions are finalized. Furthermore, the homeownership counselor should offer an assessment of the candidate's qualifications, steps toward homeownership and ability to achieve ownership, including a subjective sense of the candidate's motivation to ownership.

1. Standard rental criteria can form the basis for leasing as well as the foundation to build other criteria. Typical leasing criteria include standard income ranges, employment history, stability of the income and family, credit, outstanding debts, judgments, bankruptcies, criminal background check, household size, and stewardship for property as evidenced by a home visit.

2. Rental history – a track record of on-time rent payments for two years, "rental history" that requires a release to ask past landlords about late payments, damage, and evictions. Usually failure to complete a lease will show up on credit reports, but this category of investigation should be used as well.

3. FICO score – since this is the standard used for qualifying for a mortgage, it can also be used to provide a parameter for qualifying a lease-purchase candidate. Fannie Mae/Freddie Mac and FHA have set the standard for mortgage eligibility, thus a score below the current standard can be considered for the lease-purchase program. The lower the score, however, the more time it may take to achieve a score that meets the standard minimum mortgage eligibility level. The extent to which the score is lowered may also be an indicator of risk. For example, if the current standard FICO score is 620, then the minimum score for a lease-purchaser might be 580. Other factors may directly impact their ability to obtain a mortgage in the future – such as a previous default – even if the credit score is in the high 500's.

4. Employment history – any variations from the standard number of years of steady employment (usually two years) or evidence of steady work in a variety of jobs (for seasonal, construction workers) need to follow local or the organization's usual requirements for rental or exceptions for homeownership.

5. Debt payment history – an estimate that the lease-purchaser's ability to pay down debts within the term of the program is within an acceptable back-end ratio for an eventual mortgage application. For example, if the back-end ratio for a current mortgage is 41%, the back-end ratio for a lease-purchaser might be set at no more than 55%, anticipating that it will take no more than the lease period (minus three or more months to allow time for the lease-purchaser to apply for financing prior to the purchase due date) to lower the 55% to 41%.

6. Extinguishing judgments and bankruptcies – estimates that the compliance or extinguishing period ends in time to apply for a mortgage.

7. Criminal background – this is used more often for multi-family rental situations than ownership, especially single-family, detached homes. A policy should be established to determine eligibility and a consistent approach for exceptions to comply with Fair Housing Laws. Some local jurisdictions require sexual offender information and there are local ordinances that govern using housing subsidies for convicted offenders.

8. Legal status to qualify for the loans or programs

9. Savings - cash savings at time of lease of no less than a certain amount or the minimum down-payment

10. Other – such as an analysis of bank statement activity (for example, no overdraft fees in the past six months) and their consistency with candidate's description of spending pattern.