



CITY OF LOS ANGELES HOUSING DEPARTMENT



Los Angeles Housing Department

LAHD

**MORTGAGE CREDIT
CERTIFICATE (MCC) PROGRAM**

PROGRAM MANUAL

MARCH 2005

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SECTION I

INTRODUCTION TO THE MORTGAGE CREDIT CERTIFICATE PROGRAM

A. PURPOSE OF THE MCC MANUAL

The purpose of this Mortgage Credit Certificate (MCC) Manual is to describe the MCC Program and set forth the roles of the City of Los Angeles, the Participating Lenders and the MCC Applicants. This document contains a description of the MCC Program requirements, processing procedures and policies. The borrower, purchase price and mortgage underwriting requirements as set forth in state and federal regulations are also described. MCC processing forms are included in an appendix. The City may revise these guidelines from time to time. Public notice will be given only for significant changes.

Participating Lenders are expected to be well informed about all the local, state and federal lenders' requirements as contained in this Manual. Both Applicants and Lenders alike must be aware of these requirements before an MCC application is accepted. The Lender shall disqualify those Applicants where the submitted information indicates that the Applicant or the home does not qualify for the Program.

B. PROGRAM SUMMARY

The Mortgage Credit Certificate Program (MCC), authorized by Congress in the Tax Reform Act of 1984, is an alternative to mortgage revenue bond-backed financing as a means of providing financial assistance for the purchase of owner-occupied single family housing (see definition, on page 5 of eligible properties.) The Program is designed primarily to benefit first time home buyers. In 1985, California adopted legislation authorizing local agencies to make MCCs available.

What is an MCC?

An MCC is a certificate awarded by the City of Los Angeles authorizing the holder to take certain federal income tax credits. For example, a qualified borrower who is awarded an MCC may take an annual credit against federal income taxes of up to twenty percent (20%) of the annual interest paid on the borrower's mortgage. (The City of Los Angeles Program offers a 15% and 20% credit amount based on household income, location of property or other factors.) The value of the MCC is taken into consideration by the mortgage lender in underwriting the loan and may be used to adjust the borrower's federal income tax withholding. This adjustment will result in an effective reduction in monthly housing costs, and therefore, an increased ability to afford a mortgage payment.

What is the difference between a "tax credit" and a "tax deduction"?

A "tax credit" entitles a taxpayer to subtract the amount of the credit from his/her total federal income taxes owed, allowing the taxpayer to receive a dollar-for-dollar savings. This is different from a "tax deduction" which is subtracted from the adjusted gross income before federal income taxes are computed. With a deduction, only a percentage of the amount deducted is realized in savings.

How does the MCC “reduce” the effective mortgage interest rate?

An MCC reduces the amount of federal income taxes owed, thus increasing the qualified borrower’s spendable income to help qualify for a loan or to make the monthly mortgage payments.

For example, a borrower with an 8.5% fixed rate over 30-year mortgage of \$130,000 would make approximately \$11,012 in interest payments during the first year of the mortgage. With a 20% MCC, up to \$2,202 (20% of \$11,012) of the interest payments would be allowed to be taken as a tax credit toward the borrower’s federal income tax liability. This would effectively reduce the monthly mortgage payment, giving the borrower greater ability to qualify for and support a mortgage.

By increasing the purchase power, the MCC has the economic effect of reducing the interest rate on the mortgage. It is important to realize, however, that the total effect is achieved only when the MCC holder has sufficient income tax liability to receive the entire benefit of the MCC tax credit.

Monthly Mortgage Costs With & Without an MCC			
	Without MCC	With 15% MCC	With 20% MCC
First Mortgage Amount	\$130,000	\$130,000	\$130,000
Mortgage Interest Rate	8.50%	8.50%	8.50%
Term	30 years	30 years	30 years
Monthly Mortgage Payment (PI)	\$1,000	\$1,000	\$1,000
Mortgage Credit Certificate Rate	n/a	15%	20%
Monthly Credit Amount in First Year*	n/a	\$138	\$184
Value of Monthly Interest Deduction in First Year @ 28% Tax Bracket*	\$257	\$220	\$206
After-Tax Monthly Mortgage Payment in First Year	\$743	\$642	\$610

*As the principal of the loan is repaid and as the amount of interest paid in each year decreases, both the value of the Monthly Interest Deduction and the value of the Monthly Credit Amount will be reduced.

What happens to the tax deduction for mortgage interest when a home buyer uses an MCC?

When using the MCC tax credit rate, the home buyer is still eligible to deduct the remaining 80% or 85% of the annual mortgage interest payment not claimed as a credit. For example, assume the home buyer pays \$10,000 for the first year in mortgage interest. With a 20% MCC, the home buyer could take a credit of \$2,000 (20% of \$10,000) and a mortgage interest deduction of \$8,000 (80% of

\$10,000). With a 15% MCC, the home buyer could take a credit of \$1,500 (15% of \$10,000) and a mortgage interest deduction of \$8,500 (85% of \$10,000).

How does the MCC credit work?

The MCC reduces the amount of federal income taxes otherwise due to the federal government from the home buyer; however, if the credit is greater than the home buyer's tax liability, the IRS will not make a cash payment. Therefore, the benefit to the home buyer in a given year cannot exceed the amount of federal taxes owed for the year, after other credits and deductions have been taken into account.

What happens if a qualified home buyer cannot use the entire amount of the MCC credit in any one year?

If the amount of the MCC credit exceeds the home buyer's tax liability, the unused portion of the credit **can be carried forward for the next three tax years** or until used, whichever comes first. The home buyer must keep track of the unused credit by year. The current year credit is applied first and the "oldest" credit is used next.

How does the home buyer realize the increase in "home buying power?"

The home buyer may consider adjusting his/her federal income tax withholding to receive the benefit from the credit on a monthly basis. In this case, the home buyer will refile a W-4 form with his/her employer reflecting the MCC credit. By taking this action, the number of exemptions will increase, thus reducing the amount of taxes withheld and increasing the home buyer's disposable income.

The home buyer also has the option to wait until the end of the year and realize the tax credit savings in one lump sum when filing the federal income tax return. Regardless of whether the home buyer adjusts the W-4 form or not, the home buyer will report the tax credit when filing future federal income tax returns.

How does a home buyer apply for an MCC?

The prospective home buyer applies for the MCC at the same time he/she makes a formal application for a mortgage loan. Lenders vary in their requirements for mortgage loan applications, but generally the borrower should be ready to supply credit information, employment data and other information to the lender.

After determining preliminary eligibility, lenders may charge a non-refundable fee of **\$250** to process the application. There is no allocation of MCCs by Participating Lender. After an application has been made, the Participating Lender will arrange with the City to reserve an MCC for the qualified applicant household. This commitment will reserve the MCC while the mortgage loan application is being processed by the Lender.

What kind of properties are eligible?

An MCC can be used for single family homes including single-family detached homes, condominiums, manufactured homes, planned unit development (PUD) or townhouses in the

City of Los Angeles. Both new properties (never previously occupied) and existing properties are eligible. The residence must become the principal residence of the borrower after the financing has been completed, within 60 days except where rehabilitation of the home delays occupancy.

What loans can be used with the MCC?

MCCs can be used with conventional fixed rate loans, adjustable rate loans, FHA and VA loans, and privately insured loans. MCCs are not available with tax-exempt bond-backed loans such as those provided by the California Housing Finance Agency (CHFA) or Cal-Vet that carry a below-market fixed interest rate, or negative amortization loans.

The City of Los Angeles does not underwrite the loans. Participating Lenders will process the underlying mortgages using their standard procedures, taking into account the value of the MCC in qualifying borrowers.

What are the MCC eligibility requirements?

- **3-Year Requirements:** The MCC applicant cannot have had ownership interest in a principal residence at any time in the past three years (this requirement does not apply to purchasers buying homes in target areas).

- **Income Requirements:** In all cases, the applicant’s household income must be below the following limits.

	<u>1-2 Persons</u>	<u>3 or More Persons</u>
Outside Targeted Area	\$78,600	\$91,700
Inside Targeted Area	\$78,600	\$91,700

- **Purchased Price Requirement (1 unit-Single Family Homes):** The purchase price of the house must be below the following amounts:

	<u>Existing Homes</u>	<u>New Homes</u>
Outside Targeted Area	\$457,608	\$549,601
Inside Targeted Area	\$559,298	\$671,755

- **Location:** The property to be purchased must be in the City of Los Angeles. (White background in Thomas Guide® map.)

How many MCCs will be available under the Program?

The City of Los Angeles has adopted a pool system for MCCs. The purpose of the system is to assist the households with the greatest need and to increase the number of MCCs at a time when MCC authority is diminishing. All Pools except Pool A (Targeted Census Tracts) are available Citywide.

There are two categories of MCCs: 20% credits and 15% credits. This allocation may change over time, as may the percentages of the total authority assigned to each pool listed below. The Program Administrator will notify Participating Lenders of significant changes in the pools.

Pool A: 20% credit – 20% of the total allocation is reserved for IRS-targeted census tracts. The reservation must be held for a 12-month period, but at all times target area borrowers will be eligible for a 20% credit.

Pool B: 15% credit – (remaining dollars) of the total allocation will be available with all loan types for households that meet all basic MCC requirements.

Lenders and borrowers are cautioned to stay in touch with the Program Administrator prior to submitting a loan commitment package in order to ascertain the MCC availability.

C. GENERAL DEFINITIONS

As used in this MCC Manual and all MCC Program documents, unless the context requires otherwise, the following words and terms have the meanings set forth below:

ACQUISITION

COST: Has the meaning given that term under IRS Section 143 and the regulations thereunder. Acquisition Cost is used interchangeably with Purchase Price.

ADMINISTRATOR: City of Los Angeles and/or its designee.

AFFIDAVIT: Means an affidavit filed in connection with the Program made under oath and subject to penalties of perjury.

APPLICANT: Any person who applies for an MCC under the Program and who will be on title, liable for the mortgage, and reside in the principal residence.

CERTIFIED INDEBTEDNESS

AMOUNT: The amount of indebtedness incurred by the taxpayer to acquire the principal residence and is specified in the Mortgage Credit Certificate.

CITY: The City of Los Angeles, California.

DATE OF ISSUE: The date the Mortgage Credit Certificate is executed by the City.

ELIGIBLE

APPLICANT: Any person meeting the criteria for an eligible borrower set forth in this Manual who is in the process of securing financing for the purchase of a Principal Residence.

ELIGIBLE

DWELLING: Real property located in the City of Los Angeles which includes a residential unit to be built, new (not previously occupied) unit, or an

existing home, including a manufactured home, which has been previously occupied and designed as a residential unit for one household.

EXISTING HOME: Means a single family, condominium, manufactured home, planned unit development or townhouse dwelling unit that has been previously occupied prior to loan commitment.

INCOME: Gross income of the mortgagor(s) (as defined by Revenue Ruling 86-124 promulgated by the Internal Revenue Service) is the mortgagor's annualized gross income. Annualized gross income is gross monthly income multiplied by twelve (12). Gross monthly income is the sum of monthly gross pay, any

additional income from overtime, part-time employment, bonuses, dividends, interest, royalties, pensions, Veterans Administration (VA) compensation, net rental income, etc., and other income (such as alimony, child support, public assistance, sick pay, Social Security benefits, unemployment compensation, income received from trusts, and income received from business activities or investments).

Information with respect to gross monthly income may be determined at any time during the four month period ending on the date of the closing of the mortgage, provided that any gross monthly income not included on the loan documents must be included in determining gross monthly income. The income to be taken into account in determining gross income is income of all mortgagors, regardless of whether they are to live in the residence. In addition, the income of any other person who is expected to both (1) live in the residence being financed and (2) to be secondarily liable on the mortgage is also to be taken into account. If a co-borrower, co-signer, or co-habitor who is not also a mortgagor meets both requirements in the sentence above, his/her income is included in gross income calculations. Income includes the income of both spouses even if they are separated unless there has been a legal adjudication terminating the marital estate.

LOAN: An extension of credit to which a Mortgage Credit Certificate applies provided to an Eligible Applicant to finance the purchase of an Eligible Dwelling which meets the City requirements set forth in this Manual.

MANUFACTURED HOME:

A residence which has a minimum of 400 square feet of living space and a minimum width in excess of 102 inches and which is of a kind customarily used at a fixed location. Residence does not include recreational vehicles, campers and other similar vehicles.

MCC PROGRAM: The Mortgage Credit Certificate Program established by the City of Los Angeles and administered by the City as Program Administrator pursuant to the rules and regulations included in this MCC Program Manual.

**MORTGAGE CREDIT
CERTIFICATE**

RATE: The credit rate specified by the City on the Mortgage Credit Certificate. For this program, the Mortgage Credit Certificate Rate is either 15% or 20%.

MORTGAGE CREDIT

CERTIFICATE: A certificate issued by the City pursuant to Section 25 of the Internal Revenue Code of 1986, as amended, and applicable state and local requirements.

NEW HOME: A dwelling unit that is proposed to be constructed, currently under construction, or completed but not previously occupied.

NEW MORTGAGE

LOAN: A new mortgage originated in conjunction with an MCC; a mortgage that has not been transferred, refinanced or assumed.

OWNERSHIP

INTEREST: Any of the following interests in residential real property:

- fee simple interest
- joint tenancy
- tenancy in common
- interest of a tenant-shareholder in a cooperative
- life estate
- interest held in trust for the Applicant that would constitute a present ownership interest if held by the Applicant.

Ownership does not include a remainder interest, a lease with or without an option to purchase or any interest acquired on the execution of the purchase contract.

PARTICIPATING

LENDERS: A financial institution which is licensed to do business in the state or is exempt from such license, has met all of the requirements established by the City to participate as a Lender in the MCC Program, and has entered into an MCC Participation Agreement acceptable to the City.

PRINCIPAL

RESIDENCE: (1) A single family house; (2) condominium unit; (3) stock held by a tenant-stockholder in a cooperative housing corporation (as those terms are defined in the Internal Revenue Code Section 216(b)(1) and (2)); and (4) any manufactured home (including a mobile home) as defined under federal law which is of a type customarily used at a fixed location. Principal Residence does not include recreational vehicles, campers, and other similar vehicles. It does not include property such as appliances, furniture, or other personal property, which, under applicable local law, is not a fixture. The Applicant must expect to occupy the Principal Residence substantially all of each year.

**PROHIBITED
MORTGAGE:**

A negative amortization loan or a mortgage financed by a qualified mortgage bond or a qualified veteran's mortgage bond such as loans provided by a lender using California Housing Finance Agency (CHFA) bond proceeds.

**PURCHASE
PRICE:**

The cost of acquiring the residence as a completed residential unit, including all construction items, all commissions, all builder's fees, hook-up and tap-in fees, permits, architectural fees, all site improvements, discount points paid by the seller, work credit, subcontracted items, or construction loan interest but

excluding usual and reasonable settlement or finance costs, including title and transfer costs, title insurance, survey fees, credit reference fee, legal fees, appraisal expenses, points which are paid by the purchaser and the value of services performed by the mortgagor or members of his/her family in completing the acquisition of the residence.

**RELATED
PERSON:**

A "related person," as that term is defined under Internal Revenue Code and applicable regulations: siblings, spouses, ancestors and lineal descendants, or entities that are more than 50% owned by the Applicant or any other Related Persons.

**SINGLE FAMILY
OWNER OCCUPIED**

RESIDENCE: A housing unit intended and used for occupancy by one household.

TARGET AREA: A census tract in which 70% or more of the households have incomes which are 80% or less of the statewide median family income, or an area designated as an area of chronic economic distress. Such areas are not subject to the rule prohibiting home ownership within the last three years and have higher income and purchase price limits. Home buyers in Target Areas will receive a 20% Mortgage Credit Certificate Rate.

SECTION II

PROGRAM REQUIREMENTS

A. OVERVIEW

For loans involving MCCs, the conventional underwriting standards will be modified to recognize the MCC-derived mortgage interest credit in determining housing expense and indebtedness ratios. Some secondary mortgage markets and the mortgage insurance industry have established underwriting policies for MCC-linked loans.

The Purchase Price and loan underwriting requirements discussed in this section are incorporated in the MCC Program documents that are contained in the appendix to this Manual. All Applicants and Program Participants must complete and sign the appropriate MCC Program

documents and attest to their validity. The Participating Lender will be required to submit certifications on which it will state that to the best of its knowledge no material misstatements appear in the application and Program documents. If the Lender becomes aware of misstatements, whether negligently or willfully made, it must notify the City immediately. The City will take all appropriate actions to enforce Program requirements.

The Participating Lender should also be aware and inform the Applicant that penalties are provided for in federal and California law if a person makes a false statement or misrepresentation so as to obtain an MCC. In an attempt to assure that all requirements are clear, an Affidavit is required of each Applicant and must be included in the MCC submission package submitted to the City.

The MCC cannot be used with tax-exempt bond-backed mortgages (e.g., CHFA, Cal Vet). The MCC Program imposes no restrictions on the type of financing arrangement the Lender uses except that mortgage underwriting must take into account the value of the MCC. The MCC Program allows the use of any conventional mortgage instrument being generally used in the conventional marketplace and places no restrictions on mortgage terms, whether fixed or variable rate. **(Negative amortization loans are not eligible).**

B. APPLICANT ELIGIBILITY REQUIREMENTS

As with any conventional mortgage loan program, the Applicant must meet credit and underwriting criteria established by the lender providing the mortgage loan, taking into account the value of the MCC.

Based on applicable federal and state regulations, in order to qualify for an MCC, an Applicant must also meet the following requirements:

- 1. The Applicant may not have held an ownership interest in a Principal Residence within the past three years.** The Applicant applying for an MCC cannot have had an ownership interest in a Principal Residence at any time during the preceding three years ending on the date the mortgage is executed. This requirement does not apply to the acquisition of units in Targeted Areas. This requirement qualifies the Applicant as a “first time home buyer” under the federal regulations. The Participating Lender must obtain from the Applicant an affidavit to the effect that he or she has had no present ownership interest in a Principal Residence at anytime during the three-year period prior to the date on which the mortgage for the MCC is executed. This must be verified by the Lender’s examination of the Applicant’s federal tax returns for the preceding three years, to determine whether the Applicant has claimed a deduction for mortgage interest or taxes on real property claimed as a Principal Residence.

A Principal Residence includes a single family house, condominium unit, townhouse, planned unit development, manufactured home (as defined by federal law), or share of a housing cooperative. “Ownership interest” means ownership by any means, whether outright or partial, including property subject to a mortgage or other security interest. Ownership interest also means a fee simple ownership interest, joint ownership interest by joint tenancy, tenancy in common, or tenancy by the entirety, an ownership interest in trust, a life estate interest, and purchase by land contract.

To demonstrate compliance with this three-year requirement, Applicants must complete and sign the MCC Program Affidavit and provide copies of their last three (3) years signed federal tax returns (or acceptable alternative exhibits – see below).

- a. If the Applicant(s) can produce signed 1040A, 1040EZ or 1040 federal income tax returns for the three preceding years with all schedules which show no deductions for mortgage interest or real estate taxes for a Principal Residence, these forms shall be submitted to the Lender, and forwarded to the City with the MCC Affidavit and the complete MCC Submission Package. If the Applicant filed the 1040 long form and cannot produce an original copy of the signed tax returns, then the Applicant can request a copy of the returns from the IRS by using IRS Request Form 4506. The Applicant should allow approximately 45 days for the copies.
- b. If the Applicant(s) has filed the short form 1040A or 1040EZ for the last three (3) years, completes and signs the required affidavits, but is unable to produce the signed returns, the City will accept a letter from the IRS verifying the filing status of the Applicant. The letter should confirm that the Applicant filed the 1040A or 1040EZ for the years in question. The Applicant can request tax account information, which is available free of charge, from the local IRS office. This information will be provided on IRS Letter Form 1722 and will include: (1) name and social security number; (2) type of return filed; (3) marital status; (4) tax shown on return; (5) adjusted gross income; (6) taxable income; (7) self-employment tax; and (8) number of exemptions. If the address on the tax returns filed is different than the current address, the Applicant must also provide a handwritten note (signed by all Applicants) indicating that the previous returns had been filed at a different address.

The tax account information should be requested, in person, from the IRS office. The Applicant will not receive a response on the spot but can expect a written reply within (15) fifteen days. **The tax returns must have an original signature certifying that “this is a true and exact copy of the returns submitted to the IRS.”**

- c. In the event the Applicant(s) was not obligated to file federal income tax returns for any of the preceding three (3) years, it will be necessary for the Lender to obtain from the Applicant(s) a completed and signed Income Tax Affidavit (MCC-4) which is required in place of (a) or (b) above, along with the other Program Affidavits. This document is to be forwarded to the City with the Application Affidavit and the Lender Certification. The Income Tax Affidavit must be accompanied by documented proof of the reason for not filing taxes. For example, if the Applicant was in school, he/she would have to submit a copy of transcripts to support the status of the Applicant for that period of time. The Affidavit must also be accompanied by documented proof that the Applicant was a renter during the specified period (e.g. notarized letter from the landlord or manager, canceled checks, or rent receipts).
- d. When an MCC application is submitted during the period between **January 1 and February 15** and the Applicant has not yet filed his/her federal income tax return for the preceding year with the IRS, the City may, with respect to such year, rely on affidavit of the Applicant that the Applicant is not entitled to claim deductions for taxes or interest on indebtedness with respect to property constituting his/her Principal Residence for the preceding calendar year. The affidavit must be forwarded to the City with the Submission Package.

- e. If the tax returns indicate the Applicant took a deduction for mortgage interest or real estate taxes on property claimed not to be the Principal Residence, documentation would be required to show proof of rental to other persons (e.g. leases).

The Participating Lender is cautioned that in the above noted situations involving approval of a conditional MCC Commitment, the Lender may be closing the loan without the benefit of the city review of the certified tax returns prior to closing (“certified” tax returns are those with an original or “live” signature of the Applicant certifying that the returns are true and exact copies of the returns submitted to the IRS for each of the previous three years). In the event the certified tax returns do show a deduction for interest or taxes on Principal Residence, or in the event the certified tax returns are not obtained, the City will not issue the MCC. The Lender, at its option, may forward federal tax return exhibits to the City for review prior to loan closing.

- 2. **The MCC Applicant must occupy the acquired residential housing as a Principal Residence.** The Applicant must use the housing being purchased with the MCC-linked mortgage as his or her Principal Residence. The Lender must obtain from the Applicant, using the Program affidavits; a statement of the Applicant’s intent to use the residence as his/her Principal Residence within a reasonable time (60 days) after the MCC is issued. This Affidavit further states that the MCC holder will notify the Lender and the issuer of the MCC, the City of Los Angeles, if the residence ceases to be his/her Principal Residence.

- 3. **Qualified Applicants must have an annual gross household income not to exceed the following limits:**

	<u>1-2 Persons</u>	<u>3 or more Persons</u>
Inside Target Area	\$78,600	\$91,700
Outside Target Area	\$78,600	\$91,700

Gross Income is calculated prospectively by taking the Applicant’s current gross monthly income (at time of application) and multiplying this income by 12. Gross income includes the gross amount, before payroll deductions, of wages, salaries, commissions, fees, tips, and bonuses; dividends and interest, including otherwise tax-exempt interest; alimony; public assistance; etc. The gross income of all co-mortgagors is counted.

In addition, gross income includes the combined income of all members of the household (other than minors) who will both be living in the dwelling unit and be secondarily liable for the payment of the mortgage. If the co-borrower, co-signer, or co-habitor who is not a co-mortgagor meets both of the requirements in the sentence above, his/her income must be included in gross income calculations. Income includes the income of both spouses even if separated unless there has been a legal adjudication terminating the marital estate. Income limits are based on HUD guidelines and may be altered if HUD determines new income levels.

The Applicant’s monthly gross income information can be taken from the available loan documents executed during the previous four month period ending on the date of the closing of the mortgage provided that any gross income not included on the loan documents must be included for the Program. Thus, for example, if the mortgagor does not include alimony on the loan documents the Lender, in determining gross monthly income, must determine the amount of alimony and add that amount shown on the loan documents.

(1) Self-Employed or Seasonal Employees

The formula that the Lender uses in determining the monthly income of self-employed persons and/ or seasonal workers is acceptable so long as the Lender includes any other income sources that are required to be added.

(2) Income of Co-borrower/Co-mortgagor

If a co-signer or co-mortgagor will be both on the title and the deed of trust, his or her income must be included in determining eligibility for the Program. The IRS regulation states that “income to be taken into account in determining ‘gross income’ is income of the mortgagor (or mortgagors) and any other person who is expected to both live in the residence being financed and to be secondarily liable on the mortgage.” The first part of the regulation specifies that the income of any and all mortgagors shall be included in the gross income calculations. Therefore, if someone is considered a mortgagor (on both the title and deed of trust) then their income should be included. Secondly, the regulation specifies that the income of any other person who is expected to both live in the residence being financed and to be secondarily liable for the mortgage should also be included in the gross income calculation for the Program.

In summary:

- Income of all mortgagors shall be included in the gross income calculation for the Program;
 - Income of anyone else who will both live in the residence and be secondarily liable on the mortgage must be included;
 - Income does not have to be included if there is a co-signer who signs only the note or a separate personal guarantee, is not on the grant deed, and will not live in the residence;
 - If a co-mortgagor is not going to live in the residence, he or she is not required to meet the first-time home ownership requirement (but their income is included);
 - Non-occupant co-mortgagors will not be on the MCC application and will not be eligible for the tax credit. However, the income of the co-mortgagor must be included.
- 4. The MCC may be automatically revoked if the Applicant fails to comply with Program requirements.** An MCC may be revoked under certain circumstances (Please see Section IV D for a detailed list of causes for revocation). For example, revocation occurs if the residence to which the MCC relates ceases to be the borrower’s Principal Residence. An MCC also may be revoked if the certificate does not meet the requirements of a “qualified MCC.”
- 5. Strict penalties may be imposed on any Applicant making a material misstatement, misrepresentation or fraudulent act on documents submitted to obtain an MCC.** Any person making a negligent material misstatement or misrepresentation in any affidavit or certification in connection with the application for or the issuance of an MCC shall be subject

to all applicable fines (up to \$10,000) and penalties, including possible repayment of any credit claimed.

C. PURCHASE PRICE REQUIREMENTS

The borrower must comply with the following Purchase Price limits in order to qualify:

1. For **NEW (Never Previously Occupied) HOUSING UNITS**, the maximum Purchase Price of house and land may not exceed \$549,601 if the residence is not in a Target Area, or \$671,755 if it is in a Target Area.
2. For **EXISTING (Resale) HOUSING UNITS**, the maximum Purchase Price of the residential unit and land may not exceed \$457,608 if the unit is not located in a Target Area or \$559,298 if it is in a Target Area.

The property to be purchased must be in the City of Los Angeles. (White background in a Thomas Guide® map)

Furthermore, the mortgage amount cannot exceed the maximum Purchase Price limits.

The Participating Lender must obtain the Seller's Affidavit executed by the seller, which states that the Purchase Price requirements have been met. The affidavit includes an itemized list of: (1) Any payments made by the buyer or for the benefit of the buyer; and (2) an estimate of the reasonable cost of completing construction of the residence if it is incomplete.

D. MORTGAGE REQUIREMENTS

1. **New Mortgage Requirements:** Except for construction period loans, bridge loans or similar temporary initial financing of 24 months or less, a Mortgage Credit Certificate can only be issued in conjunction with a New Mortgage Loan. The Lender must obtain from the Applicant, using the Program affidavits, a statement to the effect that the mortgage being acquired in connection with the certificate will not be used to acquire or replace an existing mortgage or land contract.
2. **Prohibited Mortgages:** A Mortgage Credit Certificate shall not be used in direct or indirect connection with a qualified mortgage bond or a qualified veteran's mortgage bond. The Lender must obtain from the Applicant, using the Program affidavits, a statement to the effect that no portion of the financing for acquisition of the residence in connection with which the MCC is issued is provided from a qualified mortgage or veteran's bond such as loans provided by a lender using California Housing Finance Agency (CHFA) or Cal-Vet bond proceeds **OR from a NEGATIVE AMORTIZATION loan.**
3. **No Interest Paid to Related Persons:** No interest on the mortgage (or certified indebtedness) amount may be paid to a person who is a Related Person. The Lender must obtain from the Applicant, using the Program affidavits, a statement to the effect that no Related Person has or is expected to have an interest as a creditor in the certified indebtedness amount.

- 4. Transferability:** The MCC is not transferable. If the mortgage or certified indebtedness is assumed by a subsequent purchaser, the Applicant may apply for a new MCC under certain circumstances:
- a. The purchaser must reasonably demonstrate to the satisfaction of the City that he/she has assumed the liability for the remaining balance of the certified indebtedness.
 - b. The new MCC must meet all the conditions of the original certificate including any changes in federal, state and local regulations or policies that amend the requirements of the original certificate.
 - c. The City must agree to and issue a new MCC.
 - d. The purchaser's Acquisition Cost must meet the Purchase Price requirements for an existing (resale) unit in order to comply with federal regulations.

E. TARGET AREA REQUIREMENTS

The City is required to set aside 20% of the MCC Authority for properties purchased in a federally designated Target Area. This amount must be set aside for a one-year period. After the one year, any of the remaining set aside MCC Authority can be released and made available throughout the City.

The rule prohibiting home ownership within the previously 3 years does not apply in such Target Areas. In addition, the income and purchase price limits are higher. Targeted Areas in the City of Los Angeles are listed on Attachment A.

SECTION III

PROGRAM PROCEDURES

A. OVERVIEW

In general, an eligible Applicant would apply for a Mortgage Credit Certificate as part of the normal mortgage loan application process. The MCC application filed with the City must be done in conjunction with an application for a mortgage from one of the Participating Lenders in the MCC Program.

The MCC processing procedures are designated to coincide with the standard mortgage loan processing and underwriting procedures that are in place at most mortgage lending institutions. Recognizing there are procedural variations among the Participating Lenders, the procedures outlined here are meant to serve as guidelines with respect to the sequence of events. However, all the elements of the processing sequence outlined in the Manual must at some point be completed, regardless of sequence, by the Lender, the City, the Applicant and the seller.

The City may delegate part of its administrative functions to Participating Lenders through a Lender Participation Agreement.

Figure 1 presents a schematic outline of the MCC application and delivery process.

Figure 1

MCC PROGRAM PROCESS

Commitment Phase

- Applicant:
- Applies to Participating Lender to initiate the MCC and mortgage loan applications
 - Signs Application and Affidavit (MCC-3 & Attachment MCC-3a)
- Lender:
- Determines initial eligibility
 - **Submits**
 - MCC Transmittal and Checklist (MCC-2)
 - \$150 certified or corporate check
 - MCC Application and Affidavit (MCC-3 & MCC-3a – Attachment)
 - Uniform Residential Loan Application (1003)
 - FHA Title I approval (if needed)
 - Sales Agreement
 - Income Tax Returns
 - Income Tax Affidavit (MCC-4) (if needed)
 - Income Verification Documents
 - Commitment (MCC-5)
 - Recapture Notice (MCC-6a)
 - Income Summary Worksheet (MCC-7) (optional)
- City:
- Reviews eligibility
 - Completes and Approves Commitment (MCC-5)
-

Closing Phase

- Applicant:
- Signs Closing Affidavit (MCC-9)
- Lender:
- Approves loan and notifies City.
 - **Submits**
 - Seller Affidavit (MCC-8)
 - Closing Affidavit (MCC-9)
 - Signed copy of Recapture Worksheet (MCC-6b)
 - HUD-1 (the HUD-1 must reflect the FHA Title I loan, if applicable)
 - Loan Assignment/Cancellation/Commitment Extension Notice (MCC-10) (if needed)
- City:
- Reviews closing documents
 - Issues Mortgage Credit Certificate

Following are the loan processing and program administration activities for the MCC Program:

B. COMMITMENT PHASE

During the Commitment Phase, the Lender performs the following:

1. Lender gives Applicant the brochures that explain the Program and contain consumer information.
2. Lender determines if Applicant is an eligible candidate for an MCC, based on preliminary indications of income, purchase price, prior home ownership, tax liability and other factors.
3. Applicant applies for a mortgage loan from Lender and remits a non-refundable MCC application fee of \$250 to Lender.
4. As part of the mortgage application process, the Lender directs Applicant to sign the Application and Affidavit (MCC-3 and Attachment 3a). this document serves as the MCC application and contains all the certifications and affidavits required by the MCC Program regulations and requirements as follows:
 - a. Certification that the residence will be used as the Principal Residence within 60 days after the MCC is issued and that the MCC holder must notify the City when the home ceases to be his or her Principal Residence.
 - b. Certification that the residence will not be used as an investment property, vacation home, or recreational home and that not more than 15% of the area of the residence will be used in a trade or business.
 - c. Certification that the Applicant has not had an ownership interest in a Principal Residence during the preceding three-year period (not required for a Target Area).
 - d. Certification that the Purchase Price does not exceed the Purchase Price limit.
 - e. Certification that this is a New Mortgage Loan, as defined in Internal Revenue Service regulations.
 - f. Certification that the loan applied for does not constitute a Prohibited Mortgage.
 - g. Certification that the Applicant was not forced to apply through a particular Lender.
 - h. Certification that the Applicant's income does not exceed the permitted income limit.
 - i. Certification that no interest is being paid to a Related Person.
 - j. Certification that the MCC cannot be transferred without the prior written approval of the City in accordance with Program requirements.
 - k. Acknowledgement that any material misstatement or fraud is made under penalty of perjury.
5. Lender transmits all MCC documents as required in **Figure 1: MCC Transmittal and Checklist** (MCC-2), Application and Affidavit (MCC-3 & Attachment MCC-3a), a copy of the Sales Agreement (signed by all parties), a check for \$150 to the City of Los Angeles, MCC Commitment (MCC-5), the Certificate of Recapture Notice (MCC-6a), FHA Title I approval letter if needed, MCC Income Summary Worksheet (MCC-7, **optional**), Loan Application (1003), Income Tax Returns, Income Tax Affidavit (MCC-4) if needed, and Income Verification Documentation.

6. The City examines all documents for completeness and consistency. After confirming this information, the City establishes a commitment by assigning a unique MCC Code Number to the commitment and by notifying the Lender in writing of the commitment. The commitment will state that the Application is approved and the City is prepared to issue an MCC upon confirmation of the mortgage closing, so long as there are no material changes from the time of the dated, approved Commitment Letter. The City retains the Submission Package.
7. The MCC Commitment Letter will contain an expiration date of 60 calendar days for existing (resale) housing units and 120 calendar days for newly-constructed units (see Section IV, G for further details regarding expiration). This period begins running on the date the Commitment Letter is approved.
8. The City maintains a cumulative-to-date total of mortgage amounts reserved to monitor the amount of expected aggregate certified indebtedness and aggregate amount of MCCs to be issued. The aggregate amounts of MCCs issued shall not exceed the authorized amounts for the specific period. The City will notify Lenders when its MCC authority is close to being depleted.

After the MCC commitment has been confirmed by the City, the Lender performs the following standard underwriting and verification procedures:

9. Lender performs standard mortgage loan underwriting procedures, but takes into consideration the effect of the MCC when determining the net amount of the monthly housing payment. Lender determines acceptability of loan in accordance with applicable Fannie Mae, Freddie Mac, FHA, VA or private mortgage insurance standards and/or underwriting guidelines.
10. Lender performs standard verification for loan underwriting. In conjunction with Lender's regular verification process and under the agreement with the City, the Lender performs reasonable investigation to ensure that all MCC Program requirements have been satisfied. Lender may verify these facts according to federal or State requirements or in any reasonable, efficient manner as dictated by standard industry practices for processing mortgage loan applications.
11. Lender verifies that the Applicant and the mortgage transaction comply with MCC Program restrictions on income, Purchase Price, and other Program terms.
12. Lender completes all other standard underwriting and verification procedures.
13. The Lender will cooperate with the City to obtain any additional information required under the Program.
14. The City confirms that the MCC Commitment is still active and has not expired.

The City reviews the MCC Submission Package for completeness and determines whether all necessary certifications and affidavits are included and properly executed.

Cancellations and Commitment Expirations

1. In the case where a decision is made not to continue with an MCC Application, the Loan Assignment/Cancellation/Commitment Extension Form (MCC-10) must be received by the City **prior** to the expiration of the Commitment. The notice must include the reason for the cancellation and be signed by both the Lender and the Applicant.
2. **Before** the Commitment has expired, the Lender must:
 - (a) submit the closing package;
 - (b) submit a request for a 30-day extension (MCC-10 Loan Assignment/Cancellation/Commitment Extension Notice), including a \$25 extension **OR**
 - (c) submit a notice of cancellation as described above in #1.
3. **After** the Commitment has expired, the Lender must:
 - (a) if the loan **has** closed, submit the closing package and \$175;
 - (b) if the loan **has not** closed, submit a request for extension (MCC-10), an estimate of the closing date and \$175;
 - (c) if 120 days have passed since the Commitment was approved, submit new, current income verification and payment of \$175;
 - (d) if the loan was canceled, submit cancellation notice as described above in #1.

C. LOAN CLOSING PHASE

Lender Responsibilities

1. The Lender confirms that the MCC Commitment has not yet expired.
2. The Lender approves the loan with the Applicant(s) as per regular procedures. The Lender gives the Applicant a copy of IRS Form W-4 Employee's Withholding Certificate, which contains IRS instructions for the taxpayer. The Applicant uses this procedure in changing federal withholding tax, adjusting it in an amount comparable to the expected MCC tax credit. The amending of the W-4 Form is optional if the Applicant(s) does not need the MCC to qualify for the loan.
3. Lender notifies the City of approval of loan application and forwards all loan and MCC materials to the selected Escrow Officer with instructions for closing the loan and executing the Closing Affidavit (MCC-9) to be signed at closing by the Applicant(s). The Escrow Officer sends the Closing Affidavit back to the Lender.
4. The Lender forwards the MCC Close of Escrow Documents to the City indicating that the loan has closed. The documents include:
 - (a) Seller Affidavit (MCC-8)
 - (b) Closing Affidavit (MCC-9) signed by Applicant(s) at closing, and signed by Lender certifying that there has been no material change that would disqualify the Applicants for the MCC Program.

- (c) Notice to Mortgagor of Maximum Recapture Tax and Method to Compute Recapture Tax on Sale of Home (MCC-6b)
- (d) Loan Assignment /Cancellation/Commitment Extension Notice (MCC-10) as needed.

City Responsibilities

1. The City reviews Close of Escrow Documents and checks the file to make sure all necessary documents have been submitted. Upon approval, the City issues the MCC and sends copies directly to the Applicant(s) and Lender. The Applicant also receives a letter explaining generally how to use the MCC and a copy of IRS Tax Form 8396 to be filed by the Applicant(s) with their Income Tax Returns.
2. The City maintains a cumulative total for all MCCs placed into use.

D. MONITORING PHASE

1. Every year, each Participating Lender must file an annual report, using IRS Form 8329, for any year in which MCC-assisted loans are originated.
2. For six years from loan closing, the Participating Lender must retain:
 - (a) Name, mailing address, and TIN (Social Security number or tax identification number) of the MCC holder.
 - (b) Date of loan (date of issuance), certified indebtedness amount and credit rate.
3. The City shall make quarterly reports on IRS Form 8330, beginning with the quarter in which the election is made and continuing throughout the period in which MCCs are issued. The City shall make an annual report for each Program year ending June 30 in which an MCC is issued. The report must be filed by August 15 following the end of the Program year. The report must include:
 - (a) Number of Mortgage Credit Certificates by Income and Acquisitions Cost;
 - (b) Volume of Mortgage Credit Certificates by Income and Acquisition Cost; and
 - (c) Mortgage Credit Certificates for qualified Home Improvement and Rehabilitation Loans. (This is not applicable for this Program.)

SECTION IV

MCC SUBMISSION AND COMMITMENT

A. HANDLING PRIORITY

All loan applications will be processed by the City according to the date of receipt.

B. LENDER PARTICIPATING AND TRAINING

All Participating Lenders must attend an MCC Program training before being certified to participate in the City's MCC Program. Continued certification for the Program will require participation in future lender meetings, as specified by the City. Only those persons who have attended training are authorized to execute documents.

C. PROGRAM CHARGES AND FEES

All application fees and participation fees will be made payable to the City of Los Angeles by certified or corporate check.

1. **Non-refundable Application Fee** - The Lender charges each Applicant an application fee of \$250 for processing each MCC. Of this amount, \$150 is to be transferred to the City with the Initial Request for Commitment. This application fee is **non-refundable**.

Other than the non-refundable application fee, the Lender can only charge a potential borrower applying for an MCC those reasonable fees as would be charged to a potential borrower applying for mortgages not provided in connection with MCC. The Lender can choose to waive its \$100 share of the \$250 fee.

2. **Lender Participation Fee** - Each Lender will be charged an initial Program participation fee of \$250. This amount must be paid to the City on or before the required scheduled training date. This amount allows the Lender to send up to five (5) personnel to the training. For each person over 5, the Lender must pay an additional \$35.

For each subsequent year, the Lender pays a \$150 annual renewal fee. This allows for up to five (5) personnel to attend renewal training. For each person over five (5), Lender will pay \$35. This amount will be due to the City on the anniversary date of the Lender's attendance at the training session, unless otherwise specified by the City. Failure to pay the annual renewal fee by the due date will result in the Lender's being dropped from the Program. To rejoin, the Lender must pay the \$250 Lender Participation Fee again.

D. REVOCATIONS

1. Unless waived in writing by the City, automatic revocation occurs when the residence for which the MCC was issued ceases to be the MCC holder's Principal Residence.
2. Unless waived in writing by the City, automatic revocation occurs whenever the MCC holder is not in compliance with the requirements for a qualified MCC. Revocation will occur upon discovery by the City or a Participating Lender of any material misstatement, whether negligent or fraudulent.

E. TRANSFER OF MCC FOR MORTGAGE ASSUMPTIONS

If a mortgage associated with an MCC is assumed by a new buyer, the MCC will only be transferred so long as the new buyer meets the income requirement and first-time home buyer requirement and the residence meets the Purchase Price requirement. A complete MCC Package must be submitted and approved by the City just as if a new MCC were being processed.

F. TRANSFERRING MCC APPLICATIONS TO ANOTHER PARTICIPATING LENDER

If an Applicant has a pending MCC application and decides to change from one Participating Lender to another, the City will honor the original expiration date as long as no information has changed and the new Lender verifies the commitment documents and provides a letter from the Applicant requesting the transfer.

If an Applicant changes from one Participating Lender to another after a Commitment has been approved, the new Participant Lender will be required to verify that the Applicant meets the Program requirements by resubmitting the following documents:

Application and Affidavit and Attachment (MCC-3 & MCC-3a)

(a) Commitment (MCC-5)

(b) Loan Application (FNMA 1003)

The Commitment will be re-approved through the new Participating Lender with the same original expiration date. The new Participating Lender number will be assigned to the MCC number. The expiration date will not be extended without a formal request. Furthermore, if the Applicant has been approved for a conditional commitment, the missing documents (e.g. tax returns, seller affidavit) will have to be received prior to issuance of the Certificate.

G. ASSIGNMENT OF MCC COMMITMENT FOR FUNDING

If a Participating Lender packages a loan with an MCC and assigns the loan to another MCC Participating Lender for funding, the original Participating Lender should forward to the City either prior to or with the Close of Escrow documents, the letter indicating the loan has been assigned to the new funding Participating Lender. The City will adjust its records to reflect the new lender. The MCC will be issued in the funding Participating Lender's name. The funding Participating Lender will also be responsible for the reporting on that particular loan.

H. CHANGING PROPERTIES DURING MCC APPLICATION PROCESS

If an Applicant(s) has a pending application and changes the property he/she is purchasing, the Participating Lender must submit a new signed Sales Agreement and indicate by transmittal whether the mortgage amount has changed. If the Applicant has already been approved for a Commitment, the following documents must be revised and resubmitted to reflect the new property address and any change in mortgage amount.

(a) Application and Affidavit and Attachment (MCC-3 & MCC-3a)

(b) Seller Affidavit (MSS-8)

(c) Commitment (MCC-5)

The Commitment is re-approved with the original expiration date.

I. RESUBMISSION OF MORTGAGE CREDIT CERTIFICATE APPLICATIONS RETURNED OR REJECTED

If an MCC Application as represented by the submitted MCC Program documents and exhibits has been returned or denied by the City, any resubmission, if appropriate, must include all

information which the City has determined necessary for reconsideration. An MCC Application that is being submitted a second time will be reviewed, and a final disposition made.

J. CHANGES PRIOR TO CLOSING

1. Changes in the Applicant's financial or marital status after approval of Commitment and prior to closing

The eligibility of Applicant(s) for an MCC is based upon the Applicant's current income. The MCC Program will approve the Commitment based on facts as they are verified as of the date the Commitment is approved. The income verified for Commitment is valid as long as the loan closes within four months after the financial information was originally submitted and there are no additional sources of income that were not previously reported.

Upward changes in income sources already reported (e.g. raises) will not affect the validity of an MCC Commitment as long as the loan closes within four months from the time the MCC Commitment was approved. If the loan does not close within four months and an extension is requested, the income would have to be re-verified, including all new current income.

If the Applicant(s) experiences a change in marital status after approval of the Commitment and prior to closing, the spouse must satisfy the prior home ownership requirements contained in the Application Affidavit and the Closing Affidavit, and the Lender must notify the City. Any increase in the household income because of the new spouse must be considered and may affect the validity of the Commitment.

Furthermore, any added source of income received after the approval of the Commitment but prior to closing should be disclosed and included in the Income Eligibility determination if the Closing is more than four months after the date of Commitment.

2. Changes in home ownership status, acquisition cost amount of mortgage loan after approval of Commitment and prior to closing

If the Applicant(s) acquire a present ownership interest in a Principal Residence prior to loan closing, the Commitment shall be revoked if the residence is located in a non-targeted area.

If the total acquisition cost of the residence purchased in connection with the MCC increases so as to exceed the Acquisition Cost limitations set forth herein, the Commitment shall be revoked.

If the amount of the loan increases, thereby causing an increase in the credit amount, the Commitment will be revoked if that increase in credit amount serves to increase the aggregate credit amount of all MCCs issued by the City above the aggregate credit limit imposed by law.

3. Other changes in circumstances after approval of Commitment and prior to closing

The MCC Commitment is approved in reliance upon the Applicant's Application and Affidavit, the Seller's Affidavit, and the Lender's Certification that the requirements necessary for approval of a qualified MCC have been met. The Participating Lender must immediately notify the City in writing (by using the Transmittal) of any change in the circumstances upon which the Commitment was approved. If any other change of the circumstances upon which the

Commitment was approved occur so that the MCC to be issued will not meet the requirements of a qualified MCC, the Commitment will be revoked.

K. AUDIT

The City retains the express authority to perform annual random audits of Participating Lender MCC records.

L. CONFLICT OF INTEREST

No Mortgage Credit Certificate shall be issued to a person or the immediate family of a person who is in a decision-making position relative to the MCC Program or the issuance of an MCC. This includes, but is not limited to, staff of Participating Lenders and the City of Los Angeles.

M. EXPIRATION

The City of Los Angeles will provide notice of the expiration periods.

N. RECAPTURE

Loans receiving an MCC are subject to a “Recapture” in the form of additional federal tax. Participating Lenders must submit a copy of the Recapture Notice (MCC-6a-6b) to the borrower(s) at the time of Loan Closing.

The recapture provisions provide that if the residence is sold more than 9 years after the close of escrow, no recapture arises. Also, if the residence is sold during the first 9 years after closing but the MCC holder’s income does not increase more than 5% per year during that period, recapture liability will not be likely to occur. In no case will recapture liability exceed 50% of the gain from the sale of the residence.