



Credit Decisions for Rental Rehabilitation Deferred Loan (RRDL) Administrators

You are responsible for having a documented credit decision policy and making credit decisions for your RRDL applicants. We recommend starting with the following steps:

1. Determine the applicants proposed form of ownership (individual, Single Asset Entity, LLC, etc.)
2. Obtain the applicable credit documents listed below from your applicant.
3. Use the documents and tips in appropriate section below to review the loan application.
4. Ask the applicant clarifying questions as needed.
5. Determine whether or not to make the loan. You must retain **all** records supporting this decision.

Individual Applicants (Natural Person, Sole Proprietorship, or legal entity made up of only a Natural Person and his or her spouse, when applicable)

Two years of personal tax returns, including Schedule E and K-1

- Review discrepancies between the loan application and tax statements (Schedule E and K-1), paying attention to personal and real estate income and expenses. Explain any differences.

Personal Financial Statement (PFS) signed and dated within the past six months*

- Must include all assets and liabilities.
- The applicant's net worth should be at least two times the requested loan amount.
- The applicant should have enough liquidity to cover at least one month of operating expenses and debt service on the property.
- Look for liquid assets (cash, marketable securities that are outside of 401Ks, bank statements, brokerage statements, etc.). Do not count personal property, personal homestead or 401Ks.
- Is the applicant responsible for any other person's or entity's debt?
- The data on the PFS should match the tax documents. If they do not match, explain why.

A personal credit report from Equifax, TransUnion, or Experian. The borrower should provide this to you, and it must be no more than 30 days old.

- A FICO score above 680 is preferable. The applicant must have a minimum credit score of 640. A score below 640 will require detailed supporting evidence to be considered.
- Compare debt on credit report with debt noted in PFS. Explain any differences.
- Explain any judgments on the credit report. They will only be allowed if they are minor and there are reasonable explanations.

Single Asset Entity Corporation, LLC, LLP, or LP Applicants

Two or more years of accountant prepared financial statements

- Note if the statement is an audit¹, review², or a compilation³. While a compilation or review may be acceptable, they should be analyzed more closely than an audit.
- Review the Statement of Cash Flows to gauge their ability to pay. Since positive cash flow is the primary source for repayment of debt, look for positive cash flow for each year.
- Make sure the borrower has enough liquid assets to cover two months of operating expenses.
- Net worth is not a good indicator of ability to repay. IRS rules for depreciation of real estate mean the borrower may show negative net worth or real estate may be overvalued, so focus on cash flow.

Two years of complete tax returns

- Review discrepancies between the loan application and tax statements, paying attention to personal and real estate income and expenses. Explain any differences.
- If real estate is primary business, this information may appear on Schedule C instead.

Nonprofit or Governmental Agency Applicants

Two or more years of audited financial statements for governmental entities and nonprofits

- Note if the statement is an audit, review, or a compilation. While a compilation or review may be acceptable, they should be analyzed more closely than an audit.
- Review the Statement of Cash Flows to gauge their ability to pay. Since positive cash flow is the primary source for repayment of debt, look for positive cash flow for each year.

- Make sure the borrower has enough liquid assets to cover two months of operating expenses.
- Net worth is not a good indicator of ability to repay. IRS rules for depreciation of real estate mean the borrower may show negative net worth, so focus on cash flow.

IRS Form 990 for nonprofits

- The following information on Form 990 provides an indication of the nonprofit's financial strength:
 - Net revenue over expenses (no year-end deficits)
 - Asset levels that remain stable from previous year, or changes are explained satisfactorily
 - Liability levels that remain stable from previous year, or changes are explained satisfactorily
 - Fund balance (net worth) that maintains or increases from previous year
 - Net liquidity (cash and non-real estate assets) equal to 4-6 months of operating expenses

* Tax returns may be deemed sufficient documentation in place of personal Financial Statement for individual or sole proprietorship owner applicants.

¹ An audit provides the highest level of assurance on an organization's financial statements, showing they are free of material misstatement and are fairly presented based upon the application of generally accepted accounting principles.

An audit includes:

- Confirmation with outside parties,
- Testing selected transactions by examining supporting documents,
- Completing physical inspections and observations, and
- Considering and evaluating the internal control system of the organization.

² A review provides limited assurance on an organization's financial statements. During a review, inquiries and analytical procedures present a reasonable basis for expressing limited assurance that no material modifications to the financial statements are necessary; they are in conformity with generally accepted accounting principles. This "does it make sense" analysis is useful when the organization needs some assurance about their financial statements, but not the higher level of assurance provided by an audit.

³ A compilation provides no assurance on an organization's financial statements. The CPA takes financial data provided by the organization and puts them in a financial statement format that complies with generally accepted accounting principles. There are no testing or analytical procedures performed during a compilation.