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SBA Disaster Loan Program may be your path to financial bankruptcy 6.5. THE FIXED DEBT METHOD FDM

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After a disaster money becomes the top priority. We have lived as a nation of people that believe money spent will be money earned at a future date. The SBA believes that as well, they actually calculate your future pay raises when offering disaster loans

6.5. THE FIXED DEBT METHOD (FDM)

A. General Rule: Disaster loans are unplanned debts, and create neither an increase in assets nor an improvement in lifestyle. Because disaster loans repair/replace existing property, applicants pay twice to maintain those assets. Although replacing disaster damaged property and providing working capital is our mission, the nature and purpose of the debt does not affect the fact that there is a certain maximum level of debt that is reasonable. The FDM is a lending concept based on guidelines used by the mortgage banking industry and is a guideline to help you determine repayment ability and terms for home loans. You must exercise your credit analysis skills, use discretion, and evaluate all information. Only your reasoned and thorough analysis of all relevant facts can help balance between protection of the Agency's interest and sympathetic consideration of the applicant's needs.

The FDM is used when calculating individuals repayment ability for home loans and business loans. The FDM assumes:

1. There is a debt level expressed as a percentage of gross income, one can afford. This is known as the Maximum Acceptable Fixed Debt (MAFD)
2. If the maximum debt level is not exceeded, the balance of gross income can pay taxes and ordinary and necessary living expenses and
3. Once the maximum debt level is exceeded the risk of default increases

B. FDM Calculation:

1. The FDM formula is: GMI x MAFD percent = MAFD. MAFD - MFD = CA

2. Definitions:

a. GMI (Gross Monthly Income): Gross annual income divided by 12.
b. MAFD Percent (Maximum Acceptable Fixed Debt Percentage): The percentage of income which generally can be allocated for fixed debts (housing, installment and car loans, credit card or revolving charge accounts, certain extraordinary continuing expenses, etc.) without incurring an increased risk. Living expenses are not considered part of fixed debt. They are variable costs addressed by the portion of gross income remaining after subtracting MAFD. For SBA disaster loan purposes, the standard MAFD percent is 40 percent (for business files this replaces the 25% individuals additional living expenses (ALE).
c. MAFD (Maximum Acceptable Fixed Debt): The result of the GMI x MAFD percent calculation, expressed in dollars. This amount usually represents a ceiling at which point the applicant can incur no more fixed debt without an increased risk.
d. MFD (Monthly Fixed Debt): The total amount of all continuing fixed debt (exclusive of living expenses).
e. CA (Cash Available For Additional Fixed Debt): The remainder after deducting MFD from MAFD.
f. One-third of CA: The amount used as the basis to establish the standard loan term of either 15 or 30 years.

C. Components of Monthly Fixed Debt (MFD):

1. House payment (PITI) or rent includes:

a. Rent and renter&rsquos insurance.
b. Mortgage payments (principal, interest, taxes, and insurance) on all non- business RE owned (business mortgage payments are addressed separately as business fixed debt). If there is no mortgage payment, include RE taxes and insurance.
c. Payments on contracts to purchase (includes land sale contracts, contracts for deed, etc.) and any associated taxes and insurance.
d. Condominium, Homeowner, or other Association fees.
e. Manufactured home installment payment (principal, interest, taxes and insurance) lot or space rent.
f. Existing insurance premium, if not included in the mortgage payment (e.g., flood, earthquake, etc.).

2. Fixed debt payments include:

a. Any fixed debt with a balance equal to 10 or more monthly installments.

(1) You should not include payments with fewer than 10 monthly installments unless you confirm their continuance. For example, if a car loan pays out in less than 10 months, you can only retain the payment if the applicant confirms their intent to replace the vehicle.
(2) You should not include payments for non-existing debt unless you confirm the applicant&rsquos intent. For example, you should not include a replacement vehicle payment, even if the current vehicle is old, unless the applicant confirms they are buying one provides some detail on the year, make, and model and approximates the installment amount

b. Student Loans which may be in a deferred status. If you see there are student loans on the SBA application or credit bureau report that are in a deferred status and/or the payment is not disclosed or is unknown, use one 1percent of the original balance for the scheduled payment. Example: $15,000 original balance with no payment indicated, you will use $150 as the projected payment.

NOTE: Pay stubs may also be a source of debt information (e.g., payroll deducted loans, child support, garnishments, etc.)

c. Payments on business fixed debt are not components of MFD.
d. Credit card and other revolving charge accounts: If the application or CBR does not indicate a monthly payment, you must:

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(1) Contact the applicant and use the required minimum monthly payment on the current balance or
(2) Use the greater of 1 percent of the balance or $20 if you cannot make contact.
(3) If applicants state they pay credit card balances in full every month, you can exclude those payments from MFD provided:

(a) The amounts they say are paid in full each month are realistic given their overall financial condition and
(b) Your case file includes justification.

e. Extraordinary continuing expenses: In cases where the applicant advises that they cannot afford the loan being offered you should address this category and only include expenses/obligations if they are:

(1) Significant (unusually large in proportions to the applicant&rsquos income) and
(2) Continuing (for at least 10 months) and
(3) Mandatory (not discretionary and exclusive of items ordinarily treated as living expenses).
Examples include:

(a) Extraordinary medical expenses (e.g., dialysis, prescribed physical or rehabilitation therapy not covered by insurance)
(b) Extraordinary tuition expenses required by physical/mental disabilities
(c) Child/dependent care
(d) Alimony if disclosed on the FTR and
(e) Child support.

(4) After a discussion with the applicant you may determine that the following may or may not be considered extraordinary expenses:

(a) Ordinary medical expenses (including medical insurance) and
(b) Tuition for schools and colleges (basic educational expenses).

D. Effects of living expenses on FDM: Living expenses do not affect the calculation of repayment ability under the FDM. They are variable costs addressed by the portion of gross income remaining after subtracting the MAFD. The FDM assumes applicants will adjust their living expenses to meet unusual obligations.

E. Using the Fixed Debt Method to Determine Repayment Ability:

1. General Rule. Using the FDM, review the applicant&rsquos income and debts to establish a maximum debt level and target loan payment that leaves sufficient cash available to meet necessary living expenses and support repayment of additional debt. The remaining cash available will determine the applicant&rsquos ability to repay additional debt. If the standard FDM calculation results in positive CA of $50 or more and the loan can be amortized within the standard 15 or 30 year loan term, the result will be used to determine the loan terms. You set the maturity at either 15 or 30 years based on one third CA, provided it amortizes the loan within either 15 or 30 years using the standard deferment. Otherwise you write a 30 year term and set the payment up to 100 percent of CA.

a. If the standard FDM calculation results in positive CA of $50 or more, but will not amortize the loan within 30 years, you should consider additional options, such as raising the standard MAFD percentage (see subparagraph F below). The standard MAFD percentage is 40 percent but can be raised to 75 percent without further justification, unless the applicant indicates that they cannot afford the proposed loan payment when MAFD percentage has been increased from 41 percent to 75 percent.

b. If CA is negative after considering all additional options, the applicant is unlikely to be able to repay additional debt, and must be declined for lack of repayment ability.

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c. If the applicant requests a maturity of less than the 15 or 30 years which was calculated you may grant this request if:

(1) The payment does not exceed 100 percent of CA and the case file clearly indicates it was at the applicant's request.

d. If the calculations reflect that the loan maturity should be 15 years and the applicant requests a maturity greater than 15 years, you may set the maturity above the 15 years (not to exceed 30 years) only in cases of no credit elsewhere and

(1) Relatively low, fixed retirement, permanent disability, or similar income or

(2) Relatively low income (income is expected to remain low) where there is also a clear need to devote a large share of the income to living expenses (such as for a large number of dependents or to support known unusually heavy expenses) or

(3) Low income and low fixed debt with an anticipation that necessary fixed debt will materially increase. Your case file must justify setting the maturity greater than the 15 year calculation.

NOTE: On business and economic injury loans the individual&rsquos MAFD will be calculated at 40% MAFD. The results will be added to the business CA to establish total Cash Available to Service Additional Debt (CASAD). Generally, the calculated Total CASAD is used to establish a target loan payment that leaves sufficient cash available to support interest payment on unscheduled debts.

F. Determination of Repayment Ability When Exceeding the Standard MAFD Percentage: Some applicants may be able to carry debt in excess of the standard MAFD percentage indicated by the standard FDM calculation. You must make this determination on a case-by case basis.

1. Generally, we do not consider applicants with gross annual income below the minimum income level to be able to carry any additional monthly fixed debt.

2. Some applicants may be able to carry more than the recommended standard percent MAFD for their income level. You must make this determination on a case-by-case basis, and justify any recommendation in the Loan Officer&rsquos repayment analysis in the case file. When a recommended loan requires the applicant to carry more than 75 percent of MAFD it must be justified in the file prior to final signoff by ACDAP.

3. The applicant must have satisfactory credit history for any consideration of increased MAFD percent. Examples of justifications to exceed the 75% MAFD percentage based on the following:

a. High Income and Relatively Low Living Expenses: You must justify high income and low living expenses. You cannot use this justification unless both of these factors are present.

b. Future Income Prospects: This applies only to:

(1) Applicants whose earnings in their occupational field or industry are rapidly increasing (e.g., a doctor who at the time of the disaster was in the first few years of a medical practice) or

(2) Applicants with excellent prospects for substantial future income increases (e.g., a skilled tradesperson such as apprentice plumber who can reasonably expect to get a journeyman's license shortly).

c. Demonstrated Ability to Handle Debt: You can justify exceeding the standard MAFD percentage if the

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applicant has demonstrated the ability to devote a greater part of income to monthly fixed debts. You cannot exceed the historically demonstrated level using this justification. For example, assume an applicant demonstrated the ability to handle 54 percent MAFD. If the MAFD percentage after the SBA loan (with or without refinancing) exceeds 54 percent, you cannot use this justification.

d. Accumulation of Sizeable Net Worth: You can justify exceeding the standard MAFD percentage if the applicant has accumulated sizeable net worth and maintained a good credit history. For this purpose, "sizeable net worth" means tangible net worth equal to or greater than 1 year salary based on current and foreseeable annual income.

Editors Note: Today's post will be followed by many more regarding how we have balanced our budgets and survived the disaster without going into debt that may risk our family and our household to bankruptcy.

When you start your budget we need to first find out at what expense to income ratio we had before our disaster. You can use the "Living on Percentages Spreadsheet" that I've created for you and others.
It's free, no macro's and you are welcome to edit it and call it your own.

Protect yourself from the 40% or the great sounding loan that seem so easy to fit into your budget because you are using the SBA method of calculating your fixed debt which if you read it twice is only accounting for credit card, bank and the lending industry debt. Seriously, look at it, government loans, credit cards, credit accounts and car payments. Nothing about ObamaCare, care insurance, food, clothing, they feel these are not fixed debt.
I guess the SBA doesn't include Food because it's not something we require to repay a debt.
Then why would they include healthcare, they have secured your loan with your collateral.

So focus and follow the experience from others. We're not sharing fictional stories and we're not the new media looking for ratings. We are every day homeowners that want to make sure we remember who and what caused us to fail or survive after the disaster.

Resources:

- Living on Percentages spreadsheet v18.7.5
- SBA SOP 50 30 9
- Loan Calculator Website

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