Kentucky Housing Corporation

Investing in quality housing solutions.

Home Buyer Tax Credit

Program Manual

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Kentucky Housing Corporation
Mortgage Credit Certificate
Program Manual

ARTICLE I
INTRODUCTION TO THE 2018 MCC PROGRAM

Section 1. General Overview

Mortgage Credit Certificates (MCCs) are an alternative to mortgage revenue bond financing and a means of providing financial assistance to first-time home buyers (with some exceptions) for the purchase of qualifying residences. The 25 percentMCC Program (Program) is designed to benefit purchasers of certain new or existing housing units located in the Commonwealth of Kentucky (Commonwealth). Please note: KHC uses the term “Homebuyer Tax Credit” in our marketing of the MCC Program.

What is an MCC?

An MCC “converts” a portion of an available mortgage loan interest deduction into a credit against the homeowner’s federal income taxes. This tax credit has the effect of reducing the mortgage interest rate and mortgage loan payments for persons who make qualified purchases of residences by reducing their federal income tax liability. Table I-1 shows how an MCC can reduce the “effective” mortgage interest rate on a conventional mortgage.

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 or her total federal income tax liability. A “tax deduction,” on the other hand, is subtracted from adjusted gross income before federal income taxes are computed.

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

As Table I-1 indicates, a borrower who purchases an eligible residence with a 4.00 percent fixed-rate, 30-year mortgage of $100,000 would pay $4,000 in interest payments during the first year of the mortgage. The MCC tax credit is 25percent of mortgage interest paid in a calendar year for all counties. This reduces that borrower’s federal income tax liability, i.e., the credit reduces the amount of federal taxes payable by the borrower, up to the amount of the credit. The remaining 75 percent of the mortgage interest paid, in this case, $3,000, can still be taken as a tax deduction in arriving at the borrower’s adjusted gross income, thus reducing the amount of the borrower’s income subject to federal income taxation.

Table I-1 shows that if this borrower has an annual tax liability of $1,375 or more after all other deductions and credits, the effective rate of interest paid on the mortgage is reduced to 3.00 percent after the MCC tax credit is taken into account, i.e., annual interest of $3,000 on a $100,000 mortgage loan corresponds to a 3.00 percent interest rate on that loan. This effect is achieved only when the MCC holder has a sufficient income tax liability to receive the entire benefit from the MCC tax credit.

Table I-1: Effective reduction of mortgage interest rate through use of a 25percent MCC

Amount of Mortgage[1]	Rate on Conventional Loan	First-Year Interest Payments[1]	First-Year Tax Credit	After-Credit Interest Paid[2]	Effective Interest Rate[3]
$100,000	4.00%	$4,000	$1,000	$3,000	3.00%

[1] This figure is for the first year only. Assuming equal monthly payments amortizing principal and interest over 30 years, the amount of interest paid each year and, correspondingly, the MCC tax credit will decrease for each subsequent year.
[2] Derived by deducting the annual MCC tax credit from annual mortgage interest payments. This amount may be taken as a deduction for federal income tax purposes.
[3] Calculated for comparison purposes only and is not the annual percentage rate applicable to any specific mortgage loan for any specific period or for Truth-In-Lending Act purposes.

The MCC tax credit reduces the amount of federal income taxes otherwise due by the borrower. The benefit to the borrower cannot exceed the borrower's federal income tax liability for the year, after other credits and deductions have been taken into account. However, if the borrower is unable to use all of the available MCC tax credit in any year, the unused portion of the tax credit can be carried forward three tax years or until used, whichever comes first. A borrower may want to consider adjusting his or her federal income tax withholding (by filing an amended IRS Form W-4) to spread the benefit of the MCC tax credit over the entire year.

How does a borrower obtain an MCC?
A borrower who is purchasing a new or existing residence applies for an MCC through a participating lender at the same time as applying for a mortgage loan.

May an MCC be used in connection with a refinanced loan or with an assumption?

A MCC cannot presently be issued to a homeowner who is refinancing an existing mortgage loan, except in connection with certain construction loans. **A MCC may be assumable by certain qualified buyers. See Article IV.**

What are the purchase price and income limitations on MCC applicants?
MCCs are available to eligible homebuyers purchasing eligible homes in the Commonwealth. Kentucky Housing Corporation (KHC) will underwrite the loans made by the lenders going through KHC's Secondary Market program. If lender

is originating the first mortgage through another investor then all underwriting and execution of required state and federal certifications or affidavits will be performed by participating lenders in the program. Rather, KHC will only review executed certifications and affidavits from lenders in order to determine qualification and eligibility of each applicant for an MCC. Participating lenders will process the underlying mortgage loans using standard procedures, with adjustments to those procedures as needed in order to satisfy the Program requirements.

KHC may elect to not issue qualified private activity bonds throughout the year. Factors such as bonding authority, capacity and need will determine this.

It is impossible to determine the exact number of MCCs available under the Program. Since the aggregate amount of MCCs that may be issued under the Program is limited by federal law, no assurance can be given by KHC that sufficient MCC authority will be available at any time except by the endorsement and return of an MCC reservation by KHC.

How much must the authority reserve for MCCs and how is that targeted?
The MCC authority available shall equal, at any time, the amount of such authority committed to the Program by KHC, less the amount of such MCC authority previously committed to or used for MCCs.

Of the total MCC authority, 20 percent will be reserved by KHC for eligible residences located in targeted areas for at least one year after the date KHC begins to accept applications for MCCs under the Program. See Article IV, Section 7 herein.

Section 2. Purpose of this Program Manual
This Program Manual describes the MCC Program and sets forth the roles of KHC and the participating lenders and the requirements applicable to the lenders and the borrowers. This document also contains a description of the Program processing procedures and Program administration. Loan processing forms are contained in a separate packet of documents. KHC may revise the Program, the Program forms, and this Program Manual from time to time.

KHC encourages eligible borrowers to apply for an MCC after receiving an explanation of the Program from a participating lender. Participating lenders are expected to be well-informed about all the local, state, and federal regulations and eligibility criteria, as contained in this Program Manual, so that both applicants and sellers are aware of these restrictions before the application for an MCC is taken by the participating lender. The participating lender shall reject those applications where the submitted information indicates that the applicant or the residence does not qualify for the Program.

Section 3. General Definitions
As used in this Program Manual and all Program documents, unless the context requires otherwise, the following words and terms have the meanings set forth below:

- **Acquisition Cost**—Defined under Section 143(k)(3) of the Code.
- **Agreement**—The Mortgage Credit Certificate Program Lender Participation Agreement between KHC and each lender.
- **Applicant/Borrower**—Any person who applies for an MCC under the Program.
- **Certification**—A certification filed in connection with the Program made under oath and subject to penalties of perjury.
- **Closing Date**—The date on which the loan closing occurs, i.e., the deed is recorded or settlement date on Closing Disclosure.
- **Code**—The Internal Revenue Code of 1986, as amended, and applicable regulations promulgated thereunder.
- **Eligible Residence**—A new or existing residence which will be owner-occupied, must be located in the Commonwealth, and must meet the criteria set forth in Article IV of this Program Manual. No more than 15 percent of an otherwise eligible residence may be used for purposes other than as a principal residence.
- **Existing Residence**—A residence that has been previously occupied prior to loan commitment.
- **First-Time Home Buyer**—Any person who has not held an ownership interest in a principal residence at any time during the preceding three years ending on the closing date.
- **KHC**—Kentucky Housing Corporation, a *de jure* municipal corporation and political subdivision of the Commonwealth.
- **Lender/Participating Lender**—Any person, institution, or entity that provides financing for the acquisition of an eligible residence and that has entered into a Lender MCC Agreement with KHC.
- **Loan**—An extension of credit provided or to be provided to a borrower by the participating lender in connection with an MCC to finance the purchase of an eligible residence.

- **MCC Program/Program**—The Mortgage Credit Certificate Program, as authorized by KHC, and the administration procedures and forms specified in this Program Manual and Secondary Market Program Guide.

- **Mortgage Credit Certificate/MCC**—A certificate issued by KHC to establish eligibility for a tax credit against the federal income tax liability of a borrower purchasing an eligible residence. Each MCC is issued by KHC pursuant to Section 25 of the Code and applicable state and local requirements.

- **Mortgage Credit Certificates Rate**—The rate specified by KHC in each Mortgage Credit Certificate. The rate established by KHC for the Program is 25 percent (all counties) for loans to purchase an eligible residence.

- **Mortgage Revenue Bond**—A “qualified mortgage bond” as defined in Section 143(a) of the Code.

- **New residence**—A residence that is proposed to be constructed, is currently under construction, or is existing but not previously occupied.

- **Ownership**—Any of the following interests in an eligible residence: (a) a fee simple interest; (b) a joint tenancy, a tenancy in common, or a tenancy by the entirety; (c) the interest of a tenant-shareholder in a cooperative; (d) a life estate; (e) a land contract, i.e., a contract pursuant to which possession and the benefits and burdens of ownership are transferred, although legal title is not transferred until some later time; (f) an interest held in trust for the applicant (whether or not created by the applicant) that would constitute a present ownership interest if held directly by the applicant; or (g) a lease with an option to purchase for a nominal sum.

Ownership does not include: (a) a remainder interest; (b) a lease without an option to purchase or a lease with an option to purchase at fair market value; (c) a mere expectancy to inherit an interest in a principal residence; (d) the interest in a residence that an applicant acquires on the execution of a purchase contract; or (e) an interest in other than a principal residence during the three years prior to the origination of the loan.

- **Owner-Occupied**—An eligible residence occupied by a person with an ownership interest.

- **Program Manual**—This Mortgage Credit Certificate Program Manual, as revised by KHC from time to time.

- **Prohibited Mortgage loan**—A mortgage loan financed by any Veterans’ Mortgage Bonds or Mortgage Revenue Bonds.

- **Purchase Agreement**—The signed agreement between an applicant and the seller for the purchase of an eligible residence.

- **Purchase Price Limits**—Limits applicable to the Program. The acquisition cost of a residence may not exceed the applicable purchase price limits.

- **Related Person**—As such term is defined in the Code.

- **Residence**—A structure intended for occupancy by one family, regardless of the date of first occupancy. The term includes any manufactured home 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. The term does not include structures with more than one separate living unit, mobile homes, recreational vehicles, campers and trailers, unimproved land, investment or rental property, vacation homes, or residences primarily intended to be used in trade or business.

- **Targeted Area**—Any of the areas within the Commonwealth listed in Appendix B. Such areas are not subject to the three-year, first-time, home buyer restriction. (See Section IV).

- **Veterans' Mortgage Bond**—As defined in Section 143 of the Code.

ARTICLE II
REPRESENTATIONS AND WARRANTIES OF THE PARTICIPATING LENDER

Section 1. Representations, Warranties, and Covenants of the Lender

(a) The lender is duly organized, validly existing, and in good standing under the laws of the jurisdiction under which it was organized and has the power and authority, corporate and other, to own its properties and to carry on its business as now being conducted, and is duly qualified to do such business, including the origination of loans, in the Commonwealth and wherever such qualification is required, and has at least one office which is responsible for originating loans in the Commonwealth;

(b) The lender has complied and will comply with all the terms, conditions and requirements of this Program Manual, and the loans meet and will meet all of the requirements set forth in this Program Manual, unless any such shall have been waived by KHC in writing;

(c) In connection with the issuance of an MCC, the lender has not collected and will not collect from the borrower or any other person, directly or indirectly, any points, origination fees, charges, or other amounts except as permitted herein;

(d) The lender has made and will make such investigation as is necessary to verify the facts stated by each borrower in the Mortgagor Certification of Eligibility (MCC-001) and the Closing Certification (MCC-007); and

(e) The agreement is a valid and binding agreement of the lender, enforceable according to its terms, the making and performance of which had been duly authorized by all necessary corporate and other action and will not constitute a violation of any law, any requirement imposed by any judicial, arbitral body or governmental instrumentality, or the charter or bylaws of the lender, or a default under any agreement or instrument by which it is bound or affected.

If any of the warranties contained above are in fact untrue in any respect with respect to any loan, then KHC may, at its option, terminate the participation of such lender in the Program and pursue such other remedies as are appropriate.

Section 2. Survival of Representations and Warranties
It is understood and agreed that the lender's representations, warranties, and covenants shall survive the origination of loans by the lender under the Program. Upon discovery by the lender of the breach of any of such representations, warranties, and covenants which materially and adversely affects the value of any MCC, the lender shall give prompt written notice to KHC and take such other action as may be required hereunder.

ARTICLE III
PROGRAM ADMINISTRATION AND PROCEDURES

In general, the Program procedures are designed to coincide with the standard loan processing and underwriting procedures that are in place at most mortgage-lending institutions. Borrowers apply for an MCC by the participating lender completing the MCC Loan Reservation System in conjunction with an application for a loan from one of the participating lenders. There are of course procedural variations among the participating lenders, thus the procedures outlined here are meant to serve as guidelines with respect to the sequence of events. However, all elements of the processing sequence outlined in this Program Manual must at some point be completed, regardless of sequence.

Section 1. Loan Origination and MCC Application—Generally
(a) The borrower applies for a loan from a participating lender.

(b) The lender has the borrower complete the Mortgagor Certification of Eligibility (MCC-001). The lender verifies the information in such certification to the effect that:

(i) The residence will be used as the borrower's principal residence;

(ii) Either the borrower is a first-time home buyer during the preceding three-year period ending on the closing date or the eligible residence is located in a targeted area;

(iii) The residence is an existing residence or a new residence and the acquisition cost does not exceed the purchase price limits; and

(iv) Gross annual household income is within the Program limits.

(c) The lender has the seller complete the Seller Certification (MCC-002).

(d) The lender will rely on the credit report and initial 1003 to verify the borrower has not had an ownership interest in a primary residence in the last three years in a non-targeted county. The Lender may request the borrower to supply his or her federal income tax returns or IRS tax transcripts for the previous three years signed by the borrower(s) to validate the first-time homebuyer requirement.

(e) At loan closing, the lender collects from the borrower the MCC fee set forth in Article III, Section 7(d) below.

(f) The processing time by KHC for an MCC application is approximately two - three business days. Applications are processed by KHC staff according to the date of receipt. Therefore, if a purchase agreement is contingent upon MCC approval, sufficient time should be allowed in the purchase agreement for processing the MCC application. All lenders will be notified by KHC (by e-mail) through KHC's Loan Reservation System of approved or pended applications.

Section 2. MCC Application and Reservation

(a) The lender will make the MCC reservation through KHC's Loan Reservation System on the KHC Lender Website. The lender will utilize its User ID, Broker ID and Password to submit the reservation. Once the reservation is complete, the lender will print out the following documents from the Web:

(i) Mortgagor Certification of Eligibility (MCC-001)

(ii) Seller Certification (MCC-002)

(iii) KHC Reservation Confirmation

(b) Transmittal Form The lender processes the loan application and electronically submits the MCC compliance package to KHC prior to closing utilizing the Transmittal form and attaching the required documents. If the First mortgage is through KHC Secondary market Program, then both the credit and compliance package for the first mortgage and MCC must be submitted simultaneously.

(c) KHC will review the file within two-three business days and provide a response by e-mail to the participating lender. The loan will be approved, pended for additional information or rejected. The lender can print a copy of the response from KHC through the Loan Reservation System.

(d) If the file has not been completed properly or is incomplete, KHC will request the additional information. Once the additional information is received, KHC will complete the review and issue the approval or rejection. Such approval by KHC will be in the form of a Commitment Letter.

Section 3. Lender Underwriting and Verification

(a) The lender performs standard mortgage loan underwriting and verification procedures when first mortgage is through another investor other than KHC. If first mortgage through KHC's Secondary Market Program then KHC will perform the standard mortgage loan underwriting and verification procedures.

(b) Most underwriting programs will permit the lender to take into consideration the effect of the MCC when determining the total amount of household income available for the monthly housing payment in order to determine borrower qualification. The lender determines acceptability of the loan in accordance with applicable Fannie Mae, FHLMC, FHA, VA, RD, and private mortgage insurance standards and underwriting guidelines.

(c) In conjunction with the lender's regular verification process, the lender is required to perform a reasonable investigation to determine that all Program requirements have been satisfied. The lender may verify Program requirements in any reasonable, efficient manner, as dictated by standard industry practices for processing mortgage loan applications and by this Program Manual.

(d) The lender verifies that the borrower and the loan transaction comply with the Program requirements or exemptions for gross annual household income, acquisition cost, first-time home buyer, location of eligible residence, and other Program requirements.

(e) Other than the MCC Fee set forth in Article III, Section 1(e) above, the lender may charge only those points, origination fees, servicing fees, and other fees in amounts that are customarily charged with respect to loans not provided in connection with MCCs.

(f) See Article IV for specific Program requirements.

Section 4. Changes Prior to the Closing Date

(a) Changes in the applicant's gross annual household income or marital status after issuance of the MCC reservation.

(i) *Changes in Current gross annual household income*. The eligibility of the applicant for an MCC is based upon the applicant's current gross annual household income and the current gross annual household income of any other person (other than persons under 18 years of age) intending to permanently reside in the residence being financed, as verified by the lender within 120 days before the closing date. Changes in the applicant's gross annual household income occurring after the date of the MCC reservation and prior to the closing date, which were foreseen at the time of issuance of the MCC reservation, will require re-certification of the applicant's gross annual household income for purposes of determining the applicant's eligibility.

(ii) *Changes in Marital Status*. If the applicant experiences a change in marital status after issuance of the MCC Reservation and prior to the closing date, the new spouse must satisfy the requirements contained in the Mortgagor Certification of Eligibility, including, if applicable, the first-time home buyer requirement. In addition, gross annual household income must be re-verified for purposes of determining Program eligibility. Any gross annual household income attributable to a new spouse must be verified and added to the gross annual household income previously declared by the applicant. This new gross annual household income must be within KHC's Program limits.

(b) Changes in gross annual household income or marital status occurring after the closing date do not affect Program eligibility. Such changes, however, may affect calculation of the recapture tax if the residence is disposed of within nine years after the closing date. See Article V for a discussion of the recapture tax.

(c) Changes in first-time home buyer status, acquisition cost, and amount of mortgage loan after issuance of the MCC reservation.

(i) If the applicant(s) acquire(s) a present ownership interest in their principal residence prior to the closing date, the MCC reservation shall be revoked (unless such MCC reservation is for a residence located in a Targeted Area).

(ii) If the total acquisition cost of the residence purchased in connection with the MCC increases so that it exceeds the acquisition cost limitations set forth herein, the MCC reservation shall be revoked.

(iii) If the amount of the loan increases, thereby causing an increase in the MCC amount, the MCC reservation may be revoked at the discretion of the Managing Director of Single-Family.

(d) Other changes in circumstances after issuance of the MCC reservation.

(i) KHC must be notified of any changes in loan amount that occur after issuance of the MCC reservation and prior to the closing date. An increase in loan amount may negate the MCC reservation if sufficient MCC authority is not available, and such reservation may be revoked at the discretion of KHC.

(ii) An MCC reservation is issued in reliance upon information and representations in the Mortgagor Certification of Eligibility that the requirements necessary for issuance of an MCC have been met. The lender must immediately notify KHC, in writing, of any change in circumstances upon which the MCC reservation was issued. If, as a result of such change in circumstances the Program requirements are no longer satisfied, the MCC reservation will be revoked.

Section 5. Extension and Cancellation of the MCC Reservation

(a) The MCC reservation is valid for 45 calendar days, beginning on the date the MCC is reserved in KHC's Loan Reservation System. If the loan will not close prior to expiration of this 45-day period, an extension may be requested.

(b) If the lender must cancel the reservation, this can be done through KHC's Loan Reservation System.

Section 6. Determination of Program Eligibility Prior to the closing date

KHC will determine whether a particular borrower meets the Program requirements prior to the closing date when the lender submits the following documents to KHC, accompanied with a Transmittal Form (MCC-004):

(a) A Credit Report or if requested, federal income tax returns or IRS tax transcripts for the three years prior to the closing date (or other permitted proof of status as a first-time home buyer, see Article IV, Section 2);

(b) Verification of income; and

(c) Copy of the purchase agreement.

KHC will review these documents and notify the lender that the borrower meets the eligibility requirements of the MCC Program and is eligible to receive the MCC following the closing date, provided that all other required documents, as listed in Section 7 below, are completed and submitted to KHC following the closing date. Such notification from KHC to the lender will be in the form of a Commitment Letter (MCC-005).

Section 7. Loan Closing

(a) The lender confirms that the MCC reservation is still active and has not expired or been revoked.

(b) The lender or KHC approves the loan for the borrower pursuant to the lender's or KHC's regular loan/underwriting procedures.

(c) The lender informs the borrower of the opportunity to amend his or her IRS Form W-4, Employee's Withholding Allowance, to adjust federal income tax withholding in an amount comparable to the expected tax credit.

(d) The lender collects from the borrower the MCC fee as follows:

(i) If the loan is a KHC Secondary Market Program available through KHC, the fee is $200 and is payable to KHC.

(ii) If the loan is other than a KHC Secondary Market Program, the fee is $500 and is payable to KHC.

(iii) Delegated Lenders may charge a $225 MCC Review Fee.

(e) The lender prepares and/or assembles the following list of documents and other information. The lender reviews the executed Program documents and electronically uploads the following executed MCC documents and other required information to KHC, accompanied by the Transmittal Form (MCC-004):

(i) Seller Certification (MCC-002);

(ii) Closing Certification (MCC-007);

(iii) Notice to Mortgagor of Maximum Recapture Tax (MCC-008) signed by the borrower;

(iv) Copy of the Closing Disclosure;

(v) Copy of the final Uniform Residential loan Application;

(vi) Copy of signed loan note; and

(vii) Copy of lender's approval.

(f) The following documents should also be electronically submitted to KHC, unless previously submitted as provided under Section 6 above:

(i) Proof of status as first-time homebuyer for non-targeted counties;

(ii) Verification of employment (VOE);

(iii) Copy of the purchase agreement for the residence; and

(iv) The MCC fee set forth in Section 7(d)(ii) above.

(g) KHC will review the above-listed MCC forms and documents and, if all

Program requirements have been satisfied, issue the MCC in the form of MCC-009 to the borrower.

(h) The cumulative total of all MCCs issued will be maintained in the records of KHC.

Section 8. MCC Revocation After the Closing Date

The IRS has various remedies available for noncompliance with the Program, including disallowance of the tax credit. Pursuant to the Program, automatic revocation of an MCC occurs whenever:

(a) The residence for which the MCC was issued ceases to be the borrower's principal residence;

(b) Except as otherwise described herein, the loan is refinanced;

(c) KHC or a participating lender discovers any material misstatement, whether negligent or fraudulent, made by the borrower in any loan or MCC document; or

(d) The loan is paid in full.

Section 9. Recordkeeping and Federal Report Filing

(a) KHC is required to annually file (on or before January 31 of each year) a report with the IRS using IRS Form 8329 with respect to loans made in conjunction with the issuance of MCCs during the prior calendar year. A copy of Form 8329 is attached hereto as Appendix E.

(b) For a period of six years following the closing date, the lender must retain the following information with respect to each MCC:

  (i) Name, mailing address, and Social Security Number or Tax Identification Number (SSN/TIN) of the MCC holder;

  (ii) Name, mailing address, and TIN of KHC; and

  (iii) Closing date, the certified indebtedness amount (the loan amount), and the certificate credit rate for each loan and the respective MCC.

(c) KHC shall make quarterly reports on IRS Form 8330, beginning with the quarter in which the election is made. The report shall include:

  (i) Name, address, and TIN of KHC;

  (ii) Date of MCC election for the Program and the non-issued bond amount of the Program;

  (iii) The sum of the products of (A) the Certified Indebtedness Amount and

(B) the Certificate Credit Rate for each respective MCC issued; and

(iv) Name, address, and SSN of each MCC holder whenever an MCC was revoked.

(d) KHC also shall file any other reports as required by law.

Section 10. Audit Authority
KHC retains the express authority to perform periodic random audits of the participating lenders' records with respect to MCCs and the corresponding loans.

ARTICLE IV
BORROWER, ACQUISITION COST, ELIGIBLE RESIDENCE, AND LOAN REQUIREMENTS

Section 1. Overview
For loans involving MCCs, the conventional underwriting standards can often be modified at the option of the lender to recognize the tax credit available to an MCC holder in determining housing expense and indebtedness ratios.

The secondary mortgage market and the mortgage insurance industry have generally established underwriting requirements for MCC-related loans. These are available as policy statements from the mortgage-lending industry.

The Program requirements discussed in this Article IV are incorporated in the Program forms contained in the loan documents packet. With respect to each MCC requested, the lender will be required to certify that, to the best of its knowledge, no material misstatements appear in the MCC application or other Program documents. If the lender becomes aware of misstatements, whether negligently or willfully made, it must notify KHC immediately.

The Program imposes no restrictions on the type of financing arrangement the lender uses to make a loan. The Program allows the use of any Conventional, FHA, VA, RD, or other mortgage instrument generally being used in the marketplace. The loan must bear interest at a fixed rate over the life of the loan, and the loan must have a term of 30 years.

LENDERS SHOULD NOTE THAT MORTGAGE LOANS FINANCED UNDER TAX-EXEMPT BOND PROGRAMS (E.G., VETERANS' MORTGAGE BONDS OR MORTGAGE REVENUE BONDS) ARE NOT ELIGIBLE UNDER THIS PROGRAM.

Section 2. Borrower Eligibility Requirements
Similar to any conventional mortgage loan program, the borrower must meet the credit and underwriting criteria established by the lender. To qualify for an MCC, a borrower must also meet the following requirements, which are based on the applicable federal and state regulations with respect to MCCs:

(a) ***The borrower must be a first-time home buyer***. The borrower cannot have held an ownership interest in their principal residence at any time during the preceding three years ending on the closing date. This requirement does not apply to the acquisition of eligible residences in Targeted Areas. The foregoing requirement ensures that the borrower qualifies as a first-time home buyer under the federal regulations.

The lender must obtain from the borrower a certification certifying that the borrower meets this requirement. The certification must be verified by the lender's examination of the borrower's credit report, and if requested, federal income tax returns for the preceding three years, or other evidence if income tax returns were not filed, to determine whether the borrower has claimed a deduction for mortgage interest or taxes on real property claimed as a principal residence.

(b) ***Exceptions to the first-time home buyer requirement***. The first-time home buyer requirement does not apply if the eligible residence is located in a designated Targeted Area. (MCC applications relating to residences located within Targeted Areas must be clearly identified as such in the MCC documents).

(c) ***Demonstrating compliance with the first-time home buyer requirement***. To demonstrate compliance with the first-time home buyer requirement, applicants must complete and sign the Mortgagor Certification of Eligibility (MCC-001), the Closing Certification (MCC-007), and provide copies of credit report and initial1003. Three years of federal tax returns may be requested to validate the first-time homebuyer requirement.

(d) ***The applicant must occupy the eligible residence as a principal residence***. The applicant must occupy the eligible residence being purchased as a principal residence. Pursuant to the Program certifications, the borrower must state their intent to use the eligible residence as their principal residence within a reasonable time after the MCC is issued (but in no event later than 60 days after the MCC is issued or, if later, the first date the eligible residence is available for occupancy, as evidenced by the date of any applicable certificate of occupancy). The certification will further provide that the borrower notify the lender and KHC if the eligible residence ceases to be their principal residence. No portion of the residence may be used for purposes other than as the principal residence of the borrower.

(e) ***Gross annual household income must satisfy Program limitations***. To qualify for the Program, the gross annual household income of the borrower(s) and all other persons intending to permanently reside in the residence (other than persons under 18 years of age) may not exceed the MRB/MCC Program income limits determined from time to time by KHC.

(f) ***Revocation of MCC***. The MCC will be automatically revoked if the applicant fails to comply with the Program requirements. An MCC may be revoked under the circumstances described herein. (See Section 4 of Article III and Section 8 of Article III for causes for revocation.)

(g) ***Fraudulent acts***. 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 or intentional material misstatement or misrepresentation in any certification made in connection with the application for or the issuance of an MCC shall be subject to all applicable state and federal fines and penalties.

Section 3. Acquisition Cost Requirement
In order to qualify for an MCC, the acquisition cost of an eligible residence may not exceed the applicable purchase price limits of the MRB/MCC Program.

Section 4. Loan Requirements

(a) ***New Mortgage loan***. Except as provided in Section 4(b) below, an MCC cannot be issued in conjunction with the acquisition or refinancing of an existing mortgage loan (except with respect to an approved transfer as discussed in Section 6 below). Pursuant to the Program certifications, the borrower will represent that the foregoing limitation is met with respect to the loan. Refinancing of construction loans, bridge loans or other “temporary” financing (financing with an original term of 24 months or less) does not violate this restriction.

(b) ***Loan Refinancing***. The acquisition and replacement limitations of Section 4(a) above do not apply to the refinancing of any loan as to which an MCC has previously been issued, and the MCC may, at the option of KHC, be reissued, provided all of the following are met:

(i) The holder of the existing MCC applies for and obtains a new loan and a reissued MCC pursuant to all of the requirements of the Program, as such Program requirements exist at the time of the refinancing (including the payment of any fees);

(ii) The new loan refinances the existing loan on the eligible residence with respect to which the existing loan was made;

(iii) The certified mortgage indebtedness specified on the reissued MCC does not exceed the then outstanding balance of the certified mortgage indebtedness of the existing MCC;

(iv) The Credit Certificate Rate on the reissued MCC does not exceed that on the existing MCC;

(v) The expiration date of the reissued MCC does not exceed that of the existing MCC; and

(vi) The MCC is reissued not later than the date which is one year after the closing date with respect to the new loan.

(c) **Additional Limitations**

(i) An MCC is applicable only to interest paid on the loan. No tax credit is available for interest paid by the MCC holder on any other loan, regardless of whether such loan is secured by a principal residence.

(ii) An MCC cannot be issued or used, directly or indirectly, in connection with a prohibited mortgage loan. Pursuant to the Program certifications, the borrower will represent that no portion of the financing for the residence in connection with which the MCC is issued is provided from a prohibited mortgage loan.

(d) ***No Interest Paid to Related Persons***. No interest on the loan or the certified indebtedness amount may be paid to a person who is a related person. Pursuant to the Program certifications, the borrower will represent that no related person has, or is expected to have, an interest as a creditor in the loan or the certified indebtedness amount.

Section 5. Eligible Residence Requirements

(a) Types of residences eligible for MCCs:

(i) Single family residences, including manufactured housing (A) with a minimum of 400 square feet of living space, (B) with a width of over 102 inches, and (C) of a kind customarily used at a fixed location; and

(ii) Condominiums.

(b) ***Occupancy Requirements***. The residence must be occupied by the applicant as principal residence within 60 days following the date of the mortgage loan.

(c) ***Commercial Usage***. No portion of the residence may be used for purposes other than as the principal residence of the borrower.

Section 6. Assumption of Loan and Transfer of Mortgage Credit Certificates.

(a) An MCC is transferable only as follows:

(i) KHC gives written approval of the transfer;

(ii) The transferee assumes liability for the remaining balance of the certified indebtedness amount in connection with the acquisition of the eligible residence from the transferor;

(iii) A $150 transfer fee is remitted to KHC;

(iv) KHC issues a new MCC to the transferee; and

(v) The following requirements are met:

- The first-time home buyer requirement (or any permitted exception thereto);
- Gross annual household income requirement;
- The Principal residence requirement;
- The limitation regarding Prohibited Mortgage loans; and
- Acquisition Cost requirement.

(b) The requirements of Section 6(a)(v) above refer to Program requirements as they exist at the time of the MCC transfer, as if the MCC was then being issued for the first time. For example, the acquisition cost requirement is to be determined by reference to the KHC MCC Program purchase price limits in effect at the time of the loan assumption and not when the MCC was originally issued. Additionally, the transferee will be subject to the recapture tax if the eligible residence is sold within nine years of the date the new MCC is issued. (See Article V herein.)

Section 7. Targeted Area Set-Aside
KHC will set aside 20 percent of the Program allocation of MCC authority for eligible residences located in a Targeted Area. This amount will be set aside for one year from the date KHC first accepts applications for MCCs under the Program.

ARTICLE V
RECAPTURE TAX

Section 1. General
The recapture tax provisions of the Code apply to all MCC holders. If the MCC holder sells or otherwise disposes of the eligible residence at any time within nine years after the closing date or the date of the MCC, whichever is later, all or part of the tax benefit may be subject to “recapture.” Recapture is accomplished by an increase in the MCC holder’s federal income tax liability for the year in which the eligible residence is sold or transferred, provided a gain is realized and the MCC holder’s income has increased above specified levels. The tax liability is based on income, family size, and net gain realized on the sale of the residence. Generally, all of the following events must occur to trigger the recapture tax:

(a) The residence is sold within the first nine years of the closing date or the MCC issuance date (whichever is later); and

(b) The MCC holder realizes a gain on the sale of the residence (as defined by the IRS); and

(c) The MCC holder’s income has increased since the closing date and exceeds the limits established by the IRS.

Section 2. Payment

The recapture tax is payable in the year the borrower sells or transfers his or her eligible residence.

Section 3. Exceptions and Amount of Tax

(a) No recapture tax is payable if:

(i) The residence is disposed of at a loss;

(ii) The residence is disposed of as a result of the MCC holder's death;

(iii) The residence is disposed of later than nine years after the closing date or the date of the MCC, whichever is later;

(iv) The residence is transferred either to the MCC holder's spouse or former spouse incident to divorce and the MCC holder has no gain or loss pursuant to Section 1041 of the Code;

(v) The residence is destroyed by a casualty, and the MCC holder repairs it or replaces it on its original site within two years after the end of the tax year when the destruction happened; or

(vi) The MCC holder's "Modified Adjusted Gross Income" is less than his or her "Adjusted Qualifying Income" in the taxable year in which the residence is sold.

(b) **Amount of Recapture Tax**. The actual recapture tax is the lesser of:

(i) 50 percent of the gain on the sale of the eligible residence, regardless of whether that gain must be included in the MCC holder's income for federal income tax purposes; or

(ii) The calculated recapture amount. See Form MCC-008.

Section 4. Recapture Notice Procedures

(a) The Mortgagor Certification of Eligibility (MCC-001) must be signed by the applicant and accompany the initial MCC documents delivered by the lender to KHC before a Commitment Letter (MCC-005) will be issued. See Article III, Section 2.

(b) The final Notice to Mortgagor of Maximum Recapture Tax (MCC-008) must be signed by the borrower and accompany the MCC closing documents delivered to KHC before an MCC will be issued. See Article III, Section 7.

APPENDIX A

KENTUCKY HOUSING CORPORATION
MORTGAGE CREDIT CERTIFICATE PROGRAM

FORM AND DOCUMENT LISTING

The following is a list and summary description of the MCC Program documents and forms referred to in this Program Manual.

Program Document	Description
	Program Manual. This Program Manual, as revised by KHC from time to time.
	Mortgage Credit Certificate Program Lender Participation Agreement. Agreement between KHC and lenders wishing to participate in the MCC Program. Attached to the Program Manual as Appendix D.
MCC-001	***Mortgagor Certification of Eligibility***. The applicant makes the certifications required to determine eligibility for the Program, including the new mortgage, first-time home buyer (or exceptions thereto), Acquisition Cost and gross annual household income certifications.
MCC-002	***Seller Certification***. The seller of the eligible residence makes certifications as to the purchase/sale price of the residence.
MCC-003 MCC-004	***Reservation Confirmation.*** The lender is notified that the MCC application has been reserved.
MCC-005	***Transmittal Form***. Sent by the lender to KHC with application (or closing documents, as necessary) to verify that all appropriate forms and information have been included.
	Commitment Letter. Issued by KHC upon receipt of all necessary documents. The MCC Commitment Letter states KHC's intent to issue an MCC after the closing date, provided the information and certifications provided in the "closing" documents substantiate Program compliance. The MCC Reservation Confirmation must be issued prior to the closing date.

MCC-006	Closing Checklist.
MCC-007	***Closing Certification***. Used to evidence Program compliance. Certifications as to the validity of information in the Mortgagor Certification of Eligibility.
MCC-008	***Notice to Mortgagor of Maximum Recapture Tax***. Required by law to be given to the applicant. The Notice advises the borrower that a recapture tax may apply in connection with the sale or other disposition of an eligible residence for which an MCC was issued and explains the calculation of the recapture tax, if any, which may apply on such sale or other disposition.
MCC-009	***Mortgage Credit Certificate***. Issued by KHC after the closing date. This certificate must be validly issued and not be revoked for the borrower to claim the related tax credit.
MCC-010	***Reissuance Certificate.*** Issued by KHC in connection with the reissuance of an MCC.
MCC-011	Assumption Packet. $150.00

APPENDIX B

KENTUCKY HOUSING CORPORATION
MORTGAGE CREDIT CERTIFICATE PROGRAM

CONTACT INFORMATION

Kentucky Housing Corporation
1231 Louisville Road
Frankfort, KY 40601

Attention: Jaime Rice
Managing Director Single-Family Programs

Telephone: (502) 564-7630, extension 315