

CITY OF MENLO PARK



PURCHASE ASSISTANCE LOAN (PAL)

A FIRST-TIME HOMEBUYER

SECOND MORTGAGE LOAN PROGRAM

GUIDELINES AND APPLICATION

2009

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I. PROGRAM DESCRIPTION

A). Introduction

The City of Menlo Park is pleased to offer the ***Purchase Assistance Loan (PAL) Program*** to help low and moderate-income homebuyers purchase their own homes in Menlo Park. The PAL Program provides low and moderate-income first-time homebuyers who currently live or work in Menlo Park with affordable second/junior mortgage loans. The PAL second mortgage can finance up to 20% of a home's purchase price, or \$75,000, whichever amount is less. The home may be located anywhere within incorporated city of Menlo Park.

The City recognizes the serious financial obstacles that low and moderate-income households face when trying to purchase homes in Menlo Park. The high cost of housing in the city is prohibitive and many households who live and/or work in Menlo Park are unable to buy homes in Menlo Park. For these households, buying their own homes requires that they purchase outside (and sometimes far outside) the city. The result is that persons who currently live in Menlo Park, or grew up in Menlo Park, must leave the community they call home and in which they may be actively involved. It also means that persons who currently work in Menlo Park but purchase homes elsewhere may have to choose between commuting and finding new jobs that are closer to home. The loss of both residents and employees due to high housing costs is a loss and a challenge not only to our neighborhoods and businesses but also to the community at large.

To help first-time homebuyers purchase homes in Menlo Park, the PAL second mortgage is provided/financed by the City of Menlo Park. PAL is combined at the time of home purchase with a first (primary) mortgage loan. Typically the first mortgage is provided by a conventional mortgage lender such as a bank or credit union, or a mortgage broker. The homebuyer may also make a payment in cash towards the down payment if available or required by the first mortgage lender. PAL may be used in combination with affordable home loan financing provided by the Federal Housing Administration (FHA), the California Housing Finance Agency (CalHFA), the Veteran's Administration (V.A.), and California's CalVet for veterans. PAL may also be used with San Mateo County's Mortgage Credit Certificate (MCC) Program.

The PAL Program lends qualified first-time homebuyers up to 20% of a home's purchase price or \$75,000 (whichever amount is less) to purchase homes located within incorporated city of Menlo Park. The PAL loan is deferred for the first 5 years of the loan (no payments at 0% interest), followed by 30 years of monthly payments (amortized at 5% fixed interest). The total PAL loan term is 35 years (5 years deferred + 30 years amortized).

A substantial benefit of PAL is that in some cases the first mortgage lender will apply the amount of the PAL loan to help meet the down payment requirement. The down

payment requirement is expressed as a percentage of the purchase price and is determined by the first mortgage lender, according to the terms of the first mortgage. The buyer must be able to meet the first mortgage lender's down payment requirement so this can be an important benefit to using PAL.

When PAL is applied to the down payment requirement it may also help the homebuyer avoid the requirement to purchase Private Mortgage Insurance (PMI). Typically, first mortgage lenders require borrowers to purchase PMI whenever the borrower's down payment is less than 20% of the purchase price. PMI is a charge that is paid *in addition* to the monthly principal and interest mortgage payment. By not having to pay PMI, the borrower can save on monthly payments for the first mortgage loan.

The chart below is an example of how PAL can help moderate-income households afford homes in Menlo Park. This example is for a household size of three persons with a gross (pre-tax) annual household income of \$102,600. The gross monthly household income is \$8,550. The maximum monthly mortgage payment allowed by many mortgage lenders is approximately 33% of gross monthly income. Using the 33% standard, the household in this example can afford a monthly mortgage payment of \$2,822.

In the following table, **Column A** shows the amount that the example household can afford to purchase without using PAL. The buyer provides a 5% down payment. However, a 5% down payment is not enough to avoid the requirement to purchase PMI. *The first mortgage in Column A is calculated as a standard, 30-year mortgage at an interest rate of 7%.*

Column B in the table below shows the amount that the example household can afford to purchase if they do use a PAL second mortgage. As before, the buyer provides a 5% down payment (which is a somewhat larger sum in this example because the purchase price is higher). However, the PAL second mortgage allows the buyer to meet the 20% down payment necessary to avoid PMI. The savings created by not having to pay PMI is calculated in this example as a 1% lower interest rate on the first mortgage. *Therefore, the first mortgage in Column B is calculated as a 30-year mortgage at an interest rate of 6%.*

Example of how PAL works:

	Column A: Without PAL	Column B: With PAL
First Mortgage	424,168	470,686
5% Down Payment, Cash	22,325	28,720
PAL Second Mortgage	0	75,000
Home Purchase Price =	\$446,493	\$574,406

The City of Menlo Park administers the application process. Once a PAL loan is funded the City of Menlo Park also services the loan. Servicing includes the processing of monthly PAL payments, etc.

B). Homebuyer/Borrower Eligibility Requirements

A borrower is eligible to receive a PAL loan if he or she meets the requirements described below. In order to determine eligibility for the PAL Program, the borrower must complete and submit a PAL application to the City of Menlo Park Housing and Redevelopment Division. If needed, program, staff is available to assist the borrower in completing the application.

To be eligible for PAL, the borrower must meet all of the following requirements:

1. First-Time Homebuyer Status

The borrower (and any co-borrower) may not currently own a home and must be a first-time homebuyer. A “first-time homebuyer” is defined as an individual who has not had any ownership interest such as: fee simple, joint tenancy, tenancy in common, life estate, shareholder in a cooperative, or interest held in trust for the individual that would constitute an ownership interest if held by the individual, in their primary residence, in the past three (3) years as of the date of PAL application submission.

2. Low to Moderate Household Income

The borrower’s gross annual household income may not exceed 120% of the San Mateo County median income adjusted for household size. Current income limits are shown in Section III (page 17).

Household income is defined as that income determined by the first mortgage lender to be stable household income used to qualify the borrower for the first mortgage loan. If an individual is a member of the household, then that member’s income must be included in the determination of household income, unless the individual is a full-time student or under the age of 18.

Household is defined as a single person, or two or more persons sharing residency whose income resources are available to meet the household’s needs and who are related by blood, marriage or operation of law, or who give evidence of a stable relationship which has existed over a period of at least one (1) year.

3. Asset Limit

Borrower households with assets valued **up to** 50% of the purchase price of the home are considered eligible. This means that households with assets valued greater than 50% of the home purchase price are not eligible for the PAL Program.

Examples of assets include stock, bonds, inheritance, trust funds, boats, jewelry, or real property. For the purposes of this program, assets do not include funds dedicated to federally recognized retirement programs, such as the I.R.A. and 401(k) programs. Assets dedicated to federally recognized retirement programs are not counted toward the 50% of purchase price maximum asset limit.

4. Live and/or Work in Menlo Park

A minimum of 50% of the ownership interest in the property must be vested in a borrower who:

- Currently lives in incorporated city of Menlo Park and has lived in Menlo Park consistently for at least one (1) year prior to the date of PAL application submission. This must be the borrower's primary residence.

OR

- Currently works in incorporated city of Menlo Park and has worked in Menlo Park consistently for at least one (1) year prior to the date of PAL application submission.

Qualified work is defined as any of the following: (1) owning and operating a business in Menlo Park; (2) employment for wages or salary for an employer located at a Menlo Park location; (3) contract employment where the actual work is conducted at a Menlo Park location; or (4) commission work, up to and including a 100% commission arrangement, conducted in Menlo Park.

Work must average a minimum of 20 hours per week over the course of the qualifying one-year period. Unpaid volunteer work does not qualify.

5. Qualify for a First Mortgage

To finance the total purchase price of the home, the borrower must be able to qualify for a first mortgage loan secured by a deed of trust. The first mortgage provides primary loan financing for purchase of the home. The City of Menlo Park does not finance the first mortgage. The City of Menlo Park will finance the PAL loan only. PAL is a second/junior mortgage and is used in addition to the first mortgage to finance the price of the home.

The PAL loan provides up to 20% of a home's purchase price, or \$75,000, whichever amount is less. The remainder of the home's purchase price is financed through a first mortgage or a combination of a first mortgage and a payment in cash (down payment) from the borrower.

Although the PAL Program does not require the borrower to make a down payment, in many cases it may be necessary or desirable for the borrower to make a down payment in order to reduce the amount of first mortgage financing that is needed. The need for the borrower to make a down payment in addition to financing provided by the first and second mortgages is dependant on many factors, including home purchase price and the terms of the first mortgage.

The borrower may use the first mortgage lender of his or her choice. Typically the first mortgage is provided by a conventional mortgage lender such as a bank or credit union, or a mortgage broker. In many cases, the first mortgage is a conventional market-rate loan. An exception to this is a CalHFA mortgage, which is described under “PAL Partner Programs” on page 12.

The first mortgage lender must use the following criteria when qualifying the borrower for the first mortgage:

- Federal Home Loan Mortgage Corporation (FHLMC)/Freddie Mac

OR

- Federal National Mortgage Association (FNMA)/Fannie Mae

OR

- Other prudent and appropriate qualifying criteria commonly used in the lending industry.

6. Co-Borrowers

All co-borrowers must meet first-time homebuyer and income limit requirements. At least one co-borrower must meet the residence or employment requirement.

C). Property Requirements

In addition to meeting all of the borrower eligibility requirements, the borrower must also comply with the following property requirements to be eligible to receive a PAL loan. These requirements pertain to the property/home to be purchased:

1. Purchase Price

The maximum purchase price of the home is the fair market value of the home. A home may not be purchased for a price that is *higher than* fair market value.

2. Location

The property to be purchased must be located within the boundaries of incorporated city of Menlo Park.

3. Type of Residence

The property must be a single-family residence defined as an attached or detached residential unit, condominium, manufactured home, cooperative unit, or mobile home, which allows the PAL loan to be secured by the program's standard deed of trust.

4. Occupancy Standards

The total number of people who will occupy the home cannot exceed the limits set forth under the City of Menlo Park's Uniform Housing Code Occupancy Standards. (See the PAL Application Packet, form PAL-003 for specific standards.)

5. Primary Residence

The purpose of the PAL Program is to assist qualified borrowers/homebuyers to purchase a primary residence in Menlo Park. A home purchased with a PAL loan must be occupied by the borrower. *Use of the property for rental purposes is not allowed and will immediately cause the PAL loan to become due and payable.*

D). Program Requirements

The following requirements apply to the PAL loan itself:

1. PAL Loan Amount

The loan amount that PAL may provide is a maximum of up to 20% of the home's purchase price, or \$75,000, whichever amount is less.

The PAL Program requires that the total value of all mortgage loans may not exceed 100% of the appraised value of the home (the borrower cannot take cash out or receive a loan that is worth more than the value of the home). The borrower may obtain 100% financing for the home if allowed by the first mortgage lender and the terms of the first mortgage loan.

2. PAL Loan Terms and Conditions

The term of the PAL loan is 35 years and is structured as follows:

- Payments and interest are deferred for the first 5 years of the loan term. This means that for the first 5 years of the loan, zero interest accrues and zero payments are required.
- The following 30 years of the loan term are fully amortized (monthly principal and interest payments required) at a 5% fixed interest rate.

Monthly principal and interest payments will commence at the beginning of the sixth year. The loan is due and payable upon sale of the home or transfer of title, or if the owner ceases to occupy the property as a principal residence.

3. Down Payment, PMI and Closing Costs

The PAL Program does not require that the borrower make a down payment when using the PAL loan to purchase a home. The borrower's first mortgage lender will determine the down payment requirement, according to the terms of the first mortgage. Typically the first mortgage lender will require a down payment of 3%-20% of the home's purchase price. The percentage amount that the first mortgage lender requires for a down payment is referred to as the down payment requirement and this varies according to the terms of the loan received. In some cases the borrower may have the option to receive a loan package that provides 100% financing (including the PAL loan), which means that no down payment is required or provided. The PAL Program does allow this option of 100% financing, but only if the arrangement is permitted by the first mortgage lender AND is determined by program staff to provide a sustainable and beneficial financial situation for the borrower.

In some cases, the PAL loan is applied by the first mortgage lender to help meet the down payment requirement. Since the PAL loan can provide up to 20% of the purchase price (or \$75,000, whichever amount is less), in some cases the borrower may not have to make an additional payment in cash in order to meet the down payment requirement. However, in cases where PAL provides less than the down payment requirement (this will depend on the type of loan and the cost of the home), the borrower will need to supplement the PAL loan with a cash payment in order to meet the requirement. To help with this, eligible borrowers may wish to secure an additional source of funding if appropriate (for example, the CalHFA HiCAP Loan Program; see page 12).

In addition to the first mortgage lender's down payment requirement, the borrower may also wish to make a cash payment in order to avoid having to purchase **Private Mortgage Insurance (PMI)**. Typically the first mortgage lender requires the borrower to purchase PMI whenever the down payment is less than 20% of the

purchase price. For example, a 15% down payment requirement may be met by a \$75,000 PAL loan (the maximum dollar amount provided by PAL). However, the borrower may need to make a payment in cash equal to 5% of the purchase price in order to meet the minimum 20% of purchase price required to avoid PMI. This is true even though in this example the down payment requirement itself has already been met.

Closing costs are the borrower's responsibility, but may be paid by the seller if negotiated as part of the sales agreement.

4. Determining PAL Eligibility

If a borrower would like to receive a PAL loan, the City of Menlo Park must first determine that the borrower is eligible for the program. A borrower is eligible according to the eligibility requirements identified in this document (the Program Guidelines).

To determine eligibility for a PAL loan, the borrower must submit a PAL application (including all supporting worksheets and documents) to the City of Menlo Park Housing and Redevelopment Division. An application is attached to these guidelines, which can be obtained through the City's Housing and Redevelopment Division. Once the PAL application is complete and all supporting documents have been submitted, City/program staff reviews the complete application to determine the borrower's eligibility for the program.

PAL loan applications are processed on a first-come, first-served basis and only complete applications are accepted.

5. PAL Pre-Approval

Once program staff has reviewed the PAL application and determined that the borrower is eligible for the program, staff will provide the borrower at his or her request with a letter of pre-approval stating that the borrower is eligible to receive a PAL loan. The borrower is then able to take this letter to a first mortgage lender as evidence of the borrower's eligibility to receive a PAL second mortgage. The letter of pre-approval is not, however, a guarantee of funding. It simply states that the borrower currently meets all requirements for participation in the program.

Once the borrower receives pre-approval for PAL financing, he/she should begin looking earnestly for a home to purchase. To purchase a home, the borrower will need to contact a realtor and a first mortgage lender (or mortgage broker). The first mortgage lender will provide the borrower with primary loan financing for the purchase of the home.

6. Primary/First Mortgage

Primary financing for home purchase (the first mortgage loan) may be provided by a first mortgage lender of the borrower's choice. However, in order to utilize PAL partner programs, including the Mortgage Credit Certificate (MCC) Program and the CalHFA HiCAP Loan Program, the borrower must work with a first mortgage lender that is a *participating* MCC or CalHFA Program lender. The MCC Program and the CalHFA HiCAP Loan Program are discussed in further detail under "PAL Partner Programs", located on page 12.

The borrower's first mortgage may be a fixed or adjustable rate loan. **First mortgage loans with negative amortizing adjustable rates and/or graduated payments are NOT allowed.**

7. First Mortgage Lender Responsibilities

The first mortgage lender will:

- Make or arrange for the borrower/homebuyer to obtain a first mortgage secured by a deed of trust.
- Provide the City/program staff with a copy of the first mortgage application and supporting documents as requested.

8. Subordination

Recipients of the PAL loan are eligible to refinance their mortgage(s) at any time following home purchase. However, if the borrower chooses to refinance he/she must either pay off the PAL loan or meet PAL Program requirements for subordination to a new first mortgage.

The City of Menlo Park's PAL second mortgage will subordinate to a refinanced first mortgage if the borrower meets all of the following conditions:

- At the time of the request for subordination, meets the current income criteria for the PAL Program (cannot exceed maximum income limit per household size); and
- Is refinancing the existing first mortgage for the purposes of reducing their monthly housing expenses; and
- Is refinancing the amount of the balance of the first mortgage plus the cost of refinancing; and
- Is not taking any cash out of the refinance; and

- Has sufficient equity in the property so that the total loans-to-value is at least the same after the refinance as it was when the property was purchased.

If deemed appropriate, the City of Menlo Park will consider requests for an exception to these subordination requirements. City staff must present requests for an exception to the City of Menlo Park Housing Loan Committee for approval.

9. Insurance

The City will require a title insurance policy, a homeowner's insurance policy having the same coverage as required by the primary lender, and flood insurance, if applicable. The City must be named as a loss payee on all applicable policies.

E). PAL Partner Programs

To further enhance the affordability of home purchase in Menlo Park, the following two programs may be used in addition to the PAL program:

1. Mortgage Credit Certificate (MCC) Program

San Mateo County's Mortgage Credit Certificate (MCC) Program, a federal tax credit program, may be used to complement the PAL loan. MCC's will be made available to qualified PAL applicants as long as there is a sufficient allocation available to do so. The County cannot guarantee that MCC's will be available to all PAL applicants.

If the borrower would like to use the MCC Program to complement the PAL loan, he/she must work with a first mortgage lender that is a participating MCC lender. A *participating MCC lender* is a mortgage broker, mortgage banker, or conventional lender who has executed a participation agreement with the County.

The MCC Program is an independent, County-run program that has its own eligibility criteria and application procedure. To learn more about the MCC Program contact Scott Coe, County of San Mateo Department of Housing, at (650) 802-5045.

2. California Housing Finance Agency (CalHFA) Loan Programs

The PAL loan may also be used with CalHFA loan programs. California Housing Finance Agency (CalHFA) may provide both the first and second mortgages, with the PAL loan providing a third funding source. CalHFA first and second mortgages are affordable loans and are used in addition to the affordable PAL loan. The three funding sources together (CalHFA first mortgage + CalHFA second mortgage + PAL loan) can provide the borrower with an affordable home financing package.

CalHFA loan programs are separate, State-run programs and their eligibility requirements are different from those of the PAL Program. CalHFA also has its own application procedure. In order to use a CalHFA loan program the borrower must

use a participating CalHFA mortgage lender. A participating lender is a lender who has previously agreed to process CalHFA loans. With this program, the participating lender of the borrower's choice provides both the CalHFA first and second mortgages. If interested in the CalHFA loan programs, a list of participating lenders will be made available to qualified PAL applicants. To learn more about CalHFA loan programs please visit the CalHFA website at <http://www.calhfa.ca.gov/>.

II. ADMINISTRATION AND PROCEDURE

A). Overview

In general, borrowers apply for the PAL second/junior mortgage in connection with normal mortgage application procedures. Once the borrower has been pre-approved for PAL and has completed the first mortgage loan application, the first mortgage lender must provide the City of Menlo Park with a copy of the first mortgage application and all supporting documents as requested by City/program staff.

PAL Program processing procedures are designed to coincide with the standard mortgage loan processing and underwriting procedures that are common in the lending industry. There are of course procedural variations among lenders, thus the processing procedures outlined here are meant to serve as guidelines with respect to the PAL Program.

The guiding principles of PAL processing procedures are:

1. The borrower shall complete the PAL application and provide supporting documentation as requested by the City of Menlo Park. Program staff will review the application and supporting documentation to determine the borrower's eligibility for the program.
2. Following review of the application and supporting documentation, program staff will determine if the borrower is eligible to receive a PAL loan. The borrower will then be notified of his/her eligibility. If the borrower is eligible to receive a PAL loan, the City of Menlo Park will issue the borrower a PAL pre-approval letter at the borrower's request, which states that the borrower is eligible to receive a PAL second mortgage. This letter can be taken to a first mortgage lender as evidence of eligibility for PAL financing providing up to 20% of the purchase price of the home, or \$75,000, whichever amount is less.
3. Once it has been determined that the borrower is eligible for PAL, program staff will discuss the borrower's options for the MCC and/or CalHFA HiCAP Programs. These are separate programs and have their own eligibility criteria and application procedures. These programs can be used to complement the PAL loan.

4. If the borrower has not already done so, he or she should locate a first mortgage lender, a realtor, and a home to be purchased.
5. The first mortgage lender will arrange for the borrower to receive a first mortgage loan. The borrower must apply separately for the first mortgage, in accordance with the lender's standard application procedure. The first mortgage finances the majority of the home's purchase price.
6. The first mortgage lender will provide program staff with a copy of the first mortgage application and supporting documents as requested.
7. Based on a review of the first mortgage application and working with the first mortgage lender, program staff will determine if the overall home financing package is affordable and beneficial to the borrower.
8. City of Menlo Park PAL Program staff will convene a loan committee (see below). City staff will recommend approval or denial of the loan to the loan committee, which will make a final determination regarding the borrower's receipt of a PAL loan.
9. Once the borrower receives final approval for a PAL loan, program staff will prepare all PAL loan documents and forward them to the title company for signature by the borrower.
10. The City will coordinate escrow of the PAL funds with the first mortgage lender and the title/escrow company.

B). City Loan Approval

Once City of Menlo Park program staff has received all required information from the borrower and the first mortgage lender, the City will convene a loan committee that will make a final determination regarding the borrower's receipt of a PAL loan. The loan committee will consist of one member of the Housing Commission, one representative from the City of Menlo Park Finance Division, and one representative from the City of Menlo Park Planning or Engineering Divisions.

The Housing Commission representative on the loan committee may be any member in good standing of the Housing Commission. If one or both of the representatives from the City of Menlo Park Finance and/or Planning and Engineering Divisions who normally sits on the loan committee is not available, a substitute representative may sit on the loan committee for that person. Following a recommendation by City program staff, the loan committee will make the final determination regarding PAL funding approval.

If the borrower is given final approval for the PAL loan, the City of Menlo Park will issue the borrower a letter stating final approval and identifying the exact loan amount (which

in no case will exceed 20% of the home's purchase price, or \$75,000, whichever amount is less).

The first mortgage lender may not charge the City or the homebuyer for its support in processing the PAL loan application. *However, this does not preclude the first mortgage lender from charging its normal application and loan fees in association with the first mortgage.*

C). Underwriting Requirements

The intent of the City of Menlo Park is to approve PAL Program loans that follow the guidelines established by Fannie Mae or Freddie Mac for the underwriting of the first mortgage.

Applicants must demonstrate compliance with the Homebuyer/Borrower Eligibility Requirements (pages 5-7), Property Requirements (pages 7-8) and Program Requirements (pages 8-12).

D). Loan Closing

The City of Menlo Park Housing and Redevelopment Division will prepare the PAL loan documents and coordinate escrow of PAL funds. The following serve as guidelines for loan closing:

- The City/program staff will prepare PAL loan documents and forward them, along with escrow instructions, to the title company.
- The borrower will sign the PAL loan documents.
- The title/escrow company will fax the first and last pages of the signed PAL Promissory Note and Deed of Trust along with their wire instructions to the City of Menlo Park. **The City must receive wire instructions no later than 9 a.m. two days before funds are to be wired. Wire instructions received after 9 a.m. will not be executed until the next business day.**
- Original and certified copies of PAL and first mortgage/primary lender documents specified in the escrow instructions are to be delivered to the City of Menlo Park Housing and Redevelopment Division.

III. MAXIMUM HOUSEHOLD INCOME

Maximum gross annual household income for the PAL loan is limited to 120% of the San Mateo County median income adjusted for household size, as shown below.

Household Size	2009 Maximum Household Income
1	\$81,300
2	\$92,900
3	\$104,550
4	\$116,150
5	\$125,450
6	\$134,750
7	\$144,050
8	\$153,300