Primary Residence – Owner Occupied			
Transaction	**FICO**	**Number of Units**	**Maximum LTV/CLTV**
Purchase / Rate Term	620	1 - Unit	97% Conforming; 95% High Balance
		2 - Units	85
		3-4 Units	75
Cash-Out Refinance	620	1 - Unit	80
		2-4 Units	75
Second Home			
Transaction	**FICO**	**Number of Units**	**Maximum LTV/CLTV**
Purchase / Rate Term	620	1 – Unit	90
Cash-Out Refinance	620	1 – Unit	75
Investment Property – Non-Owner Occupied			
Transaction	**FICO**	**Number of Units**	**Maximum LTV/CLTV**
Purchase	620	1 – Unit	80
		2-4 Units	75
Rate / Term	620	1-4 Units	75
Cash-Out Refinance	620	1 – Unit	75
		2-4 Units	70

Platinum Conforming ARM DU Product Codes:				
5/1 ARM	1700-77		5/1 ARM LPMI	1711-77
7/1 ARM	1800-77		7/1 ARM LPMI	1811-77
10/1 ARM	1900-77		10/1 ARM LPMI	1911-77
Platinum Conforming ARM DU High Balance Product Codes:				
5/1 ARM High Balance	1733-77			
7/1 ARM High Balance	1833-77			

Highlights

Topic	Description
1031 Exchange	Not Allowed.
4506 Transcripts	Transcripts are required per documentation type in the loan file.

Appraisal Requirements	• Transferred appraisals are not allowed.
	• **Full appraisals are required for the following regardless of DU findings:**
	  ▪ Purchase of REO or auctioned properties;
	  ▪ Purchase of properties where the most recent transaction was a foreclosure sale;
	  ▪ Identity of Interest transactions; and
	  ▪ Properties with age related deed restrictions.
	• Appraisers appearing on the Fannie Mae AQM list as "subject to 100% review" or as "ineligible" are not allowed.
	• Disaster Areas:
	  ▪ Prior to loan closing: A PIW offer **may not** be exercised. A full appraisal is required.
	  ▪ After loan closing: A re-inspection with interior inspection and photos is required.
	• Properties with unpermitted structural additions must meet the following requirements:
	  ▪ The quality of the work must be described in the appraisal and deemed acceptable ("workmanlike quality") by the appraiser.
	  ▪ The addition does not result in a change in the number of units

	comprising the subject property. ▪ If the appraiser gives the unpermitted addition value, the appraiser must be able to demonstrate market acceptance using comparable sales with similar additions and the appraiser must make the following statements in the appraisal report: o "Non-permitted additions are typical for the market area and a typical buyer would consider the 'unpermitted' additional square footage to be part of the overall square footage of the property"; and o "The appraiser has no reason to believe the addition would not pass inspection for a permit".
ARM Parameters	5/1 ARM: • Caps: 2/2/5 • Margin: 2.25% • Index: One Year Libor • Qualify at the greater of: ▪ The Note rate plus 2%; or ▪ The fully indexed rate. **5/1 ARMS are not eligible if the subject property is investment property and the borrower owns any financed 1-4 unit residential properties other than the subject property.** 7/1 and 10/1 ARMS • Caps: 5/2/5 • Margin: 2.25% • Index: One Year Libor • Qualify at the greater of: ▪ The Note rate; or ▪ The fully indexed rate.
Assets	Cryptocurrency, such as Bitcoin and Ethereum may NOT be used for down payment funds or closing funds. These types of funds must be backed out of the borrower's assets.
AUS	A DU "Approve/Eligible" decision is required.
Bank Accounts	When a bank account or asset statement indicates "FBO" (for the betterment of) or "ITF" (trust account) confirmation is required that the borrower has access to the account and is either the beneficiary or the trustee. The following documentation may be used to satisfy this requirement: • A copy of the Trust or Trust Certificate indicating the borrower is the beneficiary or trustee; and The borrower's name matches the name on the FBO/ITF account.
Borrower Eligibility	• Maximum four borrowers per transaction. • Maximum four loans to the same borrower(s). • Borrowers must be natural persons or an eligible *inter-vivos* living trust. • All borrowers must have a valid social security number. **A social security card may not be used to validate employment authorization.** • **ITINs are not allowed.** • Permanent Resident Aliens: ▪ An unexpired Permanent Resident Alien card (green card) is required. • Non-Permanent Resident Aliens: ▪ An unexpired Employment Authorization Document (EAD card) is required. ▪ If a non-permanent resident alien does not have an EAD card, an acceptable Visa may be allowed **on an exception basis only**. The following Visa classifications may be acceptable: o A Series: A-1, A-2, A-3 o E Series: E-1, E-2, Treaty Trader o G Series: G-1, G-2, G-3, G-4, G-5

	- o H-1, Temporary Worker - o L-1, Intra Company Transferee - o O Series, Individual with Extraordinary Ability or Achievement - o R-1, Temporary Religious Worker - o TN, NAFTA Visa - o TC, NAFTA Visa ▪ If a non-permanent resident alien is borrowing with a U.S. citizen the above documentation is still required for the non-permanent resident alien borrower. - Non- Resident Alien or Other Status: ▪ Not eligible. - If the authorization for non-permanent residency status will expire within three months obtain the following: ▪ Confirmation from the USCIS that the employer has re-filed a petition of extension. ▪ If the borrower does not have a history of prior renewals, proof of three year continuance must be determined based on information from the USCIS. **Applicants with the following designations are not eligible:** ▪ Diplomatic Immunity; ▪ Politically Exposed Persons; ▪ Temporary Protected Status; ▪ Deferred Enforced Departure; or ▪ Humanitarian Parole.
CEMA	Not Allowed
Community Seconds	Not Allowed
Condominium	- The project must meet Fannie Mae requirements. - The following project types are ineligible: ▪ Condo projects where **any unit is < 400 square feet** and where the **subject unit is < 650 square feet**; ▪ Condotels/Hotel Condominiums: o Condo projects that include registration services and offer the rental of units for a term of 30 days or less are not eligible; o Projects that have or share facilities with a hotel or motel such as maid service, management desks, maid services, or bellmen, etc. are not eligible; and o Condo projects that restrict the owner's ability to occupy the unit are not eligible. ▪ Conversions from hotels or motels ▪ Manufactured home condos; ▪ Multi-dwelling unit condos; ▪ New condo projects where seller concessions are not disclosed on the settlement statement and/or are being offered in excess of Agency guidelines; ▪ Non-Warrantable condo projects; and ▪ Projects subject to a ground lease.
Construction to Perm	Not Allowed
Credit Report	- An RMCR or traditional tri-merge credit report is required for all borrowers. - A new credit report may not be pulled once the file has been submitted for underwriting. - A new credit report is only allowed at the underwriter's direction or after the existing credit report has expired. - Any debt not reported on the credit report must be documented as being repaid in the satisfactory manner. - If the credit report does not show a required minimum payment amount and there is no supplemental documentation to support a payment, 5% of the outstanding balance must be used as the borrower's recurring monthly debt obligation.
Deed Restrictions	Age related only.

	• Eligible occupancy and property types: ▪ 1-2 unit principal residences; ▪ 1 unit second home; and ▪ 1-2 unit investment properties.
Disabled Child/Elderly Parent	• Borrowers who wish to provide housing for their physically handicapped or developmentally disabled adult child who is unable to work or does not have sufficient income to qualify for a loan, may be considered owner-occupants; or • Borrowers who wish to provide housing for their parent who is unable to work or does not have sufficient income to qualify may be considered owner-occupants. • The borrower must provide a detailed explanation identifying the situation and need for financing. ▪ Exercise caution when the borrower owns investment properties or is doing a cash-out refinance transaction. • When borrowers are financing a home for their disabled child or parents the following apply: ▪ The disabled child or parent is not required to be on title or on the mortgage loan. ▪ Acceptable documentation must be included in the loan file to support the transaction. Documentation may include tax returns of the borrower that show the disabled adult child as a dependent or tax returns of the parent which documents insufficient income to qualify.
DAPs/MCCs	Not Allowed
Escrow Impounds	Required for all loans with LTVs > 80% unless prohibited by state law. • Flood insurance must be escrowed if the loan is secured by a primary residence or a second home located in a mandatory flood zone regardless of whether or not any other funds are escrowed. • Impounds for mortgage insurance may never be waived.
Escrow Withholds for Repairs	Not Allowed
Future Employment/Income	The borrower must begin employment before the loan is closed. Income documentation per AUS findings must be provided.
High Balance Loans	• The following additional requirements apply: ▪ For properties in attached condo projects the appraisal must include two comps from outside the project.
HPML	Not Allowed
Identity of Interest/Non-Arms-Length Transactions	• Allowed on owner occupied transactions only. • Not eligible if the property had a prior sale within 180 days. • Not eligible if the subject property is in foreclosure or a Notice of Default has been filed. • Not eligible for Delayed Financing. • Transactions must be fully disclosed in the sales contract as non-arms-length. • The file must include the following documentation: ▪ A copy of the cancelled earnest money check to verify payment to the seller; ▪ Verification that the borrower is not now on title and has not been on title within the past 24 months; ▪ A payment history for the existing mortgage (seller's mortgage) on the subject property must be obtained and must reflect that the loan is current and has no pattern of delinquency in the past 12 months; and ▪ The borrower must provide a sensible written explanation stating the relationship to the seller and the reason for the purchase. • **A full appraisal must be obtained regardless of the DU findings.**

	PIWs are not allowed. ▪ The appraiser must be informed of the non-arms-length transaction and address whether or not the market value has been affected by the relationship of the parties.
Ineligible Programs	Any Fannie Mae Affordable Housing program including: • Community Solutions and Community HomeChoice; • HomePath; • HomeReady; • HomeStyle Renovation; • Loans with Community Seconds; and • My Community Loans.
Ineligible Property Types	• Assisted Living Properties; • Board and Care Facilities; • Bed and Breakfast Establishments; • Boarding Houses; • Condition Ratings of C5, C6, or Q6; • Co-ops; • Dome Homes; • Land Loans; • Land Trusts including Illinois Land Trusts; • Leasehold Land; • Legal Non-Conforming Properties if unable to rebuild to current density; • Log Homes; • Manufactured Homes; • Mobile Homes; • Native American Land: Properties on Indian (Native American) tribal or Indian Trust Land, restricted land, or where the borrower has a leasehold interest; • On-Frame Modular Homes; • Properties that are not suitable for year-round use; • Properties where the current improvements are not the "highest and best use"; • Vacant Lots; and • Working Farms and Ranches.
Interested Party Contributions	• Loans with undisclosed interested party contributions are not eligible. • Loans with Payment Abatements are not eligible. • Financing concessions for primary residences and second homes must be within the following allowable percentages: ▪ LTV/CLTV ≤75% - 9% of value ▪ LTV/CLTV >75% - ≤ 90% - 6% of value ▪ LTV/CLTV > 90% - 3% of value • Financing concessions for investment properties is limited to: ▪ 2% of value regardless of the LTV/CLTV. • Value is the lesser of the sales price or appraised value. **Note:** The property seller cannot pay for future HOA dues.
Leasehold Properties	Not Eligible
Manual Underwriting	Not Allowed
Manufactured Homes	Not Eligible
Marijuana Related Business/Employment	Income from a marijuana based business or employment may not be used for qualifying purposes.
Mortgage Insurance	**Loans with a DTI greater than 45% and a credit score < 700 are not eligible.** **Reduced MI Levels are not eligible. Standard coverage must be obtained.** For properties in New York:

	• **Use the appraised value only to determine if MI is required**. • If MI is required, use **the lesser of** the sales price or the appraised value to determine the required coverage. Mortgage Insurance Options: • Borrower Paid Single Premium • Financed MI • Lender Paid Single Premium ▪ Must obtain MI from Genworth • Level Amount • Monthly and Zero Monthly • Standard Annual Ineligible: • Any MI where the premium is paid out of the mortgage interest received. • Borrower paid annual. • Lender paid annual. • Lender paid monthly. Slit Premium.
PACE/HERO Solar Lease	Not Allowed
Power of Attorney	Use of a Power of Attorney is not allowed for the following transactions: • Cash-out refinances; • Identity of interest or non-arms-length transactions; • Non-occupant borrowers may not use a POA; • Non-owner occupied investment properties; and • When title is taken in a trust.

Property Flipping	Prior sales within 90 days are eligible if:
	• The seller is a relocation agency;
	• The property is a foreclosure or deed-in-lieu of foreclosure sale;
	• The property was obtained through inheritance or divorce; and
	• Meets all of the below requirements.
	Prior sales within 180 days:
	• Identity of interest transactions are not allowed.
	• If the value has increased by 20% or more the appraiser must:
	  ▪ Report the previous sale transaction's price and date;
	  ▪ Describe in detail any improvements made since the prior sale; and
	  ▪ Provide an explanation for the increase in the property value, considering the impact of improvements, if any, on value, as well as any recent price trends or changes in local market conditions.

Restructured Loans/Short Payoffs	Not Allowed
Second Home	• One unit only. • Must be suitable for year-round occupancy. • Must be occupied by the borrower for some portion of the year. • The borrower must have exclusive control of the property. • The property cannot be subject to any agreements that give a management firm control over the occupancy of the property and there must not be any rental property or timeshare arrangements. • If rental income for the second home is reported on the borrower's tax returns the loan is eligible as a second home as long as the property is not being rented for the entire year (the tax returns must not reflect that the property has been rented for 365 days). •
State Restrictions	The following are ineligible: • **Hawaii** properties located in Lava Flow Zones 1 and 2 are not eligible; • **Illinois** land trusts are not eligible; • 2-4 units in **New Jersey** are not eligible**;**

	• Properties in **West Virginia** are not eligible • **Texas** 50(a)(6) transactions are not eligible; and • Properties located in any U.S. Territory or Possession are not eligible.
Student Loan Cash-Out Refinance	Not Allowed
Tax Returns	• Amended tax returns that increase the borrower's income may not be used for qualifying purposes. • If the tax returns reflect monies owed to the IRS proof of payment is required.
Temporary Buy Down	Not Allowed
Verification of Employment/Verification of Deposit/Verification of Mortgage/Rent	• The use of a Verification of Employment (VOE) and/or a Verification of Deposit (VOD) only is not allowed. ▪ At a minimum paystubs and bank statements are required. • When the borrower's current mortgagee or landlord is a private party, the use of a Verification of Mortgage (VOM) or Verification of Rent (VOR) only is not allowed. ▪ Copies of the borrower's most recent, consecutive 12 months cancelled checks will be required.

Credit Philosophy

The Lenox/WesLend philosophy is to offer the Agency Conventional program with minimal overlays to our clients. All loans are evaluated in accordance with the following principals:

- All loans must be submitted to DU.
- Each loan is evaluated in accordance with Fannie Mae, the corresponding Overlay Matrix, and the policies outlined within this Program Guide.
- Each loan applicant is underwritten individually and all credit standards are applied consistently to each borrower.
- All factors are considered when evaluating a loan file. The underwriting decision is not based on any single item or factor.

Application Package

Contents of the Application Package

Documenting the Loan Application

- The initial loan application must include sufficient information for the underwriter to reach an informed decision about whether to approve the loan.
- The final loan application signed by the borrower must include all income and debts disclosed or identified during the loan process.
- A completed, signed and dated version of the original and final 1003 must be included in the loan file.
- With few exceptions, if either the Note or security instrument is executed using a Power of Attorney, then the final, but not the original, loan application may also be executed using the Power-of-Attorney.
- **Exception:** A Power-of-Attorney may be used to execute both the original and final *Form 1003* if either:
  - A borrower is on military service with the United States armed forces serving outside the United States or deployed aboard a United States vessel, as long as the Power-of-Attorney:
    - Expressly states an intention to secure a loan on a specific property; or
    - Complies with the requirements under the *VA Lender's Handbook* relating to powers-of-attorney for VA-insured mortgage loans; or
  - Such use is required by applicable law.

Requirements for the Loan Application Package

- The loan application package must include:
  - A copy of the signed sales contract, if applicable;
  - Escrow/closing or settlement instructions;
  - Any other information or documentation needed to verify, clarify, or substantiate information in the borrower's application; and
  - Any other documentation that is needed to make a prudent underwriting decision.
- Any available technology may be used to produce copies of the documents in the loan file such as a photocopier, facsimile machine, document scanner or camera.
- Copies of documents provided by the borrower may be photos or scanned versions of the original documents and can be sent in hardcopy or via e-mail or other electronic means.

Blanket Authorization Form

- Obtain the borrower's signature on a Blanket Authorization form which will be used to obtain the documentation needed to evaluate the borrower's creditworthiness:
- Attach a copy of the Blanket Authorization form to each verification request form sent to a verifying institution.
- The information must be requested directly from the institution.
- The completed form(s) must be signed and dated and must be returned directly to Lenox/WesLend from the verifying institution.

Age of Credit Documents and Federal Income Tax Returns

- For all loans, existing and new construction, the credit documents must be no more than four months old on the Note date.
- When consecutive credit documents are in the loan file, the most recent document is used to determine whether it meets the age requirement.
  - For example, when two consecutive monthly bank statements are used to verify a depository asset, the date of the most recent statement must be no more than four months old on the Note date.
- For some types of income sources tax returns must be obtained. The "most recent year's tax return" is defined as the last return scheduled to have been filed with the IRS. For example:

If Today's Date is…	*Then the Most Recent Year's Tax Return would be…*
February 15, 2018	2016
April 30, 2018	2017
December 15, 2018	2017

- For business tax returns, if the borrower's business uses a fiscal year that is different from the calendar year, the dates may be adjusted to determine what year(s) of business tax returns are required.

Borrower Eligibility

General Borrower Eligibility Requirements

Eligibility Requirements

- Eligible borrowers are borrowers who are natural persons or *inter-vivos* revocable trusts, and have reached the age at which the mortgage Note can be enforced in the jurisdiction where the subject property is located.
- There is no maximum age limit for a borrower.
- A borrower is any applicant whose credit is used for qualifying purposes to determine his/her ability to meet underwriting and eligibility standards.
- A "co-borrower is any borrower other than the borrower whose name appears first on the Note.
- Confirm each borrower's identity prior to the extension of credit.
- Each borrower must have a valid social security number in addition to meeting existing legal residency and documentation requirements.

- DU may identify data integrity issues pertaining to the borrower's social security number. Steps must be taken to resolve any issues including numbers not issued, borrower age/issue date discrepancies, or social security numbers associated with deceased individuals. If any social security number inconsistencies cannot be resolved:
  - Validate the social security number with the Social Security Administration (SSA).
  - Direct validation with SSA by a third party is acceptable.
  - Form *SSA-89, Authorization for the Social Security Administration to Release Social Security Number Verification* must be used for this purpose.
  - **If a social security number cannot be validated with the SSA, the loan is not eligible.**

Non-U.S. Citizen Borrowers

- Non-U.S. citizens who are lawful permanent or non-permanent residents of the United States are eligible under the same terms that are available to U.S. citizens.
- All borrowers must have a valid social security number. **ITINs are not allowed.**
- Permanent Resident Aliens – obtain one of the following:
  - A copy of a valid Permanent Resident Card (front and back); or
  - A Passport with the USCIS I-551 stamp.
- Non-Permanent Resident Aliens – provide one of the following:
  - USCIS issued Employment Authorization Document (EAD Card)
    - If the borrower has less than a two year history of residing in the U.S., a copy of the Passport used to enter the country and a copy of the I-94 issued by the USCIS are required.
    - If the borrower has greater than a two year history of residing in the U.S., a copy of the current and previous EAD card is required; or
  - One of the following Visas:
    - E-1, E-2, E-3;
    - G-1, G-2, G-3, G-4, G-5;
    - H-1, H-1b, H-2A, H-3;
    - L1;
    - TC, NAFTA Visa; or
    - TN, NAFTA Visa.
- **Form I-797C, Notice of Action Taken, issued by the United States Citizenship and Immigration Services (USCIS) is not sufficient to document that a non-U.S. citizen is legally present in the United States.**

Multiple Financed Properties for the Same Borrower

Limits on the Number of Financed Properties

- If the loan is secured by the borrower's principal residence, there are no limitations on the number of other properties that the borrower may have financed.
- If the loan is secured by a second home or an investment property, the multiple financed properties policy applies.
- The financed property limit:
  - Applies to the number of one-to-four unit residential properties where the borrower is personally obligated on the mortgage(s);
  - Applies to the total number of properties financed, not to the number of mortgages on the property;
  - Includes the borrower's principal residence if it is financed; and
  - Is cumulative for all borrowers, though jointly financed properties are only counted once.
- The following property types are not subject to these limitations even if the borrower is personally obligated for a mortgage on the property:
  - Commercial real estate;
  - Multifamily property consisting of more than four units;
  - Ownership in a timeshare;

  - Ownership of a vacant lot; or
  - Ownership of a manufactured home on a leasehold estate not titled as real property with a chattel lien on the home.
- **Examples – Counting Financed Properties**
  - The borrower is personally obligated on mortgages securing two investment properties and the co-borrower is personally obligated on mortgages securing three other investment properties and they are jointly obligated on their principal residence mortgage. The borrower is refinancing the mortgage on one of the two investment properties. These borrowers have six financed properties.
  - The borrower and co-borrower are purchasing an investment property and they are already jointly obligated on the mortgages securing five other investment properties. In addition, they each own their own principal residence and are personally obligated on the mortgages. The new property being purchased is considered their eighth financed property.
  - The borrower is purchasing a second home and is personally obligated on his/her personal principal residence mortgage. Additionally the borrower owns four two-unit investment properties that are financed in the name of a limited liability company (LLC) of which he/she has a 50% ownership. Because the borrower is not personally obligated on the mortgages securing the investment properties, they would not be included in the property count and the result is only two financed properties.
  - The borrower is purchasing and financing two investment properties simultaneously. The borrower does not have a mortgage lien against his/her principal residence but does have a financed second home and is personally obligated on the mortgage, two existing financed investment properties and is personally obligated on both mortgages, and a financed building lot. In this instance, the borrower will have five financed properties because the financed building lot does not need to be included in the property count.
- If the borrower is financing a second home or investment property that is underwritten through DU, the maximum number of financed properties the borrower can have is ten.
- If the borrower will have one to six financed properties, standard eligibility policies apply such as LTV ratios and minimum credit scores.
- **If the borrower will have seven to ten financed properties, the borrower must have a minimum credit score of 720. All other standard eligibility policies apply.**
- DU will determine the number of financed properties for the loan based on the following approach:
  - If the “Number of Financed Properties” field is completed, DU will use that as the number of financed properties. Complete this field with the number of financed one-to-four residential properties including the subject transaction for which the borrower is personally obligated.
  - If the “Number of Financed Properties” field is not completed, DU will use the number of residential properties in the “Real Estate Owned (REO)” section that include a mortgage payment or that are associated with a mortgage or HELOC in the “Liabilities” section of the loan application as the number of financed properties.
  - If the “Number of Financed Properties” field and the “REO” information is not provided, DU will use the number of mortgages and HELOCs disclosed in the “Liabilities” section of the loan application as the number of financed properties.
  - When none of the information above is provided on the loan application, DU will use the number of mortgages and HELOCs disclosed on the credit report as the number of financed properties.
    - In order to account for the subject property, DU will add it to the number of financed properties on purchase transactions when the REO section, number of mortgages on the application, or number of mortgages on the credit report are used as the number of financed properties.
- After determining the number of financed properties, DU will use that value to assess the eligibility of the loan, including the minimum credit score requirements for seven to ten financed properties and the minimum required reserves that must be verified.

- DU will issue a message giving the number of financed properties that DU used and where that information was obtained.
  - If DU used the information provided in the "Number of Financed Properties" field or in the "REO" section as the number of financed properties and that information is inaccurate, update the data and re-submit the loan to DU.
  - If DU used the number of mortgages and HELOCs on the loan application or credit report as the number of financed properties and that number is inaccurate, provide the correct number in the "Number of Financed Properties" field or complete the "Real Estate Owned" section of the loan application and re-submit the file to DU.

Guarantors, Co-Signers, or Non-Occupant Borrowers

Guarantors and Co-Signers

- Guarantors and co-signers are credit applicants who:
  - Do not have ownership interest in the subject property as indicated on the title;
  - Sign the mortgage or deed of trust Note;
  - Have joint liability for the Note with the borrower; and
  - Do not have an interest in the sales transaction such as the property seller, the builder, or the real estate broker.

Non-Occupant Borrowers

- Non-occupant borrowers are credit applicants on a principal residence who:
  - Do not occupy the subject property;
  - Have an ownership interest in the subject property as indicated on the title;
  - Sign the mortgage or deed of trust Note;
  - Have joint liability for the Note with the borrower; and
  - Do not have an interest in the property sales transaction such as the property seller, the builder, or the real estate broker.

LTV Ratio Requirements for Loan Casefiles Underwritten through DU

- DU analyzes the risk factors in the loan casefile for all borrowers on the mortgage loan.
- Regardless of whether an individual borrower will be occupying the property as his/her principal residence, DU will consider the income, assets, liabilities, and credit of that borrower.
- If the income of a guarantor, co-signer, or co-borrower is used for qualifying purpose, and that guarantor, co-signer, or co-borrower will not occupy the subject property, the maximum LTV, CLTV, and HCLTV ratio may not exceed 95%.

Inter-Vivos Revocable Trusts

Overview

- Only individual persons can be considered as credit-qualifying borrowers.
- Property where no borrower has an ownership interest as an individual person is ineligible as collateral.
- An exception is provided for *inter-vivos* revocable trusts created by credit-qualifying individual borrowers.

Inter-Vivos Revocable Trust as Eligible Borrower

- An *inter-vivos* revocable trust is a trust that:
  - An individual creates during his/her lifetime;
  - Becomes effective during its creator's lifetime; and
  - Can be changed or cancelled by its creator at any time, for any reason, during that individual's lifetime.
- An *inter-vivos* revocable trust that has an ownership interest in the subject property is an eligible mortgagor for all transaction types, except Texas 50(a)(6) transactions, provided the trust complies with all the requirements in this topic.

- A trust must meet revocability and other eligibility requirements at the time the loan is closed.

Trust and Trustee Requirements

- The *inter-vivos* revocable trust must be established by one or more natural persons, solely or jointly.
- The primary beneficiary of the trust must be the individual(s) establishing the trust. If the trust is established jointly, there may be more than one primary beneficiary as long as the income or assets of at least one of the individuals establishing the trust will be used to qualify for the mortgage.
- The trustee(s) must include either:
  - The individual establishing the trust, or at least one of the individuals if there are two or more; or
  - An institutional trustee that customarily performs trust functions in, and is authorized, to act as trustee under the laws of the applicable state.
- The trustee(s) must have the power to mortgage the security property for the purpose of securing a loan to the individual(s) who are the borrower(s) under the mortgage or deed of trust Note.
  - In the event the originally named trustee is unable or unwilling to serve, as long as the trust instrument has a mechanism for appointment of a successor trustee, the trust can properly act through the successor trustee.
- All property and occupancy types are eligible. For properties that are the borrower's principal residence, at least one individual establishing the trust must occupy the subject property and sign the loan documents.
- The loan must be underwritten with at least one individual establishing the trust as borrower. Additional individuals, including other individuals establishing the trust, may also be considered co-borrowers if those individuals' credit will be used to qualify for the loan.

Title and Title Insurance Requirements

- The following requirements apply to title and title insurance:
  - Title held in the trust does not in any way diminish Fannie Mae's rights as a creditor, including the right to have full title to the property vested in Fannie Mae should foreclosure proceedings have to be initiated to cure a default under the terms of the mortgage.
  - The title insurance policy ensures full title protection to Fannie Mae.
  - The title insurance policy states that title to the security property is vested in the trustee(s) of the *inter-vivos* revocable trust.
  - The title insurance policy does not list any exceptions with respect to the trustee(s) holding title to the subject property or to the trust.
  - Title to the subject property is vested solely in the trustee(s) of the *inter-vivos* revocable trust, jointly in the trustee(s) of the *inter-vivos* revocable trust and in the name(s) of the individual borrower(s), or in the trustee(s) of more than one *inter-vivos* revocable trust.

Homeownership Education and Housing Counseling

Homebuyer Education

- Credit and underwriting guidelines alone are not always enough to assess a borrower's readiness for homeownership.
- High quality homeownership education and housing counseling can provide the borrower with the additional information and resources to make informed decisions that support long-term homeownership sustainability.
- All education, collection, and counseling efforts must comply with the requirements of applicable federal and state laws, including the Equal Credit Opportunity Act, the Fair Debt Collections Practices Act and the Fair Credit Reporting Act.
- The following definitions apply:
  - **Homeownership Education**: Education with an established curriculum and instructional goals, provided in a group or classroom setting or via other formats, that covers such

homeownership topics as the home buying process, how to maintain a home, budgeting, and the importance of good credit.
    - **Housing Counseling**: One-on-one assistance that addresses unique financial circumstances and housing issues, and focuses on overcoming specific obstacles to achieve housing goals such as:
        - Repairing credit;
        - Locating cash for a down payment;
        - Recognizing predatory lending practices;
        - Understanding fair lending and fair housing requirements;
        - Avoiding foreclosure; and
        - Resolving a financial crisis.
- All housing counseling involves the creation of a budget and a written action plan.

Transactions that Require Education

- For the following transactions, at least one borrower on the loan must complete homeownership education prior to loan closing:
    - If all borrowers on the loan are relying solely on non-traditional credit to qualify regardless of the loan product or whether the borrowers are first time homebuyers.

Education Requirements

- To meet the homeownership education requirements borrowers must complete the Framework Homeownership, LLC *(Framework)* online education program unless an exception exists as described below.
- The *Framework* homeownership education program is available in both English and Spanish. It meets the standards defined by both the National Industry Standards for Homeownership Education and Counseling and by HUD.
- A copy of the certificate of course completion from *Framework* must be retained in the loan file.
- The following exceptions provide alternatives for borrowers to meet the homeownership education requirements using a source other than *Framework*:
    - Borrowers for whom online education may not be appropriate:
        - The presence of disability, lack of Internet access or other situations may indicate that a borrower is better served through other education modes such as in-person classroom education or via telephone.
        - In these situations borrowers should be directed to *Framework's* toll-free customer service line from which they can be directed to a HUD-approved counseling agency that can meet their needs.
        - The counseling agency that handles the referral must provide a certificate of completion and a copy of the certificate must be retained in the loan file.
    - Borrowers completing homeownership education or counseling required by a Community Seconds or other down payment assistance provider:
        - If the loan involves a Community Seconds or other down payment assistance program, and that program requires its own homeownership education course or counseling provided by a HUD-approved counseling agency, the borrower is not required to complete the *Framework* program.
        - Retain a copy of the certificate issued by the HUD-approved provider in the loan file.
    - Borrowers who completed housing counseling prior to execution of the sales contract:
        - Borrowers who already completed the housing counseling are not required to complete the *Framework* program.
        - Retain a copy of the *Certificate of Completion of Housing Counseling* (Fannie Mae *Form1017*), signed by both the counseling recipient and the HUD counselor in the loan file.

Housing Counseling

- If a borrower opts to work with a counselor, completion of housing counseling will satisfy homeownership education requirements **provided it was completed before the borrower executed a sales contract**.
- Housing counseling must be provided by a HUD-approved counseling agency and meet HUD standards for the delivery of the service.
  - The requirements are described in *Form 1017*.
  - The form must be signed by both the counseling recipient and the HUD counselor and a copy of the certificate must be retained in the loan file.

Summary of Homeownership Education Options

	Homeownership Education	***Housing Counseling***
Provider	Framework Homeownership, LLC; **OR**: An education course provided by a Community Seconds or other down payment assistance program provider where the program requires its own homeownership education or counseling provided by a HUD-approved counseling agency.	HUD-approved Counseling Agency.
Method of Delivery	On-line if provided by Framework, or any method offered by the provider. ***Note:*** For borrowers who have a disability, lack of Internet access or other situation where another form of education may be more appropriate, Framework will provide a referral to a HUD-approved counseling agency that can meet their needs.	In person, telephonic or video conferencing per HUD standards.
Date Required for Completion	Prior to loan closing	Prior to execution of the sales contract.
Required Documentation	Certificate of Course Completion from Framework, or alternate provided based on Framework's referral, if applicable; **OR:** Certificate of completion from provider	*Certificate of Completion of Housing Counseling* (Fannie Mae *Form 1017*), signed by both the counseling recipient and the HUD counselor.

Mortgage Eligibility

Occupancy Types

Principal Residence Properties

- A principal residence is a property that the borrower occupies full-time as their primary residence.
- The following table describes conditions under which a residence can be considered a principal residence even when the borrower will not be occupying the property:

Borrower Types	***Requirements for Owner Occupancy***
Multiple Borrowers	Only one borrower needs to occupy and take title to the

	property except as otherwise required for mortgages that have guarantors or co-signers.
Parents or legal guardians wanting to provide housing for their physically handicapped or developmentally disabled adult child.	If the child is unable to work or does not have sufficient income to qualify for a mortgage on his/her own, the parent or legal guardian is considered the owner/occupant.
Children wanting to provide housing for parents	If the parent is unable to work or does not have sufficient income to qualify for a mortgage on his/her own, the child is considered the owner/occupant.

Second Home Properties

- The following are the requirements for second home properties:
  - Must be occupied by the borrower for some portion of the year;
  - Is restricted to one-unit dwellings;
  - Must be suitable for year-round occupancy;
  - The borrower must have exclusive control over the property;
  - Must not be a rental property or timeshare arrangement; and
  - Cannot be subject to any agreements that give a management firm control over the occupancy of the property.
- If rental income from the property is identified, the loan is eligible as a second home as long as:
  - The income is not used for qualifying purposes and all other requirements for second homes are met; and
  - **The borrower's tax returns reflect the rental income is for only part of the year rather than for a full 365 days.**

Investment Properties

- An investment property is owned but not occupied by the borrower.

Subordinate Financing

Subordinate Financing Requirements

- Subordinate liens must be recorded and clearly subordinate to the first mortgage lien.
- Following are the requirements for acceptable subordinate financing types:
  - Variable payment mortgages are eligible if the following requirements are met:
    - With the exception of HELOCs, when the repayment terms provide for a variable interest rate, the monthly payment must remain constant for each 12 month period over the term of the subordinate lien mortgage. For HELOCs the monthly payment does not have to remain constant.
    - The monthly payments for all subordinate liens must cover at least the interest due so that negative amortization does not occur with the exception of employer subordinate financing that has deferred payments.
  - Mortgages with regular payments that cover at least the interest due so that negative amortization does not occur.

Unacceptable Subordinate Financing Terms

- The following terms are not acceptable:
  - Mortgages with negative amortization with the exception of employer subordinate financing that has deferred payments.
  - Subordinate financing that does not fully amortize under a level monthly payment plan where the maturity or balloon payment is less than five years after the note date of the new first mortgage with the exception of employer subordinate financing that has deferred payments.

Employer Subordinate Financing

- Subordinate financing provided by the borrower's employer does not have to require regular payments of either principal and interest or interest only. Employer subordinate financing may be structured in any of the following ways:
  - Fully amortizing level monthly payments;
  - Deferred payments for some period before changing to fully amortizing level payments;
  - Deferred payments over the entire term; or
  - Forgiveness of the debt over time; and
  - The financing terms may provide for the employer to require payment in full of the debt if the borrower's employment is terminated, either voluntarily or involuntarily, before the maturity date of the subordinate financing.

Re-Subordination Requirements for Refinance Transactions

- If subordinate financing is left in place in connection with a first mortgage loan refinance transaction, execution and recordation of a re-subordination agreement is required.
- Title insurance against the fact that a former junior lien is not properly subordinated to the refinanced loan does not waive the requirement for compliance with these re-subordination requirements or from the requirement that the property is free and clear of all encumbrances and liens having priority over the first mortgage loan.
- The table below provides the underwriting considerations related to subordinate financing under refinance transactions:

Refinance transaction includes payoff of the first lien and…	***Then underwrite the transaction as a…***	***Comments***
The payoff of a purchase money second with no cash out,	Limited cash-out refinance	N/A
The payoff of a non-purchase money second, regardless of whether additional cash out is taken,	Cash-out refinance	N/A
The subordinate financing is being left in place, regardless of whether the subordinate financing was used to purchase the property, and the borrower is not taking cash out except to the extent permitted for a limited cash-out refinance transaction,	Limited cash-out refinance	The subordinate lien must be resubordinated to the new first mortgage loan.
The subordinate financing is being left in place regardless of whether the subordinate financing was used to purchase the property, and the borrower is taking cash out,	Cash-out refinance	The subordinate lien must be resubordinated to the new first mortgage loan.

Other Loan Attributes

Impact of Special Assessments on Maximum Loan Amount

- **If special assessments have been levied against the subject property and they are not paid at, or before, loan closing the maximum loan amount must be reduced by the amount of the unpaid special assessments.**
- If the subject property may be subject to liens for taxes and special assessments and the liens are not yet due and payable, they are not considered conditions, restrictions and encumbrances that are material and the maximum loan amount does not have to be reduced.
- Provide documentation to show that the current installments of taxes and assessments, or future installments of special assessments that have been levied, including those which may have been attached as prior liens but which are not now in arrears, have been paid or that sufficient deposits are being collected to pay them.

Premium Pricing

- Premium pricing refers to situations where a borrower selects a higher interest rate on a loan in exchange for a lender credit.
- **The lender credit cannot be used to fund any portion of the borrower's down payment and/or reserves** and should not exceed the amount needed to offset the borrower's closing costs.
- Any excess lender credit required to be returned to the borrower in accordance with applicable regulatory requirements is considered an overpayment of fees and charges and may be applied as a principal curtailment.

Private Transfer Fee Covenants

- In accordance with a regulation issued by the Federal Housing Finance Agency on March 16, 2012, Fannie Mae will not purchase or securitize mortgages on properties encumbered by private transfer fee covenants if those covenants were created on or after February 8, 2011 unless permitted by the Private Transfer Fee Regulation.
- Ensure that loans are not encumbered with a private transfer fee that is unacceptable under the Private Transfer Fee Regulation.

Rental Property Leases

- When the subject property is rented, the rental agreement or lease cannot include provisions that could significantly affect the mortgagee's first lien position.
- In some jurisdictions, leases that pre-date the mortgage have a superior claim to the mortgage even if they have not been recorded. Generally a tenant's rights under a pre-existing lease remain intact on the sale of the leased premises.
- Review each lease to ensure that any tenant's rights to purchase the property and any other rights that could adversely affect the mortgagee's interest have been waived formally by the tenant(s).

Principal Curtailments

- Curtailments are permitted for the following reasons:
  - A curtailment may be applied to refund the overpayment of fees or charges paid by the borrower, in any amount, in accordance with applicable regulatory requirements.
  - If the borrower receives more cash back than is permitted for a limited cash-out refinance, a curtailment to reduce the amount of cash back to the borrower can be applied to bring the loan into compliance with the maximum cash back requirements.
  - The maximum amount of the curtailment cannot exceed the lesser of $2,500 or 2% of the original loan amount for the subject loan.

Loan Purpose

Purchase Transactions

General Purchase Transaction Eligibility Requirements

- A purchase money transaction is one where the proceeds are used to finance the acquisition of a property.
- The minimum borrower contribution requirements for the selected mortgage loan type must be met.
- Proceeds from the transaction must be used to:
  - Finance the acquisition of the subject property; or
  - Payoff the outstanding balance on the installment land contract or contract for deed.
- Proceeds from the transaction may not be used to give the borrower cash back other than the following:

- An amount representing reimbursement for the borrower's overpayment of fees and charges including refunds that may be required in accordance with certain federal laws or regulations. The settlement statement must clearly indicate the refund and the loan file must include documentation to support the amount and reason for the refund; and
- A legitimate pro-rated real estate tax credit in locales where real estate taxes are paid in arrears.

Note: If the borrower receives cash back for a permissible purpose as listed above, confirm that the minimum borrower contribution requirements associated with the selected mortgage product, if any, have been met. Reimbursements or refunds permitted above may also be applied as a principal curtailment.

Requirements for Purchase transactions with LTV/CLTV/HCLTV Ratios of 95.01% - 97%

- If the LTV, CLTV, or HCLTV ratio exceeds 95% for a purchase transaction the following requirements apply:

Criteria	*Requirements*
LTV/CLTV or HCLTV Ratio	95.01% to 97%
Loan Type	Fixed rate loans with terms up to 30 years. **High balance loans are not permitted**.
Property	One unit principal residence. **Manufactured housing is not permitted.**
Borrower Eligibility	• At least one borrower must be a first time homebuyer. • At least one borrower on the loan must have a credit score.
Underwriting Method	DU only.
Reserves	Reserves requirements will be determined by DU.
Other	All other standard policies apply.

Non-Arms-Length Transactions

- Non-arms-length transactions are purchase transactions where there is a relationship or business affiliation between the seller and the buyer of the property.
- Non-arms-length transactions are allowed for the purchase of existing properties unless specifically forbidden for the particular scenario, such as delayed financing.
- For the purchase of newly constructed properties, if the borrower has a relationship or business affiliation (any ownership interest, or employment) with the builder, developer, or seller of the property, the mortgage transaction must be secured by a principal residence.

Purchase of Pre-foreclosure or Short Sale Properties

- Borrowers may pay additional fees, assessments or payments that are typically the responsibility of the seller or another party, in connection with acquiring a property that is a pre-foreclosure or short sale. Examples of additional fees, assessments, or payments include the following:
  - Short sale processing fees, also referred to as short sale negotiation fees, buyer discount fess, or short sale buyer fees;
    - **Note:** Short sale processing fees do not represent common and customary charges. They must be treated as a sales concession if any portion is reimbursed by an interested party to the transaction.
  - Payment to a subordinate lienholder; and
  - Payment of delinquent taxes or delinquent HOA assessments.
- The following requirements apply:
  - The borrower must be provided with written details of the additional fees, assessments, or payments and the additional necessary funds needed to complete the transaction must be documented.

- The existing lender that is agreeing to the pre-foreclosure or short sale must be provided with written details of the fees, assessment, or payments and has the option of re-negotiating the payoff amount to release its lien.
- All parties (buyer, seller and existing lender) must provide their written agreement of the final details of the transaction which must include the additional fees, assessment, or payments.
- The settlement statement must include all fees, assessments and payments included in the transaction.

Refinance Transactions

Limited Cash-Out Refinance Transactions

- Limited cash-out refinance transactions must meet the following requirements:
  - The transaction is being used to pay off an existing first mortgage loan, including an existing HELOC in first lien position, by obtaining a new first mortgage loan secured by the same property.
  - Only subordinate liens used to purchase the property may be paid off and included in the new mortgage. Exceptions are allowed for paying off a Property Assessed Clean Energy (PACE) loan or other debt (secured or unsecured) that was used solely for energy improvements.
    - For a PACE loan originated prior to July 6, 2010, there is no limit on how much of the limited cash-out refinance loan amount may be used to pay off the PACE loans.
    - For a PACE loan originated on or after July 6, 2010, or other debt used for energy improvements, the payoff amount included in the limited cash-out refinance is limited to 15% of the appraised value of the property.
  - The subject property must not be currently listed for sale. It must be taken off the market on or before the disbursement date of the new mortgage loan, and, for principal residence transactions, the borrowers must confirm their intent to occupy the subject property.
- If the LTV/CLTV/HCLTV ratio exceeds 95% for a limited cash-out transaction, the following requirements apply:

Criteria	Requirements
Existing Loan	Document that the existing loan being refinanced is owned or securitized by Fannie Mae. Documentation may come from: • The lender's servicing system; • The current servicer (if the lender is not the servicer); or • Fannie Mae's Loan Lookup Tool. Inform DU that Fannie Mae owns the existing mortgage using the "Owner of Existing Mortgage" field in the online application before submitting the loan to DU.
LTV, CLTV, or HCLTV Ratio	95.01% to 97% **Note:** The CLTV ratio can be up to 105% if the subordinate lien is a Community Seconds loan.
Loan Type	Fixed rate loans with terms up to 30 years. **Note: High balance mortgage loans are not permitted.**
Property and Occupancy	One unit principal residence. **All borrowers must occupy the property.** **Manufactured Housing is not permitted.**

Credit Score Requirements	At least one borrower on the loan must have a credit score.
Underwriting Method	DU only.
Other	All other standard limited cash-out refinance policies apply.

Note: The above requirements do not apply to DU Refi Plus loans. For additional information refer to the DU Refi Plus section of these guidelines.

Ineligible Transactions

- When the following conditions exist, the transaction is ineligible as a limited cash-out refinance and must be treated as a cash-out refinance:
  - There is no outstanding first lien on the subject property;
  - The proceeds are used to pay off a subordinate lien that was not used to purchase the property other than the exceptions for paying off PACE loans and other debt used for energy related improvements as described above;
  - The borrower finances the payment of real estate taxes that are more than 60 days delinquent for the subject property in the loan amount; and
  - A short-term refinance mortgage loan that combines a first mortgage and a non-purchase money subordinate mortgage into a new first mortgage or any refinance of that loan within six months.
- The transaction is not eligible when the subject property is listed for sale at the time of disbursement of the new mortgage loan.

Acceptable Uses

- The following are acceptable in conjunction with a limited cash-out refinance transaction:
  - Modifying the interest rate and/or term for existing mortgages;
  - Paying off the unpaid principal balance of the existing first mortgage, including pre-payment penalties.
  - Financing the payment of closing costs, points, and prepaid items. With the exception of real estate taxes that are more than 60 days delinquent, the borrower can include real estate taxes in the new loan amount as long as an escrow account is established.
    - If a particular state law does not allow required escrow accounts under certain circumstances, the loan would be eligible as a limited-cash out refinance without an escrow account.
  - Receiving cash back in an amount not to exceed **the lesser of** 2% of the loan amount or $2,000. The borrower may also receive a refund for the overpayment of fees and charges due to federal or state laws or regulations. Refunds such as these are not included in the maximum cash back limitation provided that:
    - The settlement statement clearly identifies the refunds; and
    - The loan file includes documentation to support the amount and reason for the refund.
    - This applies to standard limited cash-out refinance transactions and DU Refi Plus transactions.
  - Buying out a co-owner pursuant to an agreement;
  - Paying off a subordinate mortgage lien, including prepayment penalties, used to purchase the subject property.
    - **Document that the entire amount of the subordinate financing was used to acquire the property**; or
  - Paying off the unpaid principal balance of PACE loans and other debt used for energy related improvements, as described above.
- To treat a transaction as a limited cash-out refinance transaction, document that all proceeds of the existing subordinate lien were used to fund part of the subject property purchase price or pay for permissible energy related expenses. Written confirmation must be in the loan file.
- The following are acceptable forms of documentation:
  - A copy of the settlement statement for the purchase of the property;

- A copy of the title policy from the purchase transaction that identifies the subordinate financing;
- Other documentation from the purchase transaction that indicates that a subordinate lien was used to purchase the subject property; or
- For energy-related expenses, copies of invoices or receipts to evidence funds were used for energy improvements. An energy report may be required if the existing mortgage was a HomeStyle Energy mortgage transaction.

Remaining Existing Subordinate Liens

- When a new limited cash-out refinance transaction will not satisfy existing subordinate liens, the existing liens must be clearly subordinate to the new refinance mortgage.
- The refinance mortgage must meet all eligibility criteria for mortgages that are subject to subordinate financing.

New Subordinate Financing

- When a borrower obtains new subordinate financing with the refinancing of a first mortgage loan, treat the transaction as a limited cash-out refinance provided that the first mortgage loan meets the eligibility criteria for a limited cash-out refinance transaction.
- It is acceptable for borrowers to obtain cash from the proceeds of the new subordinate mortgage.

Refinances to Buy-Out an Owner's Interest

- A transaction that requires one owner to buy-out the interest of another owner, such as a result of a divorce settlement or dissolution of a domestic partnership, is considered a limited cash-out refinance **if the secured property was jointly owned for at least 12 months preceding the disbursement date of the new loan**.
- All parties must sign a written agreement that states the terms of the property transfer and the proposed disposition of the proceeds from the refinance transaction.
- Except in cases of recent inheritance of the subject property, documentation must be provided to indicate that the subject property was jointly owned by all parties for at least 12 months preceding the disbursement date of the new loan.
- Borrowers who acquire sole ownership of the property may not receive any of the proceeds from the refinancing. The party buying out the other party's interest must be able to qualify for the mortgage.

Exceptions to Limited Cash-Out Refinance Requirements for DU Refi Plus Transactions

- Certain exceptions to the standard limited cash-out refinance requirements exist for DU Refi Plus mortgages. These exceptions include:
  - The borrower is not permitted to pay off any existing subordinate liens with the proceeds from a new DU Refi Plus transaction;
  - The borrower may only receive $250 cash back at closing;
  - The borrower is not required to establish an escrow account if real estate taxes, regardless of due date, for the subject property are financed in the loan amount; and
  - The subject property may be listed for sale at the time of application or on the disbursement date.

Cash-Out Refinance Transactions

- Cash-out refinance transactions must meet the following requirements:
  - The transaction must be used to pay off existing mortgages by obtaining a new first mortgage secured by the same property or be a new mortgage on a property that does not have a mortgage lien against it.
  - Properties that were listed for sale must have been taken off the market on or before the disbursement date of the new loan.

- The property must have been purchased or acquired by the borrower at least six months prior to the disbursement date of the new mortgage loan except for the following:
  - There is no waiting period if it is documented that the borrower acquired the property through an inheritance or was legally awarded the property by divorce, separation, or dissolution of a domestic partnership.
  - The Delayed Financing requirements are met.
  - If the property was owned by a limited liability corporation (LLC) that is majority-owned or controlled by the borrower(s), the time is was held by the LLC may be counted towards meeting the borrower's six month ownership requirement. **In order to close the refinance transaction, ownership must be transferred out of the LLC and into the name of the individual borrower(s)**.
  - If the property was owned prior to closing by an *inter-vivos* revocable trust and the borrower is the primary beneficiary, the time held by the trust may be counted towards meeting the borrower's six month ownership requirement.

Ineligible Transactions

- The following transactions are not eligible as cash-out refinances:
  - The loan is subject to a temporary interest rate buy down.
  - The subject property was purchased by the borrower within six months preceding the disbursement date of the new loan except if delayed financing guidelines are met.
  - For certain transactions on properties that have a Property Assessed Clean Energy (PACE) loan, borrowers who refinance the first mortgage loan and have sufficient equity to pay off the PACE loan but choose not to do so will be ineligible for a cash-out refinance.
  - Transactions in which a portion of the proceeds of the refinance is used to pay off the outstanding balance on an installment land contract regardless of the date the installment land contract was executed.
  - The new loan amount includes the financing of real estate taxes that are more than 60 days delinquent and an escrow account is not established unless requiring an escrow account is not permitted by applicable law or regulation.
  - The loan is not eligible if the subject property is listed for sale at the time of disbursement of the new loan.

Acceptable Uses

- The following are acceptable uses for cash-out refinance transactions:
  - Paying off the unpaid principal balance of the existing first mortgage;
  - Financing the payment of closing costs, points, and prepaid items. The borrower can include the real estate taxes in the new loan amount.
    - Delinquent real estate taxes that are past due by more than 60 days can also be included in the new loan amount, but an escrow account must be established subject to applicable law or regulation.
  - Paying off any outstanding subordinate mortgage liens of any age;
  - Taking equity out of the subject property that may be used for any purpose; and
  - Financing a short-term refinance mortgage loan that combines a first mortgage and a non-purchase money subordinate mortgage into a new first mortgage or a refinance of the short-term refinance loan within six months.

Delayed Financing Exception

- Borrowers who purchased the subject property within the past six months, measured from the date when the property was purchased to the disbursement date of the new mortgage, are eligible for a cash-out refinance if **all** of the following requirements are met:
  - The original purchase transaction was an arms-length transaction.
  - The borrower may have initially purchased the property as one of the following:

    - A natural person;
    - An eligible *inter-vivos* revocable trust when the borrower is both the individual establishing the trust and the beneficiary of the trust;
    - An eligible land trust when the borrower is the beneficiary of the land trust; or
    - An LLC or partnership in which the borrower has an individual ownership of 100%.
  - The original purchase transaction is documented by a settlement statement which confirms that no mortgage financing was used to obtain the subject property. A recorded trustee's deed or similar alternative confirming the amount paid by the grantee to the trustee may be substituted for a settlement statement if a settlement statement was not provided to the purchaser at time of sale.
  - The preliminary title search or report must confirm that there is not an existing lien on the subject property.
  - The sources of funds for the purchase transaction are documented such as bank statements, personal loan documents or a HELOC on another property.
  - If the source of funds used to acquire the property was an unsecured loan or a loan secured by an asset other than the subject property, such as a HELOC secured by another property, the settlement statement for the refinance transaction must reflect that all cash-out proceeds be used to pay off or pay down, as applicable, the loan used to purchase the property. Any payments on the balance remaining from the original loan must be included in the DTI ratio calculated for the refinance transaction.
  - Funds received as gifts and used to purchase the property may not be reimbursed with proceeds from the new mortgage loan.
  - The new loan amount can be no more than the actual documented amount of the borrower's initial investment in purchasing the property plus the financing of closing costs, prepaid fees, and points on the new mortgage loan, subject to the maximum LTV, CLTV and HCLTV ratios for the cash-out transaction based on the current appraised value.
  - All other cash-out refinance eligibility requirements are met.
  - Cash-out pricing is applied.

Student Loan Cash-Out Refinances

- The student loan cash-out refinance feature allows for the payoff of student loan debt through the refinance transaction with a waiver of the cash-out refinance Loan Level Pricing Adjustment if all of the following requirements are met:
  - The loan must be underwritten in DU. DU cannot specifically identify these transactions but will issue a message when it appears that only subject property liens and student loans are marked "paid by closing".
  - The standard cash-out refinance LTV, CLTV, HCLTV ratios apply.
  - At least one student loan must be paid off with the proceeds from the subject transaction with the following criteria:
    - Proceeds must be paid directly to the student loan servicer at closing;
    - At least one borrower must be obligated on the student loan(s) being paid off; and
    - The student loan must be paid in full, partial payments are not permitted.
  - The transaction may also be used to pay off an existing first mortgage loan including an existing HELOC in first lien position.
  - Only subordinate liens used to purchase the property may be paid off and included in the new mortgage.
    - Exceptions are allowed for paying off a PACE loan or other debt, secured or unsecured, that was used solely for energy improvements.
  - The transaction may be used to finance the payment of closing costs, points and prepaid items. With the exception of real estate taxes that are more than 60 days delinquent, the borrower can include real estate taxes in the new loan amount as long as an escrow account is established.

- The borrower may receive cash back in an amount that is not more than the lesser of 2% of the loan amount or $2,000.
    - The borrower may also be refunded the overpayment of fees and charges due to federal or state laws or regulations or apply a principal curtailment.
- Unless otherwise stated all other standard cash-out refinance requirements apply.

Payoff of Installment Land Contract Requirements

- When the loan proceeds of a mortgage loan are used to pay off the outstanding balance on an installment land contract, also known as contract or bond for deed that was executed within 12 months preceding the date of the loan application, the loan is considered to be a purchase money mortgage loan.
- The LTV ratio for the mortgage loan must be determined by dividing the new loan amount by the **lesser of** the total acquisition cost (defined as the purchase price indicated in the land contract, plus any costs the purchaser incurs for rehabilitation, renovation or energy conservation improvements) or the appraised value of the property at the time the new mortgage loan is closed. The expenditures included in the total acquisition cost must be fully documented.
- When the installment land contract was executed more than 12 months before the date of the loan application, consider the mortgage loan to be a limited cash-out refinance. In this case the LTV ratio for the mortgage loan must be determined by dividing the new loan amount by the current appraised value of the subject property.
- Cash-out refinance transactions involving installment land contracts are not eligible.

Property Assessed Clean Energy Loans (PACE/HERO)

- Certain energy retrofit lending programs, often referred to as Property Assessed Clean Energy programs are made by localities to finance residential energy improvements and are generally repaid through the homeowner's real estate tax bill.
- These loans typically have automatic first lien priority over previously recorded mortgages.
- Mortgage loans secured by properties with an outstanding PACE/HERO loan are ineligible unless the terms of the PACE/HERO loan program do not provide for lien priority over the first mortgage lien.
- If the PACE/HERO loan is structured as a subordinate or unsecured loan, the first mortgage may be underwritten to standard guidelines.

Desktop Underwriter

General Information

Overview

- Fannie Mae's automated underwriting system, Desktop Underwriter (DU), evaluates mortgage delinquency risk and arrives at an underwriting recommendation by relying on a comprehensive examination of the primary contributory risk factors in a mortgage application. DU analyzes the information in the loan casefile to reach an overall credit risk assessment to determine eligibility.
- There is no single factor that determines a borrower's ability or willingness to make his/her mortgage payments. DU identifies the low-risk factors that can offset high risk factors. When several high risk factors are present in a loan casefile without sufficient offsets, the likelihood of serious delinquency increases.
- DU conducts its analysis uniformly and without regard to race, gender, or other prohibited factors. DU uses validated, statistically significant variables that have been shown to be predictive of mortgage delinquency across all groups.
- DU does not evaluate a loan's compliance with federal and state laws and regulations including without limitation a loan's potential status as a qualified mortgage under applicable laws and regulations.

Underwriting with DU

- When underwriting with DU:

- Employ prudent underwriting judgment in assessing whether a loan casefile should be approved.
- Confirm the accuracy of the data submitted making sure that all data that might have affected the DU recommendation has been included.
- Ensure that the loan complies with all of the verification messages and approval conditions specified in the DU Underwriting Findings report;
- Apply due diligence when reviewing the documentation in the loan file;
- Review the credit report to confirm that the data that DU evaluated with respect to the borrower's credit history was accurate and complete;
- Determine if there is any potentially derogatory or contradictory information that is not part of the data analyzed by DU; and
- Take action when erroneous data in the credit report or contradictory or derogatory information in the loan file would justify additional investigation or would provide grounds for a decision that is different from the recommendation that DU delivered.

DU Recommendations

Approve/Eligible Recommendations

- The following table describes approve/eligible recommendations:

Approve/Eligible	
Eligible for Fannie Mae's limited waiver of certain mortgage loan eligibility and underwriting reps and warranties:	Yes as long as the mortgage loan satisfies the applicable requirements related to limited waivers.
Satisfies Fannie Mae's credit risk standards/assessments:	Yes
Satisfies Fannie Mae's mortgage loan eligibility criteria:	Yes
Eligible for deliver to Fannie Mae:	Yes

Approve/Ineligible and Refer with Caution Recommendations

- These risk decisions are **not eligible**.

Out of Scope Recommendations

- An out of scope recommendation indicates that DU is unable to underwrite the particular product, mortgage or borrower described in the submission.
- Any mortgage that receives and Out of Scope recommendation is **not eligible**.

Erroneous Credit Report Data

Erroneous Credit Information

- Underwriters are responsible for ensuring that the credit report data used by DU in its underwriting analysis is accurate.
- Significant, material credit errors in a borrower's credit report may have a negative impact on the underwriting recommendation from DU.
- When there is documented evidence of material erroneous credit data, the credit repository must correct the data and the loan must be resubmitted to DU for underwriting.

Merged Credit Reports

- Errors that are the result of the credit merge do not typically affect the credit risk analysis of the casefile.

- DU attempts to identify duplicate trade lines, including public record items, that are the result of the merge and ignores duplicate accounts in the credit analysis.
- Public record information is frequently duplicated on the credit report because the credit agencies do not attempt to merge or match items of this nature. A public record item may appear in the credit report three times, once from each repository, but the duplication will not affect the analysis of the case.

Derogatory Credit Reported in Error

- If it is determined that significant derogatory credit has been reported in error, obtain written documentation that supports the error.
- The following types of written documentation supports erroneous information:
  - A supplement to the credit report;
  - A new mortgage credit report; and/or
  - Documentation from the credit provider that reported the error.

Accuracy of DU Data, DU Tolerances, and Errors in the Credit Report

DU Data Accuracy

- The data submitted to DU must reflect the loan as it was closed including occupancy type, product type, amortization, loan term, property type, loan purpose, sales price and appraised value.
- Verification documents must be reviewed and verified values compared to the data submitted to DU.
- The terms of the closed loan must match the terms of the final loan casefile submission to DU or fall within the tolerances listed in the following table:

Data Attribute and Description	*Trigger*	*Action Required*
• Interest rate increase • Discrepancies between the credit report payments and balances and those listed on the loan application, including the presence of debt that is on the credit report but not on the application. • Additional debt(s) disclosed by the borrower or identified during the mortgage process. • Verified income is less than the income on the loan application submitted to DU.	DU loans (excluding DU Refi Plus) – The result of these changes causes the DTI ratio to increase by 3 or more percentage points up to the maximum of 50%. DU Refi Plus loans – The result of these changes causes the DTI ratio to increase by 3 or more percentage points.	Loan casefile must be resubmitted to DU.
Interest rate.	Interest rate decreases, not as the result of a permanent interest rate buy down.	No resubmission required.
Interest rate.	Interest rate decreases as a result of a permanent interest	Loan casefile must be resubmitted to DU.

	rate buy down.	
Verified income used to qualify the borrower for loans subject to HUD median income limits; for example, as with community lending mortgages.	Income is greater than the loan application indicates.	Loan casefile must be resubmitted to DU.
Assets – Funds Required to Close	The actual amount of assets required to close the transaction exceeds the amount of "Funds Required to Close" per the DU Underwriting Findings report.	If sufficient liquid assets to cover the actual amount of assets required to close the transaction have been documented, no resubmission required. ***Otherwise,*** loan casefile must be resubmitted to DU.
Assets – Reserves Required to be Verified	Due to changes in the actual amount of assets required to close the transaction, the verified amount of reserves is less than the "Reserves Required to be Verified" per the DU Underwriting Findings report.	If reserves that equal at least 90% of the "Reserves Required to be Verified" per the DU Underwriting Findings report have been verified, no resubmission required. ***Otherwise***, loan casefile must be resubmitted to DU.

DU Tolerances for Refinance Loan Amounts

- For refinance transactions the following tolerances to the loan amount are allowed:
  - The loan amount may increase $500 or up to 1% of the loan amount whichever is less.
  - The loan amount may decrease 5% of the loan amount.
- The loan amount tolerances are permitted provided the new LTV/CLTV does not result in:
  - Changes to the amount of required mortgage insurance coverage;
  - Different loan-level price adjustments; or
  - Changes to loan eligibility.
  - For example, if a loan casefile is submitted with a loan amount of $100,000 and the appraised value is $120,000 (which equals 83.3% LTV) the actual loan amount can go up to $100,500 (which equals 83.75% LTV) without requiring resubmission.
- If the original loan amount was $108,000 (90% LTV) an increase without resubmission is not permitted because it would result in an LTV of 91%. The higher LTV requires different mortgage insurance coverage and may result in the loan not being eligible.
- The loan amount tolerance does not apply to requirements regarding the amount of cash back to the borrower on a limited cash-out refinance transaction.

Other Errors in the Credit Data

- In some cases errors are the result of reporting errors by the credit agency or individual creditors.
- If the credit report contains derogatory information and DU does not recognize or consider the derogatory information and does not reflect the derogatory information in the DU Underwriting Findings report, take action when information not considered by DU would result in a recommendation other than that returned by DU.
  - For example, if a borrower's credit report indicates that the borrower has a previous foreclosure, but the DU Underwriting Findings report does not reference the foreclosure, a reporting or data transfer error may have occurred preventing DU from considering the foreclosure in its analysis of the loan. Take action to ensure that the information is considered in the risk analysis.

Non-Applicant Debts/Accounts

- In a small number of cases credit reports may include accounts identified as possible non-applicant accounts, or with another similar notation.

- Non-applicant accounts may belong to the borrower or they may truly belong to another individual.
- Typical causes of non-applicant accounts include:
  - Borrowers who are Juniors/Seniors;
  - Individuals who move frequently;
  - Non-related individuals who have identical names; and
  - Debts the borrower applied for under a different social security number or under a different address. **This may indicate potential fraud**.
- When DU encounters possible non-applicant accounts on the credit report, DU will include the accounts in the credit risk assessment and will issue a message in the DU Underwriting Findings report alerting to the existence of the accounts.
- If the debts are on the loan application, DU will also include them in the DTI ratio.
- If the debts do not belong to the borrower, obtain supporting documentation, remove the debts from the loan application, and resubmit the loan casefile to DU in order for the DTI to be updated to exclude the non-applicant debts.

Potential Red Flag Messages

- DU provides a number of "potential red flag" messages designed to help detect inconsistencies in the loan casefile.
- Neither the presence nor absence of these messages alters the underwriter's responsibility to ensure accurate information in all areas of the loan process or otherwise comply with applicable law including the Fair Credit Reporting Act.
- The appearance of these messages does not affect the underwriting recommendation from DU. Rather, they are designed to help detect inconsistencies. The absence of any of these messages does not indicate or imply acceptance of the data submitted to DU.
- Following are some of the potential red flag messages:
  - Excessive resubmissions: A message alerts to when an unusually high number of loan resubmissions may be the result of data manipulation.
  - Manufactured home caution: A message alerts users when a property type was not submitted as a manufactured home but Fannie Mae's property database indicates that it may be a manufactured home.

DU Validation Service

General Information

- The DU validation service offers an opportunity to underwrite loans with more certainty.
- Certain components of the loan file – income, employment, and assets – are eligible for validation by DU using electronic verification reports obtained from vendors.
- When a component of the loan is validated by DU, the loan may be eligible for representation and warranty enforcement relief related to that component.
- Different quality control and documentation requirements may also apply.

Authorized Vendors and Verification Reports

- Obtain a verification report directly from a "report supplier" or from a "report distributor" as described below:
  - Report suppliers have entered into an agreement with Fannie Mae to participate in the DU validation service. Report suppliers generate the report and send the report electronically to the DU validation service. This report reflects the report supplier's name and logo.
  - Report distributors have not entered into an agreement with Fannie Mae, but have an agreement with an eligible report supplier. The report supplier, not the distributor, sends the report data electronically to the DU validation service. The verification report reflects the report distributor's name and the name and/or logo of the applicable report supplier.
- The DU Validation Service Verification Report Vendors list provides a listing of authorized report suppliers and report distributors and is available on Fannie Mae's website.

Lender Requirements

- In order to participate in the DU validation service lenders must:
  - Have a relationship with, and have entered into a contract for the services provided by, a vendor(s) – either a report supplier or a report distributor – that is authorized to obtain verification reports;
  - Have an agreement with a vendor(s) that allows for the report supplier to share the information contained within the verification report with Fannie Mae electronically for use by the DU validation service; and
  - Establish controls to manage and monitor the vendors.
- For loans assessed by the DU validation service, lenders must:
  - Obtain borrower authorization to receive the information from the vendor;
  - Confirm that the verification report matches the borrower;
  - Ensure information entered in DU is properly documented;
  - Investigate and resolve any conflicting or contradictory information;
  - Retain a copy of all verification reports in the loan file, in addition to any other documentation required by DU; and
  - Ensure that the most current version of the verification report is used by the DU validation service.
    - If an updated verification report is obtained, resubmit the loan to DU and make sure a message is received indicating that the component has been validated in order for the rep and warrant enforcement relief to apply.

Validation Results

- When a component of the loan file is assessed by the DU validation service, three results are possible: validated, not validated, or unable to be validated. DU will issue a message providing the validation results.
- **Validated:** DU has determined that the information provided on the verification report supports the information entered into DU for the component being validated.
- **Not Validated:** DU has determined that the information provided on the verification report does not fully support the information entered into DU for the component of the loan file eligible for validation.
- **Unable to Validate:** DU is unable to validate the information entered into DU for the component eligible for validation. This could be due to DU's inability to access the verification report data, or insufficient data in the report.
- The DU message(s) will indicate what documentation is required.
- Regardless of the validation result, DU will continue to use the information provided in determining the DU underwriting recommendation. The results of the validation service do not override, impact, or alter any information submitted to DU.

Income Validation

- **Military income is not eligible for income validation by DU.**
- The following table lists the income types that can be validated and the documentation that DU will require which may be different than the standard documentation.

<table>
<tr><th>Eligible Income Type</th><th>Eligible Verification Report</th></tr>
<tr><td>Base</td><td rowspan="4">Employment and Income Verification Report</td></tr>
<tr><td>Bonus</td></tr>
<tr><td>Overtime</td></tr>
<tr><td>Commission < 25% of total income</td></tr>
<tr><td>Commission ≥ 25% of total income</td><td>Employment and Income Verification Report; and Tax Return Transcripts (Taxpayer Tax Return Summary Report)</td></tr>
</table>

Retirement (annuities and pensions)	Tax Return Transcript (Taxpayer Tax Return Summary Report)
Social Security (retirement, disability, supplemental, survivor benefits)	Tax Return Transcript (Taxpayer Return Summary Report) Additional documentation may be required depending on the type of Social Security income.
Self-employed (IRS Form 1040 Schedules C or C-EZ for sole proprietorships only)	Tax Return Transcript (Taxpayer Tax Return Summary Report)

- The following additional information applies to income validated by DU:
  - The vendor may offer options to obtain income information. Both of the following methods are acceptable for use with the DU validation service:
    - Data obtained from the report supplier's existing database of employer provided information; and
    - Data developed from a manual request for the report supplier to contact the employer directly to obtain the information.
  - When DU validates income, underwriters are not required to determine if the borrower is employed by a family member or interested parties to the transaction.
  - When DU validates income, employment verification must also be obtained. The verification report may contain sufficient information to satisfy this requirement.
  - Review the verification report and investigate and resolve any conflicting or contradictory information.
  - The dates of the employment and income verification reports must comply with the standard age of credit documentation requirements.
- In order to ensure that the income validation is completed using the most recent tax transcripts, the following will be used to determine if the transcript contains the most recent tax return information.
  - For loan casefiles created on or before April 30, the most recent tax transcript must be provided. The most recent tax transcript would be for the prior year (current year minus 1). If the prior year tax return has not yet been filed or the transcript is not yet available, the most recent tax transcript will be the current year minus 2.
  - For loan casefiles created after April 30, the most recent year tax transcript must be provided for validation to be completed. The most recent tax transcript will be for the prior year (current year minus 1).

Employment Validation

- **Military employment is not eligible for employment validation by DU.**
- The following table describes the employment that can be validated and the documentation that DU will require, which may be different than the standard documentation requirements.

Eligible Employment	***Eligible Verification Report***
Employment related to the following income types: • Base • Bonus • Overtime • Commission income	Employment and Income Verification Report or Employment Verification Report

- The following additional information applies to employment validated by DU:
  - The vendor may offer options to obtain employment information. Both of the following methods are acceptable for use with the DU validation service:
    - Data obtained from the report supplier's existing database of employer provided information; and
    - Data developed from a manual request for the report supplier to contact the employer directly to obtain the information.

- Income and employment are assessed independently; however, the results of the employment validation may impact income validation.
  - For example, if employment is not able to be validated, the associated income will not be validated.
- When employment is validated by DU, the validation satisfies the requirement for verbal verification of employment. Comply with all DU messages, including ensuring the loan closes by the "Close by Date" stated in the DU employment validation message.
- Review the verification report including any Employer Disclaimer information, and investigate and resolve any conflicting or contradictory information.

Asset Validation

- The following table lists the asset types that can be validated and the documentation that DU will require, which may be different than the standard documentation requirement.

Eligible Asset Types	***Eligible Verification Report***
Total funds to be verified as required by DU, based on assets held in the following accounts: • Checking • Savings • Certificates of Deposit • Stocks • Money Market • Mutual Funds • Retirement	Asset Verification Report Additional documentation may be required depending on the type of asset account and the assessment conducted by DU for validation purposes.

- The account statements obtained from the vendor must cover the most recent:
  - 30 days of account activity for refinance transactions.
  - 60 days of account activity for purchase transactions.
  - The most recent quarter, if account information is reported on a quarterly basis.
- Review the verification report and investigate and resolve any conflicting or contradictory information and confirm that the borrower is listed as an account holder for each asset account.
- The DU validation service automates the assessment of large deposits on purchase transactions. When a large deposit needs to be documented, DU will issue a message specifying the amount of the large deposit, as well as the institution name and account number of the account that includes the large deposit. If no message is issued by DU, then no documentation of any large deposit appearing on the asset report is required when assets have been validated.
- If the actual amount of funds required to complete the transaction is greater than the Funds Required to Close specified in DU, document liquid assets to cover the additional amount.
- For self-employed borrowers, if an eligible asset account is reflected as a business account on the verification report, **perform a business cash flow analysis** to confirm that the withdrawal of funds for this transaction will not have a negative impact on the business. If it is determined the withdrawal would have a negative impact on the business, remove the assets from the online loan application, obtain an updated verification report that excludes the business account, and resubmit the loan to DU.

Credit History

Credit Scores

DU Credit Score Requirements

- In no case may credit scores be lower than ***620***.
  - DU Refi Plus mortgage loans are not subject to this requirement.

- Credit scores are not an integral part of DU's risk assessment because DU performs its own analysis of the credit report data. However, credit scores must still be obtained for each borrower.
- If one or two of the credit repositories do not contain any credit information for borrowers who have traditional credit the credit report is still acceptable as long as:
  - Credit data is available from one repository;
  - A credit score is obtained from that repository; and
  - A three in-file merged report was requested.
- If the transaction does not meet the above requirements refer to the DU Non-Traditional Credit History section of these guidelines for the underwriting and eligibility requirements for DU loans where one or more borrowers do not have a credit score.

Representative Credit Score

- The representative credit score for the mortgage loan is determined based on the credit scores of each borrower and is used to determine loan eligibility.
- Follow these steps to calculate the representative credit score for a mortgage:

Step	Description
1	Select a single applicable score for each borrower. • When two credit scores are obtained choose the lower score. • When three credit scores are obtained choose the middle score. • If two of the three scores are the same, choose the middle of the three scores. For example: ▪ 700, 680, 680 = 680 ▪ 700, 700, 680 = 700
2	If there is only one borrower the single applicable score is the representative credit score for the mortgage. If there are multiple borrowers determine the applicable credit score for each individual borrower and select the lowest score from the group as the representative credit score for the mortgage. If there is a borrower who does not have a credit score determine the representative credit score for the mortgage based on the credit scores of the other borrower(s).

- Foreign credit reports may not be used with DU loan casefiles.
- Borrowers with foreign credit are not eligible.

Credit Reports

Acceptable and Unacceptable Changes

- Collected credit report information should not be changed. It is permissible to delete duplicate information, translate codes to plain language, and make appropriate adjustments to resolve conflicting information to ensure the clarity of the report.
- The following types of changes are unacceptable:
  - Deleting trade lines that pertain to a borrower's bankruptcy;
  - Adding a payment amount to a creditor's trade line when the creditor does not require a payment; or
  - Restricting information collection to a shorter time period than required.

Unreported Debts

- If the credit report does not include a reference for each significant debt on the application, obtain a separate written verification for each unreported debt.
- Separately verify accounts listed as "will rate by mail only" or "need written authorization".

DU Credit Report Requirements

- A three in-file merged credit report must be ordered.
- A DU observation message will identify all of the credit reports evaluated by DU during the loan submission. The version of the credit report received by DU must be one that supports trended credit data. Trended credit data is expanded information on a borrower's credit history at a trade line level on several monthly factors including amount owed, minimum payment and payments made.
- The borrower's current address must be within the U.S., territories, or an APO, FPO, or DPO military address located within the U.S. in order to obtain a credit report that is compatible with DU loan casefile requirements.

Accuracy of Credit Information

- For all mortgage loans, underwriters are responsible for reviewing the credit report, as well as all credit information, to determine that the credit report meets all requirements and that the data evaluated by DU was accurate.
- If a borrower indicates that any significant information in the credit file is inaccurate, such as reported accounts that do not belong to a borrower or derogatory information that is reported in error, carefully review the credit information and then request that the credit reporting company that provided the information confirm its accuracy.

Disputed Trade Lines

- DU will indicate if underwriters are required to investigate the disputed account to determine if the account belongs to the borrower and confirm the accuracy and completeness of the information reported on the account.

Significant Derogatory Credit Events- Waiting Periods and Re-establishing Credit

General Information

- Examples of significant derogatory credit events include:
  - Bankruptcies;
  - Foreclosures;
  - Deeds-in-Lieu of Foreclosure;
  - Charged-Off Mortgage Accounts; and
  - Pre-Foreclosure Sales and Short sales. The terms "pre-foreclosure sale" and "short sale" are used interchangeably and have the same meaning.
- Determine the cause and significance of the derogatory information, verify that sufficient time has elapsed since the date of the last derogatory information, and confirm that the borrower has re-established an acceptable credit history.
- Underwriters must make the final decision about the acceptability of a borrower's credit history when significant derogatory credit information exists.
- Review the public records section of the credit report and all trade lines including mortgage accounts which include first liens, second liens, home improvement loans, HELOCs, and manufactured home loans, to identify previous foreclosures, deeds-in-lieu, pre-foreclosure sales, charged off mortgage accounts, and bankruptcies.
- Carefully review the current status of each trade line, manner of payment codes, and remarks to identify these types of significant derogatory credit events.
  - Remarks codes are descriptive text or codes that appear on a trade line such as "Foreclosure", "Forfeit deed-in-lieu of foreclosure", and "Settled for less than full balance".

- Significant derogatory credit events may not be accurately reported or consistently reported in the same manner by all creditors or credit reporting agencies. If not clearly identified in the credit report, obtain copies of appropriate documentation. The documentation must establish the completion date of a previous foreclosure, deed-in-lieu of foreclosure or pre-foreclosure sale, or date of the charged-off mortgage account. Confirm the bankruptcy discharge or dismissal date and identify debts that were not satisfied by the bankruptcy.
    - Debts that were not satisfied by a bankruptcy must be paid off or have an acceptable, established repayment schedule.

Bankruptcy – Chapter 7 and Chapter 11

- A four year waiting period is required measured from the discharge or dismissal date of the bankruptcy action.
- *Extenuating Circumstances:* A two year waiting period is permitted if extenuating circumstances can be documented and is measured from the discharge or dismissal date of the bankruptcy action.

Bankruptcy – Chapter 13

- A distinction is made between Chapter 13 bankruptcies that were discharged and those that were dismissed. The waiting period required for Chapter 13 bankruptcy actions is measured as follows:
    - Two years from the discharge date; or
    - Four years from the dismissal date.
- The shorter waiting period based on the discharge date recognizes that a borrower already met a portion of the waiting period within the time needed for the successful completion of a Chapter 13 plan and subsequent discharge.
- A borrower who was unable to complete the Chapter 13 plan and received a dismissal will be held to a four year waiting period.
- *Extenuating Circumstances:* A two year waiting period is permitted after a Chapter 13 dismissal if extenuating circumstances can be documented. There are no exceptions permitted to the two year waiting period after a Chapter 13 discharge.

Multiple Bankruptcy Filings

- For a borrower with more than one bankruptcy filing within the past seven years, a five year waiting period is required measured from the most recent dismissal or discharge date.
- Two or more borrowers with individual bankruptcies are not cumulative and do not constitute multiple bankruptcies.
- *Extenuating Circumstances:* A three year waiting period is permitted if extenuating circumstances can be documented and is measured from the most recent bankruptcy discharge or dismissal date. The most recent bankruptcy filing must have been the result of extenuating circumstances.

Foreclosure

- A seven year waiting period is required and is measured from the completion date of the foreclosure action as reported on the credit report or other foreclosure documents provided by the borrower.
- *Extenuating Circumstances:* A three year waiting period is permitted if extenuating circumstances can be documented and is measured from the completion date of the foreclosure action. Additional requirements apply between three and seven years which include:
    - Maximum LTV, CLTV, or HCLTV ratios of the lesser of 90%, or the maximum LTV, CLTV, or HCLTV ratios for the transaction per the *Eligibility Matrix*.
    - The purchase of a principal residence is permitted.

- Limited cash-out refinances are permitted for all occupancy types pursuant to the eligibility requirements in effect at that time.
- **The purchase of second homes or investment properties and cash-out refinances of any occupancy type are not permitted until a seven year waiting period has elapsed.**

Foreclosure and Bankruptcy on the Same Mortgage

- If a mortgage debt was discharged through a bankruptcy, the bankruptcy waiting period may be applied if the appropriate documentation is obtained to verify that the mortgage obligation was discharged in the bankruptcy.
- Otherwise, the greater of the applicable bankruptcy or foreclosure waiting periods must be applied.

Deed-in-Lieu of Foreclosure, Pre-Foreclosure Sale, and Charged-Off Mortgage Account

- These transaction types are completed as alternatives to foreclosure.
  - A deed-in-lieu of foreclosure is a transaction where the deed to the real property is transferred back to the existing lender. These are typically identified on the credit report as "Forfeit deed-in-lieu of foreclosure".
  - A pre-foreclosure sale or short sale is the sale of a property in lieu of foreclosure resulting in a payoff of less than the total amount owed which was pre-approved by the existing lender. These are typically identified on the credit report as "Settled for less than full balance".
  - A charged-off mortgage account occurs when a creditor has determined that there is little, or no, likelihood that the mortgage debt will be collected. A charge-off is typically reported after an account reaches a certain delinquency status and is identified on the credit report with a code of "9".
- A four year waiting period is required from the completion date of the deed-in-lieu of foreclosure, pre-foreclosure sale, or charged-off mortgage account as reported on the credit report or other documents provided by the borrower.
- *Extenuating Circumstances:* A two year waiting period is permitted if extenuating circumstances can be documented.

Summary – All Waiting Period Requirements

- The table below summarizes the waiting period requirements for all significant derogatory credit events:

Derogatory Event	*Waiting Period Requirements*	*Waiting Period with Extenuating Circumstances*
Bankruptcy – Chapter 7 or 11	Four Years	Two Years
Bankruptcy – Chapter 13	Two Years from Discharge Date Four Years from Dismissal Date	Two Years from Discharge Date Two Years from Dismissal Date
Multiple Bankruptcy Filings	Five years if more than one filing within the past seven years	Three years from the most recent discharge or dismissal date.
Foreclosure*****	Seven Years	Three Years Additional requirements after three years up to seven years: • 90% maximum LTV ratios****** • Purchase, principal residence • Limited cash-out refinance, all occupancy types
Deed-in-Lieu of Foreclosure, Pre-foreclosure Sale, or	Four Years	Two Years

Charged-Off Mortgage Account		

***When both a bankruptcy and foreclosure are disclosed on the loan application, or when both appear on the credit report, the bankruptcy waiting period may be applied if the appropriate documentation to verify that the mortgage loan was discharged in the bankruptcy is obtained. Otherwise the greater of the applicable bankruptcy or foreclosure waiting period must be applied.

****References to LTV ratios include LTV, CLTV, and HCLTV ratios. The maximum LTV ratios permitted are the lesser of the LTV ratios in this table or the maximum LTV ratios for the transaction per the *Eligibility Matrix*.

Requirements for Re-establishing Credit

- After a bankruptcy, foreclosure, deed-in-lieu of foreclosure, pre-foreclosure sale or charged-off mortgage account, the borrower's credit will be considered re-established if all of the following are met:
  - The waiting period and the related additional requirements are met;
  - The loan receives an approve/eligible recommendation from DU; and
  - The borrower has traditional credit. Non-traditional credit files are not acceptable.

Extenuating Circumstances for Derogatory Credit

Extenuating Circumstances

- Extenuating Circumstances are non-recurring events that are beyond the borrower's control that result in a sudden, significant, and prolonged reduction in income or a catastrophic increase in financial obligations.
- If a borrower claims that derogatory information is the result of extenuating circumstances, the borrower's claim must be substantiated. Examples of documentation that can be used to support extenuating circumstances include:
  - Documents that confirm the event such as a copy of a divorce decree, medical reports or bills, notice of job layoff, job severance papers, etc.; and
  - Documents that illustrate factors that contributed to the borrower's inability to resolve the problems that resulted from the event such as a copy of insurance papers or claim settlements, property listing agreements, lease agreements, tax returns covering the periods prior to, during, and after a loss of employment, etc.
    - **Use caution when obtaining medical reports, bills or insurance papers. It is a violation of HIPPA for the loan file to contain any information that details the nature of a borrower's medical situation.**
- Obtain a written explanation from the borrower explaining the relevance of the documentation.
- The written explanation must support the claims of extenuating circumstances, confirm the nature of the event that led to the bankruptcy or foreclosure related action, and illustrate that the borrower had no reasonable options other than to default on his/her financial obligations.

DU Credit Report Analysis

Inquiries

- Examine inquiries to determine whether they represent potential sources of undisclosed credit.
- If new debt was obtained correct the loan application to reflect the new payment(s) and balance(s) and resubmit the casefile to DU.

Trended Credit Data

- Underwriters are not required to analyze trended data in the credit report.

Omitted Accounts

- Supporting documentation is required when a credit report liability with a balance greater than zero is omitted from the loan application.

Possible Non-Applicant Debt

- The DU Underwriting Findings report will list any debts that are identified as “possible non-applicant debts” on the credit report.
- The possible non-applicant accounts will be included in the credit risk assessment and, if the debts are on the loan application, DU will include them in the DTI ratio.
- If the debts do not belong to the borrower, obtain supporting documentation, remove the debts from the loan application, and resubmit the loan casefile to DU.

Authorized User Trade Lines

- DU takes credit report trade lines designated as authorized user trade lines into consideration as part of the DU credit risk assessment.
- Review credit report trade lines where the borrower has been designated as an authorized user in order to ensure the trade lines are an accurate reflection of the borrower’s credit history.
- If the authorized user trade lines are not an accurate reflection of the borrower’s credit history, evaluate the borrower’s credit history without the benefit of these trade lines and use prudent underwriting judgment when making the final underwriting decision.
- DU issues a message providing the name of the creditor and account number for each authorized user trade line identified.
- When ensuring trade lines are an accurate reflection of the borrower’s credit history, if the borrower has several authorized user accounts but has few accounts of his/her own, establish:
  - The relationship of the borrower to the owner of the account;
  - Whether the borrower uses the account; and
  - Whether the borrower makes the payments on the account.
- If the authorized user trade line belongs to another borrower on the mortgage loan no additional investigation is needed.
- If the borrower has several trade lines in good standing and only a minor number of authorized user accounts, it may be possible to determine that:
  - The authorized user accounts had minimal, if any, impact on the borrower’s overall credit profile; and
  - The information reported on the credit report is an accurate reflection of the borrower’s credit history.
- Authorized user trade lines that belong to the borrower’s spouse, when the spouse is not on the mortgage transaction, do not have to be reviewed.

Disputed Credit Report Trade Lines

- When the credit report contains trade lines disputed by the borrower DU will first assess the risk of the loan casefile using all trade lines, including those disputed. If DU issues an “approve/eligible” recommendation using the disputed trade lines, no further documentation or action is necessary. DU will issue a message specific to this scenario.
- If DU does not issue an “approve/eligible” recommendation when including the disputed trade lines, DU will re-assess the risk without using the disputed trade lines. If DU is then able to issue an “approve/eligible” recommendation, investigate the trade lines to determine whether the borrower is responsible for the accounts or if the account information is accurate or complete.
  - If the borrower is not responsible for the disputed account, obtain supporting documentation and close the loan as a DU loan. No further action is necessary regarding the disputed trade lines.
  - If the borrower is responsible for the disputed account, investigate the information, including determining the aspect of the trade line that is being disputed. If the borrower is able to provide documentation to disprove any adverse information, such as cancelled checks, the loan may be closed as a DU loan.
  - If the borrower is responsible for the disputed account and the account and trade line information is accurate and complete, the loan is not eligible.
- Underwriters are not required to investigate disputed medical trade lines.

- The monthly payments for the disputed trade lines must be included in the debt-to-income ratio if the accounts belong to the borrower.
- The following scenarios are examples of when a loan receiving an “approve/eligible” recommendation with the disputed trade line(s) excluded from DU’s risk assessment would be eligible as a DU loan.
  - A borrower’s account was referred for collection by the creditor. Subsequently the borrower paid off the account but the payoff was not reported on the trade line. The borrower requested that a dispute be placed on the trade line. The trade line information was accurate but because it did not reflect that the borrower paid off the account, it may be considered incomplete. The borrower must provide documentation that the account was paid in full.
  - A borrower and his son have the same name (Sr. and Jr.). The borrower’s credit report contains a trade line that actually belongs to his son. The trade line is reported as disputed. The borrower can provide confirmation that he is not obligated on the account.
  - The lender of a disputed loan indicates a late payment in January of the previous year. The borrower can provide documentation, such as cancelled checks or bank statements, indicating that the payment was made on time.
- The following scenario is an example of when a loan receiving an “approve/eligible” recommendation with the disputed trade line(s) excluded from DU’s risk assessment would not be eligible as a DU loan:
  - The credit report indicates a disputed trade line on the borrower’s mortgage being refinanced. The trade line indicates a 60-day late payment in January of the previous year. The borrower cannot provide any documentation to support that the payment was made on time.

DU Debt Comparison

- DU compares the balances and payments of the debts on the credit report with the debts on the loan application.
- If material differences are found, confirm that all debts from the credit report are included on the loan application and provide documentation to support the use of payments and balances lower than those on the credit report.
- If the debt affects the DTI ratio by more than the allowable tolerances, add the debt to the loan application and resubmit the loan to DU.
- Otherwise, obtain documentation that supports the omission from the loan application.

Contradictory, Derogatory or Erroneous Information

- Underwriters are obligated to take action when contradictory, derogatory or erroneous information would justify additional investigation or would provide grounds for a decision that is different from DU’s recommendation.

Duplicate Public Records

- Items that typically appear in the public records section of the credit report such as judgments, bankruptcies, foreclosures, and tax liens, are often duplicated because the credit agencies may not attempt to merge items of this severe nature.
- These items may also appear in more than one verification message in the Underwriting Findings report. If it is clear from the credit report data that the items are duplicates such as identical account numbers, date filed, and dollar amounts, disregard the duplicates and count the item once.
- If it is unclear from the credit report whether any of the items are duplicated, treat each of them individually and obtain the required documentation for each item as indicated on the verification messages.

Judgments and Liens

- Open judgments and all outstanding liens that are in the public records section of the credit report will be identified in the Underwriting Findings report and must be paid off at, or prior to, closing.
- Documentation of the satisfaction of these liabilities along with verification of funds sufficient to satisfy these obligations must be obtained.

Mortgage Delinquencies

- DU applies the following guidelines to loans with mortgage delinquencies:
  - If any borrower's credit report contains a mortgage trade line that is 60 or more days past due and the account was reported within the 12 months prior to the credit report date, the loan casefile will receive a "refer with caution" recommendation and **is ineligible**.
  - If there is a mortgage that is disclosed on the loan application but not reported on the credit report, or the mortgage is on the credit report with an outstanding balance but the payment history has not been reported in the last six months, DU will issue a message requiring confirmation that the account is not two or more payments past due as of the date of the application and that it has not been past due by two or more payments in the last 12 months. If the borrower does have a mortgage that is past due by two or more payments or has been past due by two or more payments in the past 12 months, **then the loan casefile is not eligible**.
  - **Borrowers may not bring past due mortgage accounts current prior to closing in order to circumvent this past due policy**. Underwriters may apply some discretion with regard to the application of this policy if they determine and it can be documented that the past due account was not the fault of the borrower, for example, if the existing lender misapplied or lost the borrower's payment.
  - If the borrower has a mortgage trade line on his/her credit report that has one or more 60, 90, 120, or 150-day delinquency reported within the last 12 months, the casefile will receive an "ineligible" recommendation due to excessive prior mortgage delinquency.
- **The above policy will apply to all mortgage trade lines including first liens, second liens, home improvement loans, HELOCs, and manufactured home loans.**

Past-Due, Collection, and Charged-Off Non-Mortgage Accounts

- **Accounts that are reported as past-due, and are not reported as collection accounts, must be brought current**.
  - For one-unit principal residence properties borrowers are not required to pay off outstanding collections or non-mortgage charged-off accounts regardless of the amount.
    - If the account is marked as "Paid by Close" on the loan application, DU will issue a message stating that the collection must be paid.
  - For two-to-four unit owner-occupied and second home properties, collections and non-mortgage charged-off accounts totaling more than $5,000 must be paid in full at, or prior to, closing.
  - For investment properties, collection and non-mortgage charged-off accounts equal to or greater than $250 and accounts that total more than $1,000 must be paid in full at, or prior to, closing.

Bankruptcy, Foreclosure, Deed-in-Lieu of Foreclosure, Pre-Foreclosure Sales, and Charged-Off Mortgage Accounts

- Per the requirements in the Significant Derogatory Credit Events section, an amount of time must elapse after a significant derogatory credit event before the borrower is eligible for a new mortgage loan.
- The waiting period begins on the completion, discharge, or dismissal date, as applicable of the derogatory credit event and ends on the disbursement date of the new loan.
- Because DU does not have the disbursement date of the loan, DU uses the credit report date to measure whether or not the applicable waiting period has been met. Because the credit report date may not result in an accurate calculation of the waiting period due to being earlier

than the disbursement date, underwriters may use the disbursement date to confirm that the waiting period has been met.

- Refer to the table below for additional information:

Event	*Waiting Period*
Bankruptcy Foreclosure	If the completion, discharge, or dismissal dates, reflected on the credit report are complete and appear to comply with the applicable waiting period requirements, DU will issue a recommendation but underwriters must still confirm that the waiting period has been met and may base their determination on the disbursement date of the new loan. If the completion, discharge, or dismissal dates, reflected on the credit report are complete, but do not appear to comply with the applicable waiting period requirements, a "refer with caution" recommendation will be issued. DU uses the date of the credit report to determine whether or not the applicable waiting period has been met. An updated credit report may be obtained and the loan re-submitted to DU after the required time has elapsed. If the completion, discharge, or dismissal dates reflected on the credit report are incomplete, underwriters must confirm that the waiting period has been met and may base their determination on the disbursement date of the new loan.
Deed-in-Lieu of Foreclosure Pre-Foreclosure Sale Mortgage Charge-Off	DU will determine if the date of the event was within the applicable waiting period. The recommendation will not be changed and underwriters must confirm the waiting period requirement has been met and base their determination on the disbursement date of the new loan.

Bankruptcy

- If a Chapter 13 bankruptcy was discharged within the last two years, dismissed within the last four years, or filed but neither discharged nor dismissed within the last four years, the loan casefile will receive a "refer with caution" recommendation and **the loan is ineligible**.
- If a non-Chapter 13 bankruptcy was filed, discharged, or dismissed within the last four years, the loan casefile will receive a "refer with caution" recommendation and **the loan is ineligible**.
- DU will not take bankruptcy information in the public record section of the credit report into account if the bankruptcy is dated more than seven years prior to the credit report date.
- DU will not take trade line accounts that are reported with a bankruptcy status code or manner of payment (MOP) code of "7" into account if there is at least one bankruptcy reported in a public record within seven years of the credit report date. In this scenario DU assumes the date filed and the date discharged in the Public Record are more accurate than the dates in the trade line.
- DU will use trade line accounts that are reported with a bankruptcy status code or MOP code of "7" if there is not a bankruptcy reported in a Public Record within seven years of the credit report date. In this scenario underwriters will need to verify the actual filed and discharged dates to determine that the bankruptcy meets the DU bankruptcy requirements.
- DU is not able to determine if multiple filings have occurred due to the manner in which bankruptcies are reported to the credit report. DU will issue a message when it appears that there may have been multiple bankruptcy filings. This message will list each of the bankruptcies seen on the credit report and will instruct underwriters to ensure the loan casefile meets the criteria for loan casefiles with multiple bankruptcies.

Foreclosure

- DU applies the following guidelines to prior foreclosures:

    - Mortgage accounts, **including first liens, second liens, home improvement loans, HELOCs, and manufactured home loans**, will be identified as a foreclosure if there is an MOP code of "8" or a Remarks Code that indicates a foreclosure is present in the credit report data associated to the trade line.
    - If a foreclosure was reported within the seven year period prior to the credit report date, the loan casefile will receive a "refer with caution" recommendation and **the loan is ineligible**.
    - If the filed date and the satisfied date of the foreclosure are both unknown, but it appears that the foreclosure occurred within the seven year period prior to the credit report date, underwriters must confirm that the foreclosure did not occur within the most recent seven year period.
    - Foreclosure laws vary by state and the time it takes to complete the process may vary by state. DU assumes that the date the foreclosure was reported in the trade line is the date of the foreclosure sale or liquidation. Underwriters must confirm that all foreclosures are satisfied.
    - Mortgage accounts that are identified as deeds-in-lieu of foreclosure or pre-foreclosure sales will not be identified as a foreclosure.
    - When DU identifies a foreclosure on a credit report trade line and the foreclosure information on that trade line is inaccurate, underwriters may instruct DU to disregard the foreclosure information. This is done by entering "Confirmed CR FC Incorrect" in the Explanation field for Question c in the Declarations section of the online application and resubmitting the loan casefile to DU. When the loan casefile is resubmitted to DU the foreclosure information on the credit report will not be used in the eligibility assessment.
        - Documentation must be provided to show the foreclosure was completed seven or more years from the disbursement date of the new loan or that the account was not subject to foreclosure and the loan complies with all other applicable requirements.
- *Extenuating Circumstances:* When DU identifies a foreclosure on a credit report and that foreclosure was due to extenuating circumstances, underwriters may instruct DU to disregard the foreclosure information on the credit report. This is done by entering "Confirmed CR FC EC" in the Explanation field for Question c in the Declarations section of the online application and resubmitting the loan casefile to DU. When the loan casefile is resubmitted to DU, the foreclosure information on the credit report will not be used in the eligibility assessment.
    - If "Confirmed CR FC EC", is entered documentation must be obtained to document the foreclosure was due to extenuating circumstances, the foreclosure was completed three or more years from the disbursement date of the new loan, and the loan complies with all other requirements specific to a foreclosure due to extenuating circumstances.

Deed-in-Lieu of Foreclosure

- DU applies the following guidelines to prior deeds-in-lieu:
    - DU will determine if a mortgage trade line is a deed-in-lieu by using specific Remarks Codes that are present in the credit report data and associated with the trade line.
    - When DU identifies a deed-in-lieu, document that the event was completed four or more years from the disbursement date of the new loan, or two or more years from the disbursement date of the new loan when it is confirmed that the mortgage loan meets the applicable time frames and eligibility requirements for a deed-in-lieu of foreclosure due to extenuating circumstances.

Pre-Foreclosure Sales or Short Sales

- DU will determine if a mortgage trade line is a pre-foreclosure sale using specific Remarks Codes that are present in the credit report data and associated to the trade line.
- When DU identifies a pre-foreclosure sale, document that the event was completed four or more years from the disbursement date of the new loan, or two or more years from the disbursement date of the new loan when it is confirmed that the mortgage loan meets the applicable time frames and eligibility requirements for a pre-foreclosure sale due to extenuating circumstances.

Charged-Off Mortgage Accounts

- Mortgage accounts, **including first liens, second liens, home improvement loans, HELOCs, and manufactured home loans**, will be identified as a charged-off account if there is an MOP code of "9" and there is no information indicating the account may also be subject to a foreclosure, a deed-in-lieu of foreclosure, or a pre-foreclosure sale.
- When DU identifies a charged-off mortgage trade line, document that the event was completed four or more years from the disbursement date of the new loan, or two or more years from the disbursement date of the new loan when it is confirmed that the mortgage loan meets the applicable time frames and eligibility requirements for a charged-off mortgage loan due to extenuating circumstances.

Liability Assessment

Borrower's Liabilities

General Information

- The risk analysis must include all liabilities affecting income or assets that will affect the borrower's ability to fulfill the mortgage payment obligation.
- A borrower's liabilities include the following:
    - Housing expense on the borrower's principal residence;
    - All revolving charge accounts;
    - Lease payments;
    - Real estate loans;
    - HELOCs;
    - Alimony and child support;
    - Maintenance payments; and
    - All other debts of a recurring nature
- For each liability, determine the unpaid balance, the terms of repayment, and the borrower's payment history, and verify any other liability that is not shown on a credit report by obtaining documentation from the borrower or creditor.
- If the credit report does not contain a reference for each significant open debt shown on the loan application including outstanding mortgage debt, bank, student, or credit union loans, obtain separate credit verification.
- If a current liability appears on the credit report but is not shown on the loan application, the borrower should provide a reasonable explanation for the undisclosed debt. Documentation may be required to support the borrower's explanation.
- If the borrower discloses, or it is discovered that there are additional liabilities after the underwriting decision has been made, up to and concurrent with closing, the borrower's debt-to-income ratio must be recalculated by the underwriter and the casefile must be resubmitted to DU.

Monthly Obligations Not Included in Liabilities

- Some obligation, often identified on a borrower's paystub, are not considered a liability and will not be included as a debt or deducted from the borrower's gross income when calculating the borrower's debt-to-income ratio. These obligations include items such as:
    - Federal, state and local taxes;
    - Social Security and Medicare deductions;
    - Retirement contributions such as 401(k) account;
    - Commuting costs;
    - Union dues; and
    - Voluntary deductions.

Debt-to-Income Ratios

DTI Ratios

- The DTI ratio consists of two components:
  - Total monthly obligations which includes the qualifying payment for the subject mortgage loan and other long-term and significant short-term debts; and
  - Total monthly income of all borrowers to the extent the income is used to qualify for the mortgage.
- For loan casefiles underwritten through DU, the maximum allowable DTI ratio may not exceed 50%. If the DTI on a loan casefile exceeds 50%, the loan casefile will receive an Ineligible recommendation.
- Following exceptions to the maximum allowable DTI requirements:
  - DU Refi Plus transactions; and
  - Non-Tradition Credit program requires DTI of less than 40%.
- The total monthly obligation is the sum of the following:
  - The monthly housing expense of the borrower's principal residence or the qualifying payment amount if the subject mortgage loan is secured by the borrower's principal residence;
  - The qualifying payment amount if the subject mortgage loan is secured by a second home or investment property;
  - Monthly payments on installment debts and other mortgage debts that extend beyond ten months;
  - Monthly payments on revolving debts;
  - Monthly payments on lease agreements **regardless of the expiration date of the lease**;
  - Monthly alimony, child support, or maintenance payments that extend beyond ten months;
    - Alimony, but not child support or maintenance, may instead be deducted from the borrower's income.
  - Monthly payments for other recurring obligations; and
  - Any net loss from a rental property.
- The following steps are required, up to and concurrent with loan closing, if the borrower discloses, or additional debts or reduced income is discovered after the underwriting decision is made:

Step	*Description*
1	Document the additional debt(s) and reduced income.
2	If there is new subordinate debt on the subject property the loan must be re-underwritten.
3	Recalculate the DTI ratio.
4	For loans other than DU Refi Plus: • If the recalculated DTI ratio exceeds 50% for a DU loan casefile, the loan is not eligible • If the recalculated DTI does not exceed 50% for a DU loan casefile, but is increasing by three or more percentage point, the following applies: ▪ Update the DU online loan application with the new information and resubmit the casefile to DU. For DU Refi Plus loans: • If the recalculated DTI ratio increases by three or more percentage points, the online loan application must be updated with the new information and the loan casefile must be re-underwritten through DU. DU offers flexibilities in the maximum allowable DTI ratios for DU Refi Plus loan casefiles.
5	The final loan application signed by the borrower must include all income and debts verified, disclosed, or identified during the loan process.

Monthly Housing Expense

- Monthly housing expense is the sum of the following and is referred to as PITIA:
  - Principal and interest (P&I);
  - Property, flood, and mortgage insurance premiums (as applicable);

    - Real estate taxes;
    - Ground rent;
    - Special assessments;
    - Any owners' association dues;
    - Any subordinate financing payments on mortgages secured by the subject property.
- Enter all components of the monthly housing expense on the application including other financing P&I, property insurance, real estate taxes, mortgage insurance, homeowners' association dues, and other proposed housing expenses.
- If the subject mortgage is secured by the borrower's principal residence, the monthly housing expense is based on the qualifying payment. This amount is the monthly housing expense used to calculate the debt-to-income ratio.
- If the subject mortgage is secured by a second home or an investment property,
- The monthly housing expense in these cases represents the PITIA associated with the borrower's principal residence.
    - The qualifying payment amount for the subject property is considered one of the borrower's monthly debt obligations when calculating the debt-to-income ratio.

Calculating Monthly Real Estate Tax Payments

- Base the calculation of real estate taxes for borrower qualification on no less than the current assessed value. The real estate taxes amount may, or in some cases must, be projected if one of the following can be documented:
    - The amount of taxes will be reduced based on federal, state or local jurisdictional requirements. **The taxes may not be reduced if an appeal to reduce them is only pending and has not been final approved.**
    - If the transaction is new construction, use a reasonable estimate of the real estate taxes based on the value of the land and the completed improvements.
    - There is a tax abatement on the subject property that will last for no less than five years from the note date:
        - For a municipality with a ten year abatement, qualify the borrower with the reduced tax amount;
        - For a municipality with a ten year abatement and with annual real estate tax increase in years one through ten, qualify the borrower with the annual taxes that will be required at the end of the fifth year after the first mortgage payment date.

Qualifying Payment Amount

- The calculation of the qualifying payment amount for the subject property will differ based on the transaction type as shown in the following table:

Transaction Type	***DU Underwriting***
Fixed Rate Mortgages	Note Rate
ARMS with an initial fixed-rate period of greater than five years	Greater of the note rate or the fully indexed rate

- The fully indexed rate is defined as the index plus the margin as entered in the online loan application. The index and margin are required for all ARM loans submitted to DU.

Monthly Debt Obligations

Alimony/Child Support/Separate Maintenance Payments

- When the borrower is required to pay alimony, child support, or maintenance payments under a divorce decree, separation agreement, or other written legal agreement, and those payments must continue to made for more than ten months, the payments must be considered as part of the borrower's recurring monthly debt obligations.
- Voluntary payments do not need to be taken into consideration and an exception is allowed for alimony.

- For alimony obligations, underwriters have the option to reduce the qualifying income by the amount of the alimony obligation in lieu of including it as a monthly payment in the calculation of the DTI ratio.
  - If this option is exercised, a copy of the divorce decree, separation agreement, court order or equivalent documentation confirming the amount of the obligation must be obtained.

Business Debt in Borrower's Name

- When a self-employed borrower claims that a monthly obligation that appears on his/her personal credit report is being paid by the borrower's business, confirm that the obligation was actually paid out of company funds and that this was considered in the cash flow analysis of the borrower's business.
- The account payment does not need to be considered as part of the borrower's individual recurring monthly debt obligations if:
  - The account in question does not have a history of delinquency;
  - The business provides acceptable evidence that the obligation was paid out of company funds by providing copies of 12 months of cancelled company checks; and
  - The cash flow analysis took the payment of the obligation into consideration.
- The account payment does need to be considered as part of the borrower's individual recurring monthly debt obligations in any of the following situations:
  - If the business does not provide sufficient evidence that the obligation was paid out of company funds;
  - If the business provides acceptable evidence of its payment of the obligation, but the cash flow analysis of the business does not reflect any business expense related to the obligation, such as an interest expense and taxes and insurance if applicable, equal to or greater than the amount of interest that one would reasonably expect to see given the amount of financing shown on the credit report and the age of the loan. It is reasonable to assume that the obligation has not been accounted for in the cash flow analysis.
  - If the account in question has a history of delinquency. To ensure that the obligation is counted only once, adjust the net income of the business by the amount of interest, taxes or insurance expense, if any, that relates to the account in question.

Court-Ordered Assignment of Debt

- When a borrower has outstanding debt that was assigned to another party by court order, such as under a divorce decree or separation agreement, and the creditor does not release the borrower from liability, the borrower has a contingent liability. The contingent liability does not have to be included in the borrower's recurring monthly debt obligations.
- There is no requirement to evaluate the payment history for the assigned debt after the effective date of the assignment. The borrower's payment history for the debt before its assignment cannot be disregarded.

Debts Paid by Others

- Certain debts can be excluded from the borrower's recurring monthly obligations and the DTI ratio:
  - When a borrower is obligated on a **non-mortgage debt**, but is not the party who is actually repaying the debt, the monthly payment may be excluded from the borrower's recurring monthly obligation. This policy applies whether or not the other party is obligated on the debt, but is not applicable if the other party is an interested party to the subject transaction, such as the seller or realtor.
    - Non-mortgage debts include installment loans, student loans, revolving accounts, lease payments, alimony, child support and separate maintenance.
  - In order to exclude non-mortgage debts from the borrower's DTI ratio, obtain the most recent 12 months cancelled checks or bank statements from the other party making the payments that document a 12 month payment history with no delinquent payments.

- When a borrower is obligated on a **mortgage debt**, but is not the party who is actually repaying the debt, exclude the full monthly housing expense (PITIA) from the borrower's recurring monthly obligations if:
  - The party making the payments is obligated on the mortgage debt;
  - There are no delinquencies in the last 12 months; and
  - The borrower is not using rental income from the applicable property to qualify.
- When a borrower is obligated on a mortgage debt, regardless of whether or not the other party is making the monthly mortgage payments, **the referenced property must be included in the count of financed properties.**

Deferred Installment Debt

- Deferred installment debts must be included as part of the borrower's recurring monthly debt obligations.
- For deferred installment debts other than student loans, if the borrower's credit report does not indicate the monthly amount that will be payable at the end of the deferment period, obtain copies of the borrower's payment letters or forbearance agreements so that a monthly payment amount can be determined and used in calculating the borrower's total monthly obligations.
- For information about deferred student loans, see Student Loans below.

Home Equity Lines of Credit

- When the subject property also has a home equity line of credit (HELOC) that provides for a monthly payment of principal and interest or interest only, the payment on the HELOC must be considered as part of the borrower's recurring monthly debt obligations.
- If the HELOC does not require a payment, there is no recurring monthly debt obligation so a payment amount does not have to be developed.

Garnishments

- All garnishments with more than ten months remaining must be included in the borrower's recurring monthly debt obligations for qualifying purposes.

Installment Debt

- All installment debt that is not secured by a financial asset; including student loans, automobile loans, personal loans, and timeshares, must be considered part of the borrower's recurring monthly debt obligations if there are more than ten monthly payments remaining.
- **An installment debt with fewer than 10 monthly payment remaining also should be considered as a recurring monthly debt obligation if it significantly affects the borrower's ability to meet his/her credit obligations.**
- A timeshare account should be treated as an installment debt even if it is reported on the credit report or other documentation as a mortgage loan.

Lease Payments

- Lease payments must be considered as recurring monthly debt obligations **regardless of the number of months remaining on the lease**.
- This is because the expiration of a lease agreement for rental housing or an automobile typically leads to either a new lease agreement, the buyout of the existing lease, or the purchase of a new vehicle or house.

Loans Secured by Financial Assets

- When a borrower uses his/her financial assets; life insurance policies, 401(k) accounts, individual retirement accounts, certificates of deposit, stocks, bonds, etc., as security for a loan, the borrower has a contingent liability.

- These payments are not required to be included as part of the borrower's recurring monthly debt obligations provided a copy of the applicable loan instrument that shows the borrower's financial asset as collateral for the loan is obtained.
- If the borrower intends to use the same asset to satisfy financial reserve requirements, reduce the value of the asset by the proceeds from the secured loan and any related fees to determine whether the borrower has sufficient reserves.

Open 30-Day Charge Accounts

- Open 30-day charge accounts require the balance to be paid in full every month.
- Open 30-day charge accounts are not required to be included in the borrower's debt-to-income ratio.

Revolving Charge/Lines of Credit

- Revolving charge accounts and unsecured lines of credit are open-ended and should be treated as long terms debts and must be considered part of the borrower's recurring monthly debt obligations.
- These trade lines include credit cards, department store charge cards, and personal lines of credit.
- Equity lines of credit secured by real estate should be included in the housing expense.
- If the credit report does not show a required monthly payment amount and there is no supplemental documentation to support a payment of less than 5%, use 5% of the outstanding balance as the borrower's recurring monthly debt obligation.
- For DU loan casefiles, if a revolving debt is provided on the loan application without a monthly payment amount, DU will use the greater of $10 or 5% of the outstanding balance as the monthly payment when calculating the debt-to-income ratio.

Student Loans

- If a monthly student loan payment is provided on the credit report, use that amount for qualifying purposes.
- If the credit report does not reflect the correct monthly payment, use the monthly payment that is on the most recent student loan statement to qualify the borrower.
- If the credit report does not provide a monthly payment for the student loan, or if the credit report shows $0 as the monthly payment, determine the qualifying monthly payment using one of the options below:
    - If the borrower is on an income-driven payment plan, obtain student loan documentation to verify the actual monthly payment is $0. The borrower may then be qualified with a $0 payment.
    - For deferred loans or loans in forbearance, calculate:
        - A payment equal to 1% of the outstanding student loan balance even if this amount is lower than the actual fully amortizing payment; or
        - A fully amortizing payment using the documented loan repayment terms.

Unreimbursed Employee Business Expenses

- Determine whether the borrower has unreimbursed employee business expenses for the following scenarios:
    - When a borrower has commission income that represents 25% or more of the borrower's total annual employment income; or
    - When an automobile allowance is included in the borrower's monthly qualifying income.
- Determine the borrower's recurring monthly debt obligation for such expenses by a developing a 24 month average of the expenses, using information from the borrower's tax return including Schedule 2106.
    - Automobile depreciation claimed on Form 2106 should be netted out of this calculation.
- For both of the above scenarios when calculating the total debt-to-income ratio, the monthly average for unreimbursed expenses should be subtracted from the borrower's stable monthly

income. Automobile lease or loan payments are not subtracted from the borrower's income; they are always considered part of the borrower's recurring monthly debt obligations.
  - See the Other Sources of Income section of these guidelines for additional information regarding automobile allowances.

Qualifying Impact of Other Real Estate Owned

Qualifying Considerations

- When the borrower owns mortgaged real estate, the status of the property determines how the existing property's PITIA must be considered in qualifying for the new mortgage transaction. If the mortgaged property owned by the borrower is:
  - An existing investment property or a current principal residence converting to investment use, the borrower must be qualified in accordance with the policies in the Rental Income section of these guidelines and, if applicable, the Multiple Financed Properties for the Same Borrower section of these guidelines.
  - An existing second home or a current principal residence converting to a second home, the PITIA of the second home must also be counted as part of the borrower's recurring monthly debt obligations; or
  - The borrower's current principal residence that is pending sale but will not close prior to the subject transaction, comply with the policies in this topic.

Mortgage Assumption

- When a borrower sells a mortgaged property and the property purchaser assumes the outstanding mortgage debt without a release of liability, the borrower has a contingent liability.
- This contingent liability (PITIA) is not required to be counted as part of the borrower's recurring monthly debt obligations if it can be verified that the property purchaser has at least a 12 month history of making regular, timely payments for the mortgage. Document this by obtaining:
  - Evidence of the transfer of ownership;
  - A copy of the formal, executed assumption agreement; and
  - A credit report indicating that consistent and timely payments were made for the assumed mortgage.
- If timely payments during the most recent 12 month period cannot be documented, the mortgage payment must be counted as part of the borrower's recurring monthly debt obligations.

Property Settlement Buyout

- When a borrower's interest in a property is bought out by another co-owner of the property, such as in a divorce settlement, but the borrower is not released from liability for the mortgage, the borrower has a contingent liability.
- If documentation is obtained to confirm the transfer of title to the property, this liability does not have to be considered as part of the borrower' recurring monthly debt obligations.

Current Principal Residence Pending Sale

- If the borrower's current principal residence is pending sale, but the transaction will not close prior to the subject transaction, and the borrower is purchasing a new principal residence, the current PITIA and the proposed PITIA must be used in qualifying the borrower for the new mortgage loan.
- The current principal residence's PITIA will not be required to be used in qualifying the borrower as long as the following documentation is provided:
  - The executed sales contract for the current residence; and
  - Confirmation that any financing contingencies have been cleared.

Debts Paid Off at or Prior to Closing

Payoff or Pay Down of Debt for Qualification

- Payoff or pay down of debt solely to qualify must be carefully evaluated and considered in the overall loan analysis.

- The borrower's history of credit use should be a factor in determining whether the appropriate approach is to include or exclude debt for qualification.
  - Installment loans that are being paid off or paid down to ten or fewer remaining monthly payments do not need to be included in the borrower's long-term debt.
  - If a revolving account balance is paid off at or prior to closing, a monthly payment on the current outstanding balance does not have to be included in the borrower's long term debt. Such accounts do not need to be closed as a condition of excluding the payment from the debt-to-income ratio.

Open 30-Day Charge Accounts

- For open 30-day charge accounts that do not reflect a monthly payment on the credit report, or 30-day accounts that reflect a monthly payment that is identical to the account balance, verify sufficient borrower funds to cover the account balance. The verified funds must be in addition to any funds required for closing and reserves.
- DU will include the balance of the 30-day charge accounts in the "Reserves
- Required to be Verified" amount shown on the DU Underwriting Findings report.
- For transactions that do not require the verification of reserves, the balance of the 30-day charge accounts in the "Reserves to be Verified" amount will be reduced by any cash out the borrower will receive through the transaction.
- If the borrower paid off the account balance prior to closing, obtain proof of payoff in lieu of verifying funds to cover the account balance.

Collections, Charged-Off Non-Mortgage Accounts, Judgments and Liens

- Delinquent credit, including taxes, judgments, charged-off non-mortgage accounts, tax liens, mechanic's or materialmen's liens, and liens that have the potential to affect the first lien position or diminish the borrower's equity, must be paid off at or prior to closing.

Reconciling the Loan Application with the Credit Report

- DU uses liabilities from the online loan application, not debts from the credit report, to calculate the debt-to-income ratio.
- To help ensure that all appropriate liabilities are included in the debt-to-income ratio, DU performs a series of reasonableness tests comparing loan application balances and payments with the credit report balances and payments.
- If the values on the loan application are less than the values on the credit report by more than selected tolerances, reconcile the discrepancies between the two.
- Update the online loan application values if the values are needed to calculate accurate ratios. The information must be updated either with verified values from the credit report or with independent outside verifications.

Income Assessment

Employment and Other Sources of Income

Stable and Predictable Income

- Individuals who change jobs frequently, but who are nevertheless able to earn consistent and predictable income, are considered to have a reliable flow of income for qualifying purposes.
- To demonstrate the likelihood that a consistent level of income will continue to be received for borrowers with less predictable sources of income, obtain information about prior earnings. Examples of less predictable income sources include:
  - Commissions;
  - Bonuses;
  - Overtime pay; or
  - Employment that is subject to time limits such as contract employees or trades persons.

Variable Income

- All income that is calculated by an averaging method must be reviewed to assess the borrower's history of receipt, the frequency of payment and the trending of the amount of income being received.
- Examples of income of this type include:
  - Income from hourly workers with fluctuating hours; or
  - Income that includes commissions, bonuses and overtime.
- **History of Receipt:** Two or more years of receipt of a particular type of variable income is recommended. Variable income that has been received for 12 to 24 months may be considered as acceptable income as long as the borrower's loan application demonstrates that there are positive factors that reasonably offset the shorter income history.
- **Frequency of Payment:** Determine the frequency of the payment; weekly, biweekly, monthly, quarterly, or annually to arrive at an accurate calculation of the monthly income to be used in the trending analysis. Examples:
  - If a borrower is paid an annual bonus on March 31 of every year, the amount of the March bonus should be divided by 12 to obtain an accurate calculation of the current monthly bonus amount.
  - If a borrower is paid overtime on a biweekly basis, the most recent pay stub must be analyzed to determine that both the current overtime earnings for the period and the year-to-date overtime earnings are consistent and.
    - There are legitimate reasons why these amounts may be inconsistent yet still eligible for use as qualifying income.
    - For example, borrowers may have overtime income that is cyclical such as transportation employees who operate snow plows in winter or package delivery service workers who work longer hours through the holidays. Investigate the difference between current period overtime and year-to-date earnings and document the analysis before using the income amount in the trending analysis.
- **Income Trending:** After the monthly year-to-date income amount is calculated it must be compared to prior years' earnings using the borrower's W2 or signed federal income tax returns.
  - If the trend in the amount of income is stable or increasing the income amount should be averaged.
  - If the trend was declining but has since stabilized and there is no reason to believe that the borrower will not continue to be employed at the current level, the current lower amount of variable income must be used.
  - If the trend is declining, the income may not be stable. Additional analysis must be conducted to determine if any variable income should be used but in no instance may it be averaged over the period when the declination occurred.

Continuity of Income

- Unless there is knowledge to the contrary, if the income does not have a defined expiration date and the applicable history of receipt of the income is documented, it may be concluded that the income is stable, predictable and likely to continue. Additional documentation is not necessary.
- If the income source does not have a defined expiration date or is dependent on the depletion of an asset account or other limited benefit, document the likelihood of continued receipt of the income for at least three years.
- If it becomes known that the borrower is transitioning to a lower pay structure, such as pending retirement, use the lower amount to qualify the borrower.
- The following table contains examples of income types with and without defined expiration dates. This information is provided to assist in determining whether additional income documentation may be necessary to support a three year continuance.

Expiration Date Not Defined	***Defined Expiration Date***
Three year continuance does not need to be documented: • Automobile Allowance • Base Salary	Three year continuance must be documented: • Alimony or Child Support • Distributions from a Retirement Account such as 401(k), IRA, SEP, or KEOUGH

• Bonus, Overtime, Commission, or Tip Income • Capital Gains Income • Corporate Retirement or Pension • Disability Income – Long Term • Foster Care Income • Interest and Dividend Income (unless there is evidence that the asset will be depleted) • Military Income • Part-Time Job, Second Job, or Seasonal Income • Rental Income • Self-Employment Income • Social Security, VA, or Other Government Retirement or Annuity	account • Notes Receivable • Royalty Payment Income • Social Security (not including retirement or long-term disability) • Trust Income • VA Benefits (not including retirement or long-term disability)

- When using income sources that have a defined expiration date or allow the depletion of an asset to qualify the borrower, care must be taken when this is the sole source or the majority of qualifying income. Consider the borrower's continued capacity to repay the mortgage loan when the income source expires or when the distributions will deplete the asset prior to the term of the mortgage.
- Income sources that are not listed above will require underwriter judgment to determine if documentation of continuance must be obtained.

Determining When Tax Returns are Required

- Obtain copies of the borrower's signed federal income tax returns for the past one or two years, depending on income type, for the following sources of income or employment. Tax returns are required if the borrower:
  - Earns 25% or more of his/her income from commissions;
  - Is employed by family members (requires two years' returns);
  - Is employed by interested parties to the property sale or purchase (requires two years' tax returns);
  - Receives rental income from an investment property;
  - Receives income from temporary or periodic employment, or unemployment, or employment that is subject to time limits such a contract employee or a trades person;
  - Receives income from capital gains, royalties, or other miscellaneous non-employment earnings reported on *Form 1099*;
  - Receives income that cannot otherwise be verified by an independent and knowledgeable source (requires two year's returns);
  - Receives foreign income that is used to qualify;
  - Receives tip income reported on *Form 4137* that was not reported by the employer on the W2; or
  - Receives income from sole proprietorships, limited liability companies, partnerships, or corporations, or any other type of business structure in which the borrower has a 25% or greater ownership interest.
    - Borrowers with a 25% or greater ownership interest are considered self-employed.
    - Document and underwrite the loan using the requirements for self-employed borrowers.
    - For DU loan casefiles, the number of years of tax returns required will be per the DU Findings.

Verification of Income for Non-U.S. Citizens

- The following table describes income verification requirements for borrowers who are non-U.S. citizens:

Employment Type	Employment and Income Verification Requirements
Salaried or commissioned borrower employed by a U.S. company or individual	Same as for a U.S. citizen.
Self-employed	Same as for a U.S. citizen.
Employed by a foreign corporation or a foreign government and paid in foreign currency	Obtain: • Copies of the borrower's signed federal income tax returns filed with the IRS for the most recent two year period; and • Documentation to satisfy the standard documentation requirements. • **Note:** All income must be translated to U.S. dollars.

Grossing Up Non-Taxable Income

- Give special consideration to regular sources of income that may be non-taxable such as child support payments, social security benefits, and workers' compensation benefits.
- Verify that the particular source of income is non-taxable. Documentation that can be used for this verification includes award letters, policy agreements, account statements, or any other documents that address the non-taxable status of the income.
- If the income is verified to be non-taxable, and the income and its tax-exempt status are likely to continue, an "adjusted gross income" may be developed by adding an amount equivalent to 25% of the non-taxable income and adding it to the borrower's income amount.
- If the actual amount of federal and state taxes that would generally be paid by a wage earner in a similar tax bracket is more than 25% of the borrower's non-taxable income, use that amount to develop the adjusted gross income.

Standards for Employment and Documentation

Income Verification in DU

- The level of documentation required by DU may not be adequate for every borrower and every situation. Determine whether additional documentation is warranted. If unable to determine the stability of the borrower's income on the basis of the available documentation, the income must be removed and the loan casefile resubmitted to DU.
- When a component of the loan file is validated by the DU validation service DU will issue a message indicating the required documentation. This documentation requirement may differ from those described below.

Paystubs and W2s

- The pay stub must be dated no earlier than 30 days prior to the initial loan application date and it must include all year-to-date earnings. The pay stub must include sufficient information to appropriately calculate the income otherwise, additional documentation must be obtained.
- W2s must cover the most recent one or two year period based on the documentation requirements for the particular income type. The W2 must clearly identify the borrower as the employee.
- Documents must be computer generated or typed by the borrower's employer(s). Pay stubs that the borrower downloads from the Internet are also acceptable. Documents must clearly identify the employer's name and source of information.
- The documents must clearly identify the borrower as the employee.
- The information must be complete and legible.

- The original source of the information must be a third party such as the borrower's Human Resources Department, Personnel Office, Payroll Department, the company's payroll vendor, or his/her supervisor.

Tax Returns

- When required, personal federal income tax returns must be copies of the original returns that were filed with the IRS. All supporting schedules must be included.
- "Most recent" tax return is defined as the last return scheduled to have been filed with the IRS.
- The information must be complete and legible.
- Each tax return must be signed by the borrower.

Employment Documentation from the Employer

- When a written Verification of Employment is required to document income for a salaried or commissioned borrower, *Form 1005, Request for Verification of Employment* may be used.
- The information on the written VOE must be legible, The following fields on *Form 1005* are optional:
  - Field #11: Probability of continued employment
  - Field #14: If overtime or bonus is applicable is the continuance likely?
  - Field #16: Date of the borrower's next pay increase
  - Field #17: Projected amount of the next pay increase
  - Field #18: Date of the borrower's last pay increase
  - Field #19: The amount of the last pay increase;
  - Field #24 Reason for leaving (Part III – Verification of Previous Employment)
- The remaining fields on the form must be completed as applicable to the borrower.
- Employment and income verification may be received directly from a third party employment verification vendor. These verifications are acceptable as long as:
  - The borrower provided written authorization for the vendor's service to be used; and
  - It can be reasonably determined that the vendor has made provisions to comply with reasonable quality control requests; and
  - If necessary supplement these verifications by obtaining any missing information from the borrower or his/her employer.

Base Pay, Bonus, Overtime, Commission and Secondary income

Verification of Base Pay, Bonus and Overtime Income

- A minimum history of two years of employment income is recommended. However, income that has been received for a shorter period of time may be considered as acceptable income as long as the borrower's employment profile demonstrates that there are positive factors to reasonably offset the shorter income history.
- Borrowers relying on overtime or bonus income for qualifying purposes must have a history of no less than 12 months to be considered stable.
- **Base Pay (Salary and Hourly):** Obtain the following documents:
  - A written Verification of Employment and the borrower's most recent pay stub; or
  - A verbal Verification of Employment and the borrower's most recent pay stub and W2s covering the most recent two year period.
  - **Note: At no time is it acceptable to provide a Verification of Employment only regardless of the DU findings.**
- **Bonus or Overtime:** Obtain the following documents:
  - A completed written Verification of Employment reflecting a breakdown of the bonus and/or overtime income for year-to-date and for the past two years; and
  - The borrower's most recent paystub and W2s covering the most recent two year period.
- If the borrower has recently changed positions with his/her employer determine the effect of the change on the borrower's eligibility and opportunity to receive bonus or overtime pay in the future.
- If a borrower who has historically been employed on a part-time basis indicates that he/she will now be working full-time, obtain written confirmation from the borrower's employer.

Base Pay Income Calculations

- Calculate the borrower's eligible qualifying base income. The following table provides guidance for standard employment documentation:

Pay Frequency	*How to Calculate Monthly Income*
Annually	Annual gross pay / 12 months
Monthly	Use monthly gross payment amount
Semi-Monthly (twice monthly)	Semi-monthly gross pay X 24 / 12 months
Bi-weekly (every two weeks)	Biweekly gross pay X 26 / 12 months
Weekly	Weekly gross pay X 52 / 12 months
Hourly	Hourly gross pay X average number of hours worked per week X 52 / 12 months

- All of the above calculations must be compared with the documented year-to-date base earnings and past year earnings to determine if the income amount appears to be consistent.

Military Income

- Military personnel may be entitled to different types of pay in addition to their base pay.
- Flight or hazard pay, rations, clothing allowance, quarters' allowance, and proficiency pay are acceptable sources of stable income as long as it can be established that the particular source of income will continue to be received.
- Income paid to military reservists while they are satisfying their reserve obligations is acceptable if it satisfies the same stability and continuity tests applied to secondary employment.

Commission Income

- A minimum history of two years of commission income is preferred. Commission income that has been received for 12 to 24 months may be considered as acceptable income as long as there are positive factors to reasonably offset the shorter income history.
- If the commission income represents less than 25% of the borrower's total annual employment income, obtain the following documents:
  - A completed *Form 1005, Request for Verification of Employment* breaking down the income for year-to-date and for the past two years; and
  - The borrower's most recent pay stub and W2 forms covering the most recent two year period, as applicable.
- If the commission income represents 25% or more of the borrower's total annual employment income, obtain the following documents:
  - Copies of the borrower's signed federal tax returns for the past two years;
  - A completed *Form 1005, Request for Verification of Employment* breaking down the income for year-to-date and the past two years; and
  - The borrower's most recent pay stub and W2s covering the most recent two year period, as applicable.
- **For borrowers with commission income representing 25% or more of their total annual employment income, any unreimbursed business expenses must be subtracted from the gross commission income.**

Secondary Employment Income

- When a second job is not from self-employment DU will require:
  - A Verbal VOE; and
  - The borrower's most recent paystub and W2s covering the most recent two year period.
  - **The income from any second job or multiple jobs must be included in the "Base Income" field, not in the "Other Income" field**.

- Signed federal income tax returns may also be required to verify unemployment related to seasonal income.

- **Second Job/Multiple Jobs Employment Income:** Verification of a minimum history of two years of uninterrupted secondary employment income is recommended. Income that has been received for a shorter period of time, but not less than 12 months, may be considered as acceptable income as long as there are positive factors to reasonably offset the shorter income history.
  - A borrower may have a history that includes different employers which is acceptable as long as the income has been consistently received.
- **Seasonal Income:** Verify that the borrower has worked at the same job, or the same line of seasonal work, for the past two years. Obtain confirmation from the borrower's employer that there is a reasonable expectation that the borrower will be rehired for the next season.
  - For seasonal unemployment compensation verify that it is appropriately documented, clearly associated with seasonal layoffs, expected to recur and is reported on the borrower's federal income tax returns. Otherwise, unemployment compensation cannot be used to qualify the borrower.

Verbal Verification of Employment

- Obtain a verbal verification of employment for each borrower using employment or self-employment income to qualify.
- The verbal VOE must be obtained within ten business days prior to the Note date for employment income and within 120 calendar days prior to the Note date for self-employment income

- The Verbal VOE must include an independently obtained phone number and if possible an address for the borrower's employer. This information may be obtained from a telephone book, the Internet, directory assistance or by contacting applicable licensing bureaus; and
  - The name and title of the person who confirmed the employment;
  - The name and title of the person who completed the verification for the employer;
  - The date of the call; and
  - The source of the phone number used to contact the employer.
- Exceptions:
  - If the employer will not verbally verify employment, obtain a written verification confirming the borrower's current employment status within the same time frame as the verbal VOE requirements. The written documentation must include the name and title of the person who completed the verification.
  - If the employer uses a third party employment verification vendor, obtain written verification from the vendor of the borrower's current employment status within the same time frame as the verbal VOE requirements.
    - Because third party vendor databases are typically updated monthly, the verification must evidence that the information in the vendor's database was no more than 35 days old as of the Note date.
- If the borrower is in the military, in lieu of a verbal or written VOE, obtain either:
  - A military Leave and Earnings Statement (LES) dated within 30 days prior to the Note date; or
  - A verification of employment through the Defense Manpower Data Center at: https://www.dmdc.osd.mil/appj/mla/
- For self-employed borrowers verify the existence of the borrower's business within 120 calendar days prior to the Note date:
  - From a third party such as a CPA, regulatory agency, or the applicable licensing bureau; or
  - By verifying a phone listing and address for the borrower's business using a telephone book, the Internet or directory assistance.
  - Document the source of the information obtained and the name and title of the Processor/Account Manager who obtained the information.

Rental Income

Eligible Properties

- Rental income is an acceptable source of stable income if it can be established that the income is likely to continue.
- If the income is from the subject property, the property must be one of the following:
    - A two-to-four unit principal residence property where the borrower occupies one of the units; or
    - A one-to-four unit investment property.
- If the income is derived from a property that is not the subject property, there are no restrictions on the property type. For example, rental income from a commercial property owned by the borrower is acceptable if the income otherwise meets all other requirements.
- Rental income from the borrower's principal residence, a one-unit principal residence or the unit the borrower occupies in a two-to-four unit property, or a second home cannot be used to qualify the borrower. For the exceptions to this rule, refer to the "Boarder Income" and "Accessory Unit" rental income requirements in these guidelines.

Documenting Rental Income

- If a borrower has a history of renting the subject property or another property, generally the rental income will be reported on *IRS Form 1040, Schedule E* of the borrower's personal tax returns or on *Rental Real Estate Income and Expenses* of a partnership or S corporation form (*IRS Form 8825*) of a business tax return.
- If the borrower does not have a history of renting the subject property or if, in certain cases, the tax returns do not accurately reflect the ongoing income and expenses of the property, it might be possible to use a fully executed lease agreement. Examples of scenarios that justify the use of lease agreements are:
    - Purchase transactions;
    - Refinance transactions where the borrower purchased the rental property during or subsequent to the last tax return filing; or
    - Refinance transactions of a property that experienced significant rental interruptions such that income is not reported on the recent tax return. For example; major renovations to a property that occurred in the prior year that affected rental income.
- When the subject property will generate rental income, one of the following Fannie Mae forms must be used to support the income earning potential of the property:
    - For one-unit properties: *Single-Family Comparable Rent Schedule (Form 1007)* provided in conjunction with the applicable appraisal report; or
    - For two-to-four unit properties: *Small Residential Income Property Appraisal Report (Form 1025)*.

Rental Income from the Subject Property

- Obtain documentation to verify the monthly rental income for qualifying purposes. The documentation may vary depending on whether the borrower has a history of renting the property and whether the prior year tax return includes the income.

Does the Borrower have a History of Receiving Rental Income from the Subject Property?	*Transaction Type*	*Documentation Requirements*
Yes	Refinance	*Form 1007* or *Form 1025*, as applicable and either: • The borrower's most recent year's signed federal income tax return including *Schedule E*; or

		• Copies of the current lease agreement(s) if the borrower can document a qualifying exception (see "Partial or No Rental History on Tax Returns" below).
No	Purchase	*Form 1007* or *Form 1025*, as applicable, and • Copies of the current lease agreement(s). If the property is not currently rented, lease agreements are not required and *Form 1007* or *Form 1025* may be used. **If there is a lease on the property that is being transferred to the borrower, verify that it does not contain any provisions that could affect the first lien position on the property.**
No	Refinance	*Form 1007* or *Form 1025*, as applicable, and: • Copies of the current lease agreement(s).

- **If the borrower is not using any rental income from the subject property to qualify, the gross monthly rent must still be documented for reporting purposes.**

Rental Income from Property other than the Subject Property

- When the borrower owns rental property, other than the subject property, document the monthly gross and net rental income with the borrower's most recent signed federal income tax return that includes *Schedule E*.
- Copies of the current lease agreement(s) may be substituted if the borrower can document a qualifying exception.

Partial or No Rental History on Tax Returns

- Determine whether or not the rental property was in service for the entire tax year or only a portion of the year.
- In some situations the income analysis may determine that using alternative rental income calculations or using lease agreements to calculate the income are more appropriate methods for calculating the qualifying income from rental properties.
- This policy may be applied to refinances of a subject rental property or to other rental properties owned by the borrower.
- If the borrower is able to document, per the table below, that the rental property was not in service in the previous tax year, or was in service for only a portion of the previous tax year, determine qualifying rental income by using:
  - *Schedule E* income and expenses and annualizing the income, or loss, calculation; or
  - Fully executed lease agreement(s) to determine the gross rental income to be used in the net rental income, or loss, calculation

If….	*Then….*
The property was acquired during or subsequent to the most recent tax filing year:	Confirm the purchase date using the Closing Disclosure or other settlement documentation: • If acquired during the year, *Schedule E,* (Fair Rental Days section) must confirm a partial year rental income and expenses. • If acquired after the last tax filing year, *Schedule E* will not reflect rental income or expenses for this property.

The rental property was out of service for an extended period:	• *Schedule E* will reflect the costs for renovation or rehabilitation as repair expenses. Additional documentation may be required to ensure that the expenses support a significant renovation that supports the amount of time that the rental property was out of service. • *Schedule E,* (Fair Rental Days section) will confirm the number of days that the rental unit was in service, which must support the unit being out of service for all or a portion of the year.
There exists some other situation that warrants the use of a lease agreement:	Provide an explanation and justification in the loan file.

Calculating Monthly Qualifying Rental Income or Loss

- The method for calculating rental income or loss for qualifying purposes is dependent upon the documentation that is being used.
- ***Schedule E*.** When *Schedule E* is used to calculate qualifying rental income add back any listed depreciation, interest, homeowners' association dues, taxes, or insurance expenses to the borrower's cash flow. Non-recurring property expenses may be added back if documented accordingly.
- If the property was in service:
  - For the entire tax year, the rental income must be averaged over 12 months; or
  - For less than the full year, the rental income must be averaged over the number of months that the borrower used the property as a rental unit.
  - Subtract the entire PITIA to determine the monthly property cash flow (does not apply to properties that are the borrower's principal residence).
- **Lease Agreements or *Form 1007* or *Form 1025*.** When current lease agreements or market rents reported on *Form 1007* or *Form 1025* are used, calculate the rental income by multiplying the gross monthly rent(s) by 75%. This is referred to as "monthly market rent" on the *Form 1007* or *Form 1025*. The remaining 25% of the gross rent will be absorbed by vacancy losses and ongoing maintenance expenses.
- Subtract the entire PITIA to determine the monthly property cash flow (does not apply to properties that are the borrower's principal residence).

Treatment of the Income or Loss

- The amount of monthly qualifying rental income or loss that is considered as part of the borrower's total monthly income or loss, and its treatment in the calculation of the borrower's total debt-to-income ratio, varies depending on whether the borrower occupies the rental property as his/her principal residence.
- If the rental income relates to the borrower's principal residence:
  - The monthly qualifying rental income must be added to the borrower's total monthly income. The income is not to be netted against the PITIA of the property.
  - The full amount of the mortgage payment (PITIA) must be included in the borrower's total monthly obligations when calculating the debt-to-income ratio.
- If the rental income or loss relates to a property other than the borrower's principal residence:
  - If the monthly qualifying rental income minus the full PITIA is positive, it must be added to the borrower's total monthly income.
  - If the monthly qualifying rental income minus the PITIA is negative, the monthly net rental loss must be added to the borrower's total monthly obligations.
  - The full PITIA for the rental property is factored into the amount of the net rental income or loss therefore it should not be counted as a monthly obligation.

- The full monthly payment for the borrower's principal residence, full PITIA or monthly rent, must be counted as a monthly obligation.

Rental Income on a Partnership or S Corporation Tax Return

- **If the borrower is personally obligated on the mortgage debt** and gross rents and related expenses are reported through a partnership or S corporation, the business tax returns may be used to offset the property's PITIA. The steps described below should be followed:
  - Obtain the borrower's business tax returns including *IRS Form 8825* for the most recent year.
  - Evaluate each property listed on *Form 8825* as shown below:
    - From total gross rents, subtract total expenses. Then add back insurance, mortgage interest, taxes, homeowners' association dues (if applicable), depreciation, and non-recurring property expenses.
    - Divide by the number of months the property was in service.
    - Subtract the entire PITIA to determine the monthly property cash flow.
- If the resulting net cash flow is positive, the PITIA may be excluded from the borrower's monthly obligations when calculating the debt-to-income ratio.
- If the resulting net cash flow is negative, the calculated negative amount must be included in the borrower's monthly obligations when calculating the debt-to-income ratio.
- In order to include a positive net rental income received through a partnership or an S corporation in the borrower's monthly qualifying income, it must be evaluated according to the guidelines in the "Analyzing Partnership Returns" and "Analyzing Returns for an S Corporation" sections of these guidelines.

Other Sources of Income

Other Non-Employment Income

- Other non-employment income must be entered in DU selecting the applicable income type. The other income types available in DU are listed below. Income types not in the Other Income List must be entered in DU as "Other Types of Income".
  - Accessory Unit
  - Alimony or Child Support
  - Automobile/Expense Account
  - Boarder Income
  - Capital Gains
  - Dividends/Interest
  - Employment-Related Assets
  - Foreign Income
  - Foster Care
  - Military Base Pay, Clothing Allowance, Combat Pay, Flight Pay, Hazard Pay, Overseas Pay, Pro Pay, Quarters Allowance, Rations Allowance, Variable Housing Allowance.
  - Non-Borrower Household Income
  - Notes Receivable and Installment Debt
  - Other Types of Income
  - Pension and Retirement Income
  - Royalty Payments
  - Seasonal Income
  - Schedule K-1
  - Social Security Disability Income
  - Temporary Leave
  - Tip Income
  - Trust Income
  - Unemployment Income
  - VA Benefits (non-educational)

Documentation Requirements

- The documentation required for each income source is described below.
- The documentation must support the history of receipt, if applicable, and the amount, frequency and duration of the income.
- In addition, evidence of current receipt of the income must be obtained.
- Current receipt may be documented by various means depending on the income type. Examples include:
  - Current pay stubs;
  - Bank statements confirming direct deposit;
  - Cancelled checks from the payer's account to the borrower;
  - Court records; or
  - Copies of the borrower's bank statement showing regular deposit of these funds.

Alimony or Child Support

- Document the alimony or child support will continue to be paid for at least three years after the date of the mortgage application as verified by one of the following:
  - A copy of a divorce decree or separation agreement (if the divorce is not final) that indicates payment of alimony or child support and states the amount of the award and the period of time over which it will be received.
    - **If a borrower who is separated does not have a separation agreement that specifies alimony or child support payments, do not consider any proposed or voluntary payments as income.**
  - Any other type of written legal agreement or court decree describing the payment terms for the alimony or child support.
  - Documentation that verifies any applicable state law that mandates alimony, child support, or separate maintenance payments. The documentation must specify the conditions under which the payments must be made.
  - Check for limitations on the continuance of the payments such as the age of the children for whom the support is being paid or the duration over which alimony is required to be paid.
  - Document no less than six months of the borrower's most recent, regular receipt of the full payment.
    - Review the payment history to determine its suitability as stable qualifying income.
    - To be considered stable income, full regular and timely payments must have been received for six months or longer.
    - **Income received for less than six months is considered unstable and may not be used to qualify the borrower for the mortgage. In addition, if full or partial payments are made on an inconsistent or sporadic basis, the income is not acceptable for the purpose of qualifying the borrower.**

Automobile Allowance

- For an automobile allowance to be considered as acceptable stable income the borrower must have received the payments for at least two years. Include all associated business expenses in the calculation of the borrower's total DTI ratio.
- There are two methods for calculating the income associated with an automobile allowance:
  - **Actual Cash Flow:** If the borrower reports automobile allowance on *IRS Form 2106, Employee Business Expenses* or *IRS Form 1040, Schedule C*:
    - Funds in excess of the borrower's monthly expenditures are added to the borrower's monthly income; or
    - Expenses in excess of the monthly allowance are included in the borrower's total monthly obligations.
    - If the borrower used *IRS Form 2106* and recognized "actual expenses" instead of the "standard mileage rate", look at the "actual expenses" section to identify the borrower's actual lease payments and make appropriate adjustments.

- **Income and Debt Approach:** If the borrower does not report the allowance on either *IRS Form 2106* or *Schedule C*, the full amount of the allowance is added to the borrower's monthly income and the full amount of the lease or financing payment for the automobile is added to the borrower's total monthly obligations.

Boarder Income

- Income from boarders in the borrower's principal residence or second home is not considered acceptable stable income with the following exception:
  - When a borrower with disabilities receives rental from a live-in personal assistant, whether or not that individual is the borrower's relative, the rental payment can be considered as acceptable stable income in an amount up to 30% of the total gross income that is used to qualify the borrower for the mortgage loan.
  - Personal assistants typically are paid by Medicaid Waiver funds and include room and board from which rental payments are made to the borrower.
  - Following are the requirements for income from boarders:
    - Obtain documentation of the boarder's history of shared residency such as a copy of a driver's license, bills, bank statements or W2s that shows the boarder's address is the same as the borrower's address.
    - Obtain documentation of the boarder's rental payments for the most recent 12 months.

Capital Gains Income

- Income received from capital gains is generally a one-time transaction. It should not be considered as part of the borrower's stable monthly income. If the borrower needs to rely on income from capital gains to qualify, the income must be verified in accordance with the following requirements:
  - Document a two year history of capital gains income by obtaining copies of the borrower's signed federal income tax returns for the most recent two years, including *IRS Form 1040, Schedule D*.
  - Develop an average income from the last two years and use the averaged amount as part of the borrower's qualifying income as long as the borrower provides current evidence that he/she owns additional property or assets that verifies the income will continue.
- Capital losses do not have to be considered when calculating income or liabilities even if the losses are recurring.

Disability Income – Long Term

- Following are the verification requirements for long-term disability income. **Note:** This does not apply to disability income that is received from the Social Security Administration:
  - Obtain a copy of the borrower's disability policy or benefits statement from the benefits payer such as an insurance company, employer, or other qualified disinterested party, to determine:
    - The borrower's current eligibility for the disability benefits;
    - The amount and frequency of the disability payments; and
    - If there is a contractually established termination or modification date.
  - Generally long-term disability will not have a defined expiration date and must be expected to continue. The requirement for re-evaluation of benefits is not considered a defined expiration date.
  - If a borrower is currently receiving short-term disability payments that will decrease to a lesser amount within the next three years because they are being converted to long-term benefits, the amount of the long-term benefits must be used as income to qualify the borrower.
    - For additional information on short-term disability see Temporary Leave income below.

Employment Offers or Contracts

- If the borrower is scheduled to begin employment after the loan closes, the loan may be delivered in accordance with one of the options outlined below:

X	Option 1 – Loan Delivered After Borrower Starts Employment
	Obtain an executed copy of the borrower's offer or contract for future employment and anticipated income.
	Obtain a paystub from the borrower that includes sufficient information to support the income used to qualify the borrower based on the offer or contract.
X	***Option 2 – Loan Delivered Prior to Borrower Starting Employment***
	This option is limited to loans that meet the following criteria: • Purchase transaction; • Principal residence; • One-unit property; • The borrower is not employed by a family member or by an interested party to the transaction; and • The borrower is qualified using only fixed base income.
	Obtain and review the borrower's offer or contract for future employment. The employment offer or contract must: • Clearly identify the employer and the borrower, be signed by the employer, and be accepted and signed by the borrower; • Clearly identify the terms of employment; including position, type and rate of pay, and start date; and • Be non-contingent. If conditions of employment exist, confirm **prior to closing** that all conditions of employment are satisfied either by verbal verification or written documentation.
	The employment start date as shown on the employment offer or contract must be within 90 days of the Note date.
	Document, in addition to the amount of reserves required by DU or for the transaction, one of the following: • Reserves sufficient to cover principal, interest, taxes, insurance and association dues (PITIA) for the subject property for six months; or • Reserves or current income sufficient to cover the monthly liabilities included in the borrower's debt-to-income ratio, including the PITIA for the subject property, for the number of months between the Note date and the employment start date, plus one. ▪ Current income refers to income that is currently being received by the borrower that may or may not be used for qualifying and that may or may not continue after the borrower starts employment under the offer or contract. ▪ Current income may be used in lieu of, or in addition to, financial reserves. For this purpose, use the amount of income the borrower is expected to receive between the Note date and the employment start date. ▪ If the current income is not being used for qualifying purposes it can be documented by using income documentation, such as a paystub, and no verification of employment is required. For calculation purposes consider any portion of a month as a full month.

Employment Related Assets as Qualifying Income

- Following are the requirements for employment related assets that may be used as qualifying income:
  - Assets used for the calculation of the monthly income stream must be owned individually by the borrower or the co-owner of the assets must be a co-borrower on the loan.

- Assets must be liquid and available to the borrower and must be sourced as one of the following:
    - A non-self-employed severance package or non-self-employed lump sum distribution retirement package. These funds must be documented with a distribution letter from the employer or *IRS Form 1099-R* and deposited to a verified asset account.
    - For 401(k), IRA, SEP, or KEOUGH retirement accounts, the borrower must have unrestricted access to the funds in the accounts and can only use the accounts if distribution is not already set up or the distribution amount is not enough to qualify. The account and its asset composition must be documented with the most recent monthly, quarterly, or annual statement.
- If a penalty would apply to a distribution of funds from the account made at the time of calculation then the amount of such penalty applicable to complete a distribution from the account, after costs for the transaction, must be subtracted to determine the income stream from these assets.
- If the employment related assets are in the form of stocks, bonds, and mutual funds, 70% of the value remaining after costs for the transaction and consideration of any penalty, must be used to determine the income stream.
- A borrower shall only be considered to have unrestricted access to a 401(k), IRA, SEP, or KEOUGH retirement account if the borrower has, as of the time of calculation, the unqualified and unlimited right to request a distribution of all funds in the account regardless of any possible tax withholding or applicable penalty applied to such distribution.
- "Net documented assets" are equal to the sum of eligible assets minus:
    - The amount of the penalty that would apply if the account was completely distributed at the time of calculation;
    - The amount of funds used for down payment, closing costs, and required reserves;
    - 30% of the remaining value of any stocks, bonds, or mutual fund assets.
- Ineligible assets are non-employment related assets (for example, stock options, non-vested restricted stock, lawsuits, lottery winnings, sale of real estate, inheritance, and divorce proceeds).
    - Funds in checking and savings accounts are generally not eligible as employment related assets unless the source of the balance in a checking or savings account was from an eligible employment related asset such as a severance package or lump sum retirement distribution.

Calculation of Net Documented Assets

Asset Requirements	
IRA (made up of stocks and mutual funds)	$500,000
Minus 10% of $500,000 ($500,000 x .10) (this assumes the borrower is not yet 59 ½ years of age at the time this income is being calculated; therefore, it is subject to a 10% penalty for early distribution. This penalty must be levied against any cash being withdrawn for closing the transaction as well as the remaining funds used to calculate the income stream.)	(-) $50,000
Total eligible documented assets	(=) $450,000
Minus funds required for closing (down payment, closing costs, reserves)	(-) $100,000
(a) Subtotal	(=) $350,000
Minus 30% of $350,000 ($350,000 x .30) (assumes funds are in the form of stocks, bonds and mutual funds)	(-) $105,000

(b) Net Documented Assets	(=) **$245,000**
Monthly income calculation ($245,000/360 or applicable term of the loan in months) See Income Payout Stream in the table below.	$680.56/month

- All of the following loan parameters must be met in order for employment related assets to be used as qualifying income:

Parameter	***Requirement***
Maximum LTV/CLTV/HCLTV	70%
Minimum Credit Score	DU: 620
Loan Purpose	Purchase and Rate/Term Refinance only
Occupancy	Principal Residence and Second Home only
Number of Units	One-to-Four Properties
Income Calculation/Payout Stream	Divide "Net Documented Assets" by the amortization term of the loan (in months)

Foreign Income

- Foreign income is income that is earned by a borrower who is employed by a foreign corporation or foreign government and is paid foreign currency. Borrowers may use foreign income if the following documentation can be obtained:
  - Copies of signed federal income tax returns for the most recent two years that include foreign income; and
  - All income must be translated to U.S. dollars.

Foster Care Income

- Income received from a state or county sponsored organization for providing temporary care for one or more children may be considered acceptable stable income if the following requirements are met:
  - Verify the foster care income with letters of verification from the organizations providing the income.
  - Document that the borrower has a two year history of providing foster care services. If the borrower has not been receiving this type of income for two full years, the income may still be counted as stable income if:
    - The borrower has at least a 12 month history of providing foster care services; and
    - The income does not represent more than 30% of the total gross income that is used to qualify for the mortgage loan.

Housing or Parsonage Income

- Housing or parsonage income may be considered qualifying income if there is documentation that the income has been received for the most recent 12 months and the allowance is likely to continue for the next three years.
- The housing allowance may be added to income but may not be used to offset the monthly housing payment.
- This requirement does not apply to military quarters' allowance. For information on military housing refer to the Base Pay section of these guidelines.

Interest and Dividend Income

- Verify the borrower's ownership of the assets generating the interest or dividend income.
- Document a two year history of the income as verified by:
  - Copies of the borrower's signed federal income tax returns; or
  - Copies of account statements.

- Develop an average of the income received for the most recent two years.
- Subtract any assets used for down payment or closing costs from the borrower's total assets before calculating expected future interest or dividend income.

Non-Occupant Borrower Income

- DU will consider a non-occupant borrower's income as qualifying income for a principal residence with certain LTV ratio limitations.
- If the income from a non-occupant borrower is used for qualifying, the LTV ratios are limited. Refer to the "Guarantors, Co-Signers, or Non-Occupant Borrowers" section of these guidelines for information about the maximum LTV/CLTV/HCLTV ratios that would apply when a non-occupant borrower's income is used for qualifying purposes.

Notes Receivable Income

- Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application.
- Obtain a copy of the note to establish the amount and length of payment.
- Document regular receipt of the income for the most recent 12 months.
- **Payments on a note executed within the past 12 months, regardless of the duration, may not be used as stable income.**

Retirement/Government Annuity/Pension Income

- Document regular and continued receipt of the income as verified by:
  - Letters from the organizations providing the income;
  - Copies of retirement award letters;
  - Copies of signed federal income tax returns;
  - W2 or 1099 forms; or
  - Proof of current receipt.
- If retirement income is paid in the form of a distribution from a 401(k), IRA, or KEOUGH account, determine whether the income is expected to continue for at least three years after the date of the mortgage application. In addition:
  - The borrower must have unrestricted access without penalty to the accounts; and
  - If the assets are in the form of stocks, bonds, or mutual funds, 70% of the value, remaining after any applicable costs for the subject transaction, must be used to determine the number of distributions remaining.

Royalty Payment Income

- Obtain copies of the following:
  - Royalty contract, agreement or statement confirming the amount, frequency and duration of the income; and
  - The borrower's most recent signed federal income tax return including Schedule E.
  - Confirm that the borrower has received royalty payments for at least 12 months and that the payments will continue for a minimum of three years after the date of the mortgage application.

Social Security Income

- Social security income for retirement or long-term disability that the borrower is drawing from his/her own account/work record will not have a defined expiration date and must be expected to continue.
- If social security benefits are being paid as a benefit for a family member to the benefit owner, that income may be used in qualifying if documentation is obtained that confirms the remaining term is at least three years from the date of the mortgage application.
- Document regular receipt of payments as verified by the following, depending on the type of benefit and the relationship of the beneficiary (self or other) as shown in the table below:

Documentation Requirements		
Type of social security benefit	**Borrower is drawing social security benefits from his/her own account/work record***	**Borrower is drawing social security benefits from another person's account/work record**
Retirement	• Social Security Administrator's (SSA) Award letter; or • Proof of current receipt	• SSA Award letter; • Proof of current receipt; **and** • Three year continuance (verification of beneficiary's age)
Disability	• Social Security Administrator's (SSA) Award letter; or • Proof of current receipt	• SSA Award letter; • Proof of current receipt; **and** • Three year continuance (verification of beneficiary's age)
Survivor Benefits	N/A	• SSA Award letter; • Proof of current receipt; **and** • Three year continuance (verification of beneficiary's age)
Supplemental Security Income (SSI)	• SSA Award letter; and • Proof of current receipt	N/A

*An SSA Award letter may be used to document the income if the borrower is receiving Social Security payments or if the borrower will begin receiving payments on or before the first payment date of the subject mortgage as confirmed by a recently issued award letter.

- Examples of how a borrower might draw social security benefits from another person's account/work record and use the income for qualifying:
  - A borrower may be eligible for benefits from a spouse, ex-spouse, or dependent parents (the benefit is paid to the borrower on behalf of the spouse, etc.); or
  - A borrower may use social security income received by a minor dependent or disabled dependent.

Temporary Leave Income

- Temporary leave from work is generally short in duration and for reasons of maternity or parental leave, short-term medical disability, or other temporary leave types that are acceptable by law or the borrower's employer.
- Borrowers on temporary leave may or may not be paid during their absence from work.
- If a borrower will be on temporary leave at the time of closing and that borrower's income is needed to qualify for the loan, determine the allowable income and confirm employment as follows:
  - The borrower's employment and income history must meet standard eligibility requirements.
  - The borrower must provide written confirmation of his/her intent to return to work.
  - Document the borrower's agreed upon date of return by obtaining, either from the borrower or directly from the employer, documentation evidencing such date that has been produced by the employer. Examples of documentation may include:
    - Previous correspondence from the employer that specified the duration of leave or expected return date; or
    - A computer printout from the employer of record.

- The following must be obtained:
  - The amount and duration of the borrower's temporary leave income which may include multiple documents or sources depending on the type and duration of the leave period; and
  - The amount of the regular employment income the borrower received prior to the temporary leave. Regular employment income includes the income the borrower receives from employment on a regular basis that is eligible for qualifying purposes such as base pay, commissions, and bonus.
- If the employer indicates the borrower does not have the right to return to work after the leave period, the income may not be used for qualifying purposes.
- If the borrower **will return to work** as of the first mortgage payment date, consider the borrower's regular employment income in qualifying.
- If the borrower **will not return to work** as of the first mortgage payment date, use the lesser of the borrower's temporary leave income, if any, or the regular employment income.
- If the borrower's temporary leave income is less than his/her regular employment income, the temporary leave income may be supplemented with available liquid reserves. Calculate the "supplemental income" as follows:
  - Supplemental income amount = available liquid reserves divided by the number of months of supplemental income.
  - **Available Liquid Reserves:** Subtract any funds needed to complete the transaction such as down payment, closing costs, other required debt payoff, escrows, and minimum required reserves from the total verified liquid asset amount.
  - **Number of Months of Supplemental Income:** The number of months from the first mortgage payment date to the date the borrower will begin receiving his/her regular employment income rounded up to the next whole number
  - The total qualifying income will be calculated as follows:
    - Supplemental income plus the temporary leave income, if any.
  - The total qualifying income may not exceed the borrower's regular employment income. For example:

Regular Monthly Income Amount	$ 6,000
Temporary Leave Monthly Income	$ 2,000
Total Verified Liquid Assets	$30,000
Funds Needed to Complete the Transaction	$18,000
Available Liquid Reserves	$12,000
First Payment Date	July 1
Date borrower will begin receiving regular income	November 1
Supplemental income: $12,000/4 =	$ 3,000
Total qualifying income: $3,000 + $2,000 =	$ 5,000

- **Note:** These requirements apply when it is discovered through the employment and income verification process that the borrower is on temporary leave. **If a borrower is not on temporary leave, he/she must not be asked if he/she intends to take leave in the future.**

DU Temporary Leave Income

- When income from temporary leave is used to qualify for the loan enter the appropriate qualifying income amount into DU based on the above requirements.
- If the borrower will return to work as of the first mortgage payment date, consider the borrower's regular employment income in qualifying and enter the income into DU using the applicable income type.
- If the borrower will not return to work as of the first mortgage payment date, but is able to qualify using the lesser of the borrower's temporary leave income, if any, or regular employment income, that "lesser of" income must be entered into DU. Entry of the income into DU depends on what was derived as the "lesser of" amount:

        - When the borrower’s temporary leave income is used, enter the income amount into DU as “Temporary Leave Income”.
        - When the borrower’s regular employment income is used, enter the income amount in DU using the applicable income type.
- If the borrower’s temporary leave income is less than the regular employment income and that income is able to be “supplemented” with available liquid reserves, the following must be applied:
    - Enter the combined temporary leave income and supplemental income from reserves in DU as “Temporary Leave Income”. The combination of the two incomes may not exceed the borrower’s regular monthly employment income.
    - Since DU is not able to determine that supplemental income is being used, nor is it able to determine the amount of reserves used to supplement the temporary income, reduce in DU the amount of the borrower’s total liquid assets by the amount of reserves used to supplement the temporary income in order to avoid the reserves being used for both income and assets.

Tip Income

- Obtain the following documents:
    - A completed *Form 1005, Request for Verification of Employment* breaking down base pay vs tip income for year-to-date and for the past two years, the borrower’s most recent pay stub and W2s covering the most recent two year period; and, if tip income is not reported by the employer;
    - *IRS Form 4137, Social Security and Medicare Tax on Unreported Tip Income*, to verify tips not reported by the employer, as applicable.
- Tip income may be used to qualify the borrower if the borrower has received it for the last two years.

Trust Income

- Following are the verification requirements for trust income:
    - Confirm the trust income by obtaining a copy of the trust agreement or the trustee’s statement confirming the amount, frequency and duration of payments.
    - Verify that the trust income will continue for at least three years from the date of the mortgage application.

VA Benefits Income

- Document the borrower’s receipt of VA benefits with a letter or distribution from the Department of Veterans Affairs.
- Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application.
    - Verification of continuance is not required for VA retirement or long-term disability benefits.

Individual Tax Returns

Analyzing Individual Tax Returns – Form 1040

- In analyzing a borrower’s personal income, focus on earnings trends and the actual sources of the income not just on the total amount of the income.
- Confirm the stability and likelihood of continuance for each source of income that the borrower reports on his/her *IRS Form 1040*. Do not include any income that does not appear to be stable or likely to continue. Consider all recurring income that the borrower can expect to continue receiving over time.

- Income may be considered as recurring if the loan application package does not include any specific indication of an upcoming change in the borrower's employment or income, the borrower's employment history has no gaps or other significant fluctuations in income, and any income received under a contractual agreement, other than an "at will" contract, will continue to be received for at least three years. Examples of recurring income include:
  - Regular salaries or wages;
  - Bonus or commission income that has been received on a consistent basis;
  - Interest income from long-term investments that are not being liquidated in connection with the mortgage transaction; and
  - Earnings from the operation of the borrower's business.
- Any non-recurring loss such as an extraordinary one-time expense should not be included in the cash flow analysis in developing the borrower's qualifying income.

Adjusted Gross Income

- *IRS Form 1040* permits a taxpayer to adjust his/her total reported income by reporting certain deductions in the "Adjusted Gross Income" section.
- If the adjusted gross income approach is used in the cash flow analysis, add back to the borrower's cash flow all deductions in this section that represent:
  - Voluntary payments to savings accounts (IRA and KEOUGH deductions);
  - Deductions for taxes or health insurance plans;
  - Deductions for obligations that must be counted in the calculation of the borrower's debt-to-income ratio such as alimony or payments on student loans; and
  - Other non-recurring expenses such as moving expenses or penalties for early withdrawal of savings.

Wages, Salary, and Tips

- If an amount is shown for wages, salary, or tips for a self-employed borrower, it may mean:
  - The borrower operates as a corporation and pays himself or herself a salary; or
  - The borrower's spouse is employed and receives a salary either from the borrower's business or from another employer.
- If the income relates to the borrower's spouse who is employed by another company and the income will be used in qualifying for the mortgage, the spouse's income must be verified directly with his/her employer since it may be more appropriate to use the spouse's current earnings in underwriting the mortgage.
- Any income that is based on current earnings or that will not be used for qualifying purposes should be deducted from the borrower's cash flow.

Interest and Dividend Income

- The taxable interest and dividend income that is reported on *Form 1040*, *Schedule B*, may be counted as stable income only if it has been received for the past two years.
- The income cannot be counted if the borrower is using the interest bearing or dividend producing asset as the source of the down payment or closing costs.
- Tax-exempt interest income may be counted as stable income only if it has been received for the past two years and is expected to continue. If so this income can be added to the borrower's cash flow.

State and Local Tax Refunds

- Taxable state and local tax refunds, credits, or offsets of state and local income taxes should not be used as qualifying income since the income was accounted for in the previous year's tax returns.

IRS Distributions, Pensions and Annuities, and Social Security Benefits

- Income received from IRA distributions, pensions, annuities, and social security benefits may be accepted as qualifying income.

- The non-taxable portion of such recurring income must be added to the borrower's cash flow. The non-taxable portion of income from these sources may be "grossed up"

Other Income or Loss

- If the borrower reported income from other sources, verify that the income is an eligible source for qualifying purposes.
- Income that is determined to be non-recurring is ineligible for qualifying purposes.

2106 Expenses

- When evaluating commission income that represents 25% or more of the borrower's total annual employment income, consider certain tax deductions reported on *IRS Form 2106, Employee Business Expenses* when conducting the cash flow analysis:
  - **Out-of-pocket, unreimbursed business expenses:** These expenses must be deducted from the borrower's income.
  - **Actual expenses for a leased automobile, rather than the standard mileage rate:** Analyze the "Actual Expenses" section of *Form 2106* to determine the amount of the lease payments and make sure the lease expense is counted only once either as an expense on *Form 2106* or as a monthly obligation.
  - **Standard mileage deduction:** The business miles driven should be multiplied by the depreciation factor for the appropriate year and the calculated amount added to the borrower's cash flow.
    - If a borrower claims an "actual depreciation expense" deduction, the amount the borrower claimed should be added to the borrower's income.

Schedule C

- The income or loss from a borrower's sole proprietorship is calculated on Schedule C. Certain adjustments to the net profit or loss shown on Schedule C may be needed to arrive at the borrower's actual cash flow.
  - For example; Schedule C may include income that was not obtained from the profits of the borrower's business. If it is determined that such income is non-recurring, deduct the non-recurring income.
- Meals and entertainment expenses must be deducted.
- The following recurring items claimed by the borrower on Schedule C may be added back to the cash flow analysis:
  - Depreciation;
  - Depletion;
  - Business use of a home;
  - Amortization; and
  - Casualty losses.

Schedule D

- Schedule D is used to report capital gains and losses. Income received from a capital gain is generally a one-time transaction. Generally it should not be considered part of the borrower's stable monthly income.
- If the income calculated on the Schedule D shows that the borrower has realized capital gains for the last two years, the recurring gains can be considered in determining the borrower's stable monthly income.
  - In this case the borrower must provide evidence of ownership of additional property or assets that will generate this income for at least the next three years.
- Capital losses do not have to be considered when calculating income or liabilities even if the loss is recurring.

Schedule E

- Income received from rents, royalties and distributions from partnerships, corporations, estates, trusts, etc. is reported on Schedule E.
- **Rather than using Schedule E for income related to distributions from partnerships, corporations, estates and trusts; income from the K-1 must be used**.
- **Royalty Income**: Refer to Royalty Income in the "Other Income" section of these guidelines.
- **Rental Income**: Refer to Rental Income in the "Rental Income" section of these guidelines.

Schedule F

- Income received from farming is calculated on Schedule F. Certain adjustments may need to be made to the net income amount.
  - For example; certain federal agricultural payments, co-op distributions, and insurance or loan proceeds are not fully taxable so they would not be reported. These income sources may or may not be stable or continuous and could be a one-time occurrence.
- If it can be verified that net income amounts are stable, consistent and continuing, the income may be used for qualifying purposes, otherwise, the income must be deducted from the borrower's income.
- The net income may be adjusted by adding the amount of any deduction the borrower claimed on Schedule F for depreciation, amortization, casualty loss, depletion or business use of his/her home.

Schedule K1 Income

- **For borrowers who have less than 25% ownership** of a partnership, S Corporation, or limited liability company (LLC), ordinary income, net rental real estate income, and other net rental income reported on *IRS Form 1065* or *IRS Form 1120S,* the K1 income may be used in qualifying the borrower provided it can be confirmed the business has adequate liquidity to support the withdrawal of earnings. If the Schedule K1 provides this confirmation, no further documentation of business liquidity is required.
- The following table provides verification of income requirements for Schedule K1 borrowers **with less than 25% ownership** of a partnership, an S corporation or an LLC:

X	*Verification of Schedule K1 Income*
	If the Schedule K1 reflects a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then no further documentation of access to the income or adequate business liquidity is required. The Schedule K1 income may be used for qualifying purposes.
	If the Schedule K1 does not reflect a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, confirm the business has adequate liquidity to support the withdrawal of earnings. Use discretion in the method used to confirm the business has adequate liquidity.
	If the borrower has a two year history of receiving "guaranteed payments to the partner" from a partnership or an LLC, these payments can be added to the borrower's income. **Note:** An exception to the two year requirement of receiving "guaranteed payments to the partner" is when a borrower has recently acquired nominal ownership in a professional services partnership (for example, a medical practice or a law firm) after having an established employment history with the partnership. In this situation use the borrower's guaranteed compensation. This must be evidenced by the borrower's partnership agreement and further supported by evidence of current year-to-date income.
	The borrower must provide the most recent two years of signed personal federal income tax returns and the most recent two years of IRS Schedule K1.

Self-Employment Income

Factors to Consider for a Self-Employed Borrower

- When determining the appropriate qualifying income for a self-employed borrower it is important to note that business income, specifically from a partnership or S corporation, reported on the borrower's personal tax returns may not necessarily represent income that has actually been distributed to the borrower.
- When conducting a self-employment income cash flow analysis, determine the amount of income that can be relied on by the borrower in qualifying for their personal mortgage obligation.
- When underwriting these borrowers it is important to review business income distributions that have been made or could be made to the borrower while maintaining the viability of the underlying business. This analysis includes assessing the stability of business income and the ability of the business to continue to generate sufficient income to enable the borrower to meet his/her financial obligations.
- Any individual who has a 25% or greater ownership interest in a business is considered to be self-employed.
- The following factors must be analyzed before approving a mortgage for a self-employed borrower:
  - The stability of the borrower's income;
  - The location and nature of the borrower's business;
  - The demand for products or services offered by the business;
  - The financial strength of the business; and
  - The ability of the business to continue generating and distributing sufficient income to enable the borrower to make the payments on the mortgage loan.

Verification of Income

- Generally a two year history of the borrower's prior earnings is required as a means of demonstrating the likelihood that the income will continue to be received.
- A person who has a shorter history of self-employment, from 12 to 24 months, may be considered as long as the borrower's business is in the same line of work as his/her previous employment and the self-employed income, as reflected on the borrower's tax returns, is at the same rate of pay, or higher, as was earned at his/her previous employment.
  - In such cases give careful consideration to the nature of the borrower's level of experience and the amount of debt the business has acquired.
- Verify self-employment and income by obtaining copies of the borrower's signed federal income tax returns, both personal and business tax returns that were filed with the IRS for the past two years with all applicable schedules attached.
- When two years of tax returns are provided, the requirement for business tax returns may be waived if:
  - The borrower is using his/her own personal funds to pay the down payment and closing costs and to satisfy applicable reserve requirements;
  - The borrower has been self-employed in the same business for at least five years; and
  - The borrower's personal tax returns show an increase in self-employment income over the past two years.
- For certain loan casefiles DU will issue a message permitting only one year of personal and business tax returns provided the income is documented by:
  - Obtaining signed personal and business federal tax returns for the most recent year,
  - Confirming the tax returns reflect at least 12 months of self-employment income; and
  - Completing *Form 1084, Cash Flow Analysis* or any other type of cash flow analysis that applies the same principles.
- When co-borrower income that is derived from self-employment is not being used for qualifying purposes, underwriters are not required to document or evaluate the co-borrower's self-employment income or loss. Any business debt for which the co-borrower is personally obligated must be included in the total monthly obligations when calculating the debt-to-income ratio.
- The net income from self-employment should be entered in the "Base Income" field and answer "yes" to the self-employment indicator.

Analysis of the Borrower's Personal Income

- Underwriters must prepare a written evaluation of their analysis of a self-employed borrower's personal income, including the business income or loss, reported on the borrower's personal tax returns. The purpose of this written analysis is to determine the amount of stable and continuous income that will be available to the borrower.
- This analysis is not required when a borrower is qualified using only income that is not derived from self-employment and self-employment is a secondary and separate source of income or loss.
- **As noted above, *Form 1084, Cash Flow Analysis* or any other type of cash flow analysis that applies the same principles may be used. A copy of the written analysis must be included in the loan file.**

Analysis of the Borrower's Business Income

- When a borrower is relying upon self-employed income to qualify for a mortgage and the requirements that permit business tax returns to be waived are not met, underwriters must prepare a written evaluation of their analysis of the borrower's business income.
- Evaluate the borrower's business through knowledge of other businesses in the same industry to confirm the stability of the borrower's business income and to estimate the potential for long-term earnings. The purpose of this analysis is to:
  - Consider the recurring nature of the business income, including identification of pass-through income that may require additional evaluation;
  - Measure year-to-year trends for gross income, expenses, and taxable income for the business;
  - Determine on a yearly or interim basis the percentage of gross income attributed to expenses and taxable income; and
  - Determine a trend for the business based on the change in these percentages over time.
- Use *Form 1088, Comparative Income Analysis* or any other method of trend analysis that assists with determining a business's viability. A copy of the written analysis and conclusions must be retained in the loan file.

Use of Business Assets

- **When a borrower intends to use business assets as funds for the down payment, closing costs, and/or financial reserves, perform a business cash flow analysis to confirm that the withdrawal of funds for this transaction will not have a negative impact on the business**.
- In order to assess the impact a level of documentation greater than what is required may be needed to evaluate the borrower's business income such as several months of recent business asset statements in order to see cash flow needs and trends over time, or a current balance sheet.

Business Structures

- The legal structure of a business determines the following:
  - The way business income or loss is reported to the IRS;
  - The taxes that are paid;
  - The ability of the business to accumulate capital; and
  - The extent of the owner's liability.
- There are five principal business structures:
  - Sole Proprietorships;
  - Partnerships;
  - Limited Liability Companies (LLC);
  - S Corporations; and
  - Corporations.

Sole Proprietorships

- A sole proprietorship is an unincorporated business that is individually owned and managed.

- The individual owner has unlimited personal liability for all of the business's debts. If the business fails the borrower not only will have to replace his/her lost income but also will be expected to satisfy the outstanding obligations of the business.
- Since no distinction is made between the owner's personal assets and the assets used in the business, creditors may take either, or both, to satisfy the borrower's business obligations.
- The financial success or failure of this type of business depends solely on the owner's ability to obtain capital and to manage the various aspects of the business. Poor management skills or an inability to secure capital to keep the business running will compromise the continuance of the borrower's business and income.
- The owner's death terminates the business and may cause the assets to be placed into probate which will delay the disposition of the assets to creditors and heirs.
- The income, expenses, and taxable profits of a sole proprietorship are reported on the owner's personal tax returns and are taxed at the tax rates that apply to individuals.
- When evaluating a sole proprietorship, underwriters must:
  - Review the owner's most recent signed federal income tax returns to ensure that there is sufficient and stable cash flow to support both the business and the payments for the requested mortgage; and
  - Determine whether the business can accommodate the withdrawal of assets or revenues should the borrower need them to pay the mortgage payment and/or other personal expenses.

Schedule K1 Income

- The version of schedule K1 that is used to report a borrower's share of income or loss is based on how the business reports earnings for tax purposes:
  - **Partnership:** Reported on *IRS Form 1065, Schedule K-1*;
  - **S Corporation:** Reported on *IRS Form 1120S, Schedule K-1*; and
  - **LLC:** Reported on either *IRS Form 1065* or *IRS Form 1120S, Schedule K1*, depending on how the federal income tax returns are filed for the LLC.
- Use caution when including income that the borrower draws from the borrower's partnership or S corporation as qualifying income. Ordinary income, net rental real estate income, and other net rental income reported on Schedule K1 may be included in the borrower's income provided it can be confirmed that the business has adequate liquidity to support the withdrawal of earnings as described below:
  - If the borrower has a two year history of receiving "guaranteed payments to the partner" from a partnership or an LLC, these payments can be added to the borrower's income.
  - If the Schedule K1 reflects a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then no further documentation of access to the income or adequate business liquidity is required.
  - If the Schedule K1 does not reflect a documented, stable history, confirm adequate business liquidity as discussed below.
- If business tax returns are required, consider the type of business structure and analyze the business returns.
- Use discretion in selecting the method to confirm that the business has adequate liquidity to support the withdrawal of earnings.
- It is important to select a business liquidity formula based on how the business operates. For example:
  - The Quick Ratio (also known as the Acid Test Ratio) is appropriate for businesses that rely heavily on inventory to generate income. This test excludes inventory from current assets in calculating the proportion of current assets available to meet current liabilities.

Quick Ratio = (current assets – inventory) / current liabilities

- The Current Ratio (also known as the Working Capital Ratio) may be more appropriate for businesses not relying on inventory to generate income.

Current Ratio = Current assets/current liabilities

- For either ratio a result of one or greater is generally sufficient to confirm adequate business liquidity to support the withdrawal of earnings.

Partnerships

- A partnership is an arrangement between two or more individuals who have pooled their assets and skills to form a business and who will share profits and losses according to pre-determined proportions that are set out in the partnership agreement. A partnership may be either a general partnership or a limited partnership.
- **General Partnership:** Under a general partnership each partner has responsibility for running the business, is personally liable for the debts of the entire business, and is responsible for the actions of every other partner.
  - A general partnership is dissolved immediately on the death, withdrawal or insolvency of any of the partners, although the personal liability to partnership creditors exists even after the partnership is dissolved.
  - The partnership's assets will first be applied to the creditors of the business and the partners' individual assets will first be applied to their personal creditors with any surplus in a partner's personal assets then being applied to the remaining business creditors.
- **Limited Partnership:** Under a limited partnership a limited partner has limited liability based on the amount he/she invested in the partnership, does not typically participate in the management and operation of the business, and has limited decision making ability.
  - A limited partnership will have at least one general partner who manages the business and is personally liable for the debts of the entire business.
  - A limited partner's death, withdrawal or insolvency does not dissolve the partnership.
  - Because limited partnerships often are formed as tax shelters it is more likely that Schedule K1 will reflect a loss instead of income. In such cases the borrower's ability to deduct the loss will be limited by the "at risk" amount of his/her limited partnership interest and will probably be subject to passive loss limitations.
- The partnership must report its profit or loss on *IRS Form 1065* and each partner's share of the profit or loss on Schedule K1. The partnership pays no tax on the partnership income.
- Each partner uses his/her K1 to report his/her share of the partnership's net profit or loss on his/her personal tax returns whether or not the partner receives a cash distribution from the partnership. Individual partners pay taxes on their proportionate share of the net partnership income at their individual tax rates.
- To determine the level of the borrower's financial risk, underwriters must:
  - Determine whether the borrower has guaranteed any loans obtained by the partnership other than loans that are considered non-recourse debt or qualified non-recourse debt.
  - Determine if the borrower received a distribution from the partnership; and
  - Determine the borrower's share of non-cash expenses that can be added back to the cash flow of the partnership business.

Analyzing Partnership Returns

- Partnerships and some LLCs use *Form 1065* for filing tax returns for the partnership or LLC.
- The partner's or member-owner's share of income or loss is reported on their personal tax returns, Schedule E.
- A borrower with an ownership interest in a partnership or LLC may receive income in the form of wages or other compensation from the partnership or LLC in addition to the borrower's proportionate share of income or loss reported on the Schedule K1.
- When the borrower has 25% or more ownership interest in the business and business tax returns are required, perform a business cash flow analysis and evaluate the overall financial position of the borrower's business to determine whether:
  - The income is stable and consistent; and
  - The sales and earnings trends are positive.

- If the business does not meet these standards business income cannot be used to qualify the borrower.
- The borrower's proportionate share of income or loss is based on the borrower's percentage of Ending Capital in the business as shown on Schedule K1. Only consider the borrower's share of the business income or loss.
- Items that can be added back to the business cash flow include:
  - Depreciation;
  - Depletion;
  - Amortization;
  - Casualty Losses; and
  - Other losses which are not consistent and recurring.
- The following items should be subtracted from the business cash flow:
  - Meals and entertainment exclusion;
  - Other reported income that is not consistent and recurring; and
  - The total amount of obligations on mortgages or notes payable in less than one year.
    - These adjustments are not required for lines of credit or if there is evidence that these obligations roll over regularly and/or the business has sufficient liquid assets to cover them.

Limited Liability Companies

- A limited liability company (LLC) is a hybrid business structure that is designed to offer its member-owners the tax efficiencies of a partnership and the limited liability advantages of a corporation.
- The member-owners of the LLC can sign contracts, sell assets, and make other important business decisions.
- The LLC operating agreement may set out specific divisions of power among the member-owners or manager.
- Although the member-owners generally have limited liability there may be some instances in which they are required to personally guarantee some of the loans that the LLC obtains. Profits from the operation of the LLC may be distributed beyond the pool of member-owners such as by offering profit distributions to managers.
- The LLC may report its profit or loss on *IRS Form 1065* or *IRS Form 1120S* with each member-owner's share of the profit or loss on Schedule K1. The LLC pays no tax on its income.
- Each member-owner uses the information from Schedule K1 to report his/her share of the LLC's net profit or loss on his/her personal tax returns whether or not the member-owner receives a cash distribution from the LLC. Individual member-owners pay taxes on their proportionate share of the LLC's net income at their individual tax rates.
- Evaluate the LLC using *IRS Form 1065* or *IRS Form 1120S* along with Schedule K1 to determine the following:
  - Whether the borrower actually received a cash distribution from the LLC since profits may or may not be distributed to the individual member-owners; and
  - Whether the borrower has guaranteed any loans obtained by the LLC other than loans that are considered as non-recourse debt or qualified non-recourse debt.

Income form Partnerships, LLCs, Estates and Trusts

- Income from partnerships, LLCs, estates or trusts can only be considered if documentation is obtained that verifies:
  - The income was actually distributed to the borrower; or
  - The business has adequate liquidity to support the withdrawal of earnings. If the K1 provides this confirmation no further documentation of business liquidity is required.
- It is important to select a business liquidity formula based on how the business operates. Refer to the Quick Ratio and Current Ratio discussion in the K1 section above.

S Corporations

- An S corporation is a legal entity that has a limited number of stockholders and elects not to be taxed as a regular corporation. Business gains and losses are passed on to the stockholders.
- An S corporation has many of the characteristics of a partnership. Stockholders are taxed at their individual tax rates for their proportionate share of ordinary income, capital gains, and other taxable items.
- The ordinary income for an S corporation is reported on *IRS Form 1120S* with each shareholder's share of the income reported on *IRS Form 1120S*, Schedule K1.
- Because this income from the distribution of corporate earnings may or may not be distributed to the individual shareholders, determine if the borrower received a cash distribution from the S corporation.
- The cash flow of an S corporation is otherwise evaluated similarly to that of a regular corporation.

Analyzing S Corporation Returns

- S corporations and some LLCs pass gains and losses on to their shareholders who are then taxed at the tax rates for individuals.
- S corporations and some LLCs use *Form 1120S*, *Schedule K1* for filing federal income tax returns for the corporation.
- The shareholder's share of income or loss is carried over to the borrower's personal tax returns, Schedule E.
- When the borrower has 25% or more ownership interest in the business, perform a business cash flow analysis in order to evaluate the overall financial portion of the business and confirm:
  - The business income is stable and consistent; and
  - The sales and earnings trends are positive.
- If the business does not meet these standards, business income cannot be used to qualify the borrower.

Income from S Corporations

- The borrower's proportionate share of income or loss is based on the borrower's (shareholder) percentage of stock ownership in the business for the tax year as shown on *Form 1120S*.
- The cash flow analysis should consider only the borrower's proportionate share of the business income or loss, taking into account any adjustments to the business income that are discussed below. Business income may only be used to qualify the borrower if documentation is obtained verifying that:
  - The income was actually distributed to the borrower; or
  - The business has adequate liquidity to support the withdrawal of earnings. If Schedule K1 provides this confirmation no further documentation of business liquidity is required.
- Use discretion in selecting the method to confirm that the business has adequate liquidity to support the withdrawal of earnings.
- When business tax returns are provided calculate a ratio using a generally accepted formula that measures business liquidity by deriving the proportion of current assets available to meet current liabilities.
- It is important to select a business liquidity formula based on how the business operates. Refer to the Quick Ratio and Current Ratio discussion in the K1 section above.
- Items that can be added back to the business cash flow include:
  - Depreciation;
  - Depletion;
  - Amortization;
  - Casualty losses; and
  - Other losses which are not consistent and recurring.
- The following items should be subtracted from the business cash flow:
  - Meals and entertainment exclusion;

    - Other reported income that is not consistent and recurring; and
    - The total amount of obligations on mortgages or notes that are payable in less than one year.
        - These adjustments are not required for lines of credit or if there is evidence that these obligations roll over regularly and/or the business has sufficient liquid assets to cover them.

Corporations

- A corporation is a state-chartered legal entity that exists separately and distinctly from its owners who are called stockholders or shareholders. It is the most flexible form of business organization for purposes of obtaining capital.
- A corporation can sue, be sued, hold, convey, or receive property, enter into contracts under its own name and does not dissolve when its ownership changes.
- There are two types of corporations; publicly owned (widely held) corporations and privately owned (closely held) corporations. Because more than 50% of the outstanding stock of a privately owned corporation is owned directly or indirectly by no more than five people the corporation has little or no access to public funds and must raise capital through institutional financing.
- Although legal control of the corporation rests with its stockholders they typically are not responsible for the day-to-day operations of the business since they elect a board of directors to manage the corporation and delegate responsibility for the day-to-day operations to the directors and officers of the company.
- The distribution of profits earned by the business is determined by the corporation's board of directors or other entities that have a significant financial interest in the business. The profits usually are filtered down to the owners in the form of dividends.
- Since a stockholder is not personally liable for the debts of the corporation, losses are limited to his/her individual investment in the corporation's stock.
- Corporations must report income and losses on *IRS Form 1120* and pay taxes on the net income. The corporation distributes profits to its shareholders in the form of dividends which it reports on *IRS Form 1099-DIV*. The shareholders must then report the dividends as income on their personal tax returns.

Analyzing Corporation Tax Returns

- Corporations use *IRS Form 1120* to report their taxes.
- When funds from a corporation that operates on a fiscal year that is different from the calendar year are used in qualifying a self-employed borrower, make time adjustments to relate corporate income to the borrower's personal tax return.
- After determining the income available to the borrower for qualifying purposes, evaluate the overall financial position of the corporation. Ordinary income from the corporation can be used to qualify the borrower only if the following requirements are met:
    - The business must be stable and consistent;
    - The sales and earnings trends must be positive; and
    - The business must have adequate liquidity to support the borrower's withdrawals of cash without having severe negative effects.
- The cash flow analysis can only consider the borrower's share of the business income or loss taking into consideration adjustments to business income provided below**. Earnings may not be used unless the borrower owns 100% of the business.**
- Items that can be added back to the business cash flow include:
    - Depreciation;
    - Depletion;
    - Amortization;
    - Casualty losses;
    - Net operating losses; and
    - Other special deductions which are not consistent and recurring.
- The following items should be subtracted from the business cash flow:

   - Meals and entertainment exclusion;
   - Tax liability and amount of any dividends; and
   - The total amount of obligations on mortgages or notes that are payable in less than one year.
      - These adjustments are not required if there is evidence that these obligations roll over regularly and/or the business has sufficient liquid assets to cover them.

Analyzing Profit and Loss Statements

- Use a profit and loss statement, audited or unaudited, for a self-employed borrower's business to support the determination of stability or continuance of the borrower's income.
- A year-to-date profit and loss statement is not required for most businesses but if the borrower's loan application is dated more than 120 days after the end of the business's tax year, underwriters may choose to require this document if they believe that it is need to support their determination of the stability or continuance of the borrower's income.
- If the borrower's year-to-date salary or draws were not used in determining the borrower's qualifying income, they may be added to the net profit shown on the profit and loss statement as well as adding any of the allowable adjustments used in analyzing the tax returns for the business such as non-recurring income and expenses, depreciation, and depletion.
- Only the borrower's proportionate share of these items may be considered in determining the amount of income from the business that the borrower can use for qualifying purposes.

Asset Requirements

Verification of Depository Assets

Deposits and Assets

- Any of the following types of documentation may be used to verify that a borrower has sufficient funds for closing, down payment, and/or reserves:
   - Copies of bank statements or investment portfolio statements. The statements must cover the most recent full two month period of account activity or, if the account information is reported on a quarterly basis, the most recent quarter. The statements must:
      - Clearly identify the borrower as the account holder;
      - Include at least the last four digits of the account number;
      - Include the time period covered by the statement;
      - Include all deposits and withdrawal transactions;
      - Include all purchase and sale transactions for portfolio accounts; and
      - Include the ending balance.
   - Direct verification by a third party asset verification vendor are acceptable as long as:
      - The borrower provided proper authorization to use the verification method;
      - The verified information provided must conform with the information that would be provided on bank statements;
      - The date of the completed verification is in compliance with the allowable age of credit documents; and
      - The vendor maintains reasonable practices that ensure reliable and authorized verifications of deposit and asset information.
   - Copies of retirement account statements. They must be the most recent statements and they must identify the borrower's vested amount and the terms.
- If a bank statement is more than 45 days earlier than the loan application, obtain a more recent, supplemental, bank-generated form that shows at least the last four digits of the account number, balance and date. The statements may be computer generated forms including online account or portfolio statements downloaded by the borrower from the Internet.
- Documents that are faxed or downloaded from the Internet must clearly identify the name of the depository or investment institution and the source of information by including that information in the Internet or fax banner at the top of the document.

- Loans with assets validated by DU must comply with all requirements pertaining to the DU validation service. Compliance with the DU messages satisfies the requirement for documenting assets. This documentation may differ from the requirements described above.

Depository Accounts

- Funds held in checking, savings, money market, certificates of deposit, or other depository accounts may be used for the down payment, closing costs, and reserves.
- Unverified funds are not acceptable for the down payment, closing costs, or reserves. Investigate any indications of borrowed funds.

DU Depository Assets

- DU indicates the minimum verification documentation requirements necessary to process the loan application. This level of documentation may not be adequate for every borrower and every situation. Determine whether additional documentation is warranted.
- For depository accounts such as checking and savings accounts, money market funds, and certificates of deposit, DU will require two consecutive monthly bank statements reflecting 60 days of activity.
- Monthly bank statements must be dated within 45 days of the initial loan application date.
- Quarterly bank statements must be dated within 90 days of the initial loan application date.
- **Under no circumstances may a Verification of Deposit only be obtained in lieu of bank statements. Bank statements are required regardless of DU findings.**
- When DU validates assets, DU issues a message indicating the acceptable documentation. Compliance with the DU message satisfies the requirement for documenting assets with the following exception:

Business Assets

- Business assets may be an acceptable source of funds for the down payment, closing costs, and reserves when a borrower is self-employed and the individual federal tax returns have been evaluated including, if applicable, the business federal income tax returns for that particular business.
- The borrower must be listed as an owner of the account and the account must be verified in accordance with the requirements for verifying depository accounts.
- **Perform a business cash flow analysis** to confirm that the withdrawal of funds for this transaction will not have a negative impact on the business.

Evaluating Large Deposits

- Evaluate large deposits reflected on the borrower's bank statements. Large deposits are defined as a single deposit that exceeds 50% of the borrower's total monthly qualifying income.
- Requirements for evaluating large deposits vary based on the transaction type as shown in the table below:

Transaction Type	*Evaluation Requirements*
Refinance transactions	Documentation or explanation for large deposits is not required. Underwriters remain responsible for ensuring that any borrowed funds, including any related liability, are considered.
Purchase transactions	• If funds from a large deposit are needed to complete the purchase transaction, document that those funds are from an acceptable source. • Verified funds must be reduced by the amount of the undocumented large deposit. Confirm that the remaining funds are sufficient for the down payment, closing costs, and reserves. When using a reduced asset amount, that reduced amount must be used for underwriting purposes. When a

	deposit has both sourced and unsourced portions, only the unsourced portion must be used to calculate whether or not it must be considered a large deposit. **Examples** **Scenario 1:** Borrower has monthly income of $4,000 and an account at ABC Bank with a balance of $20,000. A deposit of $3,000 is identified but $2,500 of that deposit is documented as coming from the borrower's federal income tax refund. Only the unsourced $500 must be considered in calculating whether it meets the large deposit definition. The unsourced $500 is 12.5% of the borrower's $4,000 monthly income. Since this is less than the 50% definition of a large deposit it is not considered a large deposit and the entire $20,000 balance in the ABC Bank account can be used for underwriting purposes. **Scenario 2:** Using the same borrower example, a deposit of $3,000 is identified, but only $500 is documented as coming from the borrower's federal income tax refund, leaving $2,500 unsourced. In this instance the unsourced $2,500 is 63% of the borrower's $4,000 monthly income which does meet the definition of a large deposit. It must be subtracted from the account balance of $20,000 and only the remaining $17,500 may be used for underwriting purposes.

- If the source of a large deposit is readily identifiable on the account statement, such as a direct deposit from an employer's payroll, the Social Security Administration, IRS, state income tax refund, or a transfer of funds between verified accounts, and the source of the deposit is printed on the statement, no further explanation or documentation is required.
- If the source of the deposit is printed on the statement but there are still questions as to whether the funds may have been borrowed, obtain additional information.
- The DU validation service automates the assessment of large deposits. When assets are validated, DU issues a message indicating which large deposits require documentation.

Pooled Savings

- Funds from a community savings account or any other type of pooled savings may be used for the down payment if the borrower can document regular contributions to the fund.
- Acceptable documentation includes written confirmation from the party managing the pooled savings fund and documentation of regular borrower contributions.
- **The borrower's obligation to continue making contributions to the fund must be considered as part of the borrower's debt when calculating the total debt-to-income ratio.**

Verification of Assets for Non-U.S. Citizen Borrowers

- Document all sources of funds used for down payments and closing costs.
- Funds that a non-U.S. citizen borrower recently deposited in a U.S. depository institution are an acceptable source of funds provided all of the following requirements are met:
  - There is documented evidence of funds transfer from the country from where the borrower immigrated;
  - It can be established that the funds belonged to the borrower before the date of the transfer; and
  - The sources of all funds used for closing can be verified just as they would for a borrower who is a U.S. citizen.

- Documentation in a foreign language must be translated into English by an authorized translation service.
- **Funds from the following U.S. sanctioned countries are not acceptable:**
  - Burma, also known as the Union of Myanmar;
  - The Ivory Coast (Cote de Ivoire);
  - Cuba;
  - Iran;
  - North Korea; and
  - Syria

Verification of Non-Depository Assets

Stocks, Stock Options, Bonds, and Mutual Funds

- Vested assets in the form of stocks, government bonds, and mutual funds are acceptable sources of funds for the down payment, closing costs, and reserves provided their value can be verified. The value of the asset and any related documentation must meet the requirements outlined in the table below:

Asset Type	*Determining the Value of the Asset*
Stocks and mutual funds	Determine the value of the asset, net of any margin accounts, by obtaining either: • The most recent monthly or quarterly statement from the depository or investment firm; or • A copy of the stock certificate accompanied by a newspaper stock list that is dated as of or near the date of the loan application.
Stock options	The value of vested stock options can be documented by: • A statement that lists the number of options and the option price; and • Using the current stock price to determine the gain that would be realized from exercise of an option and the sale of the optioned stock. • Non-vested stock options are not an acceptable source of funds for the down payment, closing costs, or reserves.
Government bonds	The value of government bonds must be based on their purchase price unless the redemption value can be documented.

- When used for the down payment or closing costs, if the value of the asset is at least 20% more than the amount of funds needed for the down payment and closing costs, no documentation of the borrower's actual receipt of the funds realized from the sale or liquidation is required. Otherwise, evidence of the borrower's actual receipt of funds realized for the sale or liquidation must be documented.
- When used for reserves, 100% of the value of the assets may be considered and liquidation is not required.

Trust Accounts

- Funds disbursed from a borrower's trust account are an acceptable source for the down payment, closing costs and reserves provided the borrower has immediate access to the funds.
- To document trust account funds obtain the following:
  - Written documentation of the value of the trust account from either the trust manager or the trustee; and
  - Document the conditions under which the borrower has access to the funds and the effect, if any, that the withdrawal of funds will have on the trust income if it is being used in qualifying the borrower for the mortgage.

Retirement Accounts

- Vested funds from individual retirement accounts (IRA/SEP/KEOUGH accounts) and tax-favored retirement savings accounts (401(k) accounts) are acceptable sources of funds for the down payment, closing costs and reserves. Verify the ownership of the account and confirm that the account is vested and allows withdrawals regardless of current employment status.
- **If withdrawal of the retirement funds is allowed only upon termination of employment, retirement or death the funds are not eligible**.
- If the retirement assets are in the form of stocks, bonds or mutual funds the account must meet the requirements discussed in the Stocks, Bonds and Mutual Funds section described above for determining value and whether documentation of the borrower's actual receipt of funds is required.
- When funds from retirement accounts are used for reserves, the funds do not have to be withdrawn from the account.

Gift funds

- Gifts from an acceptable donor are allowed on principal residence and second home transactions.
- Gift funds may fund all or part of the down payment, closing costs, or reserves subject to the minimum borrower contribution requirements indicated below.
- **Gifts are not allowed on an investment property**.
- A gift can be provided by:
  - A relative, defined as the borrower's spouse, child or other dependent, or by any other individual who is related to the borrower by blood, marriage, adoption or legal guardianship; or
  - A fiancé, fiancée, or domestic partner.
- The donor may not be, or have any affiliation with, the builder, the developer, the real estate agent, or any other interested party to the transaction.
- The following table describes the minimum borrower contribution requirements for transactions that contain gifts:

LTV, CLTV, or HCLTV Ratio	*Minimum Borrower Contribution Requirement from Borrower's Own Funds*	
80% or less	One-to-four unit principal residence Second home	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction may come from a gift.
Greater than 80%	One unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction may come from a gift.
	Two-to-four unit principal residence Second home	The borrower must make a 5% minimum borrower contribution from his/her own funds.* After the minimum borrower contribution has been met, gifts may be used to supplement the down payment, closing costs and reserves.

*****If the borrower receives a gift from a relative or domestic partner who has lived with the borrower for the last 12 months, or from a fiancé or fiancée, the gift is considered the borrower's own funds and may be used to satisfy the minimum borrower contribution requirement as long as both individuals will use the home being purchased as their principal residence.

- Gifts must be evidenced by a gift letter signed by the donor. The gift letter must:
  - Specify the dollar amount of the gift;
  - Specify the date the funds were transferred;

  - Include the donor's statement that no repayment is expected; and
  - Indicate the donor's name, address, telephone number and relationship to the borrower.
- When a gift from a relative or domestic partner is being pooled with the borrower's funds to make up the required minimum cash down payment, the following items must also be included:
  - A certification from the donor stating he/she has lived with the borrower for the past 12 months and will continue to do so in the new residence.
  - Documents that demonstrate a history of the borrower's and the donor's shared residency such as a copy of a driver's license, a bill, or a bank statement. The donor's address on the document(s) must be the same as the borrower's address.
- Verify that sufficient funds to cover the gift are either in the donor's account or have been transferred to the borrower's account. Acceptable documentation includes the following:
  - A copy of the donor's check and the borrower's deposit slip;
  - A copy of the donor's withdrawal slip and the borrower's deposit slip;
  - A copy of the donor's check to the closing agent; or
  - A settlement statement showing receipt of the donor's check.
- When the funds are not transferred prior to settlement, document that the donor gave the closing agent the gift funds in the form or a certified check, a cashier's check, or other official check.

DU Gift Funds

- Gifts are permitted. The entry of gifts in the online loan application is as follows:
  - When a gift is entered in the Assets section as a gift, the funds are included in available funds.
  - **It is important that the gift amount is identified separately as a gift even if the funds have already been deposited in a liquid asset account owned by the borrower**.
  - The balance of the liquid asset account entered in the loan application must be adjusted accordingly to prevent duplicate entry of funds.
    - For example; if the borrower's verified checking account reflects a balance of $15,000 and $5,000 of that amount was from a gift, the checking account balance should be adjusted to reflect $10,000 and the $5,000 should be entered separately as a gift.

Gift of Equity

- A gift of equity refers to a gift provided by the seller of a property to the buyer.
- The gift represents a portion of the seller's equity in the property and is transferred to the buyer as a credit in the transaction.
- A gift of equity is permitted for principal residence and second home purchase transactions.
- The acceptable donor and minimum borrower contribution requirements for gifts also apply to gifts of equity.
- The following documents are required:
  - A signed gift letter; and
  - The settlement statement listing the gift of equity.
- Gifts of equity are not subject to the interested party contribution requirements.

Employer Assistance

- The employer assistance may be in the form of:
  - A grant;
  - A direct fully repayable second mortgage or unsecured loan;
  - A forgivable second mortgage or unsecured loan; or
  - A deferred payment second mortgage or unsecured loan.
- When the mortgage loan is secured by the borrower's principal residence, the borrower may use funds provided by an employer to fund all or part of the down payment or closing costs, subject to the minimum borrower contribution requirements described below.
- Employer assistance can also be used for reserves for all types of assistance with the exception of unsecured loans.

- **Unsecured loans may only be used for down payment and closing costs**.
- Employer assistance funds are not allowed on a second home or an investment property.
- Funds must come directly from the employer.
- When employer assistance is extended as a secured second mortgage, the transaction may be structured as a Community Seconds or it must satisfy the standard eligibility criteria for mortgages that are subject to subordinate financing.
- If the secured second mortgage or unsecured loan does not require regular payments of either principal and interest or interest only, a monthly payment does not need to be calculated and included in the borrower's qualifying ratios.
- If regular payments are required for the secured second mortgage, the payments must be included in the calculation of the debt-to-income ratio.
- Document:
  - The program is an established company program, not just an accommodation developed for an individual employee.
  - The dollar amount of the employer's assistance;
  - An unsecured loan from an employer with an award letter or legal agreement from the note holder that discloses the terms and conditions of the loan.
  - The terms of any other employee assistance being offered to the borrower such as relocation benefits or gifts.
  - The borrower received the employer assistance funds directly from the employer.
- The following table describes the minimum borrower contribution requirements for transactions that contain employer assistance:

LTV, CLTV, or HCLTV Ratio	***Minimum Borrower Contribution Requirement from Borrower's Own Funds***	
80% or less	One-to-four unit principal residence Second home	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction may come from a employer assistance.
Greater than 80%	One unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction may come from employer assistance.
	Two-to-four unit principal residence Second home	The borrower must make a 5% minimum borrower contribution from his/her own funds. After the minimum borrower contribution has been met employer assistance may be used to supplement the down payment, closing costs and reserves.

Earnest Money Deposit

- The earnest money deposit on the sales contract for the purchase of the subject property is an acceptable source of funds for both the down payment and closing costs.
- If the deposit is being used as part of the borrower's minimum contribution requirement verify that the funds are from an acceptable source.
- Bank statements must evidence that the average balance for the past two months was large enough to support the amount of the deposit. If a copy of the cancelled deposit check is used to document the source of funds, the bank statements must cover the period up to and including the date the check cleared the bank account.
- Large earnest money deposits and deposits that exceed the amount customary for the area should be closely evaluated.
- Receipt of the deposit must be verified by a copy of the borrower's cancelled check.

DU Earnest Money

- When a cash deposit on sales contract (earnest money) is entered in Assets, DU does not consider it liquid. In order to give the borrower credit for earnest money that is not already reflected in a liquid account, enter the earnest money amount as follows:
  - If the earnest money check has not cleared the borrower's bank account, the amount can be included in a depository account such as a checking or savings account.
  - If the earnest money check has cleared the borrower's bank account, the amount can be entered as "Other Credit" in the Details of Transaction section where it is assumed to be verified.

Sales Proceeds

- If the borrower's currently owned home is listed for sale but has not been sold, qualify the borrower on the basis of anticipated sales proceeds.
- Prior to closing the actual proceeds received by the borrower must be documented.
- The following table describes how to determine the amount of net proceeds based on a borrower's anticipated equity:

Sales Price Established?	*Net Proceeds Calculation*
Yes	Sales Price – (Sales Costs + All Liens) = Estimated Proceeds
No	90% of Listing Price – All Liens = Estimated Proceeds

- If the proceeds from the sale of a currently owned home are needed for the down payment and closing costs on the new house, verify the source of funds by obtaining a copy of the settlement statement on the existing home before, or simultaneously with, the settlement on the new home, showing sufficient net cash proceeds to consummate the purchase of a new home.
- Assets for the down payment from a "like-kind exchange" also known as a 1031 exchange are eligible if properly documented and in compliance with Internal Revenue Code Section 1031.
- When the borrower's employer assumes responsibility for paying off the existing mortgage in connection with a relocation plan, obtain a copy of the executed buy-out agreement to document the source of funds.
- A photocopy of a sales contract or a listing agreement is not considered an acceptable source of verification of proceeds from the sale.

DU Net Equity

- When full REO data is entered, DU automatically calculates the estimated net equity from properties marked "Pending Sale" using the following formula:
  Present Market Value x 90% – Amount of Mortgages and Liens
- Net equity can be calculated outside of DU and the positive or negative amount entered as Net Equity.
- When the net equity is positive DU will add the amount to the funds available for closing. When the net equity is negative DU will subtract the amount from the funds available for closing.
- Proceeds from properties that have already been sold should be included in a depository account such as a checking or savings account

Rent Credit for Option to Purchase

- Rent credit for option to purchase is an acceptable source of funds toward the down payment or minimum borrower contribution. Borrowers are not required to make a minimum borrower contribution from their own funds in order for the rental payments to be credited toward the down payment.
- Credit for the down payment is determined by calculating the difference between the market rent and the actual rent paid for the last 12 months. The market rent is determined by the appraiser in the appraisal for the subject property.

- Obtain the following documentation:
  - A copy of the rental/purchase agreement evidencing a minimum original term of at least 12 months, clearly stating the monthly rental amount and specifying the terms of a lease.
  - Copies of the borrower's cancelled checks or money order receipts for the last 12 months evidencing the rental payments.
  - Market rent as determined by the subject property appraisal.

Funds Secured by an Asset

- Borrowed funds secured by an asset are an acceptable source of funds for the down payment, closing costs, and reserves.
- Assets that may be used to secure funds include:
  - Automobiles;
  - Artwork;
  - Collectibles;
  - Real estate; or
  - Financial assets such as savings accounts, certificates of deposit, stocks, bonds, and 401(k) accounts.
- When qualifying the borrower consider monthly payments for secured loans as a debt.
- If a secured loan does not require monthly payments, calculate an equivalent amount and consider that amount as a recurring debt.
- When loans are secured by the borrower's financial assets, monthly payments for the loan do not have to be considered as long-term debt.
- If the borrower uses the same financial asset as part of his/her reserves, reduce the value of the asset by the amount of proceeds and related fees for the secured loan.
- Document the following:
  - The terms of the secured loan;
  - Evidence that the party providing the secured loan is not a party to the transaction; and
  - Evidence that the funds have been transferred to the borrower.
- **Personal unsecured loans are not an acceptable source of funds for the down payment, closing costs, or reserves.**
  - Examples of personal unsecured loans include signature loans, lines of credit on credit cards, and overdraft protection on checking accounts.

DU Funds Secured by an Asset

- Borrowers may borrow against an asset they own such as a 401(k) account or real estate.
- The amount of the secured loan should be entered as Secured Borrowed Funds. The secured loan amount should be subtracted from the market value of the actual asset.
  - For example; if the borrower has a vested value, less taxes and penalties, of $30,000 in a 401(k) account and borrows $10,000 against the 401(k), enter $10,000 as "Secured Borrowed Funds" and enter $20,000 as retirement funds.
- Loans that are secured against a liquid asset owned by the borrower such as a 401(k) or mutual fund do not have to be entered as Liabilities if the appropriate documentation is provided.
- Loans that are secured against real estate or any other non-liquid asset must be entered as Liabilities.

Credit Card Financing

- Certain costs that must be paid early in the application process such as lock-in fees, origination fees, commitment fees, credit report fees, and appraisal fees may be charged to the borrower's credit card. Borrowers are not required to pay off these credit card charges before closing.
- **Under no circumstances may credit card financing be used for the down payment.**
- Credit card financing is allowable for the payment of common and customary fees paid outside of closing up to a maximum of 2% of the loan amount if:
  - It is confirmed that the borrower has sufficient liquid funds to cover these charges in addition to the funds needed for other closing costs and the down payment; or

- The credit card payment is recalculated to account for the new charges and the updated payment is included in the qualifying ratio calculation.

Sale of Personal Assets

- Proceeds from the sale of personal assets are an acceptable source of funds for the down payment, closing costs, and reserves provided the individual purchasing the asset is not a party to the property sale transaction or the mortgage financing transaction.
- Document the following:
  - The borrower's ownership of the asset;
  - The value of the asset as determined by an independent reputable source;
  - The transfer of ownership of the asset as documented by a bill of sale; and
  - The borrower's receipt of the sale proceeds from documents such as deposit slips, bank statements, or copies of the purchaser's cancelled check.

Cash Value of Life Insurance

- Net proceeds from a loan against a cash value or from the surrender of a life insurance policy are an acceptable source of funds for the down payment, closing costs, and reserves.
- Assess the repayment or additional obligation to determine the impact on the borrower's qualification or reserves.
- If penalties for failure to repay the loan are limited to the surrender of the policy, payments on a loan secured by the cash value of a borrower's life insurance policy do not have to be considered in the total debt-to-income ratio.
- If additional obligations are indicated, the obligation amount must be included in the total debt-to-income ratio or subtracted from the borrower's reserves.
- If the funds are needed for the down payment or closing costs, document the borrower's receipt of the funds from the insurance company by obtaining a copy of the check from the insurer or a copy of the payout statement issued by the insurer.
- If the cash value of the life insurance is being used for reserves, the cash-value must be documented but does not need to be liquidated.

DU Sale of Personal Assets

- Enter the value of personal assets that will be converted to a liquid asset, or sold, prior to closing.
  - For example; enter as "Other Liquid Asset" the net cash value of life insurance, automobiles, or other personal assets that will be sold, or the amount of pending tax refunds that will be received prior to closing. A verification message will require evidence of the value of the asset and confirmation that the asset was converted to cash.

Cash on Hand

- **Cash on hand is not an acceptable source of funds.**

Minimum Reserve Requirements

Liquid Financial Reserves

- Liquid financial reserves are those liquid assets that are available to a borrower after the mortgage closes.
- Liquid financial reserves include assets that are easily converted to cash by:
  - Drafting or withdrawing funds from an account;
  - Selling an asset;
  - Redeeming vested funds; or
  - Obtaining a loan secured by assets from a fund administrator or an insurance company.
- Reserves are measured by the number of months of the qualifying payment amount for the subject mortgage, based on PITIA, that a borrower could pay using his/her financial assets.

Acceptable Sources of Reserves

- Examples of liquid financial assets that can be used for reserves include readily available funds in:
  - Checking or savings accounts;
  - Investments in stocks, bonds, and mutual funds;
  - Certificates of deposit;
  - Money market funds;
  - Trust accounts;
  - The amount vested in a retirement savings account; and
  - The cash value of a vested life insurance policy.
- Funds received from acceptable sources may be used to supplement the borrower's funds to satisfy any financial reserve requirement.

Unacceptable Sources of Reserves

- The following cannot be counted as part of the borrower's reserves:
  - Funds that have not been vested;
  - Funds that cannot be withdrawn under circumstances other than the account owner's retirement, employment termination, or death;
  - Stock held in an unlisted corporation;
  - Non-vested stock options and non-vested restricted stock;
  - Personal unsecured loans;
  - Interested party contributions;
  - Any amount of a lender credit derived from premium pricing; and
  - Cash proceeds from a cash-out refinance transaction on the subject property.

Determining Required Minimum Reserves

- Minimum required reserves vary depending on:
  - The transaction;
  - The occupancy status and amortization type of the subject property;
  - The number of units in the subject property; and
  - The number of other financed properties the borrower currently owns.
- DU will determine the reserves requirements based on the overall risk assessment of the loan, the minimum reserve requirement that may be required for the transaction, and whether the borrower has multiple financed properties.
- If a borrower has multiple financed properties and is financing a second home or investment property, DU will base the reserve calculations for the other financed properties on the number of financed properties determined by DU.
  - Du Refi Plus mortgage loans are exempt from the minimum reserve requirements.

Calculation of Reserves for Multiple Financed Properties

- If the borrower owns other financed properties, additional reserves must be calculated and documented for financed properties other than the subject property and the borrower's principal residence.
- The other financed properties' reserves amount must be determined by applying a specific percentage to the aggregate of the outstanding unpaid principal balance (UPB) for mortgages and HELOCs on these other financed properties.
- The percentages are based on the number of financed properties:
  - 2% of the aggregate UPB if the borrower has one to four financed properties;
  - 4% of the aggregate UPB if the borrower has five to six financed properties; or
  - 6% of the aggregate UPB if the borrower has seven to ten financed properties.
- The aggregate UPB calculation does not include the mortgages and HELOCs that are on:
  - The subject property;
  - The borrower's principal residence;
  - Properties that are sold or pending sale; and
  - Accounts that will be paid by closing.

Simultaneous Second Home or Investment Property Transactions

- If multiple second home or investment property applications are being processed simultaneously, the same assets may be used to satisfy the reserve requirements for both mortgages. Reserves are not cumulative for multiple transactions.
    - Example, two refinance applications for two investment properties owned by the borrower are being processed simultaneously – the application for property A requires reserves of $5,000 and the application for property B requires reserves of $10,000. Because the reserves are covering the same properties, $15,000 in reserves does not have to be verified but only those required per each application – in this example only $10,000 in reserves is required to be verified.

Example 1: Three Financed Properties

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations	
Second Home	$78,750	$775	2 Months PITIA =	$1,552
Principal	$0	$179	N/A	$0
Investor	$87,550	$787	$230,050 x 2% =	$4,601
Investor	$142,500	$905		
	$230,050		**Total =**	**$6,153**

Example 2: Six Financed Properties

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations	
Subject Investor	$78,750	$776	6 months PITIA =	$4656
Principal	$133,000	$946	N/A	0
Investor	$87,550	$787	$345,030 x 4% =	$13,801
Investor	$142,500	$905		
Investor	$84,950	$722		
Investor	$30,030	$412		
	$345,030		**Total =**	**$18,457**

Example 3: Eight Financed Properties

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations	
Subject Investor	$78,750	$778	$629,530 x 6% =	$37,772
Principal	$133,000	$946		
Investor	$87,550	$787		
Investor	$142,500	$905		
Investor	$84,950	$722		
Investor	$30,030	$412		
Second Home	$124,500	$837		
Investor	$160,000	$1,283		
	$629,530		**Total =**	**$42,427**

Interested Party Contributions

Overview

- Interested party contributions (IPCs) are costs that are normally the responsibility of the property purchaser paid directly or indirectly by someone else who has a financial interest in, or can influence the terms and sale or transfer of, the subject property.
- Interested parties to a transaction include:
  - The property seller;
  - The builder/developer;
  - The real estate agent or broker; or
  - An affiliate who may benefit from the sale of the property.
- A lender or employer is not considered an interested party to a sales transaction unless it is the property seller or is affiliated with the property seller or other interested party to the transaction.
  - An affiliation exists when there is direct common ownership or control by the lender over the interested party or vice versa, or when there is direct common ownership or control by a third party over both the lender and the interested party. A typical ongoing business relationship – for example, the relationship between a builder and a lender that serves as its financial institution – does not constitute an affiliation.
- IPCs are either financing concessions or sales concessions. The following are considered to be IPCs:
  - Funds that are paid directly from the interested party to the borrower;
  - Funds that flow from an interested party through a third-party organization to the borrower;
  - Funds that flow to the transaction on the borrower's behalf from an interested party, including a third-party organization or nonprofit agency; and
  - Funds that are donated to a third-party, which then provides the money to pay some or all of the closing costs for a specific transaction.
- A lender credit derived from premium pricing is not considered an IPC even if the lender is an interested party to the transaction.
- **IPCs may not be used to make the borrower's down payment, meet reserve requirements, or meet minimum borrower contribution requirements.**

IPC Limits

- The table below provides IPC limits. IPCs that exceed these limits are considered sales concessions.
- The property's sales price must be adjusted downward, for purposes of calculating the LTV/CLTV ratios, to reflect the amount of contribution that exceeds the maximum allowed. The LTV/CLTV must be calculated using the reduced sales price or appraised value.

Occupancy Type	*LTV/CLTV Ratio*	*Maximum IPC*
Principal residence or second home	Greater than 90%	3%
	75.01% - 90%	6%
	75% or less	9%
Investment property	All LTV/CLTV ratios	2%

- Ensure that all of the following requirements for an IPC are satisfied:

X	*Checklist for IPCs*
	Ensure that any and all IPCs have been identified and taken into consideration.
	Provide the appraiser with all appropriate financing data and IPCs for the subject property provided by anyone associated with the transaction.
	Ensure that the property value is adequately supported.
	Ensure that the LTV and CLTV ratios, after any IPCs are taken into consideration, remain within eligibility limits for the particular product.
	Ensure that mortgage insurance coverage, if applicable, has been obtained, based on the LTV ratio after any IPC adjustments have been made.
	Scrutinize all loan and sales contract documents, including the sales contract, the loan estimate,

	and loan application, the appraisal report and the settlement statement.
	Ensure that all elements of the settlement statement were taken into consideration during the underwriting process.
	Ensure that fees and expenses are consistent between all documents. Analyze any differences and review any discrepancies.

Lender Incentives

- The lender may provide the borrower with a cash or cash-like (gift card), incentive that is not reflected on the settlement statement provided that:
  - The amount of the incentive does not exceed $500; and
  - No repayment is required.
  - Because the lender is not typically a party to the sales transaction, these types of lender incentives are not considered IPCs and are not included in the IPC limit calculation.
  - These incentives are not considered cash out to the borrower and do not have to be included in the cash back to the borrower calculation.
- For DU Refi Plus transaction the lender may provide an incentive to the borrower in the form of a payment to pay off a portion of the mortgage loan being refinanced provided that:
  - The amount of the incentive does not exceed $2,000;
  - No repayment is required; and
  - The payment is reflected on the settlement statement as a lender credit.
  - Because these are refinance transactions, the incentive is not considered an IPC and is not included in the IPC limit calculation.
  - This incentive is not considered cash out to the borrower and does not have to be included in the cash back to the borrower at closing calculation.

Undisclosed IPCs

- Mortgages with undisclosed IPCs are not eligible. Examples of these types of contributions include:
  - Payment of moving expenses;
  - Payment of various fees on the borrower's behalf;
  - "Silent" second mortgages held by the property seller; and
  - Other contributions that are given to the borrower outside of closing and are not disclosed on the settlement statement.

Financing Concessions

- Financing concessions that are paid on the borrower's behalf are subject to the IPC limits. Financing concessions are:
  - Financial contributions from interested parties that provide a benefit to the borrower in the financing transaction;
  - Payments or credits related to acquiring the property; and
  - Payments or credits for financing terms, including prepaid expenses.
- Typical fees and/or closing costs paid by a seller in accordance with local custom, known as common and customary fees or costs, are not subject to the IPC limits.
- Payoff of a PACE loan by a seller is not subject to the IPC limits.
- Financing concessions that exceed the limits listed below are considered sales concessions and are subject to the IPC limits.
- Financing concessions typically include:
  - Origination fees;
  - Discount points;
  - Commitment fees;
  - Appraisal costs;
  - Transfer taxes;
  - Stamps;
  - Attorneys' fees;
  - Survey charges;

  - Title insurance premiums or charges; and
  - Real estate tax service fees.
- Financing concessions can also include prepaid items such as:
  - Interest charges (limited to no more than 30 days of interest);
  - Real estate taxes covering any period after the settlement date (only if the taxes are being impounded for future payment);
  - Property insurance premiums (limited to no more than 14 months);
  - Homeowners' association (HOA) assessments covering any period after the settlement date (limited to no more than 12 months);
  - Initial and/or renewal mortgage insurance premiums; and
  - Escrow accruals required for renewal of borrower purchased mortgage insurance coverage.

Sales Concessions

- Sales concessions are IPCs that take the form of non-realty items. They include:
  - Cash;
  - Furniture;
  - Automobiles;
  - Decorator allowances;
  - Moving costs;
  - Other giveaways; and
  - Financing concessions that exceed the allowable limits.
- The value of sales concessions must be deducted from the sales price for calculating the LTV and CLTV ratios for underwriting and eligibility purposes.

Interest Rate Buy Downs

- If a permanent interest rate buy down is being offered to the borrower, the cost of the subsidy to fund that buy down must be included in the IPC calculation if it is received from an interested party or a lender affiliated with an interested party.
- Determine if the cost of the subsidy meets allowable IPC limits. This can be accomplished by confirming the current market interest rate and the discount points being charged to obtain the interest rate being offered with the buy down.
- Fees for standby commitments that a builder obtains for blanket coverage before it enters into a contract with a borrower are not subject to the IPC limits because they are not attributable to the specific mortgage transaction.

Payment Abatements

- Payment abatements are considered to be financing concessions since they are an incentive provided to the borrower by an interested party where the interested party provides funds to pay or reimburse a certain number of monthly payments on the borrower's behalf.
- The monthly payments may cover, in whole or in part, principal, interest, taxes, insurance and other assessments (PITIA). These funds are provided to the lender or a third party to be distributed over the term of the abatement period or credited against the borrower's future obligations.
- **Loans with payment abatements of any type are not eligible regardless of whether they are disclosed on the settlement statement**.
  - This prohibition applies to transaction where an interested party is directly funding the abatement.
- The payment of HOA fees is not considered a payment abatement unless the payment of the fee extends for more than 12 months. The payment of HOA fees for 12 months or less is considered an interested party contribution.

High Balance Mortgage Loans

High Balance Loan Eligibility

Loan Limits

- The high balance loan requirements apply to mortgage loans with original loan amounts meeting the high-cost area loan limits established by the Federal Housing Finance Agency.
- Fannie Mae publishes on its website the maximum high-cost area loan limits that may apply by state.
- Specific loan limits are established for each county and may be lower for each specific high-cost area.
- Refer to *Loan Limits for Conventional Mortgages* for additional information including the loan limits for each area.
- Underwriters are responsible for ensuring that the original principal balance of each mortgage loan does not exceed the applicable maximum loan limit for the specific area where the property is located.
- Fannie Mae posts reference material on its website including the Loan Limit Geocoder which can be used to look up loan limits based on a specific address.

Loan Eligibility and Underwriting Requirements

- High balance mortgage loans must meet all standard eligibility and underwriting requirements as outlined in these guidelines except as noted in this section.
- The following guidelines apply to all high balance mortgage loans:
  - Loans must be conventional first lien mortgages only.
  - Loans must meet the LTV, CLTV, and HCLTV ratios outlined in the *Eligibility Matrix*.
  - All borrowers must have a credit score.
  - All loans must be underwritten by DU.
- High balance mortgage loans are eligible for DU Refi Plus. The eligibility and appraisal requirements specific to DU Refi Plus supersede all requirements that apply to high balance mortgage loans.
- **Appraisals:** In addition to the standard field work requirements a ***Form 2000, One-Unit Residential Appraisal Field Report*** **or a** ***Form 2000A, Two-to-Four Unit Residential Appraisal Field Review Report*** **is required if the property is valued at $1,000,000 or more and the LTV, CLTV, or HCLTV value is greater than 75%.**
  - A field review is required to ensure that the appraisal is an accurate representation of value.
  - If the field review results in a different opinion of value than the appraisal, the lowest of the original appraised value, the Field Review value, or the sales price should be used to calculate the LTV ratios.
- **Mortgage Insurance:** Mortgage insurance coverage is required for high balance mortgage loans with LTV ratios greater than 80%.
- Financed borrower purchased mortgage insurance is permitted. The maximum gross LTV, after the inclusion of the financed premium, cannot exceed 95%.

DU Non-Traditional Credit History

DU Loan Casefiles

No Borrower has a Credit Score

- Loan casefiles must be submitted to DU even when no borrower has a credit score. DU will apply the following requirements:
  - The property must be a one-unit, principal residence and **all borrowers must occupy the property.**
  - **Manufactured housing is not allowed.**
  - The transaction must be a **purchase or limited-cash out refinance**.
  - The loan amount must meet the conforming loan limits - **High Balance mortgage loans are not eligible.**

- The loan must be a fixed-rate mortgage.
- The maximum LTV, CLTV, HCLTV ratios are 90%.
- The debt-to-income ratio must be **less than 40%**.
- Reserves may be required as determined by DU.
- A non-traditional credit history must be documented for each borrower without a credit score.

DU Loan Casefiles: At Least One Borrower has a Credit Score

- If one or more borrowers has a credit score and at least one borrower does not have a credit score then DU will apply the following requirements:
  - The property must be a one-unit, principal residence and **all borrowers must occupy the property.**
  - The transaction must be a **purchase or limited cash-out refinance**.
  - The loan amount must meet the conforming loan limits - **High Balance mortgage loans are not eligible.**
  - Reserves may be required as determined by DU.
  - If the borrower(s) with a credit score is contributing more than 50% of the qualifying income, non-traditional credit is not required to be documented for the borrower(s) without a credit score.
  - If the borrower(s) with a credit score is contributing 50% or less of the qualifying income, document a non-traditional credit history for each borrower without a credit score.

Homeownership Education

- If all borrowers on the loan are relying solely on non-traditional credit to qualify, at least one borrower must complete homeownership education prior to loan closing.

Non-Traditional Credit

Number of Required Non-Traditional Credit Sources

- The number of non-traditional credit sources that must be documented are described in the table below:

Underwriting Method	*Number of Required Non-Traditional Sources*
Loans underwritten through DU	• If no borrower has a credit score: ▪ At least two sources for each borrower
	• If the borrower(s) with a credit score contributes: ▪ 50% or less of qualifying income, at least two sources for each borrower without a credit score. ▪ More than 50% of qualifying income, then no non-traditional credit history is required for the borrower(s) without a credit score.

Eligible Types of Non-Traditional Credit

- The types of credit that can be used to develop a non-traditional credit history are those that require the borrower to make periodic payments on a regular basis with intervals that are no longer than every three months.
- The payment history for each credit reference must be documented for the most recent consecutive 12 month period. All credit sources must be included, not just those that reflect acceptable performance.
- The following non-traditional credit sources may be used to develop a non-traditional credit history for the borrower:
  - Rental housing payments. This includes payments made to a landlord or management company. Also included are payments made on a privately held mortgage loan that is not reported to the credit bureaus, contract for deed payments and other similar arrangements provided the payments are related to the borrower's housing.

- **Loans underwritten through DU where a non-traditional credit history is required must include rental housing payments as one source of non-traditional credit.**
- Utilities, such as electricity, gas, water, telephone service, television, and internet service providers. If utilities are included in the rental housing payment, they cannot be considered a separate source of non-traditional credit. Utilities can be considered a source of non-traditional credit only if the payment history can be separately documented.
- Medical insurance coverage, excluding payroll deductions.
- Automobile insurance payments
- Cell phone payments
- Life insurance policies, excluding payroll deductions
- Payments for household or renter's insurance
- Payments to local stores, such as department stores, furniture stores, appliance stores
- Rental payments for durable goods such as automobiles
- Payment of medical bills
- Payment of school tuition
- Payments for child care
- A loan obtained from an individual provided the repayment terms can be documented in a written agreement
- Checking accounts, savings accounts, voluntary payments made to a payroll savings plan or contributions to a stock purchase plan
- Wire remittance statements

General Documentation Requirements

Rental Payment History

- The borrower's rental payment history must be documented for the most recent consecutive 12 month period. The following documentation is acceptable:
  - Cancelled checks can be provided. In lieu of cancelled checks the borrower's bank statements, copies of money orders, or other reasonable methods for documenting the timely payment of rent may be used. The documentation must clearly indicate the payee and amount being paid and reflect that payments were made on a consistent basis.
  - Direct verification of the payment of rent from the landlord is acceptable as long as the landlord is a professional management company.
- If at least one borrower on the loan can document a rental housing payment as a source of non-traditional credit, the loan has met the rental payment history requirement. A rental payment history does not have to be documented for the other non-traditional credit borrowers on the loan. However, the minimum number of non-traditional credit sources required for each non-traditional credit borrower must still be documented.
- If two or more borrowers on a loan share the housing-related source, that documentation counts as one source of non-traditional credit documentation for each borrower even if only one borrower has been making the payments.
  - For example, both borrowers are named on the lease for the property where they both live.

Credit References Obtained Directly from a Creditor

- Individual credit references, other than rental housing payments, from a creditor must include the following:
  - The creditor's name;
  - The name of the individual providing the reference;
  - The date the account was opened;
  - The amount of highest credit;
  - The current status of the account;
  - The required payment amount;
  - The unpaid balance; and
  - The payment history.

- The historical status of each account must be stated in a "number of times past due" format using "0 x 30, 0 x 60, 0x 90" days late.
- Vague statements such as "current", "satisfactory" or "pays as agreed" are not acceptable by themselves.

Payment History Obtained from the Borrower

- For documentation obtained directly from the borrower the following standards must be met:
  - Documentation that describes the terms of the debt repayment or contract together with cancelled checks or copies of bills marked "paid" that reflect the borrower's payment history over the most recent consecutive 12 months.
  - Withdrawals or debits on the borrower's bank statements that show the payee information clearly listed for the creditor. Twelve months of bank statements reflecting this information is required.

Bank Accounts and Wire Remittance Statements

- Account statements can be used to document the borrower's checking account, savings account, voluntary payments made to a payroll savings plan, or contributions to a stock purchase plan.
- The account statements must reflect an increasing balance as a result of periodic deposits over at least the most recent consecutive 12 month period with contributions being made no less than quarterly.
- If the account statements demonstrate overdraft activity, that information suggests a weakness in the borrower's ability to meet financial obligations. Assess the significance of this information relative to the borrower's overall credit risk.
- Wire remittance statements can be used to document a source of non-traditional credit provided they demonstrate a consistent amount of funds being remitted over the most recent consecutive 12 month period.

Borrowers with Disabilities

- If a borrower with disabilities does not have a credit score and a non-traditional credit history is being developed, documentation may be provided by a court-appointed guardian, a Social Security Administration (SSA) representative payee, or a parent, provided that this party:
  - Manages the borrower's financial transactions;
  - Maintains records on the borrower's behalf; and
  - Uses credit accounts held jointly in the name of the person with disabilities to pay financial obligations.
- The documentation provided can be used either to request a non-traditional mortgage credit report from a consumer reporting agency or to establish a non-traditional credit history for the borrower.

Non-U.S. Citizens and Foreign Borrowers

- If a non-U.S. citizen or foreign borrower lacks sufficient credit references in the United States, use credit references from foreign countries to achieve the required number of non-traditional credit references and establish a non-traditional credit profile.
- Foreign credit reports are not acceptable.

Assessment of the Payment History for Non-Traditional Credit

- For each non-traditional credit source, the following requirements must be met:
  - There cannot be any delinquency on rental housing payments within the past 12 months.
  - Only one account, excluding rental housing payments, can have a 30-day delinquency in the past 12 months.
  - No collections, other than medical collections, or judgments have been filed in the past 24 months.
  - Judgments, liens, collections, and charge-offs of non-mortgage accounts must be satisfied in accordance with the standard guidelines.

- A borrower may lack sufficient credit to obtain a credit score. Any derogatory credit references that appear on the credit report must still be considered.

DU Refi Plus

Overview

Program Expiration/Lender Incentives

- DU Refi Plus mortgage loans must have application dates on or before December 31, 2018. All DU Refi Plus whole loans must be purchased by Fannie Mae on or before September 30, 2019.
- The DU Refi Plus program is available to all Fannie Mae approved lenders using DU. Lenders are not required to be the servicer of the existing mortgage loan.
- DU may be instructed to underwrite a DU Refi Plus eligible loan casefile as a standard limited cash-out refinance by entering the phrase, "Standard LCOR" in the Product Description field prior to running DU.
  - Loan casefiles with no value entered in the Product Description field, or a value entered other than "Standard LCOR" will be underwritten as a DU Refi Plus transaction if the loan is matched to an existing eligible Fannie Mae loan and the loan meets the eligibility criteria required for a DU Refi Plus transaction.
- The following incentives may be offered to the borrower to refinance through DU Refi Plus:
  - Cash or cash-like incentives, such as gift cards, that are not part of the refinance transaction in an amount not to exceed $500; and
  - A payment to pay off a portion of the mortgage loan being refinanced not to exceed $2,000.

Loan Purpose

- The standard limited cash-out refinance requirements are modified as follows for DU Refi Plus loan transactions. All other guidelines for limited cash-out refinances continue to apply.
- DU Refi Plus loans must be originated according to the following limited cash-out refinance requirements:
  - The new loan amount can include:
    - The payoff of the unpaid principal balance on the existing first mortgage;
    - The financing of the payment of closing costs, prepaid items, and points;
    - Cash back to the borrower in an amount of no more than $250.
      - ✓ If the borrower is receiving more than $250 cash back the loan casefile will not be underwritten as a DU Refi Plus transaction. Any excess funds at closing must be applied as a principal curtailment.
  - Subordinate financing is permitted. Refer to the Subordinate Financing section below.

Maximum LTV, CLTV, and HCLTV Ratios/Eligible Loan Types

- The following table provides maximum LTV, CLTV, HCLTV ratios, loan type and amortization requirements for DU Refi Plus mortgage loans:

DU Refi Plus Maximum LTV, CLTV, HCLTV Ratios	
Maximum LTV ratio	For all occupancy and property types: • No maximum for fixed-rate loans. Exception to the LTV ratio limits apply to Texas Section 50(a)(6) loans. Refer to requirements that follow.
Maximum Term	The term of the mortgage loan may not exceed 30 years.
Maximum CLTV ratio	No maximum. Exceptions apply to Texas Section 50(a)(6) loans. Refer to requirements that follow.
Maximum HCLTV	No maximum.

- All DU Refi Plus mortgage loans must be fully amortizing and must meet the current loan limit requirements.

Eligible Subordinate Financing

- The following policies apply to subordinate financing:
  - New subordinate financing is only permitted if it replaces existing subordinate financing.
  - Existing subordinate financing can remain in place as long as it is resubordinated to the new DU Refi Plus mortgage loan.
  - Existing subordinate financing may be simultaneously refinanced as long as the new subordinate lien loan amount does not exceed the existing unpaid principal balance.
- Comply with the following provisions outlined in the standard Subordinate Financing section of these guidelines:
  - Subordinate Financing Requirements; and
  - Re-subordination Requirements for Refinance Transactions.
- The remaining provisions related to existing subordinate financing including acceptable subordinate financing types do not apply to DU Refi Plus transactions.

Ineligible New Mortgage Loan Types

- The following are ineligible new mortgage loan types for DU Refi Plus transactions.
  - ARM loans;
  - HomeReady mortgage loans; and
  - Mortgage loans with temporary interest rate buy downs unless dated before July 1, 2009 and delivered to Fannie Mae prior to December 1, 2009.

Borrower Eligibility

- Generally the borrower(s) on the existing mortgage, or the current borrower(s) if the existing mortgage was assumed, must be identical to the borrower(s) on the new mortgage. An existing borrower may be removed from the new loan provided that at least one of the original borrower(s) is retained on the new loan and that one of the following conditions is met:
  - The remaining borrower(s) meets the mortgage payment history requirements described in the DU Refi Plus Underwriting Considerations section of these guidelines, and provides evidence that he/she has been making the payments on the existing mortgage from his/her own funds for the most recent 12 months prior to the loan application for the new mortgage. This 12 month payment history must be on the existing mortgage and may not be satisfied using multiple consecutive first mortgages; or
  - If the borrower is being removed due to death, evidence of the deceased borrower's death must be documented in the file.
- A new borrower may be added to the new loan provided the existing borrower(s) is retained.
- Each person who has an ownership interest in the subject property, even if that person's income is not used to qualify, must sign the security instrument.

Occupancy and Property Eligibility

- The following occupancy and property types are eligible for securing a DU Refi Plus mortgage loan:
  - One-to-four unit principal residences;
  - One-unit second homes; and
  - One-to-four unit investment properties.
- All property types are eligible including detached, attached, manufactured housing and units in a PUD or condo project.
- The existing mortgage and the new DU Refi Plus mortgage loan do not have to represent the same occupancy. The occupancy of the subject property may have changed by the time of the new mortgage transaction. There is no requirement that the occupancy type has stayed the same.

Eligible Existing Loan Types

- Loans with Note dates prior to June 1, 2009.

- Jumbo-conforming loans and high-balance mortgage loans.
- The eligibility parameters for DU Refi Plus supersede those for the high-balance feature. The new loan may have a high-balance feature subject to current loan limits.
- Existing loans with the following types of credit enhancement or mortgage insurance coverage are eligible for refinancing under DU Refi Plus:
  - Borrower-paid primary mortgage insurance, including financed premiums.
  - Lender-paid primary mortgage insurance.
  - Investor-paid primary or pool insurance coverage.
    - *Existing loans with investor-paid mortgage insurance necessary to meet Fannie Mae minimum credit enhancement requirements applicable to loans with LTV ratios greater than 80% are eligible for DU Refi Plus with conversion of the existing mortgage insurance to borrower-paid or lender-paid coverage. If coverage cannot be converted from investor-paid, existing loans will be ineligible for DU Refi Plus.*

Ineligible Existing Loan Types

- The following loan types are ineligible for DU Refi Plus:
  - Loans that are currently subject to any outstanding repurchase demand from Fannie Mae.
  - Reverse mortgage loans.
  - Second mortgage loans.
  - Government mortgage loans.

Texas Section 50(a)(6) Loans

- If the existing loan was originated as a Texas 50(a)(6) loan, and if the new DU Refi Plus loan will be a Texas Section 50(a)(6) loan, then the new DU Refi Plus loan must meet the more restrictive of the Texas Section 50(a)(6) loan requirements per standard agency guidelines or the DU Refi Plus requirements as applicable.
  - The only exceptions to this requirement are that a minimum credit score does not apply, unless the monthly principal and interest payment is increasing more than 20%, and the DU Refi Plus loan-level price adjustments are applicable.
- All Texas 50(a)(6) loan requirements apply including the following which may be different that the standard DU Refi Plus requirements:
  - Maximum 80% LTV and CLTV ratio;
  - Minimum 12 months seasoning;
  - One-unit principal residence only;
  - A new full appraisal is required.
  - Title insurance requirements for Texas Section 50(a)(6) loans must be met; and
  - Only mortgage products approved for Texas 50(a)(6) loans are eligible.
- DU is not able to determine if Texas Constitution Section 50(a)(6) applies to specific limited cash-out loan casefiles. Underwriters must make the determination and apply the corresponding eligibility requirements. All other DU Refi Plus requirements apply.

Representations and Warranties

- For DU Refi Plus mortgage loans lenders are responsible for the standard representations and warranties with the following exceptions:
  - The standard underwriting reps and warrants (eligibility, credit history, liabilities, income and asset assessment) do not apply with respect to the new loan if all of the following requirements are met:
    - All data in the casefile is complete, accurate, and not fraudulent.
    - The instructions in the DU Underwriting Findings report regarding income, employment, asset, and fieldwork documentation have been followed.
- When the DU Refi Plus property fieldwork waiver is exercised, Fannie Mae accepts the property value estimate submitted to DU as the market value for the subject property. Lenders are not

required to make any representation or warranty as to the value, marketability and condition of the subject property.
- If an appraisal is obtained the standard reps and warrants related to the value, marketability and condition of the property as reflected in the property valuation do not apply.
- The standard reps and warrants related to project eligibility do not apply, with the exception that underwriters must determine that the property is not a condo hotel or motel, houseboat project, or a timeshare or segmented ownership project.
- The limited waiver of reps and warrants for loans submitted to DU applies to DU Refi Plus loan casefiles that receive an Approve/Eligible recommendation.

Community Seconds

Loan Eligibility

Community Seconds Mortgage Terms/Proceeds

- A Community Seconds mortgage may be funded by:
  - A federal agency;
  - Municipality;
  - State;
  - County, state or local housing finance agency;
  - Non-profit organization;
  - A regional Federal Home Loan Bank under one of its affordable housing programs; or
  - An employer.
- It may not be funded by the property seller or any other interested party to the transaction. A Community Seconds mortgage that an employer guarantees as part of its affordable housing program is eligible.
- The Community Seconds mortgage must be subordinate to the first mortgage.
- A borrower of a mortgage loan secured by a principal residence may use funds received from a Community Seconds mortgage to fund all or part of the down payment provided the Community Seconds is not funded in any way through the first lien mortgage, such as through premium pricing.
- Community Seconds proceeds may fund closing costs or a permanent interest rate buy down.
- Community Seconds are not allowed on second homes or investment properties.

Minimum Borrower Contribution Requirements

- The following table describes the minimum borrower contribution requirements for transactions that contain a Community Seconds loan:

LTV, CLTV, or HCLTV	*Minimum Borrower Contribution Requirements from Borrower's Own Funds*	
80% or less	One-to-four unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction may come from a Community Seconds loan.
Greater than 80%	One unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction may come from a Community Seconds loan.

	Two-to-four unit principal residence	The borrower must make a 5% minimum borrower contribution from his/her own funds. After the minimum borrower contribution has been met, a Community Seconds may be used to supplement the down payment, closing costs, or to fund a permanent interest rate buy down.

- Non-community lending mortgages may be used in a Community Seconds transaction with the following limitations:
  - All non-community lending mortgages are eligible with the exception of ARMS with an initial fixed-rate period of less than five years.
  - The transaction is limited to a purchase or limited cash-out refinance.
  - For a limited cash-out refinance transaction, a recorded subordination agreement is required.
  - Only principal residences are eligible.
  - If the product is secured by a manufactured home, the loan must comply with all manufactured home policies including the LTV and CLTV ratios.
  - The maximum LTV of the underlying product remains unchanged.
  - If the mortgage does not have an independent CLTV cap, the CLTV can be expanded to 105% provided the subordinate financing meets all conditions of a Community Seconds mortgage.
  - When non-community lending mortgages do not mandate any income restrictions for the borrower; the income limits that the Community Seconds program requires will apply.

Repayment

- Repayment of the Community Seconds mortgage may be structured in any number of ways as long as the terms are consistent with the types of terms that are acceptable, such as:
  - Requiring fully amortizing, level monthly payments;
  - Deferring payments for some period before changing to fully amortizing, level monthly payments;
  - Deferring payments over the entire term, unless the mortgage is paid off or the property is sold before the maturity date of the mortgage; or
  - Forgiving the debt over time.
- When the borrower’s employer is the provider of the Community Seconds mortgage, the financing terms may provide for the employer to require full repayment of the debt should an employee’s employment terminate, either voluntarily or involuntarily, for reasons other than those related to disability, before the maturity date of the Community Seconds mortgage.
- Where payment of the Community Seconds mortgage is deferred for five or more years, the monthly payment is not required to be used in the calculation of the borrower’s debt-to-income ratio.
- Where repayment is deferred for fewer than five years, the monthly payment that will be required after the end of the deferral period must be included in the calculation of the borrower’s debt-to-income ratio.
- A balloon payment that is due no earlier than 15 years from the Note date of the first mortgage loan or the maturity date of the first mortgage loan is eligible.
- The interest rate for the Community Seconds mortgage may not be more than 2% higher than the interest rate of the first mortgage.
- The Community Seconds mortgage may not provide for negative amortization.
  - Because negative amortization will occur if the interest rate is greater than zero and the payment of interest is deferred for a period of time, negative amortization will be acceptable as long as:

- o Interest is accrued on a simple-interest basis at a rate that is not more than 75% of the rate of the related first lien loan, and the accrued interest is deferred until:
  - ✓ Sale or transfer of the property;
  - ✓ The mortgage loan is refinanced or other full repayment of the first lien loan is received; or
  - ✓ Declaration of an event of default under the subordinate Note or the security instrument; or
  - ✓ The accrued interest is assessed only as a penalty upon declaration of an event of default under the subordinate Note or the security instrument.

Texas 50(a)(6) Loan Eligibility

Refer to the Texas 50(a)(6) requirements in the Policies and Procedures manual

Property Eligibility

Property

Property Requirements

- Residential properties secured by one-to-four unit properties are eligible.
- The subject property must be located in the United States including the District of Columbia.
- The subject property must be:
  - Residential in nature as defined by the characteristics of the property and surrounding market area.
  - Safe, sound and structurally secure.
  - Adequately insured for hazard and flood insurance.
  - The highest and best use of the property as improved, or as proposed per plans and specifications, and the use of the property must be legal or legal non-conforming use.
    - o If legal non-conforming use, re-building of the property must be allowed in the case of destruction by fire or other disasters.
  - Readily accessible by roads that meet local standards.
  - Served by utilities that meet community standards.
  - Suitable for year-round use.
- Title to the property must be held as a fee simple estate.
  - Leasehold estates are not permitted.

Acceptable Dwelling Types

- Dwelling units may be detached, attached or semi-detached.
- Properties may be located:
  - On an individual lot,
  - In a condominium project, or
  - In a planned unit development (PUD) or subdivision project.

Ineligible Properties

- The following property types are not eligible:
  - Vacant land or land development properties;
  - Properties that are not readily accessible by roads that meet local standards;
  - Agricultural properties such as farms or ranches;
  - On-frame modular construction;
  - Co-ops
  - Units in condo or co-op hotels;
  - Boarding houses;
  - Bed and breakfast properties; or
  - Properties which are not suitable for year-round occupancy regardless of location.

    - Single wide manufactured homes and manufactured homes located in condo or PUD projects.

Factory Built Housing

Modular, Prefabricated, Panelized, or Sectional Housing Eligibility

- **Modular Homes:** Modular homes built in accordance with the Uniform Building Code administered by state agencies responsible for adopting and administering building code (UBC) requirements for the state in which the modular home is installed are eligible.
- Loans secured by on-frame modular construction **are not eligible**.
    - On-frame modular construction is defined as having a permanent chassis but no evidence of compliance with the June 15, 1976 Federal Manufactured Home Construction and Safety Standards.
- **Prefabricated, Panelized and Sectional Homes:** Loans secured by prefabricated, panelized or sectional housing are eligible.
    - These properties do not have to satisfy HUD's Federal Manufactured Home Construction and Safety Standards or the Uniform Building Codes that are adopted and administered by the state where the home is installed.
- The home must conform to local building codes in the area where it is located.
- Factory built housing not built on a permanent chassis such as modular, prefabricated, panelized, or sectional housing is not considered manufactured housing and is eligible under the guidelines for one unit properties. These types of properties:
    - Must assume the characteristics of site-built housing;
    - Must be legally classified as real property; and
    - Must conform to all local building codes in the jurisdiction where they are permanently located.
- The purchase, conveyance and financing must be evidenced by a valid and enforceable first lien mortgage or deed of trust that is recorded in the land records and must represent a single real estate transaction under applicable state law.
- Modular, prefabricated, panelized or sectional housing may be treated the same as site-built housing. There are no minimum requirements for width, size, roof pitch or any other specific construction details.

Special Property Eligibility

Multiple Parcels

- The requirements when the subject property consists of more than one parcel of real estate are:
    - Each parcel must be conveyed in its entirety.
    - Parcels must be adjoined to the other unless they comply with the following exception:
        - Parcels that otherwise would be adjoined but are divided by a road are acceptable if the parcel without a residence is a non-buildable lot (for example, waterfront properties where the parcel without the residence provides access to the water).
    - Each parcel must have the same basic zoning such as residential, agricultural, etc.
    - The entire property may contain only one dwelling unit. Limited additional non-residential improvements such as a garage are acceptable.
    - An improvement that has been built across lot lines is acceptable such as a home built across both parcels where the lot line runs under the home.
    - The mortgage must be a valid first lien that covers each parcel.

Mixed-Use Properties

- Properties that have a business use in addition to their residential use, such as a property with space set aside for a day care facility, a beauty or barber shop, or a doctor's office are acceptable.
- The following special eligibility requirements must be met:

- The property must be a one unit dwelling that the borrower occupies as a principal residence;
- The borrower must be both the owner and the operator of the business;
- The property must be primarily residential in nature; and
- The dwelling may not be modified in a manner that has an adverse impact on its marketability as a residential property.

Hawaiian Lava Zones

- Subject properties located within Lava Zones 3 through 9 on the island of Hawaii are eligible.
- Properties in Lava Zones 1 and 2 **are not eligible** due to the increased risk of property destruction from lava flows within these areas.
- Hawaiian lava flow maps and other information are available on-line at the U.S. Geological Survey Hawaiian Volcano Observatory website.

Properties with Solar Panels

- Properties with solar panels are eligible.
- If the property owner is the owner of the solar panels standard eligibility requirements apply.
- If the solar panels are leased from or owned by a third party under a power purchase agreement or other similar arrangement, the following requirements apply:
  - The solar panels may not be included in the appraised value of the property.
  - The property must maintain access to an alternate source of electric power that meets community standards.
  - The monthly lease payment must be included in the debt-to-income ratio calculation unless the lease is structured to:
    - Provide delivery of a specific amount of energy at a fixed payment during a given period; and
    - Have a production guarantee that compensates the borrower on a prorated basis in the event the solar panels fail to meet the energy output required by the lease for that period.
- Payments under power purchase agreements where the payment is calculated on the energy produced may be excluded from the DTI.
- The lease or power purchase agreement must indicate that:
  - Any damage that occurs as a result of installation, malfunction, manufacturing defect, or the removal of the solar panels is the responsibility of the owner of the equipment and the owner must be obligated to repair the damage and return the improvements to their original or prior condition.
  - The owner of the solar panels agrees not to be named loss payee, or named insured, on the property owner's insurance policy covering the residential structure where the panels are attached.
  - In the event of foreclosure the lender assignee has the discretion to:
    - Terminate the lease agreement and require the third party owner to remove the equipment;
    - Become, without payment of any transfer or similar fee, the beneficiary of the borrower's lease agreement with the third party; or
    - Enter into a new lease agreement with the third party under terms no less favorable than the prior owner.

Appraisal Requirements

General Appraisal Requirements

Objective and Unbiased Appraisals

- Ensure that the appraiser:
  - Described the property and the neighborhood in factual, unbiased and specific terms;
  - Considered all factors that have an effect on value; and
  - Was objective and unbiased in the development of the opinion of market value in the appraisal report.
- A number of federal, state and local laws prohibit discrimination in the appraisal of housing.
- Professional appraisers are expected to fully understand that discriminatory valuation and appraisal reporting practices are not only illegal but also unethical.
- Unintentional discrimination can occur as the result of what an appraiser states, or fails to state, in his/her appraisal report.
- Ensure that the integrity of the loan decision is not influenced by subjective, racial, or stereotypical terms, phrases or comments in the appraisal report.
- Prohibited practices include making the following statements in the appraisal report:
  - “Pride of ownership”, “No pride of ownership”, and “Lack of pride of ownership”;
  - “Poor neighborhood”;
  - “Good neighborhood”;
  - “Crime-ridden area”;
  - “Desirable neighborhood or location”; or
  - “Undesirable neighborhood or location”.
- Ensure that the appraiser provides comments regarding unfavorable conditions, such as the existence of an adverse environmental or economic factor, and also discusses how the condition affects the value or marketability of the property being appraised and explain how the condition was taken into consideration in the valuation process.
- The appraiser must address the impact these factors may have, if any, on the value and marketability of the subject property.

Unacceptable Appraisal Practices

- The following are examples of unacceptable appraisal practices:
  - Development of or reporting an opinion of market value that is not supportable by market data or is misleading;
  - Development of a valuation conclusion based either partially or completely on the sex, race, color, religion, handicap, national origin, familial status, or other protected classes of either the prospective owners or occupants of the subject property, or of the present owners or occupants of the properties in the vicinity of the subject property;
  - Development of a valuation conclusion based on factors that local, state, or federal law designate as discriminatory, and which are prohibited;
  - Misrepresentation of the physical characteristics of the subject property, improvements or comparable sales;
  - Failure to comment on negative factors with respect to the subject neighborhood, the subject property, or proximity of the subject property to adverse influences;
  - Failure to adequately analyze and report any current contract of sale, option, offering, or listing of the subject property and the prior sales of the subject property and the comparable sales;
  - Selection and use of inappropriate comparable sales;
  - Failure to use comparable sales that are the most similar in location and are the most physically similar to the subject property;
  - Creation of comparable sales by combining vacant land sales with the contract purchase price of a home that has been built or will be built on the land;
  - Use of comparable sales in the valuation process when the appraiser has not personally inspected the exterior of the comparable property;
  - Use of adjustments to comparable sales that do not reflect market reaction to the differences between the subject property and the comparable sales;
  - Not supporting adjustments in the sales comparison approach;

- Failure to make adjustments when they are clearly indicated;
- Use of data, particularly comparable sales data, provided by parties that have a financial interest in the sale or in the financing of the subject property without the appraiser's verification of the information from a disinterested source;
- Development of an appraisal or reporting an appraisal in a manner or direction that favors the cause of either the client or any related party, the amount of the opinion of value, the attainment of a specific result, or the occurrence of a subsequent event in order to receive compensation or employment for performing the appraisal or in anticipation of receiving future assignments; or
- Development of or reporting an appraisal in a manner that is inconsistent with the requirements of the USPAP in place as of the effective date of the appraisal.

Documentation Standards

Scope of Work

- Appraisers must use the most recent version of the appraisal report forms and include any other information, either as an attachment or addendum to the appraisal report form, needed to adequately support the opinion of market value.
- Although the scope of work for the appraisal or the extent of the appraisal process is guided by the report forms, the forms do not limit or control the appraisal process.
- The appraiser's analysis should go beyond any limitations of the forms, with additional comments and exhibits being used if they are needed to adequately describe the subject property, document the analysis and valuation process, or support the appraiser's conclusions.
- The extent of the appraiser's data collection, analysis and reporting must be determined by the complexity of the appraisal assignment.
- Ensure that appraisal reports are completed on one of the following Fannie Mae forms. The table below provides the acceptable appraisal report forms

Form	*Purpose*
Uniform Residential Appraisal Report, Form 1004	For appraisals of one-unit properties and units in PUDS based on interior and exterior property inspections. Appraisals for units in condo projects that consist solely of detached dwellings may be documented on *Form 1004* if the appraiser includes an adequate description of the project and information about the homeowners' association fees and the quality of the project maintenance. Appraisals reported on *Form 1004* must be completed in accordance with the UAD Specifications.
Individual Condominium Unit Appraisal Report, Form 1073	For appraisals of one-unit properties in condo projects based on interior and exterior property inspections. Appraisals reported on *Form 1073* must be completed in accordance with UAD Specifications.
Small Residential Income Property Appraisal Report, Form 1025	For appraisals of two-to-four unit properties including two-to-four unit properties in PUD or condo projects, based on interior and exterior inspections.
Appraisal Update and/or Completion Report, Form 1004D	For appraisal updates and/or completion reports for all one-to-four unit appraisal reports.

- The exhibits in the following table must accompany the appraisal report.
- The appraiser is expected to provide any additional attachments or addenda to the appraisal report necessary to provide an adequately supported opinion of market value.

Exhibit	*Requirements*
Market Conditions Addendum, Form 1004MC	Required for all one-to-four unit properties. *Form 1004MC* is intended to provide a clear and accurate understanding of the market trends and conditions prevalent in the subject neighborhood. The form

	provides the appraiser with a structured format to report the data and to more easily identify current market trends and conditions. There are several shaded areas in the form to recognize that all the requested data may not be available from the data sources used by the appraiser and therefore the information may not be provided. The lack of completion of these areas is acceptable as long as the appraiser provides an explanation as to why these sections of the form are not completed. If the data is available the appraiser must include the data in the analysis.
Building Sketch and Calculations	An exterior building sketch that indicates dimensions and calculations that demonstrate how the estimate for gross living area is derived. If the floor plan is atypical or functionally obsolete, thus limiting the market appeal for the property in comparison to competitive properties in the neighborhood, a floor plan sketch that includes the interior walls is required. For a unit in a condo project, the sketch of the unit must indicate interior perimeter unit dimensions rather than exterior building dimensions. Dimensions and estimates for gross living area shown in the condo documents are acceptable.
Street Map	Showing the location of the subject property and the comparable sales that the appraiser used.
Exterior Photographs	Clear, descriptive photographs showing the front, back and street scene of the subject property and the front of each comparable sale. The subject and all comparable sales must be appropriately identified. Acceptable photographs include original images from photographs or electronic images, copies of photographs from a multiple listing service, or copies from the appraiser's files. Photographs of comparable rentals used in the *Small Income Residential Report, Form 1025* are not required.
Interior Photographs	At a minimum, the report must include photographs of the following: • The kitchen; • All bathrooms; • The main living area; • Examples of physical deterioration, if present; and • Examples of recent updates such as restoration, remodeling and renovation, if applicable. **Note:** Interior photographs on proposed or under construction properties may be taken by the appraiser at the time of the inspection for the Certification of Completion and provided with the *Form 1004D*.
Appraisal Update and/or Completion Report, Form 1004D	At a minimum when completing the Appraisal Update portion of the report, a photograph of the front of the subject property must be included.
Single-Family Comparable Rent Schedule, Form 1007	Required if the property is a one-unit investment property and the borrower is using rental income to qualify. Otherwise, *Form 1007* is not required. However, a *Form 1007* may be obtained for the purpose of reporting gross monthly rent.

Appraisal Age and Use Requirements

Age of Appraisal and Appraisal Update Requirements

- When an appraisal report will be more than four months old on the date of the Note and mortgage, regardless of whether the property was appraised as proposed or existing construction, the appraiser must inspect the exterior of the property and review current market data to determine whether the property has declined in value since the date of the original

appraisal. This inspection and results of the analysis must be reported on the *Appraisal Update and/or Completion Form, Form 1004D*.
  - If the appraiser indicates on the *Form 1004D* that the property value has declined, a new appraisal must be obtained.
  - If the appraiser indicates on the *Form 1004D* that the property value has not declined, no additional fieldwork is required.
  - **The appraisal update must occur before the appraisal expires. If the appraisal has expired a new appraisal must be ordered.**
- The original appraiser should complete the appraisal update. When necessary substitute appraisers may be used.
  - When updates are completed by substitute appraisers, the substitute appraiser must review the original appraisal and express an opinion about whether the original appraiser's opinion of market value was reasonable on the date of the original appraisal report. The underwriter must note in the file why the original appraiser was not used.

Appraisal Report Assessment

Appraisal Report Analysis

- When an appraisal is obtained, the underwriter must analyze the:
  - Current contract for sale for purchase money transactions;
  - Current offering or listing for sale for both purchase and refinance transactions where the home has been listed for sale;
  - Comparable sales for both purchase and refinance transactions; and
  - Current ownership of the subject property.
- The underwriter is responsible for validating that:
  - The property meets eligibility criteria; and
  - The appraiser has provided an accurate and reliable opinion of value that reflects market value, condition, and marketability of the subject property.

Subject Section

- The appraiser must identify the subject property by its complete property address and legal description.
  - The appraiser must enter the physical property address, including the unit number for a condo, in a format that conforms to the United States Postal Service (USPS) address standards. Address standards can be found at usps.com.
  - The subject address must be populated consistently throughout the appraisal report.
- When the legal description is lengthy, the appraiser may attach the full legal description as an addendum to the appraisal report. The appraiser must also identify the property rights to be appraised.
- The appraisal report forms require the appraiser to research and identify whether the subject property is currently for sale or if it has been offered for sale in the 12 months prior to the effective date of the appraisal. If the subject property has not been listed for sale in the last 12 months, the data source(s) used to support that conclusion must be provided. If the subject property has been listed for sale in the last 12 months, the appraiser must report on each occurrence or listing and provide the following information:
  - The offering price;
  - The offer date; and
  - The data source(s) used.
    - For example; if the subject property is currently listed for sale and was previously listed eight months ago, the appraiser must report on both offerings.
  - For appraisals required to be UAD compliant, Days on Market (DOM) must be reported.

Contract Section

- Provide the appraiser with a copy of the complete sales contract. The appraiser must indicate whether an analysis of the sales contract was or was not performed. If an analysis was performed the appraiser must provide the results of the analysis. If an analysis was not performed the appraiser must provide an explanation for why the analysis was not performed.

- For appraisals required to be UAD compliant, the appraiser must also indicate the type of sale for the transaction. The appraiser may report any other relevant information in this field or elsewhere in the report regarding the sale type including whether more than one sale type applies. The appraiser must:
  - Enter an amount in the Contract Price field if the assignment type is a purchase transaction. The contract price must be the same as the sales price for the subject property reflected in the Sales Comparison Approach section;
  - Enter a contract date if the Assignment Type is a purchase transaction; and
  - Indicate if the property seller is the owner of record.
- The appraiser may indicate if there is any financial assistance such as loan charges, sales concessions or gifts, or down payment assistance to be paid by any party on behalf of the borrower including any closing costs or other payments from the seller or another third party. If there is financial assistance, the appraiser must:
  - Report the total dollar amount of the loan charges or concessions that will be paid. If the appraiser is not able to determine a dollar amount for all or part of the financial assistance, the number must reflect the total known dollar amount; and
  - Provide a description of the items being paid.
- Financial assistance or concessions paid by any party on behalf of the borrower includes both monetary and non-monetary items, including below market-rate mortgage financing, gifts of personal property, and payment of property taxes or HOA dues for a period of time.

Neighborhood Section of the Appraisal Report

Neighborhood Analysis

- The appraiser is required to perform an objective neighborhood analysis by identifying neighborhood boundaries, neighborhood characteristics and the factors that affect the value and marketability of properties in the neighborhood.
  - **Neighborhood Boundaries:** The appraiser should provide an outline of the neighborhood boundaries which should be clearly delineated using “North”, “South”, “East”, and “West”. These boundaries may include streets, legally recognized neighborhood boundaries, waterways or other natural boundaries that define the separation of one neighborhood from another. Appraisers should not reference a map or other addendum as the only example of the neighborhood boundaries.
  - **Neighborhood Characteristics:** These can be addressed by the types of structures such as detached or attached, and architectural styles in the neighborhood such as row or townhouse, colonial, ranch, or Victorian; current land use such as single family residential, commercial, or industrial; typical site size such as 10,000 sf, or 2.00 ac; or street patterns or design such as one-way street, cul-de-sac, or court.
  - **Factors that affect the value and marketability of properties:** These can be addressed by such things as the proximity of the property to employment and amenities, employment stability, appeal to the market, changes in land use, access to public transportation, and adverse environmental influences.
- The appraiser must fully consider all of the value influencing characteristics in the neighborhood and arrive at an appropriate neighborhood description and opinion of value for the property even if this requires more extensive research for particular property types or for properties in certain geographic locations.
- The appraiser must perform a neighborhood analysis in order to identify the area that is subject to the same influence as the property being appraised, based on the actions of typical buyers. The results of a neighborhood analysis enable the appraiser not only to identify the factors that influence the value of properties in the neighborhood but also to define the area from which to select the market data needed to perform a sales comparison analysis. In performing a neighborhood analysis the appraiser:
  - Collects pertinent data;

  - Conducts a visual inspection of the neighborhood to observe its physical characteristics and determine its boundaries; and
  - Identifies land uses and any signs that the land uses are changing.
- The appraiser and the underwriter should be aware of the varying conditions that characterize different types of neighborhoods.
- Conditions that are typical in certain neighborhoods may not be present in other neighborhoods. This does not mean that the existence of certain types of conditions or characteristics are unacceptable, rather it is an indication that they may be viewed in context with the nature of the neighborhood where the subject property is located.
  - For example, some neighborhoods consist of a variety of property types that have different uses.
  - It is not uncommon to find properties that have mixed-uses such as residential properties that also have child-care facilities, doctor or dental offices, and other types of business or commercial uses.
  - The presence of mixed-use properties or a variety of property types within a neighborhood should be viewed as a neighborhood characteristic that the appraiser considers when performing the neighborhood analysis and describing the neighborhood boundaries.
- The appraiser must consider the influence of the market forces including, but not limited to economic, governmental, and environmental factors on property values in the neighborhood.
- Economic forces that must be considered include such things as the existence of vacant or boarded-up properties in the neighborhood and the level of essential local support services.
- Examples of governmental forces that should be taken into consideration include the regulations, laws, and taxes that are imposed on properties.
- Environmental forces that must be considered include, among other things, the existence of a hazardous waste site on or near the property, and the proximity of a property to an airport.
  - Certain other factors that are not appraisal factors such as the racial or ethnic composition of a neighborhood or the age and sex of the individuals who live in a particular neighborhood must not be considered in the valuation process.
- The appraiser must determine, analyze and consider factors in the valuation process based on his/her identification of all forces or factors that have the potential to influence the value of the property.
- The appraiser must report neighborhood conditions in factual, specific terms and be impartial and specific in describing favorable or unfavorable factors in a neighborhood.
- If an appraiser can demonstrate by market evidence that a characteristic has an effect on the value or marketability of the properties in the neighborhood, he/she must consider it in the valuation process.
- The appraiser must not make unsupported assumptions or interject personal opinion or perceptions about market forces or other factors that may or may not affect the use and value of a property.
  - For example, a property located in an older neighborhood can be as sound an investment as a property located in a new neighborhood.

Market Conditions Addendum to the Appraisal Report

- Confirm that current market conditions are identified and analyzed in the valuation process and described in the appraisal report.
- *Form 1004MC* is required for all loans with appraisals of one-to-four unit properties.
- It is intended to provide the underwriter with a clear and accurate understanding of the market trends and conditions prevalent in the subject neighborhood.
- The conclusions regarding trends that are obtained from *Form 1004MC* must be reported in the Neighborhood section of the appraisal report.
- In situations where there is not sufficient data to provide a meaningful analysis for the defined neighborhood, the form must be completed based on the information available and an explanation must be provided.

- The lack of data may be an indication of the market conditions. If additional analysis of nearby areas that include competitive properties is performed, it must be discussed in the summary/conclusions section of the form.
- In any scenario the Neighborhood section of the appraisal report must include the appraiser's conclusions regarding the housing trends.

Site Section of the Appraisal Report

Site Analysis

- The property site should be of a size, shape and topography that is generally conforming and acceptable in the market area.
- It must also have competitive utilities, street improvements, adequate vehicular access, and other amenities.
- Because amenities, easements, and encroachments may either detract from or enhance the marketability of a site, the appraiser must reflect them in his/her analysis and evaluation.
- The appraiser must comment if the site has any adverse conditions or if there is market resistance to a property because the site is not comparable with the neighborhood or the requirements of the competitive market, and assess the effect, if any, on the value and marketability of the property.
- The appraisal must include the actual size of the site and not a hypothetical portion of the site for the subject property.
    - For example, the appraiser may not appraise only five acres of a non-subdivided 40 acre parcel. The appraised value must reflect the entire 40 acre parcel.
- The appraiser must consider the present or anticipated use of any adjoining property that may adversely affect the value or marketability of the subject property.

Subject Property Zoning

- The appraiser must report the specific zoning class in the appraisal along with a general statement as to what the zoning permits such as one or two unit properties when he/she indicates a specific zoning such as R-1 or R-2. The appraiser must indicate whether the subject property presents:
    - A legal conforming use;
    - A legal non-conforming use;
    - An illegal use under the zoning regulations; or
    - That there is no local zoning.
- Properties where the improvements constitute a legal conforming use of the land are eligible.
- Properties that constitute a legal, non-conforming use of the land are eligible in the following scenarios:
    - The property is a one-to-four unit property or a unit in a PUD and the use of the land and the appraisal analysis reflects any adverse effect that the non-conforming use has on the value and marketability of the property and that the property can be rebuilt in the event of partial or full destruction; or
    - The property is a condo unit and the improvements can be rebuilt to current density in the event of partial or full destruction and the mortgage file includes either a copy of the applicable zoning regulations or a letter from the local zoning authority that authorizes reconstruction to current density.
- Certain properties are always ineligible - properties that are subject to certain land-use regulations, such as **coastal tideland or wetland laws**, or that create setback lines or other provisions that prevent the reconstruction or maintenance of the property improvements if they are damaged or destroyed.
    - The intent of these types of land-use regulations is to remove existing land uses and to stop land development including the maintenance or construction of seawalls within specific setback lines.

Highest and Best Use

- Properties must represent the highest and best use of the site as improved. If the current improvements clearly do not represent the highest and best use of the improved site, it must be indicated on the appraisal report.
- The appraiser determines highest and best use of a site as the reasonable and probable use that supports the highest present value on the effective date of the appraisal.
- For improvements to represent the highest and best use of a site, they must be legally permitted, financially feasible, and physically possible, and must provide more profit than any other use of the site would generate. All of these criteria must be met if the improvements are to be considered as the highest and best use of a site.
- The appraiser's highest and best use analysis of the subject property should consider the property as it is improved.
- This treatment recognizes that the existing improvements should continue in use until it is financially feasible to remove the dwelling and build a new one, or to renovate the existing dwelling.
- If the use of comparable sales demonstrates that the improvements are reasonably typical and compatible with market demand for the neighborhood, and the present improvements contribute to the value of the subject property so that its value is greater than the estimated vacant site value, the appraiser should consider the existing use as reasonable and report it as the highest and best use.

Site Utilities

- The utilities of the property must meet community standards.
- If public sewer and/or water facilities, those that are supplied and regulated by the local government, are not available, community or private well and septic facilities must be available and used by the subject property.
- The owners of the subject property must have the right to access those facilities which must be viable on an ongoing basis.
- Private well or septic facilities must be located on the subject site, unless the subject property has the right to access off-site private facilities and there is an adequate, legally binding agreement for access and maintenance.
- If there is market resistance to an area because of environmental hazards or any other conditions that affect well, septic or public water facilities, the appraiser must address the effect of the hazards on the value and marketability of the subject property.

Off-Site Improvements

- Off-site improvements include streets, alleys, sidewalks, curbs and gutters, and street lights.
- The subject property should front on a publicly dedicated and maintained street that meets community standards and is generally accepted by area residents.
- If a property fronts on a street that is not typical of those found in the community, the appraiser must address the effect of that location on the value and marketability of the subject property.
- The presence of sidewalks, curbs and gutters, street lights, and alleys depends on local custom. If they are typical in the community, they should be present on the subject site. The appraiser must comment on any adverse conditions and address their effect on the value and marketability of the subject property.

Community Owned or Privately Maintained Streets

- If the property is located on a community owned or privately owned and maintained street, an adequate, legally enforceable agreement or covenant for maintenance of the street is required. The agreement or covenant should include the following provisions and be recorded in the land records of the appropriate jurisdiction.
  - Responsibility for payment of repairs including each party's representative share;
  - Default remedies in the event a party to the agreement or covenant fails to comply with his/her obligations; and

  - The effective term of the agreement or covenant which in most cases should be perpetual and binding on any future owners.
- If the property is located in a state that has statutory provisions that define the responsibilities of property owners for the maintenance and repair of a private street no separate agreement or covenant is required.
- If the property is not located in a state that imposes statutory requirements for maintenance, and either there is no agreement or covenant for maintenance of the street, or an agreement or covenant exists but does not meet the requirements listed above, **the property is ineligible**.

Special Flood Hazard Areas

- The appraisal report form provides an area for the appraiser to indicate whether the property is located in a Special Flood Hazard Area that is identified on the Federal Emergency Management Agency's (FEMA) Flood Insurance Rate Maps (FIRM).
- The appraiser must also indicate the specific FEMA flood zone and the map number and its effective date.

Improvements Section of the Appraisal Report

Overview

- The appraisal must provide a clear, detailed and accurate description of the improvements. The description must be as specific as possible, commenting on such things as needed repairs, additional features and modernization, and should provide supporting addenda if necessary.
- If the subject property has an accessory unit the appraiser should describe it.
- The improvements should conform to the neighborhood in terms of age, type, design and material used for their construction.
- If there is market resistance to a property because its improvements are not compatible with the neighborhood or with the requirements of the competitive market because of adequacy of plumbing, heating, or electrical services; design; quality; size; condition; or any other reason directly related to market demand, the appraiser must address the impact to the value and marketability of the subject property.

Actual and Effective Ages

- There are no restrictions on the actual age of the dwelling. Older dwellings that meet the general requirements are acceptable.
- Improvements for all properties must be of the quality and condition that will be acceptable to typical purchasers in the subject neighborhood.
- The relationship between the actual and effective ages of the property is a good indication of its condition. A property that has been well maintained generally will have an effective age somewhat lower than its actual age.
- A property that has an effective age higher than its actual age probably has not been well maintained or may have a particular physical problem. In such cases, pay particular attention to the condition of the subject property.
- When the appraiser makes adjustments for the "Year Built" he/she must explain the adjustments that are made.

Layout and Floor Plans

- Dwellings with unusual layouts and floor plans generally have limited market appeal.
- A review of the room list and floor plan for the dwelling unit may indicate an unusual layout, such as bedrooms on a level that does not have a bathroom, or a kitchen on a different level from the dining room.
- If the appraiser indicates that such inadequacies will result in market resistance to the subject property, he/she must reflect this in his/her overall analysis.
- If market acceptance can be demonstrated through the use of comparable sales with the same inadequacies no adjustments are required.

Accessory Units

- An accessory unit is typically an additional living area independent of the primary dwelling unit, and includes a fully functioning kitchen and bathroom such as a living area over a garage and basement units.
- Whether a property is defined as a one-unit property with an accessory unit or a two-unit property will be based on the characteristics of the property which may include:
  - The existence of separate utilities;
  - A unique postal address; and
  - Whether the unit is rented.
- The appraiser is required to provide a description of the accessory unit and analyze any effect it has on the value or marketability of the subject property.
- If the property contains an accessory unit, the property is eligible under the following conditions:
  - The property is defined as a one-unit property.
  - There is only one accessory unit on the property; **multiple accessory units are not permitted**.
  - The appraisal report demonstrates the improvements are typical for the market through an analysis of at least one comparable property with the same use.
  - The borrower qualifies for the mortgage without considering any rental income from the accessory unit.
- If it is determined that the property contains an accessory unit that does not comply with zoning, the property is eligible under the following additional conditions:
  - Confirm that the existence will not jeopardize any future property insurance claim that might need to be filed for the property.
  - The use conforms to the subject neighborhood and to the market.
  - The property is appraised based upon its current use.
  - The appraiser must report that the improvements represent a use that does not comply with zoning.
  - The appraisal report must demonstrate that the improvements are typical for the market through an analysis of **at least three comparable properties that have the same non-compliant zoning use.**

Additions without Permits

- If the appraiser identifies additions that do not have the required permit, the appraiser must comment on the quality and appearance of the work and its impact, if any, on the market value of the subject property.

Properties with Outbuildings

- Give properties with outbuildings special consideration to ensure that the property is residential in nature. Descriptions of the outbuildings should be reported in the Improvements and Sales Comparison Approach sections of the appraisal report.

Type of Outbuilding	***Acceptability***
Minimal outbuildings such as small barns or stables that are of relatively insignificant value in relation to the total appraised value of the subject property.	The appraiser must demonstrate through the use of comparable sales with similar amenities that the improvements are typical of other residential properties in the subject area for which an active, viable residential market exists.
An atypical outbuilding.	The property is acceptable provided the appraiser's analysis reflects little or no contributory value for it.
Significant outbuildings such as silos, large barns, storage areas or facilities for farm type animals.	The presence of the outbuildings may indicate that the property is agricultural in nature. Determine whether the property is residential in nature regardless of whether the appraiser assigns value to the outbuildings.

Property Condition and Quality of Construction

Property Condition

- Take the necessary steps to confirm that a property meets condition requirements as outlined in this topic.
- The table below provides the requirements for property condition:

X	Requirements
	The appraisal report must express an opinion about the condition of the improvements based on the factual data of the improvements analysis.
	Appraisals based on interior and exterior inspections must include complete visual inspections of the accessible areas of the property. Appraisers are not responsible for hidden or unapparent conditions.
	Appraisal reports must reflect adverse conditions that were apparent during the inspection or discovered while performing research such as needed repairs, deterioration, or the presence of hazardous wastes, toxic substances or adverse environmental conditions.
	Detrimental conditions of the improvements must be reported in the appraisal even if the conditions are typical for competing properties.
	The appraiser must consider and describe the overall condition and quality of the property improvements.
	The appraiser must identify: • Items that require immediate repair; and • Items where maintenance may have been deferred which may or may not require immediate repair.
	The appraisal Additional Comments section must address needed repairs and physical, functional, or external inadequacies.

Property Condition Ratings

- For appraisals required to be completed with the UAD, the appraiser must assign one of the following standardized Condition ratings in the table below when identifying the condition of the improvements for the subject property and comparable sales.

Rating	Description
C1	The improvements have been very recently constructed and have not previously been occupied. The entire structure and all components are new and the dwelling features no physical depreciation.
C2	The improvements feature no deferred maintenance, little or no physical depreciation, and require no repairs. Virtually all building components are new or have been recently repaired, refinished, or rehabilitated. All outdated components and finishes have been updated and/or replaced with components that meet current standards. Dwellings in this category either are almost new or have been recently completely renovated and are similar in condition to new construction.
C3	The improvements are well maintained and feature limited physical depreciation due to normal wear and tear. Some components, but not every major component, may be updated or recently rehabilitated. The structure has been well maintained.
C4	The improvements feature some minor deferred maintenance and physical deterioration due to normal wear and tear. The dwelling has been adequately maintained and requires only minimal repairs to building components/mechanical systems and cosmetic repairs. All major

	building components have been adequately maintained and are functionally adequate.
C5	The improvements feature obvious deferred maintenance and are in need of some significant repairs. Some building components need repairs, rehabilitation, or updating. The functional utility and overall livability are somewhat diminished due to condition, but the dwelling remains useable and functional as a residence.
C6	The improvements have substantial damage or deferred maintenance with deficiencies or defects that are severe enough to affect the safety, soundness, or structural integrity of the improvements. The improvements are in need of substantial repairs and rehabilitation, including many or most major components.

Property Condition

- The Condition rating selected for the property must reflect an overall view of the condition of the property improvements. It would be inappropriate to select either a lower or higher overall rating on the basis of one or two minor inferior or superior areas of the property improvements.
- The C6 rating is an exception because it indicates that the property is impacted by one or more deficiencies that negatively affect the safety, soundness or structural integrity of the property. If any portion of the dwelling is rated a C6, the whole dwelling must be rated a C6.
- For appraisals required to be completed using the UAD as a subset of identifying the condition of the subject property, the appraiser must also identify the level of updating, if any, that the subject property has received by using the definitions in the table below:

Level of Updating	***Description***
Not Updated	Little or no updating or modernization. This description includes new homes. Residential properties of 15 years of age or less often reflect an original condition with no updating when no major components have been replaced or updated. Those over 15 years of age are also considered not updated if the appliances, fixtures, and finishes are dated. An area that is “Not Updated” may still be well maintained and fully functional and this rating does not necessarily imply deferred maintenance or physical/functional deterioration.
Updated	The area of the home has been modified to meet current market expectations. These modifications are limited in terms of both scope and cost. An updated area of the home should have an improved look and feel, or functional utility. Changes that constitute updates include refurbishment and/or replacing components to meet existing market expectations. Updates do not include significant alterations to the existing structure.
Remodeled	Significant finish and/or structural changes have been made that increase utility and appeal through complete replacement and/or expansion. A remodeled area reflects fundamental changes that include multiple alterations. These alterations may include some or all of the following: replacement of a major component such as cabinets, bathtub, or bathroom tile; relocation of plumbing/gas fixtures/appliances, significant structural alterations such as relocating walls and/or the addition of square footage. This would include a complete gutting and rebuild.

Appraisals Completed “As Is”

- Appraisals may be based on the “as is” condition of the property provided existing conditions are minor and do not affect the safety, soundness or structural integrity of the property and the appraiser’s opinion of value reflects the existence of these conditions.
- Minor conditions and deferred maintenance are typically due to normal wear and tear from the aging process and the occupancy of the property. While such conditions generally do not rise to the level of a required repair, they must be reported.
  - Examples of minor conditions and deferred maintenance include:

- Worn floor finishes or carpet;
- Minor plumbing leaks;
- Holes in window screens; or
- Cracked window glass.

- Condition Ratings C1, C2, C3, C4 as previously defined are eligible in their "as is" condition.
- Properties with the initial Condition Rating of C5 or C6 are required to be repaired as needed to bring the condition to at least a C4 rating. The appraisal must be completed "subject to completion" of the deficient items.
- Properties that will remain in C5 or C6 condition are **not eligible**.

Quality of Construction Rating

- For appraisals required to be completed using the UAD the appraiser must assign one of the following standardized quality ratings in the table below when identifying the quality of construction for the subject property and comparable sales:

Rating	Description
Q1	Dwellings with this quality rating are usually unique structures that are individually designed by an architect for a specified user. Such residences typically are constructed from detailed architectural plans and specifications and feature an exceptionally high level of workmanship and exceptionally high-grade materials throughout the interior and exterior of the structure. The design features exceptionally high quality exterior refinements and ornamentation, and exceptionally high-quality interior refinements. The workmanship, materials, and finishes throughout the dwelling are of exceptionally high quality.
Q2	Dwellings with this quality rating are often custom designed for construction on an individual property owner's site. Dwellings in this quality grade are also found in high-quality tract developments featuring residences constructed from individual plans or from highly modified or upgraded plans. The design features detailed, high-quality exterior ornamentation, high-quality interior refinements and detail. The workmanship, materials and finishes throughout the dwelling are generally of high or very high quality.
Q3	Dwellings with this quality rating are residences of higher quality built from individual or readily available designer plans in above-standard residential tract developments or on an individual property owner's site. The design includes significant exterior ornamentation and interiors that are well finished. The workmanship exceeds acceptable standards and many materials and finishes throughout the dwelling have been upgraded from "stock" standards.
Q4	Dwellings with this quality rating meet or exceed the requirements of applicable building codes. Standard or modified standard building plans are used and the design includes adequate fenestration (placement of windows and doors) and some exterior ornamentation and interior refinements. Materials, workmanship, finish and equipment are of stock or builder grade and may feature some upgrades.
Q5	Dwellings with this quality rating feature economy of construction and basic functionality as main considerations. Such dwellings feature a plan design using readily available or basic floor plans featuring minimal fenestration and basic finishes with minimal exterior ornamentation and limited interior detail. These dwellings meet minimum building codes and are constructed with inexpensive, stock materials with limited refinements and upgrades.
Q6	Dwellings with this quality rating are of basic quality and lower cost. Some may not be suitable for year-round occupancy. Such dwellings are often built with simple plans or without plans, often using the lowest quality building materials. Such dwellings are often built or expanded by persons who are professionally unskilled or possess only minimal construction skills. Electrical, plumbing, and other mechanical systems and equipment may be minimal or non-existent. Older dwellings may feature one or more substandard or non-conforming additions to the original structure.

- The Q6 rating indicates that the property is impacted by one or more deficiencies that negatively affect the safety, soundness or structural integrity of the property. If any portion of the dwelling is rated Q6, the whole dwelling must be rated Q6.

- Properties with a quality of construction rating of Q6 are eligible provided any items in relation to the quality of construction that impact the safety, soundness, or structural integrity of the property are repaired prior to loan closing.
- Properties that will remain with a quality rating of Q6 are **not eligible.**

Physical Deficiencies

- The appraisal report must identify and describe physical deficiencies that could affect a property's safety, soundness, or structural integrity. If the appraiser has identified any of these deficiencies the property must be appraised "subject to completion" of the specific repairs or alterations.
- In these instances the property condition and quality ratings must reflect the condition and quality of the property based on the hypothetical condition that the repairs or alterations have been completed.

Infestation, Dampness, or Settlement

- If the appraisal indicates evidence of wood-boring insects, dampness, or abnormal settlement, the appraiser must comment on the effect on the value and marketability of the subject property.
- Obtain either satisfactory evidence that the condition was corrected or submit a professionally prepared report indicating that the condition does not pose any threat of structural damage to the improvements.

Requirements for New (or Recently Converted) Condos, Subdivisions and PUDs

- If the subject property is located in a new, or recently converted, condo subdivision or PUD then it must be compared to other properties in the neighborhood as well as to properties within the subject subdivision or project.
- This comparison should help demonstrate market acceptance of new developments and the properties within them. The appraiser must select one comparable sale from the subject subdivision or project and one comparable sale from outside the subject subdivision or project.
- The third comparable sale can be from inside or outside of the subject subdivision or project provided it is a good indicator of value for the subject property.
- Two of the sales must be verifiable from reliable data sources, other than the builder. Sales or resales from within the subject subdivision or project are preferable to sales from outside the subdivision or project provided the developer or builder of the subject property is not involved in the transactions.
- In the event there are no closed sales inside a new subject project or subdivision because the subject property transaction is one of the first units to sell, the appraiser may use two pending sales in the subject project or subdivision in lieu of one closed sale. When the appraiser is using two pending comparable sales in lieu of a closed sale, the appraiser must also use at least three closed comparable sales from projects or subdivisions outside the subject property's project or subdivision.
- To meet the requirement that the appraiser use one comparable sale from inside the subject subdivision or project, the appraiser may need to rely solely on the builder of the property he/she is appraising as this data may not yet be available through typical data sources such as public records or multiple listing services. In this scenario it is acceptable for the appraiser to verify the transaction of the comparable sale by viewing a copy of the settlement statement from the builder's file.
- When providing builder sales from competing projects that are not presently available through traditional data sources, the appraiser must verify the sale from the applicable settlement statement and indicate on the appraisal report that the settlement statement was the document used for verification.

- The appraiser must include discussion and analysis of sales concessions and upgrades for the subject property relative to concessions and upgrades for each builder sale.

Rural Properties

- Rural properties often have large lot sizes and rural locations can be relatively undeveloped.
- There may be a shortage, or absence of recent comparable sales in the immediate vicinity of a subject property that is in a rural location.
- Comparable sales located a considerable distance from the subject property can be used if they represent the best indicator of value for the subject property. In such cases the appraiser must use his/her knowledge of the area and apply good judgment in selecting comparable sales that are the best indicators of value.
- The appraisal report must include an explanation of why the particular comparable sales were selected.

Foreclosure and Short Comparable Sales

- It is acceptable to use foreclosures and short sales as comparable sales if the appraiser believes they are the best and most appropriate sales available. The appraiser must address the prevalence of such sales in the subject's neighborhood and the impact, if any, of such sales.
- The appraiser must identify and consider any differences from the subject property, such as the condition of the property and whether any stigma has been associated with it. The appraiser cannot assume it is equal to the subject property. A foreclosure or short sale property may be in worse condition when compared to the subject property especially if the subject property is new construction or was recently renovated.
- For appraisals that are required to be UAD compliant, the appraiser must identify the sale type as "REO" or "Short Sale" as appropriate.

Cost Approach to Value

- The cost approach to value is not required.
- USPAP requires the appraiser to develop and report the result of any approach to value that is necessary for credible assignment results.
  - For example, when appraising proposed or newly constructed properties if the appraiser believes the cost approach is necessary for credible assignment results, then the cost approach must be provided.
- Appraisals that rely solely on the cost approach as an indicator of market value are not acceptable.
- The cost approach to value assumes that a potential purchaser will consider building a substitute residence that has the same use as the property being appraised. This approach, then, measures value as a cost of production.
- It may be appropriate to use the cost approach when appraising new or proposed construction, property that is undergoing renovation, unique property, or property that features functional depreciation, to support the sales comparison approach analysis.
- The reliability of the cost approach depends on valid reproduction cost estimates, proper depreciation estimates, and accurate site values.
- If the appraiser has completed the cost approach, thoroughly review the information provided to confirm that the appraiser's analysis and comments for the cost approach to value are consistent with comments and adjustments mentioned elsewhere in the appraisal report.

  - For example, if the neighborhood or site description reveals that the property backs up to a shopping center, expect to see an amount indicated for external depreciation in the cost approach. Or, if the improvement analysis indicates that it is necessary to go through one bedroom to get to another bedroom, expect to see an amount indicated for functional depreciation.

Income Approach to Value

- The income approach to value is based on the assumption that market value is related to the market rent or income that a property can be expected to earn.
- The income approach to value is required in the valuation of two-to-four unit properties and may be appropriate in neighborhoods that consist of one-unit properties when there is a substantial rental market.
- The income approach to value may not be appropriate in areas that consist mostly of owner-occupied properties because adequate rental data does not exist for those areas.
- USPAP requires the appraiser to develop and report the result of any approach to value that is necessary for credible assignment results. If the appraiser believes the income approach is necessary for credible assignment results, then the income approach must be included.
- Appraisals that rely solely on the income approach as an indicator of market value are not acceptable.

Quality Assurance

Changes to the Appraised Value

- Underwriters are responsible for confirming that appraisal reports are complete and that any changes to the reports are made by the appraiser that originally completed the report.
- When underwriters have concerns with any aspect of the appraisal that result in questions about the reliability of the opinion of market value, they must attempt to resolve their concerns with the appraiser that originally prepared the report. When underwriters are unable to resolve their concerns with the appraiser, they must condition for a replacement report prior to making a final underwriting decision.
- Any request for a change in the opinion of market value must be based on material and substantive issues and must not be made solely on the basis that the opinion of market value does not support the proposed loan amount.
- Pay particular attention and apply extra due diligence for those loans where the appraised value is believed to be excessive or when the value of the property has experienced significant appreciation in a short time period since the prior sale.

Addressing Appraisal Deficiencies

- When underwriters consider an appraisal deficient, they have the following options for addressing the deficiencies:
  - Contacting the appraiser to address deficiencies contained in the appraisal report;
  - Obtaining a desk review or a field review of the original appraisal; or
  - Obtaining a new appraisal of the subject property.
- Underwriters can return the appraisal report to the appraiser that completed the assignment, identify the deficiencies found, and provide justification for requesting correction of the deficiencies that they believe make the report unreliable.
- When underwriters are unable to obtain a revised appraisal that adequately addresses their concerns, a desk or field review of the report may be obtained.
- The review must be completed in accordance with USPAP. Because the Scope of Work for either type of review allows for a change of the opinion of market value for something other than a

mathematical error, the appraiser completing the appraisal review must be licensed or certified in the state in which the property is located, and he/she must have access to the appropriate data sources and must possess the knowledge and experience to appraise the subject property with respect to both the specific property type and geographical location.

- Underwriters may forego either type of review and obtain a new appraisal. When a new appraisal is obtained, use of the opinion of market value as stated in the review or new appraisal is required because the original appraisal has been rejected.
- It is not acceptable for underwriters to exercise blanket discretion by arbitrarily changing the opinion of market value from a report for use in the lending process.
  - For example, it is not within the underwriters' discretion to simply average the two opinions of market value in order to arrive at a final value conclusion.

Factory Built Housing

Modular/Prefabricated/Panelized/Sectional Housing

- Modular homes must be built under the Uniform Building Code (UBC) that is administered by the state agency that is responsible for adopting and administering building code requirements for the state where the modular home is installed.
- Prefabricated, panelized or sectional housing does not have to satisfy either HUD's Federal Manufactured Home Construction and Safety Standards or the UBC that are adopted and administered by the state where the home is installed. The home must conform to local building codes in the area where it is installed.
- There are no minimum requirements for width, size, roof pitch or any other specific construction detail for modular homes or any other types of factory-built homes.
- The process of selecting comparable sales for factory-built housing is generally the same as that for selecting comparable sales for site-built housing. The appraiser is required to address both the marketability and comparability of modular homes and other types of factory-built housing.
- When the subject property is modular, prefabricated, panelized, or sectional housing it is not required that one or more of the comparable sales be the same type of factory-built housing although using comparable sales of similar types of homes generally enhances the reliability of the appraiser's opinion of value.
- The appraiser is required to include in the appraisal report the most appropriate comparable sales data to support his/her opinion of value for the subject property.

Appraisal Requirements for Mixed-Use Properties

- The appraisal report for mixed-use properties must:
  - Provide a detailed description of the mixed-use characteristics of the subject property;
  - Indicate that the mixed use of the property is a legal, permissible use of the property under the local zoning requirements;
  - Report any adverse impact on marketability and market resistance to the commercial use of the property; and
  - Report the market value of the property based on the residential characteristics rather than of the business use or any special business use modifications that were made.

Property Inspection Waivers

Eligible Transactions

- The PIW will be considered for the following transactions:
  - One-unit properties including condos;
  - Principal residence and second home transactions;
  - Investment property refinance transactions;
  - Certain purchases, limited cash-out, and cash-out refinance transactions; and
  - DU loan casefiles that receive an Approve/Eligible recommendation.

Ineligible Transactions

- The following transactions are not eligible for a PIW:

  - Properties located in a disaster-impacted area;
  - Newly constructed dwellings;
  - Two-to-four unit properties;
  - Manufactured homes;
  - DU loan casefiles that receive an Ineligible recommendation;
  - **Transactions using gifts of equity; and**
  - **Texas Section 50(a)(6) mortgage loans.**
- The PIW may not be exercised and an appraisal must be ordered if one or more of the following applies:
  - DU was unable to identify ineligible criteria in the list above;
  - A law exists requiring an appraisal;
  - Rental income is being used from the subject property to qualify the borrower; or
  - The underwriter believes that an appraisal is warranted based on additional information the underwriter has about the property or subsequent events, such as a natural disaster.
- **A PIW offering may not be exercised if an appraisal has already been obtained for the transaction**.
- When a loan casefile is eligible for a PIW and the waiver is exercised, Fannie Mae accepts the value estimate as the value for the subject property.
- The PIW may only be exercised if:
  - The final submission of the loan casefile to DU resulted in a PIW offer;
  - An appraisal is not obtained for the transaction; and
  - The PIW offer is not more than four months old on the date of the Note and the mortgage.

Condominiums

Refer to the Condominium Guidelines for condo requirements.