Conventional Underwriting Guidelines

Version 06.23.2020
FCM CONVENTIONAL UNDERWRITING GUIDELINES

(INCLUDES: CONFORMING, CONFORMING FNMA HIGH BALANCE, FHLMC SUPER CONFORMING, HOMEREADY AND HOMEPOSSIBLE)

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Section 1.02 Program Overview

1.02 Program Overview

Conventional programs encompass both Conforming and Non-Conforming products. Fannie Mae and Freddie Mac both offer similar products which are often referred to as “agency” or Conforming loans. Products which fall outside of Fannie Mae or Freddie Mac’s offerings are considered Non-Conforming.

The intent of this guide is to outline the acceptable parameters for loan submissions of products which fall under the Standard Conforming category. In addition, this guide also references some of the conforming and non-conforming tailored product offerings which offer slightly different terms than the standard conforming program. On the Conforming side: Conforming FNMA High Balance, Conforming FHLMC Super Conforming, HomeReady and HomePossible. On the Non-Conforming Side: Non-Conforming Jumbo. Each of these sub-products has a specific section in the guide which outlines the differences and advantages of each program.
1.02.01  Multiple Risk Layering

Underwriters must take into account the file as a whole when evaluating any file for approval. Although the AUS findings are an essential tool in today’s mortgage underwriting marketplace, in the end they are just that, tools to be used by the underwriter to help evaluate the overall risk tolerance for any given file. It will always fall back to the underwriter’s experience and seasoned real-world skills in order to determine a file’s creditworthiness and viability in the secondary marketplace.

That said, our underwriters are trained to assess the transaction for multiple layers of risk on any given file. Past performance has shown that individual risks and blemishes on a borrower’s application may not pose a large potential for lack of repayment, however when multiple layers of risk are combined the performance levels drop significantly.

Some examples of these types of risks are:

- High Debt-To-Income Ratios
- Payment Shock
- Serious Adverse Credit
- Duration of Employment
- ARM Loans
1.03 Program Terms

1.03.01 Program Code

- CF10: Conforming Fixed Rate Purchase or Refinance 10-Year Term
- CF15: Conforming Fixed Rate Purchase or Refinance 15-Year Term
- CF20: Conforming Fixed Rate Purchase or Refinance 20-Year Term
- CF30: Conforming Fixed Rate Purchase or Refinance 30-Year Term
- C5/1ARM: Conforming 5/1 Adjustable Rate Purchase or Refinance (see ARM section)
- C7/1ARM: Conforming 7/1 Adjustable Rate Purchase or Refinance (see ARM section)
- LPMI15: Lender Paid Mortgage Insurance 15-Year Term
- LPMI30: Lender Paid Mortgage Insurance 30-Year Term
- LPMI15HB: Lender Paid Mortgage Insurance High Balance 15-Year Term
- LPMI30HB: Lender Paid Mortgage Insurance High Balance 30-Year Term
- SC15: Conforming FHLMC Super Conforming 15-Year Term
- SC30: Conforming FHLMC Super Conforming & 30-Year Term
- HB15: Conforming FNMA High Balance 15-Year Term
- HB30: Conforming FNMA High Balance 30-Year Term
- HR30: HomeReady Mortgage
- HP/HPA Home Possible/Home Possible Advantage

1.03.02 Term

- Standard Conforming: 10/15/20/30 Year Terms Available
- FNMA High Balance: 15/30 Year Terms Available
- FHLMC Super Conforming: 15/30 Year Terms Available
- HomeReady Mortgage: 30-year Term Only

1.03.03 Loan Type

- Standard Conforming: Fixed Rate, 5/1 ARM, 7/1 ARM
- FNMA High Balance: Fixed Rate Only
- FHLMC Super Conforming: Fixed Rate Only
- HomeReady Mortgages: Fixed Rate Only
- Home Possible/HP Advantage: Fixed Rate Only

1.03.04 Occupancy Type

- Standard Conforming: Primary Residences, 2nd Homes, Investment Properties
- FNMA High Balance: Primary Residences, 2nd Homes, Investment Properties
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- FHLMC Super Conforming: Primary Residences, 2nd Homes, Investment Properties
- HomeReady Mortgage: Primary Residence Only
- Home Possible/HP Advantage: Primary Residence Only

1.03.05 Higher Priced Mortgage Loans
Residual income must be calculated on all Higher Priced Mortgage Loans. Total income minus total debt.

<table>
<thead>
<tr>
<th>Primary Residence</th>
</tr>
</thead>
<tbody>
<tr>
<td>If the monthly residual income is...</td>
</tr>
<tr>
<td>$2500 or greater</td>
</tr>
<tr>
<td>&gt;=$800 and &lt;$2500</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>&lt;$800</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Second Home and Investment Properties</th>
</tr>
</thead>
<tbody>
<tr>
<td>$2500 or greater</td>
</tr>
<tr>
<td>&lt;$2500</td>
</tr>
</tbody>
</table>

1.03.06 Loan-To-Value
The most recent FCM Credit Score/Loan-To-Value Matrix can be found by referencing the link below:

FCM CREDIT SCORE/LTV MATRIX

1.03.07 Manufactured Homes Requirements and Restrictions
Manufactured Homes are eligible for financing for conventional loan programs. The following list of restrictions and requirements are in addition to regular program underwriting requirements:

- Primary Residence Only
- 30 Year Fixed Rate Only on Purchase and R/T refi
- No High Balance
- Non-Occupant Co-Borrowers allowed at LTVs ≤ 80%
- Purchase, Rate and Term/LCOR and Cash Out
- Cash Out is capped at 65% LTV, max term of 20 years, borrower must have owned both manufactured home and land for at least 12 months preceding the date of the loan application.
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- Approve/Accept/Eligible only
- There is no specific acreage limit, however, generally the land-to-value should not exceed 30% of total value.
- If property is less than 1 year old, a structural engineer’s report meeting HUD guidelines must be provided. Reports must be dated within 12 months of note date.
- Properties with an unexpired right of redemption are ineligible
- Income and Age Based deed restrictions are ineligible.
- Repair escrows are ineligible.

Dwelling Requirements:

- Home must have been manufactured in 1994 or newer.
- Singlewide homes are not eligible.
- Appraiser must be able to verify that the subject has not been removed from original installation site. Verification of wheels, axles, tongue and running lights have been removed.
- Manufactured Home must be titled as real property prior to “Clear-to-Close”
- New construction is eligible if the manufactured home will be sold as real estate (de-titled and classified as Real Estate by dealer/seller) and vested in fee simple ownership prior to closing and reflected as real property on title commitment.

1.03.08 Mortgage Insurance

1.03.08.01 Overview
Mortgage Insurance is a financial guaranty that insures lenders against loss in the event a borrower defaults on a mortgage.

Mortgage Insurance requires separate underwriting and could contain additional overlays specific to MI company guidelines.

****effective with loan applications dated on or after March 1, 2020, must be insured under one of the new approved Forms. A revised list of approved Forms for each provider is available here: Mortgage Insurance Forms.

1.03.08.02 PMI Types
FCM accepts the following types of Private Mortgage Insurance (PMI):

- Borrower-Paid Single Premium Plan
- Borrower-Paid Monthly Premium Plan
- Split Premium Mortgage Insurance (allowed through Radian, Genworth, and ARCH).
The 1.00% and 0.75% upfront options are allowed. The upfront portion cannot be financed.
- Lender-Paid Single Premium Mortgage Insurance

Custom/Reduced MI is not acceptable on any loan program FCM offers including but not limited to HomeReady and HomePossible.

1.03.08.03 MI Coverage Amounts
The highest percentage of coverage per the AUS findings is reflective of the standard coverage requirement.

<table>
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<th>LTV</th>
<th>Standard Agency MI Coverage Amounts</th>
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<td></td>
<td>&lt;= 20 Year Fixed Rate</td>
</tr>
<tr>
<td>95.01 - 97%</td>
<td>35%</td>
</tr>
<tr>
<td>90.01 – 95%</td>
<td>25%</td>
</tr>
<tr>
<td>85.01 – 90%</td>
<td>12%</td>
</tr>
<tr>
<td>80.01 – 85%</td>
<td>6%</td>
</tr>
</tbody>
</table>

1.03.08.04 Financed Mortgage Insurance
The gross LTV calculated after inclusion of the financed premium cannot exceed the maximum LTV for the product. The total loan amount cannot exceed the maximum loan amount for the program, including the financed MI.

Partial financing of the mortgage insurance is not allowed. The mortgage insurance must be 100% financed into the mortgage or paid entirely in cash.

Note that financed MI is not allowed on cash out refinances or Super Conforming transactions.

The upfront portion of a split premium MI product is not allowed to be financed.

1.03.08.05 Lender Paid Mortgage Insurance
Lender paid mortgage insurance allows the borrower to include the mortgage insurance premium in the rate. Using the product codes for this feature (LPMI30, LPMI15, LPMI30HB, & LPMI15HB) will automatically adjust pricing to include the LPMI premium. All standard conforming restrictions and adjustors apply in addition to the LPMI adjustors.

In the case of High Balance and Super Conforming loans, all High Balance and Super Conforming restrictions and adjustors apply.
1.03.09 Minimum and Maximum Loan Amount
The minimum base loan amount is $50,000.

The total maximum loan amount for Standard Conforming loans cannot exceed the General Conforming Loan Limit which can be found:

Conforming Loan Limits

For information regarding FNMA High Balance and FHLMC Super Conforming loan limits please refer to the specific section of this guide.

1.03.10 Acceptable AUS Findings
The following AUS findings are acceptable. Refer findings and manual underwriting is not allowed.

- DU Approve/Eligible
- LP Accept/Accept/Eligible

Note that DU Approve/Ineligible and LP Accept/Accept/Ineligible findings may be acceptable for certain loan products depending on the reason for ineligibility (i.e. Non-Conforming Jumbo receiving an ineligible finding due to excessive loan amount).

1.03.11 DU Tolerances

<table>
<thead>
<tr>
<th>Data Attribute and Description</th>
<th>Trigger</th>
<th>Action Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Interest rate increase</td>
<td>DU loans—the result of these changes causes the DTI ratio recalculated by the lender to • exceed 45%, or • increase by 3 percentage points or more (if the recalculated DTI ratio is 50% or less)</td>
<td>Loan casefile must be resubmitted to DU</td>
</tr>
<tr>
<td>• Discrepancies between the credit report payments and balances and those listed on the online loan application, including the</td>
<td></td>
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</tr>
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<th>Presence of debt that is on the credit report but not on the application</th>
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<td>• Additional debt(s) disclosed by the borrower or identified by the lender during the mortgage process</td>
</tr>
<tr>
<td>• Verified income is less than the income on the loan application submitted to DU</td>
</tr>
<tr>
<td>Interest rate on fixed-rate and adjustable-rate mortgages</td>
</tr>
<tr>
<td>Interest rate decreases, not as the result of a permanent interest rate buydown</td>
</tr>
<tr>
<td>No resubmission required</td>
</tr>
<tr>
<td>Interest rate on fixed-rate and adjustable-rate mortgages</td>
</tr>
<tr>
<td>Interest rate decreases as the result of a permanent interest rate buydown</td>
</tr>
<tr>
<td>Loan casefile must be resubmitted to DU</td>
</tr>
<tr>
<td>Verified income used to qualify the borrower for loans subject to HUD median income limits; for example, as with community lending mortgages.</td>
</tr>
<tr>
<td>Income is greater than the loan application indicates</td>
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<tr>
<td>Loan casefile must be resubmitted to DU</td>
</tr>
<tr>
<td>Assets — Funds Required to Close</td>
</tr>
<tr>
<td>The actual amount of assets required to close the transaction exceeds the amount of “Funds Required to Close” per the DU Underwriting Findings report</td>
</tr>
<tr>
<td>If the lender has documented sufficient liquid assets to cover the actual amount of assets required to close the transaction, no resubmission required</td>
</tr>
<tr>
<td>Otherwise, loan casefile must be resubmitted to DU</td>
</tr>
<tr>
<td>Assets — Reserves Required to be Verified</td>
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<tr>
<td>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</td>
</tr>
<tr>
<td>If the lender has documented reserves that equal at least 90% of the Reserves Required to be Verified per the DU Underwriting Findings report, no resubmission required</td>
</tr>
<tr>
<td>Otherwise, loan casefile must be resubmitted to DU</td>
</tr>
</tbody>
</table>

1.03.12 LPA Tolerances

Resubmission not required:

A change from the previous submission involving the following does not require resubmission:

• Debts/income:
  • The monthly debt payment (including monthly housing expense) decreases
  • The income for any Borrower increases; however, for Home Possible® Mortgages, resubmission is required if the income used to qualify the Borrower increases
Conventional Underwriting Guidelines

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- The income for any Borrower decreases and/or the monthly debt payment (including monthly housing expense) increases, and
  - The total new debt payment-to-income ratio does not exceed 45%, and
  - The total difference does not change the total debt payment-to-income ratio by more than three percentage points

- Assets/reserves:
  - The amount of verified assets increases
  - The amount of verified reserves increases
  - The amount of verified reserves decreases to an amount that is no less than the reserves required to be verified on the Feedback Certificate

1.03.13  Reduced AUS Documentation
Reduced documentation as specifically addressed by properly submitted AUS findings is acceptable.

1.03.14  Fannie Mae Day 1 Certainty
FCM participates and accepts valid findings under the Fannie Mae Day 1 Certainty program. FCM’s current D1C approved vendors are:

  VOI: The WorkNumber/Equifax
  VOD: AccountChek/FormFree

1.03.15  Acceptable Documentation Formats:
- a copy of a document provided by a borrower to be produced by any available technology, such as a photocopier, facsimile machine, document scanner, or camera;
- a borrower explanation of derogatory credit to be in the form of a letter from the borrower, an email from the borrower, or some other form of written documentation from the borrower.

When email correspondence is used as part of the borrower’s documentation the originating email must be the same email provided for Electronic Disclosures and Appraisal Delivery. The E-Delivery disclosure must be signed and maintained in the file.

1.03.16  Sales Contract Review
FCM will review the sales contract to verify it is ratified (signed) by a Buyer(s) and a Seller(s). At least one buyer must be a borrower on the loan. The seller of the property must be the seller on title and the appraisal. FCM will review for terms of the contract that impact the loan amount and/or financing requirements. FCM will NOT review the contract for compliance with State Real Estate
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Governing Board, Realtor Board/Association or Broker requirements. All sales contract addenda specifically referenced in the sales contract should be included. Counter Offers that do not impact the final contract terms DO NOT need to be included.

FCM will review the contracts for sales concessions and inducements to purchase within agency limits for investor compliance.

The terms of the sales contract should be reported accurately on the appraisal. If the terms are stated incorrectly, a correction to the appraisal must be requested as it may have an impact on the appraisal’s value. Changes to the contract made AFTER the appraisal has been performed do not need to be addressed in the appraisal. Dates on the contract amendments should support the changes occurred after the appraisal effective date.

1.03.17 Red Flags, Fraud Alerts, LQI and QC Policies

FCM requirements compliance with all agency, regulatory and investor policies regarding due diligence, loan quality and loan fraud prevention. FCM has several policies (Red Flags Best Practices), procedures (Red Flags Worksheet) and 3rd party services in place to comply with these requirements.

**DU/LP Potential Red Flags**: These messages as stated on the AUS must be resolved/reviewed in accordance with DU’s Feedback recommendation and FCM’s Red Flags policy. Red Flags include potential identity discrepancies, value discrepancies, changes in AUS data input, conflicting applicant information and information obtained from credit report.

**Credit Report/Fraud Alerts**: Fraud, Active Duty and Hawk Alerts reported on the consumer’s credit report should be resolved/reviewed in accordance with our Red Flags policy. The Red Flags Validation Form should be completed to clear these alerts.

**DataVerify**: All variances listed in the DataVerify report should be resolved/reviewed in accordance with FCM’s red flag policies and best practices.

**LQI Requirements**: FCM’s LQI Policy meets the requirements set by Fannie/Freddie - all loans must meet/follow the Lender Quality Initiative Requirements including:

- Confirming Identity and Occupancy of the borrower
- Verifying the Social Security Number of the borrowers
- Validation of Qualified Parties to the transaction (GSA/LDP)
- Verbal Verification of Employment within 10 days of closing
- Debt monitoring up to and concurrent with loan closing
QC Policies: In 2013 Fannie Mae required lenders to implement Lender Quality Control Requirements. These requirements include a pre-closing review. The pre-closing review includes reviewing the underwriting decision, approval conditions, supporting documentation and in some instances re-verification.

For additional details regarding FCM’s LQI or QC Policies please contact your manager or Account Executive.

1.03.18 General Letters of Explanation
Generally, letters of explanation are not required if AUS does not require them in the underwriting feedback.

Any borrower letter of explanation requested from FCM should be absolutely necessary in nature, should not be used to “confirm” what is already verified/documented.

Letters of explanation should not be requested for Cash-Out explanations.

1.03.19 Secondary Financing

1.03.19.01 Overview
Secondary or subordinate financing is allowed on most conforming loan programs subject to CLTV restrictions unless noted otherwise in the specific program’s subsection.

Secondary financing falls into one of two categories:

- **Home Equity Line of Credit (HELOC):** a mortgage loan that allows that borrower to obtain multiple advances from a line of credit at his/her discretion and that is typically in a subordinate position.
- **Closed End Loan:** a mortgage providing a single advance of funds at the time of loan closing and that is not eligible for additional draws.

1.03.19.02 Terms
For transactions including subordinate financing, the following requirements apply for both HELOC and Closed End Loans:

- The subordinate financing must be recorded and clearly subordinate to First Community's first mortgage.
- The maximum LTV/CLTV may not exceed the guideline limits for the product and occupancy type shown in the FCM CREDIT SCORE/LTV MATRIX.
Conventional Underwriting Guidelines

Section 1.03 Program Terms

- If there is/will be an outstanding balance at the time of closing, the payment on the subordinate financing must be included in the calculation of the borrower's debt-to-income ratio(s).
- Negative amortization is not allowed; scheduled payments must be sufficient to cover at least the interest due.
- Equity share or shared appreciation is not allowed.
- Subordinate financing from the borrower's employer may not include a provision requiring repayment upon termination.
- Subordinate financing from the property seller (seller carry-back, including any property seller or other private party carried financing).
  - Is allowed only after the borrower has made a 5% minimum down payment / cash investment
  - Is allowed only when the maximum CLTV is the lesser of 95% or the published CLTV limits for the product/program
  - Affects interested party Contribution Limits
  - Should be at market rate. If the interest rate is more than 2% below Fannie Mae’s posted net yield in effect for second mortgages at time of closing it must be treated as a sales concession and a dollar for dollar reduction made to the sales price

- For HELOCs, the total balance cannot exceed the credit limit amount. Any amount over the credit limit amount must be paid down prior to closing.

**Note:** For Conforming Loans, the TLTV ratio is calculated by adding the disbursed (or to be disbursed at closing) amount of the HELOC to the first mortgage amount, plus any other subordinate financing, and dividing the sum by the value of the mortgaged premises.

**Note:** The CLTV ratio is applicable to Conforming Loans and calculated by adding the HELOC credit line limit (rather than the amount of the HELOC in use) to the first mortgage amount, plus any other subordinate financing, and dividing that sum by the value of the mortgaged premises.

For new and existing Closed End subordinate financing the following also apply:

- Maturity date or amortization basis of the junior lien must not be less than five years after the Note date of the first lien Mortgage, unless the junior lien is fullyamortizing
- The loan cannot have a balloon or call option within five years of the date of the Note.
Subordinate financing that does not fully amortize under a level monthly payment plan where the maturity or balloon payment date is less than five years after the note date of the new first mortgage is not acceptable.

**1.03.19.03 Acceptable Documentation**

The terms of any subordinate financing must be verified with a copy of the initial mortgage note. Other sources of verification are not acceptable.

- For existing subordinate financing a copy of the initial mortgage note should be provided.
- For new subordinate financing an unsigned/unrecorded copy of the new Note that will be signed at closing should be provided for review by the underwriter.

Reminder for home equity lines of credit (HELOC): If an existing HELOC is reduced without modifying the original Note, the original line limit must be used to calculate the Combined-Loan-to-Value ratio.

Notes:

- Whether the subordinate financing is existing or new, a full underwrite of the documentation provided is required to ensure the subordinate financing meets the requirements.
- If the subordinate financing is a community second or affordable second, it must comply with Fannie Mae and Freddie Mac requirements.

**1.03.19.04 Rate/Term Refinances**

Existing subordinate financing must have been used to purchase the property to be included in the new loan amount and still be considered a rate/term refinance. New subordinate financing is allowed subject to CLTV restrictions listed in the Credit Score/LTV Matrix.

**1.03.20 Escrows**

Tax and Insurance escrows are required on all loans with an LTV of 80% or more. Any loan less than 80% LTV with waived escrows requires an escrow waiver acknowledgment form as well as an escrow waiver pricing adjustment. Flood insurance, if required, cannot be waived.

Homestead taxes may be used for qualifying and escrow purposes if the amount is verified by the title company and there is a reasonable belief the borrower will qualify for, or continue to qualify for, the exemption based on local and state qualification standards.
Conventional Underwriting Guidelines

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1.03.21 Repair Escrows
Repair Escrows are reviewed on a case-by-case basis, but as a general guideline must satisfy at least all of the stipulations below:

- Repairs must be required by the appraiser on the appraisal report.
- Repair Escrows may not cover any repair that would be considered a structural issue, is hazardous or may affect safety/soundness. (i.e. Mold removal and mitigation)
- Maximum Repair Amount: $5,000
- Major Repairs require a Professional Estimate from a Licensed/Bonded Individual. Major repairs to include major electrical, plumbing, mechanical systems or erosion/drainage.
- Minor Repairs up to $1500 may be completed by the borrower (ie. Paint, Drywall, Trim etc). Repairs beyond the $1500 limit can be completed by borrower with prior underwriting approval.
- Escrow amount will be 150% of the estimated cost to complete the repair. The higher of the Appraiser’s estimate and/or professional estimate obtained by borrower will be used.
- 30-day standard escrow timeframe. An extension may be allowed if weather related items cannot be completed in time due to inclement weather
- A Final inspection is required, and an Inspection Fee must be added
- Borrower/LO must notify FCM of completed repairs. All receipts must be sent to escrowhb@fcmpartners.com. FCM will order a final inspection and pay for that inspection from escrow funds.

1.03.22 Ineligible Transactions
- Transactions where one or more borrowers have entered in to a short refinance or restricted debt on the subject property.
- Non-warrantable condominiums.
- Hotel or Motel Condominium Conversions (or conversions of other similar transient properties)
1.04 Borrower Eligibility

1.04.01 Eligible Borrowers

Note: An individual/spouse can be listed as a buyer on the sales contract and/or vested as an owner on the title commitment without being listed on the loan application.

1.04.01.01 Valid Social Security number (U.S. Citizens and Non-U.S. Citizens)

Each borrower on the loan transaction must have a valid Social Security number. In addition, any borrower who is not a U.S. citizen must meet the requirements in the following section.

1.04.01.02 Permanent Resident Aliens

A copy of the Green Card is required for all permanent resident aliens whose income and/or assets are being used to qualify for a loan. A copy of the front and back of the card is required and must be included in the loan file.

While the Green Card itself states "Do Not Duplicate" for the purpose of replacing the original card, U.S. Citizenship and Immigration Services (USCIS) allows photocopying of the Green Card. Making an enlarged copy or copying on colored paper may alleviate any concerns the borrower may have with photocopying.

1.04.01.03 Non-Permanent Resident Aliens, EAD Card and VISA Holders

Please submit identity and status documentation for review and approval to citizenshipdocs@fcmmorloans.com.

1.04.01.04 Borrowers Not Yet Divorced/Divorce Not Final

Borrowers who are separated/legally separated and not yet divorced may be eligible to purchase a primary residence prior to finalizing their divorce provided specific documentation is provided:

- Recorded Legal Separation Agreement: In states where legal separations are recorded the agreement may be provided to determine assignment of credit obligations, current real estate holding disposition and future alimony/child support obligations. If there are minor children a child support worksheet provided by the court or attorneys must be provided.
- Marital Dissolution Agreement: In states where MDAs are prepared, the agreement may be provided to determine assignment of credit obligations, current real estate holding disposition and future alimony/child support obligations. If there are minor
Conventional Underwriting Guidelines

Section 1.04 Borrower Eligibility

children a child support worksheet provided by the court or attorneys must be provided.

- Notarized Letter from Borrowers and Attorneys: In states where legal separation is not recognized, and Marital Dissolution Agreements are not prepared, the borrower may provide a written separation plan signed by both parties and notarized. The attorneys representing each spouse must also submit letters stating this plan has been agreed upon and is likely to be accepted as is by the courts. If there are minor children, a child support worksheet completed by each attorney must be included.

NOTE: Please see Alimony, Child Support or Separate Maintenance section to determine if payments being received may be included in qualifying income.

1.04.02 Ineligible Borrowers

1.04.02.01 Non-natural Borrowers
Non-natural Borrowers including LLC’s, Corporations, Trusts, Inter-vivo revocable trust.

NOTE: Title may be held in the name of a Revocable Trust provided it meets FCM’s guidelines. The Trust agreement or Certification of Trust should be submitted to underwriting for review.

1.04.02.02 Foreign Nationals
Foreign nationals who have no lawful residency status in the U.S. are not considered to be non-permanent resident aliens and are not eligible for financing.

1.04.02.03 Borrower’s with a foreign address
Regarding a foreign address, DU requires the borrower’s present address to be within the U.S, U.S. territories, or APO military addresses located within the U.S per https://www.fanniemae.com/content/guide/selling/b3/5.2/01.html (see Credit Report Requirements in DU). If the borrowers use a U.S. address on their tax returns, it is acceptable for the lender to use that address in DU provided they can ensure that the credit reports are accurate. This assumes that the borrower has established credit in the U.S. Borrowers with a foreign address are not eligible for LP.

1.04.02.04 Diplomatic Immunity
Due to the inability to compel payment or seek judgment, transactions with individuals who are not subject to United States jurisdiction are not eligible. This includes embassy personnel with diplomatic immunity. Verification the borrower does not have diplomatic immunity can be determined by reviewing the visa, passport or the U.S. Department of State's Diplomatic List at http://www.state.gov/s/cpr/rls/.
Conventional Underwriting Guidelines

Section 1.04 Borrower Eligibility

1.04.02.05 Non-arms-length transactions
Non-arms-length transactions involving originator principals, employees, and spouses are not eligible.

1.04.03 Non-Occupant Co-Borrowers

1.04.03.01 Overview
Non-occupant co-borrower’s income may be used for qualification purposes. Under no circumstances can a non-occupant co-borrower be added to overcome any borrower’s derogatory credit history.

Non-occupant co-borrowers may not have an interest in the property sale (i.e. seller, realtor, builder).

1.04.04 Power of Attorney (POA)
All POA’s used by the borrower(s) on the loan must be pre-approved by the Underwriter and may not be allowed to close without underwriter approval. POA’s must be reviewed by all departments involved for accuracy up to and including Processing, Underwriting and Closing.

POA’s used by the seller, realtor or other parties to the transaction, may be requested but do not need approval by FCM. Other POA Requirements are listed below:

- There must be a letter in the file that states the hardship/reason for using the Power of Attorney.
- POAs cannot be used on cash out refinance transactions.
- Date of POA cannot be dated more than 180 days from the closing date.
- POA must be fully-executed.
- POA must not be expired on the date of the closing.
- POA must be specific to the transaction with the subject property address and authorization for attorney in fact to be able to execute all documents necessary to purchase or refinance the property/mortgage.
- Grantor’s Names must be as they will appear on closing documents.
- A separate POA must be used for each borrower unless the borrowers are married.
- The Attorney in Fact cannot have a financial interest in the transaction (i.e. Realtor, Broker, LO, Closing Attorney)
- When using a POA for closing, the borrower’s signature must be on the Uniform Residential Loan Application (1003), the initial disclosures and the sales contract/purchase agreement.
1.04.05 Non-Arms-Length/Identity of Interest Transactions
Non-Arm's Length transactions can pose additional layers of risk. All documentation should be carefully evaluated. The Appraisal should be carefully reviewed. Additional Seller information may be required to confirm the transaction is acceptable.

Non-Arm’s Length transactions involving new construction (relationship with builder) is allowed on a Primary Residence transaction only. No 2nd Homes or Investment Properties allowed when there is a builder relationship. No exceptions.

1.04.06 LDP/GSA Screening
All of the following parties to the transaction must be checked on the HUD Limited Denial of Participation (LDP) and Excluded Parties List System (EPLS/GSA) lists:

- Borrower(s)
- Seller(s)
- Buyers’ and Sellers’ agents
- Builders
- Closing Agents
- Brokers
- Loan Originators
- Power of Attorney
- Processor (Broker side of Business)

1.04.07 Social Security Number Verification
All borrowers, including United States citizens, must have a valid Social Security Number (SSN) and must provide evidence of that SSN to the lender. Tax ID numbers issued by the Social Security Office are unacceptable. Any credit report used in the file must indicate that a Social Security validation vendor has validated the borrower’s Social Security Number.

Social Security Number verification may be documented using any of the following:

- W-2, paystub, etc.
- Copies of social security cards
- Direct verification through the Social Security Administration (SSA)
- Tax Transcripts

*Note:* These requirements apply to purchase money loans and all refinances.
1.05 Income Assessment

1.05.01 Overview
Conforming underwriting guidelines emphasize the continuity of a borrower’s stable income. The stable and reliable flow of income is a key consideration in mortgage loan underwriting. Individuals who change jobs frequently, but who are nevertheless able to earn consistent and predictable income, are also 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, the lender must obtain information about prior earnings. Examples of less predictable income sources include commissions, bonuses, substantial amounts of overtime pay, or employment that is subject to time limits, such as contract employees or tradesmen.

1.05.02 Length of Employment
All borrowers with qualifying income must have an acceptable and stable employment history to be considered effective income for qualifying purposes. Borrowers do not need to be in their current job for two years but must be able to show a verifiable two-year work history.

1.05.02.01 Gaps in Employment
A letter of explanation is required on all gaps of employment exceeding 6 months.

1.05.02.02 College Transcripts
College transcripts may be used in some circumstances to meet the 2-year employment history requirement for wage earners. Diplomas are not necessary and will not satisfy the condition.

1.05.02.03 Extended Absences
An extended absence is defined as any job gap greater than 6 months.

If the borrower is just returning to the workforce there is no specific time frame required for the borrower to have been back to work. Heavy consideration will be place on whether the income is stable, predictable and likely to continue. Documentation of earnings prior to gap will be required.
1.05.03 Continuance

A key driver of successful homeownership is confidence that all income used in qualifying the borrower will continue to be received by the borrower for the foreseeable future. Unless the lender has 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 (per the specific income type), the lender may conclude that the income is stable, predictable, and likely to continue. The lender is not expected to request additional documentation from the borrower.

If the income source does have a defined expiration date or is dependent on the depletion of an asset account or other limited benefit, the lender must document the likelihood of continued receipt of the income for at least three years.

The following table contains examples of income types with and without defined expiration dates. This information is provided to assist lenders in determining whether additional income documentation may be necessary to support a three-year continuance. Note that lenders remain responsible for making the final determination of whether the borrower’s specific income source has a defined expiration date.

<table>
<thead>
<tr>
<th>Expiration Date Not Defined (Lender does NOT need to document 3-year continuance)</th>
<th>Defined Expiration Date* (Lender must document 3-year continuance)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Base salary</td>
<td>• Alimony or child support</td>
</tr>
<tr>
<td>• Bonus, overtime, commission, or tip income</td>
<td>• Distributions from a retirement account – for example: 401(k), IRA, SEP, Keogh</td>
</tr>
<tr>
<td>• Capital gains income</td>
<td>• Mortgage differential payments</td>
</tr>
<tr>
<td>• Corporate retirement or pension</td>
<td>• Notes receivable</td>
</tr>
<tr>
<td>• Disability income – long-term</td>
<td>• Public assistance</td>
</tr>
<tr>
<td>• Foster-care income</td>
<td>• Royalty payment income</td>
</tr>
<tr>
<td>• Interest and dividend income (unless other evidence that asset will be depleted)</td>
<td>• Social Security being drawn from someone other than borrower’s own SS Account</td>
</tr>
<tr>
<td>• Military income</td>
<td>• Trust income</td>
</tr>
<tr>
<td>• Part-time job, second job, or seasonal income</td>
<td>• VA benefits (not including retirement or long-term disability)</td>
</tr>
<tr>
<td>• Rental income</td>
<td>• Self-employment income</td>
</tr>
<tr>
<td>• Self-employment income</td>
<td>• Social Security, VA, or other government retirement or annuity **</td>
</tr>
<tr>
<td>• Social Security, VA, or other government retirement or annuity ** Drawn from borrower’s own SS/Disability Account</td>
<td>**</td>
</tr>
</tbody>
</table>

*Drawn from borrower’s own SS/Disability Account
Section 1.05 Income Assessment

1.05.04 Salaried or Hourly Wage Earner

1.05.04.01 Documentation Requirements
Minimum income documentation required for salaried or hourly wage earners is determined by AUS findings. Generally, the AUS findings for salaried or hourly wage earner income is as follows:

The most recent year-to-date pay stub documenting one full month’s earnings and IRS W-2 forms covering the most recent two-year period and any one of the following to verify current employment:

- Written verification of employment;
- Verbal verification of employment; or
- Electronic verification by an acceptable third-party vendor.

The employer’s address and phone listing must be independently verified by using the telephone book, the internet or directory assistance; a copy of the information should be kept with the Verification of Employment in the file.

Paystubs and W-2s should:

- Clearly identify the employer’s name
- Clearly identify the borrower as the employee
- Be complete and legible
- Contain year-to-date earnings (paystubs)
- Contain one full month’s earnings at a minimum (paystubs)
- Be computer-generated or typed by the borrower’s employer

Handwritten paystubs are allowed provided a copy of the cancelled checks covering a 30 day period is reviewed by underwriting along with a full Verification of Employment.

IRS Obtained W-2 transcripts are acceptable in lieu of borrower provided W-2s.

1.05.04.02 Variable Pay/Fluctuating Hourly Pay

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
Conventional Underwriting Guidelines

Section 1.05 Income Assessment

Income being received. Examples of income of this type include income from hourly workers with fluctuating hours, or income that includes commissions, bonuses or overtime.

Two or more years of receipt of a particular type of variable income is recommended; however, 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.

1.05.04.03 Verbal Verification of Employment for Closing
At a maximum of 10 days prior to closing a final verification of employment should be obtained. A written, verbal or electronic re-verification is acceptable.

1.05.04.04 Additional Notations
Teachers must have a full VOE completed to determine the proper pay schedule.

Salaried or Hourly Wage Earners cannot own 25.00% or more interest in the business for which they receive their primary income. Analysis of income that is derived from self-employment that is a secondary and separate source of income (or loss) is not required.

1.05.05 Self-Employed
A borrower is considered self-employed if they own 25.00% or more interest in a business or if they are a 1099 employee which files a Schedule C. The four basic types of business structures are: sole proprietorships, corporations, limited liability or “S” corporations, and partnerships.

1.05.05.01 Documentation Requirements for DU
- Documentation Requirements are determined by AUS.

1.05.05.02 Documentation for AUS Documentation Levels for LP

<table>
<thead>
<tr>
<th>Business Structure</th>
<th>Streamlined Accept and Standard Documentation levels</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Borrower has been self-employed in the same business for &gt; 5 years</td>
</tr>
<tr>
<td>Sole Proprietor</td>
<td>Complete signed federal individual income tax return for the most recent year.</td>
</tr>
<tr>
<td>Partnership</td>
<td>Complete signed federal individual and Partnership (Form 1065) income tax returns, including K-1(s) for the most recent year.</td>
</tr>
</tbody>
</table>
### Conventional Underwriting Guidelines

#### Section 1.05 Income Assessment

<table>
<thead>
<tr>
<th>S Corp</th>
<th>Complete signed federal individual and S Corporation (Form 1120S) income tax returns, including K-1(s) for the most recent year.</th>
<th>Complete signed federal individual and S Corporation (Form 1120S) income tax returns, including K-1(s) for the two most recent years.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporation</td>
<td>Complete signed federal individual and Corporation (Form 1120) income tax returns, including W-2(s) for the most recent year.</td>
<td>Complete signed federal individual and Corporation (Form 1120) income tax returns, including W-2(s) for the two most recent years.</td>
</tr>
</tbody>
</table>

**Note:** A business credit report is not required for a corporation or “S” corporation.

- A profit and loss statement (P&L) and a balance sheet is required if more than a calendar year has elapsed since the date of most recent calendar year or fiscal-year end tax return was filed by the borrower.
- For additional requirements regarding Tax Transcripts and returns please see the [IRS Tax Transcript Requirements](#) section.

FCM Verbal VOE requirements for Self-employed Borrowers:

Verifications must be dated within 120 days of the NOTE date:

- from a third party, such as a CPA, regulatory agency, or the applicable licensing bureau, if possible;
  - OR
- by verifying a phone listing and address for the borrower's business using a telephone book, the Internet, or directory assistance.

The lender must document the source of the information obtained and the name and title of the lender’s employee who obtained the information.

#### 1.05.03 History

Self-employed borrowers are required to have a minimum of 2 years consecutive self-employment in the same business and geographic area.

#### 1.05.04 Analysis

FCM requires self-employed income to be calculated using [Fannie Mae Cash Flow Analysis Form 1084](#).

Business income is averaged over a two-year period using Federal Tax Returns.
Conventional Underwriting Guidelines

Section 1.05 Income Assessment

In the case of declining income, significant compensating factors must exist to consider the income in the qualifying ratios. A significant decline in income is not acceptable, even if the current income and debt ratios meet agency guidelines.

(1) Business Types for Self-Employed Borrowers

Sole Proprietorships: the total net profit of the business with depreciation or depletion added back to the adjusted gross income.

Partnerships:

- If the Schedule K-1 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 K-1 income may then be included in the borrower’s cash flow.

- If the Schedule K-1 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, then the lender must confirm the business has adequate liquidity to support the withdrawal of earnings. The lender may 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 cash flow.

Corporations: the amount of wages or salary as shown on the W-2 plus any bonus or other compensation, deducting any spousal income. The borrower’s share of the net profit may be included in income ONLY if distribution of the net profit was received by the borrower and can be documented.

NOTE: Analysis of the business should include the impact the business activity will have on the residential use/nature of the subject property. See Property Evaluation/Mixed Use Topic for more details.
Conventional Underwriting Guidelines

Section 1.05 Income Assessment

1.05.06 Commission Income
A minimum history of 2 years of commission income is recommended; however, commission income that has been received for 12 to 24 months may be considered as acceptable if there are positive factors to reasonably offset the shorter income history.

One of the following must be obtained to document commission income:

- a completed Request for Verification of Employment
- the borrower’s recent paystub and IRS W-2 forms covering the most recent two-year period

Commission income showing a decrease requires significant compensating factors to justify loan approval.

1.05.07 Rental Income

1.05.07.01 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 rental income is derived from the subject property, the property must be one of the following:

- A two- to four-unit principal residence property in which 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 (it can be documented in accordance with the requirements below).

1.05.07.02 Ineligible Properties
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.

Boarder income is not an acceptable source of income.
Conventional Underwriting Guidelines

Section 1.05 Income Assessment

1.05.07.03 General Requirements for Documenting Rental Income
If a borrower has a history of renting the subject or another property, generally the rental income will be reported on Schedule E of the borrower’s personal tax returns or on Rental Real Estate Income and Expenses of a Partnership or an S Corporation Form 8825 of a business return. If the borrower does not have a history of renting the subject property, the underwriter may be justified in using a fully executed current lease agreement. Examples of scenarios that could justify the use of a lease agreement are

- purchase transactions when the property is currently rented;
- refinance transactions in which 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 renovation to a property, as reflect in expenses on schedule E, occurred in the prior year that affected rental income.)

When the subject property will generate rental income, one of the following forms must be used to support the income-earning potential of the property:

- For one-unit properties: Single-Family Comparable Rent Schedule (Form 1007/1000) (provided in conjunction with the applicable appraisal report), or
- For two- to four-unit properties: Small Residential Income Property Appraisal Report (Form 1025/72).

1.05.07.04 Documenting Rental Income from Subject Property
Documentation that is used to calculate the monthly rental income for qualifying purposes must be obtained. 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.

<table>
<thead>
<tr>
<th>Does the Borrower Have a History of Receiving Rental Income from the Subject Property?</th>
<th>Transaction Type</th>
<th>Documentation Requirements</th>
</tr>
</thead>
</table>
| Yes | Refinance | Form 1007 or Form 1000 as applicable, and either  
- The borrower’s most recent year of federal income tax returns including Schedule E, or  
- The borrower’s most recent year of federal income tax returns not including Schedule E, or  
- The most recent year of Federal income tax returns for the subject property, or  
- A current lease agreement, or  
- An appraisal report that supports the income, or  
- A comparable market report that supports the income |
## Section 1.05 Income Assessment

<table>
<thead>
<tr>
<th>Purchase</th>
<th>No</th>
<th>Refinance</th>
<th>If the property is currently rented:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td></td>
<td>• Form 1007 or Form 1000, as applicable, and</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td></td>
<td>• Copies of the current lease agreement(s).</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td></td>
<td>If the property is not currently rented:</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td></td>
<td>• Form 1007 or form 1000 – 75% of anticipated market rent may be used to qualify the borrower.</td>
</tr>
</tbody>
</table>

If the borrower is not using any rental income from the subject property to qualify, the gross monthly rent must still be documented using either a Form 1007/1000, current lease agreement or Fair Market Rent document for lender reporting purposes.

***LP ONLY****If a lease is used to determine the net rental income, bank statements, electronic transfers of rental payments or cancelled rent checks supporting two months of receipt of rental income can be used in lieu of Form 72 or 1000.

### 1.05.07.05 Documenting Rental Income from Property Other Than the Subject Property

When the borrower owns property – other than the subject property – that is rented, the originator must document the monthly gross (and net) rental income with the borrower’s most recent federal income tax return that includes Schedule E. 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).
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Agreement(s) may be substituted if the borrower can document a qualifying exception. See Partial or No Rental History on Tax Returns below.

1.05.07.06 Conversion of Current Principal Residence to Investment Property

When a borrower vacates a principal residence in favor of another principal residence, the rental income may be considered in the underwriting analysis at 75% of documented gross rent. This can only be used to offset the PITIA. It cannot be used as income. The following documentation is required:

- A properly executed lease agreement (that is, a lease signed by the borrower and lessee) of at least one year’s duration after the loan is closed.
- See Treatment of the Income (or Loss) for additional LP restrictions.

1.05.07.07 Partial or No Rental History on Tax Returns

To determine qualifying rental income, it must first be determined 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 analysis may determine that using alternative rental income calculations or using lease agreements to calculate 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 table below) that the rental property was out of service the previous tax year or was in service for only a portion of the previous tax year, the underwriter may determine qualifying rental income by using

- Schedule E income and expenses and annualizing the income (or loss) calculation; or
- Fully executed lease agreement to determine the gross rental income to be used in the net rental income (or loss) calculation.

<table>
<thead>
<tr>
<th>If...</th>
<th>Then...</th>
</tr>
</thead>
<tbody>
<tr>
<td>The property was acquired during or subsequent to the most recent tax filing year,</td>
<td>the underwriter must confirm the purchase date using the settlement statement or other documentation.</td>
</tr>
<tr>
<td></td>
<td>• If acquired during the year, Schedule E (Fair Rental Days) must confirm a partial year rental income and expenses (depending on when the unit was in service as a rental).</td>
</tr>
</tbody>
</table>
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<table>
<thead>
<tr>
<th>Condition</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>The rental property was out of service for an extended period,</td>
<td>• 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.</td>
</tr>
<tr>
<td></td>
<td>• Schedule E (Fair Rental Days) 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.</td>
</tr>
<tr>
<td>The underwriter determines that some other situation warrants an exception to use a lease agreement</td>
<td>The underwriter must provide an explanation and justification in the loan file.</td>
</tr>
</tbody>
</table>

1.05.07.08 Calculating Monthly Qualifying Rental Income (or Loss)

**LP:** The borrower must own a Primary Residence to use rental income to qualify when purchasing a new rental property

**DU:** To determine the amount of rental income from the subject property that can be used for qualifying purposes when the borrower is purchasing or refinancing a two-to four-unit principal residence or one-to four-unit investment property, the underwriter must consider the following:

<table>
<thead>
<tr>
<th>If the borrower...</th>
<th>Then for qualifying purposes...</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Currently owns a principal residence (or has a current housing expense), and</td>
<td>• There is no restriction on the amount of rental income that can be used.</td>
</tr>
<tr>
<td>• Has at least a one-year history of receiving rental income or documented property management experience</td>
<td></td>
</tr>
<tr>
<td>• Currently owns a principal residence (or has a current housing expense), and</td>
<td>• For a principal residence, rental income in an amount not exceeding the PITIA of</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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| • Has less than one-year history of receiving rental income or documented property management experience | the subject property can be added to the borrower’s gross income, or
| • Does not own a principal residence, and • Does not have a current housing expense | • For an investment property, rental income can only be used to offset the PITIA of the subject property.

| • Rental income from the subject property cannot be used. |

The underwriter must establish a history of property management experience by obtaining one of the following:

• The borrower’s most recent signed federal income tax return, including Schedules 1 and E. Schedule E should reflect rental income received for any property and Fair Rental Days of 365;
• If the property has been owned for at least one year, but there are less than 365 Fair Rental Days on Schedule E, a current signed lease agreement may be used to supplement the federal income tax return; or
• A current signed lease may be used to supplement a federal income tax return if the property was out of service for any time period in the prior year. Schedule E must support this by reflecting a reduced number of days in use and related repair costs. Form 1007 or Form 1025 must support the income reflected on the lease.

The underwriter must document the borrower has at least one year history of receiving rental income in accordance with Documenting Rental Income From the Property Other Than the Subject Property above.

Method for Calculating the Income

The method for calculating rental income (or loss) for qualifying purposes is dependent upon the documentation that is being used.

Federal Income Tax Returns, Schedule E. When Schedule E is used to calculate qualifying rental income, the lender must 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
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- 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.

See Treatment of the Income (or Loss) below for further instructions.

*Lease Agreements or Form 1007 or Form 1025.* When current lease agreements or market rents reported on Form 1007 or Form 1025 are used, the underwriter must 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.) The remaining 25% of the gross rent will be absorbed by vacancy losses and ongoing maintenance expenses.

**1.05.07.09  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 or her principal residence.

If the rental income relates to the borrower’s principal residence:

- The monthly qualifying rental income (as defined above) must be added to the borrower’s total monthly income. (The income is not 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 (as defined above) minus the full PITIA is positive, it must be added to the borrower’s total monthly income.
- If the monthly qualifying rental income minus 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.
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**LP:** Whether purchasing a new rental property or converting a Primary Residence to a rental property, if the borrower does not have a minimum of one-year investment property management experience:

- The rental income can only offset the principal, interest, taxes and insurance (PITI) of the rental property; and
- Rental income exceeding PITI cannot be added to the Borrower’s gross monthly income to qualify.

1.05.07.10 Offsetting Monthly Obligations for Rental Property Reported through a Partnership or an S Corporation

If the borrower is personally obligated on the mortgage debt (as evidenced by inclusion of the related mortgage(s) on the credit report) 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:

1. Obtain the borrower’s business tax returns, including IRS Form 8825 for the most recent year.

2. 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 (if documented accordingly).
   - Divide by the number of months the property was in service.
   - Subtract the entire PITIA (proposed for subject property or actual for real estate owned) to determine the monthly property cash flow.

3. If the resulting net cash flow is **positive**, the lender may exclude the property PITIA from the borrower’s monthly obligations when calculating the debt-to-income ratio.

4. If the resulting net cash flow is **negative** (that is, the rental income derived from the investment property is not sufficient to fully offset the property PITIA), 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, the underwriter must evaluate it according to Fannie Mae’s guidelines for income received from a partnership or an S corporation.

**Note:** For DU loan casefiles, the term “subject net cash flow” applies to net rental income from the subject property, and the term “net rental income” applies to rental income from properties other than the subject property.

### 1.05.08 Other Types of Income

#### 1.05.08.01 Alimony, Child Support or Separate Maintenance
Alimony, Child Support, or Maintenance income may be considered only if evidence of all the following is provided:

- Payments are likely to be received consistently for the first three years of the mortgage;
- A copy of the divorce decree, legal separation agreement, voluntary agreement, or court order specifying the amount of support and the period-of-time over which it will be received is required; and
- Evidence that the funds have been received for the last 6 months using cancelled checks, deposit slips, Federal tax returns, or court records.

Non-taxable child support income may be grossed up under the same provisions as other non-taxable sources.

**Note:** If DU or LP show reduced documentation for this type of income then all the above is required but the reduced duration of evidence of receipt is required instead of six months.

#### 1.05.08.02 Capital Gains
Capital gains or losses generally occur only one time and should not be considered when determining effective income.

However, if the individual has a constant turnover of assets resulting in gains or losses, the capital gain or loss must be considered when determining the income. Two years’ tax returns are required to evaluate an earnings trend. If the trend:

- results in a gain, it may be added as effective income, or
- Consistently shows a loss, it must be deducted from the total income.
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The originator must document anticipated continuation of income through verified assets.

**Example:** An underwriter can consider the capital gains as income for an individual who purchases old houses, remodels them, and sells them for profit.

1.05.08.03 **Car Allowances**

To be eligible for consideration a car allowance must have been received for the past two years and there must be a reasonable expectation that it will continue. Although a car allowance may not be reported as taxable income, it cannot be grossed up for qualifying purposes. The full amount of the automobile allowance is added to monthly qualifying income and the entire liability is included in the borrower's liabilities.

1.05.08.04 **Employer Differential Payments**

If the employer subsidizes a borrower’s mortgage payment through direct payments, the amount:

- Is considered gross income, and
- Cannot be used to offset the mortgage payment directly, even if the employer pays the servicing lender directly.

1.05.08.05 **Employment by Family-Owned Business**

In addition to normal employment verification, a borrower employed by a family-owned business is required to provide evidence that he/she is not an owner of the business. This evidence may include one of the following:

- a copy of the last two years’ Federal personal tax returns, and/or
- a signed copy of the Federal corporate tax return showing ownership percentages (usually evidenced on the Schedule K-1), if applicable, and

In addition to the above items, a current VOE showing the borrower does not own more than 25% of the business is required and any recent increases in income must be closely reviewed.

1.05.08.06 **Government Assistance Programs**

Government assistance in the form of workman’s compensation, welfare programs, payments for foster children, unemployment income, etc. may be used to qualify the borrower.

- Documentation must be provided from the agency paying benefits to verify that the benefits are likely to continue for at least three years after closing. If continuance of
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such income is not expected for three years, it may be considered as a compensating factor.

- Past receipt of unemployment income must be documented for two years. Reasonable assurance of its continuance is also required. This applies to individuals employed on a seasonal basis, such as farm workers, resort employees, etc.

1.05.08.07 Foster-Care Income
Income received from a state or county-sponsored organization for 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.

1.05.08.08 Interest and Dividend Income
Interest and Dividend Income are acceptable sources of income subject to the following conditions:

- Evidence required showing that the borrower still owns the assets generating the income used to qualify.
- Interest and dividend income must be documented as received for the past two years.
- A two-year average is required to use such income to qualify for the mortgage.
- Two years Federal tax returns or account statements must be provided. Funds used for down payment and/or closing costs must be subtracted before the interest is calculated.
- 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.

1.05.08.09 Long-Term Disability Income
Long-term disability income applies to income received from long-term disability insurance or benefits and does not include income received from the Social Security Administration. Long-
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Term Disability income must be verified from the third-party source (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.

Non-taxable disability income may be grossed up under the same provisions as other non-taxable sources.

1.05.08.10 Military Income

In addition to base pay, military personnel may be entitled to additional forms of pay provided its continuance is verified in writing:

- flight or hazard pay,
- BAS, Basic Allowance for subsistence (rations),
- clothing allowance,
- proficiency pay, and
- BAH, Basic Allowance for housing.

Allowances are non-taxable may be grossed up under the same provisions as other non-taxable sources.

Additional pay, such as pro-pay, hazard pay, etc. is taxable and may not be grossed up.

1.05.08.11 Overtime, Bonus, and Tip Income

Overtime, Bonus, and Tip income are acceptable sources of income subject to the following conditions:

- Verified two-year history of receiving the income; and
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- A YTD Paystub to document current receipt of income
- Full VOE

Inconsistency in this type of income from year to year will require additional years to be verified to determine a valid average.

1.05.08.12 Part-Time
If a borrower’s primary employment is less than the typical 40-hour work week, the stability and calculation of that income should be evaluated as you would any other regular, on-going primary employment.

1.05.08.13 Seasonal Income
Verify that the borrower has worked in the same job (or line of seasonal work) for the past two years. Confirm with the borrower’s employers 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 reported on the borrower’s signed federal tax returns. Otherwise, unemployment compensation cannot be sued to qualify the borrower.

1.05.08.14 Second Job Income
Income from a 2nd source of employment must be received and verified for a minimum of 24 months. The borrower must have demonstrated the ability to manage multiple employers for at least 24 months. It is not required that the borrower maintain the same employers during the 2 years if the ability to maintain multiple jobs at one time has been demonstrated. Income from all the employers should be considered. The income from all employers should be totaled for each year and be averaged over the most recent two years, then compared with prior year earnings and YTD earnings to develop a trend. Income should be consistent or trending upward. Total decreasing income may demonstrate an inability to maintain the multiple job schedule.

Analysis of income that is derived from self-employment that is a secondary and separate source of income (or loss) is not required.

1.05.08.15 Tip Income
Tip income may be included in qualifying income if it has been received for the past two years. Tip income reported on the W-2 may be verified using a standard verification of employment.
Tip income earned by the borrower but not reported on the W-2 may be used in qualifying income if it is reported on IRS form 4137 as part of the borrower's tax returns for the prior two years. A 2-year average should be developed for qualifying purposes.

**1.05.08.16  Retirement Income**

Retirement income refers to income derived from a privately-held retirement account or an employer-sponsored pension. For information on Social Security Retirement Income please refer to that section.

Retirement income must be verified from the third-party source (former employer) or from the most recent two years’ Federal tax returns.

If the income is paid in the form of a monthly distribution from a 401(k), IRA, or Keogh retirement 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 must be used to determine the number of distributions remaining to account for the volatile nature of these assets.

**1.05.08.17  Section 8 Home Ownership Vouchers**

A monthly subsidy may be treated as income if a borrower is receiving subsidies under the housing choice voucher home ownership option from a public Housing Agency.

Procedures for loan applications where the homebuyer receives a monthly homeownership assistance payment under the housing choice voucher homeownership program (Section 8) are shown below.

- The homeownership assistance payment must be paid directly to the homeowner/borrower.
- The amount of the non-taxable subsidy that is received directly by the homeowner may be grossed up by 25% and added to the borrower’s income from employment and/or other sources in calculating the qualifying ratios.

There is no requirement for the Section 8 voucher payments to have been received for any period prior to the date of the mortgage application or for the payments to continue for any period of time from the date of the mortgage application.

**Note:** Although Fannie Mae and Freddie Mac may allow the homeownership assistance payments to be made directly to the servicing lender to offset the mortgage payment, First
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Community Mortgage is unable to facilitate the procedure for receiving or allocating these funds. Therefore, the requirements shown above must be adhered to for eligibility purposes, without exception.

1.05.08.18 Social Security Income

Social Security income for retirement or long-term disability that the borrower is drawing from his or her own account/work record will not have a defined expiration date and must be expected to continue.

However, if Social Security benefits are being paid as a benefit for a family member of the benefit owner, that income may be used in qualifying, if the lender obtains documentation that confirms that 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 benefit (self or other) as shown in the table below.

<table>
<thead>
<tr>
<th>Type of Social Security benefit</th>
<th>Borrower is drawing Social Security benefits from own account/work record</th>
<th>Borrower is drawing Social Security benefits from another person’s account/work record¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement</td>
<td>• Social Security Administrator’s (SSA) Award letter, OR</td>
<td>• SSA Award letter, AND</td>
</tr>
<tr>
<td></td>
<td>• Proof of current receipt</td>
<td>• Proof of current receipt, AND</td>
</tr>
<tr>
<td>Disability</td>
<td>NA</td>
<td>• Three-year continuance (e.g., verification of beneficiary’s age)</td>
</tr>
<tr>
<td>Survivor Benefits</td>
<td>NA</td>
<td></td>
</tr>
<tr>
<td>Supplement Security Income (SSI)</td>
<td>• SSA Award letter, AND</td>
<td>NA</td>
</tr>
<tr>
<td></td>
<td>• Proof of current receipt</td>
<td></td>
</tr>
</tbody>
</table>

¹ 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 dependent (a minor or disabled dependent).
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1.05.08.19 Trust Income
A copy of the Trust Agreement or the Trustee’s statement confirming the amount, frequency and duration of payments must be provided.

- The income must continue for at least three years from the date of the mortgage application.
- If the trust documentation does not include information about the historical level of distributions from the trust, the lender may also need to obtain copies of the borrower’s federal income tax returns for the past two years, including the related IRS Form 1040, Schedule E.

1.05.08.20 VA Benefits
Income received in the form of VA benefits must be documented by a letter or distribution form from the Veterans Administration.

- The income must continue for at least three years from the date of the mortgage application. (Note that verification is not required for VA retirement or long-term disability benefits.)
- Education benefits are not acceptable income, as it offsets education expenses.

1.05.09 New Employment
Income from a new job the borrower has already started must be documented with:

- A full VOE must be obtained along with the fully executed employment offer letter (including salary information) or fully executed, valid and non-expired employment contract (including salary information).

1.05.09.01 Employment Offers or Contracts
If the borrower is scheduled to begin employment after the loan closes, the loan may close in accordance with one of the options outlined below:

<table>
<thead>
<tr>
<th>Option 1 -- Loan Closed After Borrower Starts Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>An executed copy of the borrower’s offer or contract for future employment and anticipated income must be obtained.</td>
</tr>
</tbody>
</table>
Post-closing, the customer must 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. The paystub must be retained in the mortgage loan file.

Option 2 -- Loan Closed 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 based income.

The lender must 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. Note: If conditions of employment exist, the lender must confirm prior to closing that all conditions of employment are satisfied either by verbal verification or written documentation. This confirmation must be noted in the mortgage loan file.

Also note that for a union member who works in an occupation that results in a series of short-term job assignments (such as a skilled construction worker, longshoreman, or stagehand), the union may provide the executed employment offer or contract for future employment.

The borrowers start date must be no earlier than 30 days prior to the note date or no later than 90 days after the note date.

Prior to delivery, the lender must obtain the following documentation depending on the borrower’s employment start date:

<table>
<thead>
<tr>
<th>If the borrower’s start date is...</th>
<th>Documentation Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>The note date or no more than 30 days prior to the note date</td>
<td>Employment offer or contract; and Verbal verification of employment that confirms active employment status</td>
</tr>
<tr>
<td>No more than 90 days after the note date</td>
<td>Employment offer or contract</td>
</tr>
</tbody>
</table>

The lender must document, in addition to the amount of reserves required by DU or for the transaction, one of the following:
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- Financial reserves sufficient to cover principal, interest, taxes, insurance, and association dues (PITIA) for the subject property for six months; or
- Financial resources sufficient to cover the monthly liabilities included in the 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. For calculation purposes, consider any portion of a month as a full month.

Financial resources may include:
- Financial reserves and
- Current income

Current income refers to net income that is currently being received by the borrower (or co-borrower), may or may not be used for qualifying, and may or may not continue after the borrower starts employment under the offer or contract. For this purpose, the lender may 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 the lender using income documentation, such as a paystub, but a verification of employment is not required.

The loan must be delivered with Special Feature Code 707.

1.05.10 Non-Taxable Income

Non-taxable income (or any portion of) may be “grossed-up” by twenty-five percent (25.00%) if it shows up on the borrower’s tax returns as non-taxable income. If the borrower is not required to file a federal income tax return, the tax rate assumed is 25%.

1.05.11 Temporary Leave/Short Term Disability

Temporary leave from an employer may encompass various circumstances (e.g., family and medical, short-term disability, maternity, other temporary leaves with or without pay). Temporary leave is generally short in duration. The period of time that a borrower is on temporary leave may be determined by various factors such as applicable law, employer policies and short-term insurance policy and/or benefit terms. Leave ceases being considered temporary when the borrower does not intend to return to the current employer or does not have a commitment from the current employer to return to employment. A loan should not be denied specifically because a borrower is on temporary leave or short-term disability.

1.05.11.01 Documentation Requirements for Temporary Leave/Short Term Disability

Documentation must be provided from the current employer confirming the following:
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- Borrower’s statutory right to return to work (or the employer’s commitment to permit the borrower to return to work) and
- Borrower’s confirmed date of return, and
- Borrower’s post-leave employment and income and
- Written statement signed by the borrower confirming that the borrower will return to current employer and stating the confirmed date of return that has been agreed upon between the borrower and the employer.

In addition, if the borrower is returning to the current employer AFTER the first mortgage payment is due the following additional documentation is required:

- Documentation evidencing amount, duration and consistency of all temporary leave income sources being used to qualify the borrower (e.g., short-term disability benefits or insurance, sick leave benefits, temporarily reduced income from employer) that are being received during the temporary leave and
- All available liquid assets used to supplement the reduced income for the duration of the temporary leave must meet the requirements found below and be verified and
- Written rationale explaining the analysis used to determine the qualifying income.

1.05.11.02 Determining Qualifying Income for Temporary Leave/Short Term Disability

(1) Borrowers returning to their current employer PRIOR to the first mortgage payment due date:
Qualifying income from the borrower’s gross monthly income amount that will be received upon the borrower’s return to the current employer may be used.

(2) Borrowers returning to their current employer AFTER the first mortgage payment due date:
Qualifying income used must be the lesser of the qualifying income amount that will be received upon the borrower’s return to the current employer or the borrower’s gross monthly income being received for the duration of the temporary leave. In the event the income has been reduced or interrupted, available liquid assets may be used as a partial or complete income supplement up to the amount of the income reduction. Assets that are required for the transaction (e.g., down payment, Closing Costs, Financing Costs, Prepaids/Escrows and reserves) may not be considered as available assets in determining the supplemental income amount.
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Total qualifying income = lesser of (supplemental income + temporary leave income) or (qualifying income received after borrower’s return to work)

Supplemental income = available liquid reserves divided by the number of months from the first mortgage payment due date to the date the borrower will begin receiving his or her regular employment income, rounded up to the next whole number.

1.05.12 Income Types Not Addressed
Income types not specifically addressed in this guide will be evaluated on a case-by-case basis by underwriting management.

1.05.13 Unacceptable Sources of Income
The following types of income are unacceptable for qualifying purposes:

- Trailing Spouse Income
- Boarder Income
- Education Benefits
- Per Diem Income
- Gambling Income
- Temporary Income
- Temporary Leave Income
- Short-Term Disability Income
- Non-verifiable Income
- Unstable Income
- Projected Income
- Reverse Mortgage Income
- Income from Foreign Employers not included on US Federal Tax Returns
- Mortgage Credit Certificate Income: Mortgage credit certificates may be included in the file for the borrower’s tax benefit – but may not be included in qualifying income.

1.05.14 4506-T Requirements
A fully executed IRS Form 4506-T must be included for all income types included in qualification. For example, a borrower with a personal tax return and a business tax return must sign a separate completed 4506-T for each form type. The 4506-T must be completed specifically for each form and must be completed prior to the customer signing. Multiple form types cannot be requested on the same 4506-T.
Conventional Underwriting Guidelines

Section 1.05 Income Assessment

- Form 1040 for Personal Income including business schedule C
- Form 1065 for Partnership Income
- Form 1120 US Corporation Income
- Form 1120S S Corporation Income

1.05.15 IRS Tax Transcript Requirements

Transcripts may be ordered according to the income received by the borrower:

<table>
<thead>
<tr>
<th>Income Type</th>
<th>Transcript Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower is qualified based on W-2 income. Borrower has no rental income, alimony or other evidence taxes would be required to accurately assess income or liabilities.</td>
<td>NONE</td>
</tr>
<tr>
<td>1099 Income for Pension or Social Security Income</td>
<td>NONE</td>
</tr>
<tr>
<td>Self Employed Income (Schedule C, K-1, W-2 where borrower owns more than 25%)</td>
<td>Full IRS 1040 Transcripts</td>
</tr>
<tr>
<td>Rental Income</td>
<td>Full IRS 1040 Transcripts</td>
</tr>
<tr>
<td>Capital Gains</td>
<td></td>
</tr>
<tr>
<td>Dividend Income</td>
<td></td>
</tr>
</tbody>
</table>

If tax transcripts are obtained the borrower is not required to sign the tax returns.

Tax Transcript requirements can change based on the application date and whether an extension has been filed.

*Note that Tax Transcripts are not an adequate substitute for Tax Return Schedules and should only be used to support the validity of the actual Tax Returns. In instances in these guidelines where it is specified that Tax Returns are required, actual Tax Returns including all schedules should be provided.*

1.05.15.01 Documentation requirements for Self-Employed income when an extension has been filed:

Self Employed borrowers will need P&L and Balance Sheet if more than a calendar quarter has elapsed since date of most recent calendar or fiscal-year end tax return was filed by the borrower – with no exceptions.
Conventional Underwriting Guidelines

Section 1.05 Income Assessment

Additionally, if income used to qualify self-employed borrower exceeds a two-year average, an audited Profit and Loss Statement or signed quarterly tax returns obtained from the IRS are required. Additional requirements are determined by the application date.

Application Date between Jan 1st – June 14th:

- Most recent year(s) available tax transcripts for the number of years required
- Prior calendar year W-2s for a corporation
- Prior calendar year 1099s for commission income
- After April 17th, copy of filed extension for prior calendar year with any tax payment made, if applicable. Must also have IRS notification of “no record found”

Application Date between June 15th to October 14th:

- Most recent year(s) available tax transcripts for the number of years required
- Copy of the filed extension for the prior calendar year with any tax payments made
- Prior calendar year year-end profit and loss statement
- IRS notification of “no record found” for prior calendar year
- Prior calendar year W-2s for corporations
- Prior calendar year 1099s for commission income

Application Date between October 15th to November 14th:

- Most recent year(s) available tax transcripts for the number of years required
- Copy of the prior calendar year tax returns
- IRS notification of “no record found” for prior calendar year

Application Date after November 15th:

- Most recent year(s) available tax transcripts for the number of years required
- Copy of the prior calendar year tax returns
- Transcripts from the IRS to verify the prior calendar year tax returns (regardless of the type of income used to qualify)

1.05.15.02  Documentation requirements for Self-Employed income when tax returns have been filed

Application Date between Jan 1st – June 14th:
Conventional Underwriting Guidelines

Section 1.05 Income Assessment

- Most recent year(s) available tax transcripts for the number of years required by AUS
- Copy of the prior calendar year tax returns
- Must have IRS transcripts of prior calendar year tax returns if using income to qualify

Application date on and after June 15th:

- Must have IRS transcripts of prior calendar year tax returns

1.05.15.03 SSN Misuse for Tax Filing Purposes

IRS tax transcripts may not match loan documentation due a borrower’s SSN being used fraudulently by another individual for tax filing purposes.

If IRS tax transcripts cannot be obtained or do not agree with income documentation, FCM advises the following action steps:

- Obtain 6C Record of Account
- Obtain and execute a Social Security Consent form to validate the borrower’s SSN.
- If the borrower is a wage earner, order W-2s transcripts from the IRS to support the income documentation received. If there is 1099 income, order the 1099 transcripts.
- If the borrower is a non-wage earner, request prior year 1040s to compare against current income documentation received. This is used to see if the borrower’s current income is consistent with the prior year. If the borrower’s SSN misuse has occurred over multiple tax filing years, this action step will not work.
- The borrower should be advised that there is a discrepancy with their tax information and the IRS. Once the borrower has gone to the IRS documentation should be requested. The IRS or a tax advocate will issue a letter acknowledging the case and at that point the IRS will most likely explain to them they have been a victim of identity theft. This letter must be validated by the party which completed it. There is usually a contact phone number in the letter. The phone number should be reverse searched prior to calling to verify the number goes to the IRS or tax advocate.
- The IRS should confirm that revised returns are not being accepted for the borrower until the conclusion of the identity theft case. If the IRS is accepting the borrowers’ modified tax returns then a copy of the revised returns, stamped by the IRS, should be provided in addition to the information outlined above.

It should be noted that FCM must still have a reasonable and verifiable justification for all income calculations used to determine the final qualifying income. If valid documentation is
Conventional Underwriting Guidelines

Section 1.05 Income Assessment

not available and an income determination cannot be made the income may not be used to qualify the borrower.

1.05.16 Amended Tax Returns
For Borrowers who have recently amended their tax returns, the following will apply:

- If the borrower qualified based on the original return filed and/or the amendment was clerical in nature the income is acceptable on the amended tax returns.
  OR
- If the borrower would not have qualified based on the original return filed and the income increased such that the borrower will qualify based on amendment, the borrower must wait 6 months prior to loan application from the date of the amendment.
1.06 Asset Assessment
All assets entered in DU or LP must be verified regardless of their use as cash to close or to fulfill reserve requirements.

1.06.01 Checking and Savings Accounts and Certificates of Deposit
Checking, Savings, and Certificates of Deposit must be verified with one of the following:

- Verification of Deposit (VOD) showing current and average balance
- Most recent two months statements to include beginning and ending balances. If AUS is only requiring one-month statement it falls to the underwriter to determine the need for the second statement.
- Most recent quarterly statement, if received quarterly
- Online printouts covering 60 days must show all of the information on a normal bank statement as well as the http web address at the bottom or top of the page

In addition to cash to close and required reserves, bank statements will be reviewed for undisclosed debt, overdraft/nsf activity and large deposits. Any indication of undisclosed debt (ie. IRS Tax payments, child support/alimony) will require documentation and explanation of the payments made on the bank statement. Overdraft/NSF activity can be an indicator of financial mismanagement and credit risk; Overdrafts/NSF activity may require explanation and if severe, could warrant a decline. See the Large Deposit section for documentation requirements.

Bank Statements are required to contain, at a minimum, the following information:

- Account Number
- Account Holder Name
- Account Holder Address
- Beginning and Ending Balance
- All pages
- Blacked-out information is not acceptable
- Bank printouts must cover at least 60 days and must be signed and stamped by a Bank Representative.
Conventional Underwriting Guidelines

Section 1.06 Assets and Reserves

1.06.02 Stocks, Bonds, and Mutual Funds
Stocks, Bonds, and Mutual Funds must be verified with all the following:

- The most recent monthly or quarterly statement provided by the stockbroker or financial institution managing the portfolio to verify the value of stocks and bonds.
- 100% of the value of the account may be applied to reserves.
- If the assets are being used for down payment and closing costs and the available value of the account exceeds funds to close by 20%, proof of liquidation is not required.

1.06.03 Retirement Accounts (Employer Held)
Retirement funds through an employer must be verified with all the following:

- Copy of the most recent retirement account statement.
- Terms of withdrawal including the available amount of withdraw.
- 100% of the available amount may be applied to reserves for DU Files, 70% of the available amount may be applied to reserves for LP Files.
- If the assets are being used for down payment and closing costs and the available value of the account exceeds funds to close by 20%, proof of liquidation is not required.

Any outstanding loans on the retirement account must be subtracted from the principal balance before using them as an asset.

Non-vested funds are not eligible for down payment, closing costs or reserves.

1.06.04 Retirement Accounts (Privately Held)
Privately-held retirement funds must be verified with all the following:

- Copy of the most recent retirement account statement.
- 100% of the available amount may be applied to reserves for DU Files, 70% of the available amount may be applied to reserves for LP Files.
- If the assets are being used for down payment and closing costs and the available value of the account exceeds funds to close by 20%, proof of liquidation is not required.
1.06.05  Personal Gifts

1.06.05.01 Overview
A borrower of a mortgage loan secured by a principal residence or second home may use funds received as a personal gift from an acceptable donor. Gift funds may fund all or part of the down payment, closing costs, or financial reserves subject to the borrower contribution requirements listed below. Gifts are not allowed on an investment property.

A sample gift letter can be found by clicking the hyperlink. The source of the donor’s gift funds must be verifiable.

1.06.05.02 Eligible Donors
Eligible donors for Personal Gifts include the following:

- A family member as defined in the definition section at the end of this document.

The gift funds may not be provided, either directly or indirectly, by a person or entity with an interest in the transaction, such as a realtor, seller, or builder. Gifts from these entities are considered inducements to purchase and must be subtracted from the contract sales price.

1.06.05.03 Minimum Borrower Contribution Requirements

<table>
<thead>
<tr>
<th>80% or Less</th>
<th>1-4 Unit Principal Residence &amp; Second Homes</th>
</tr>
</thead>
<tbody>
<tr>
<td>80% or Greater</td>
<td>1 Unit Primary Residence</td>
</tr>
<tr>
<td>ANY</td>
<td>2-4 Unit PR and Second Homes</td>
</tr>
<tr>
<td></td>
<td>Investment Properties</td>
</tr>
<tr>
<td>80% or Less</td>
<td>1-4 Unit Principal Residence &amp; Second Homes</td>
</tr>
</tbody>
</table>
Conventional Underwriting Guidelines

Section 1.06 Assets and Reserves

1.06.05.04 Gift Letter
A gift letter with donor’s and borrower’s signature that specifically states the following information:

- The donor’s name, address, telephone number, and relationship to the borrower
- The exact dollar amount of the gift funds
- The address of the subject property
- No repayment is necessary
- The donor’s signature
- The statement: “Our signatures above indicate that we fully understand that it is a Federal Crime punishable by fine, imprisonment, or both to knowingly make any false statement concerning any of the above facts as applicable under the provision of Title 18, United States Code, Section 1012 and 1014.”

1.06.05.05 Donor Availability of Funds and Transfer of Gift Funds
Verification that sufficient funds to cover the gift are either in the donor’s account or have been transferred to the borrower’s account is required. 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, the lender must document that the donor gave the closing agent the gift funds in the form of a certified check, a cashier’s check, or other official check.

**LPA**: Freddie requires the following:

In all instances when the gift funds are used, the following must be provided:

- Evidence of transfer from the donor’s account in a financial institution to the Borrower’s account, or
- Evidence of transfer of the funds from the donor’s account in a financial institution to the settlement or closing agent.
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Section 1.06 Assets and Reserves

Funds transferred via a third-party money transfer application or service are acceptable only when the documentation included in the mortgage file evidences that the funds were transferred, using the application service, directly from the donor’s bank account to the Borrower’s bank account or to the settlement or closing agent.

1.06.06 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 on the HUD-1. Gifts of equity are limited to Primary Residences and Second Homes.

The acceptable donor and minimum borrower contribution requirements for gifts also apply to gifts of equity. Please see the aforementioned Gift Funds and Non-Arms Length/Identity of Interest sections for more information.

1.06.07 Donations from Entities

1.06.07.01 Overview

A borrower of a mortgage loan secured by a principal residence may use donated gift or grant funds from acceptable entities to fund all or part of the down payment, closing costs, or financial reserves subject to the minimum borrower contribution requirements below. Donated gifts and grants are not allowed on a second home or an investment property.

1.06.07.02 Eligible Donors

Acceptable entities include churches, municipalities, nonprofit organizations (excluding credit unions), and public agencies.

1.06.07.03 Minimum Borrower Contribution Requirements

<table>
<thead>
<tr>
<th>LTV, CLTV, or HCLTV Ratio</th>
<th>Minimum Borrower Contribution Requirement from Borrower’s Own Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>80% or Less</td>
<td>1-4 Unit Principal Residence &amp; Second Homes</td>
</tr>
<tr>
<td></td>
<td>A minimum borrower contribution from the borrower’s own funds is not required. All funds needed to complete the transaction can come from a gift.</td>
</tr>
<tr>
<td>80% or Greater</td>
<td>1 Unit Primary Residence</td>
</tr>
<tr>
<td></td>
<td>A minimum borrower contribution from the borrower’s own funds is not required. All funds needed to complete the transaction can come from a gift.</td>
</tr>
<tr>
<td></td>
<td>2-4 Unit PR and</td>
</tr>
<tr>
<td></td>
<td>5% Borrower Contribution from own funds.</td>
</tr>
</tbody>
</table>
Conventional Underwriting Guidelines

Section 1.06 Assets and Reserves

<table>
<thead>
<tr>
<th></th>
<th>Second Homes</th>
<th>Investment Properties</th>
<th>Gift funds not allowed.</th>
</tr>
</thead>
<tbody>
<tr>
<td>ANY</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The donated gift or grant must be documented with either a copy of the letter awarding the gift or grant to the borrower or a copy of the legal agreement that specifies the terms and conditions of the gift or grant. The document must include language indicating that repayment of the gift or grant is not expected, and how the funds will be transferred to the borrower, lender, or closing agent.

The transfer of gifts or grants must be documented with a copy of the donor’s canceled check, a copy of the settlement statement showing receipt of the check, or similar evidence. The documentation must be included in the individual mortgage file.

1.06.08 Employer Assistance

1.06.08.01 Overview

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.

A borrower of a mortgage loan secured by a principal residence 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 below. Employer assistance can also be used for financial reserves for all types of assistance with the exception of unsecured loans (which may only be used for the 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, including through an employer-affiliated credit union.

When employer assistance is extended as a secured second mortgage, the transaction may be structured as a Community Second or it must satisfy 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, the lender does not need to calculate an
Conventional Underwriting Guidelines

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equivalent payment for consideration as part of the borrower’s monthly debt. If regular payments are required for the secured second mortgage, the payments must be included in the calculation of the debt-to-income ratio.

1.06.08.02 Minimum Borrower Contribution Requirements

<table>
<thead>
<tr>
<th>LTV, CLTV, or HCLTV Ratio</th>
<th>Minimum Borrower Contribution Requirement from Borrower’s Own Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>80% or Less</td>
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<tr>
<td></td>
<td>A minimum borrower contribution from the borrower’s own funds is not required. All funds needed to complete the transaction can come from a gift.</td>
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<td>80% or Greater</td>
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<td></td>
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<td></td>
<td>2-4 Unit PR and Second Homes</td>
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<td>5% Borrower Contribution from own funds.</td>
</tr>
<tr>
<td>ANY</td>
<td>Investment Properties</td>
</tr>
<tr>
<td></td>
<td>Gift funds not allowed.</td>
</tr>
</tbody>
</table>

1.06.08.03 Documentation Requirements

All the following must be documented:

- that 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 and must disclose 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).
- that the borrower received the employer assistance funds directly from the employer (or through the employer-affiliated credit union).

1.06.09 Proceeds from the Sale of Property

Proceeds from the sale of other property may be used to fulfill cash to close requirements if the sale occurs on or before the closing of our transaction.
The borrower must provide verification and documentation of the actual sale and the net sale proceeds by obtaining a fully executed Closing Disclosure, it must be signed by the borrower/owner even if it was not signed at the time of closing. Dating at the time of submission to FCM is acceptable as certification the document is accurate.

**1.06.10  Borrowed Funds**

Borrowed funds may only be used to fulfill down payment, closing costs, and reserve requirements if satisfactory evidence is provided that the funds are fully secured by investment accounts or real property (i.e. cars, trucks, boats) and the borrower can qualify with the repayment. This payment must be included in the borrower's debt ratio. When the originating bank or institution is the provider of the secured borrowed funds additional underwriting consideration and evaluation of the asset secured the funds is required to ensure the validity of the loan.

If a secured loan does not require monthly payments, the underwriter must 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 or her financial reserves, the lender must reduce the value of the asset by the amount of proceeds and related fees for the secured loan.

**1.06.10.01  Documentation Requirements**

The following must be documented:

- The terms of the secured loan,
- Evidence that the party providing the secured loan is not a party to the sale, and
- Evidence that the funds have been transferred to the borrower.

**1.06.11  Earnest Money Deposit**

The deposit on the sales contract (earnest money) for the purchase of the security property is an acceptable source of funds for both the down payment and the closing costs.

If the deposit is being used as part of the borrower's minimum contribution requirement, the borrower must provide verification that the funds are from an acceptable source.

- A VOD must indicate that the average balance for the past two months was large enough to support the amount of the deposit.
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 canceled 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.

If it cannot be determined that these funds were withdrawn from the borrower’s account, additional verification of the source and evidence that the funds have actually changed hands from the borrower to the seller, the realtor, the escrow agent, or the settlement attorney should be provided. Large earnest money deposits and deposits that exceed the amount customary for the area should be closely evaluated.

**1.06.11.01 Documentation Requirements**

Receipt of the deposit must be verified by either a copy of the borrower’s canceled check or a written statement from the holder of the deposit.

**1.06.12 Credits for Prepaid Fees**

Fees pre-paid by the applicant during the mortgage application process may be credited to the borrower on the HUD at closing. Verification of these funds must be obtained:

- **Check**: Copy of Cancelled Check/Bank Statement showing it cleared
- **Credit Card/Unsecured Line of Credit**: Verify that the borrower has sufficient funds to pay the amount of the fees charged OR include the payment for the amount charged in in the monthly DTI (credit supplement and/or new credit card statement required to show updated balance and payment)

**1.06.13 Business Assets**

The borrower must be listed as an account owner on the business account.

When business assets are used for down payment, closing costs, financing costs, prepaids/escrows or reserves, the assets must be verified in accordance with the standard documentation requirements outlined in this section and must be related to the business that the borrower owns that is documented in the mortgage file.

Because the borrower’s withdrawal of assets from the business, the business may experience a negative impact on its ability to continue operating. The impact of withdrawal must be considered in the analysis of the borrower’s self-employed income. The impact of the withdrawal must not have a detrimental effect on the business. In order to determine the effect on the business the
business tax returns should be reviewed, and a cash flow analysis should be developed using the following documentation:

- 6 Months Business Bank Statements – cash to close must have been maintained through the 6 months being reviewed. There can be no NSF or Overdrafts and sourcing of Large Deposits may be requested.
- Business Tax Returns, P&L and Balance Sheet
- Underwriter reserves the right to increase bank statement request to 12 months if cash analysis cannot be developed within 6-month period.

1.06.14 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. Extra care and diligence should be taken documenting assets of this kind when they also represent a major percentage of the borrower’s overall financial contribution.

1.06.14.01 Documentation Requirements
The following must be documented:

- The borrower’s ownership of the asset.
- The value of the asset, as determined by an independent and reputable source.
- The transfer of ownership of the asset, as documented by either a bill of sale or a statement from the purchaser.
- The borrower’s receipt of the sale proceeds from documents such as deposit slips, bank statements, or copies of the purchaser’s canceled check.

1.06.15 Trade Equity

1.06.15.01 Overview
Trade equity is an acceptable source of funds to supplement the borrower’s minimum borrower contribution provided the following requirements are met:

- The seller’s equity contribution for the traded property must be a true-value consideration supported by a current appraisal.
- The borrower must make the minimum required contribution from his or her own funds unless:
  - the LTV or CLTV ratio is less than or equal to 80%; or
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The borrower is purchasing a one-unit principal residence and meets the requirements to use gifts, donated grant funds, or funds received from an employer to pay for some or all of the borrower’s minimum contribution.

These requirements apply to all transactions that involve property trades, including those that are evidenced by two separate contracts that have the buyer and the seller on one contract reversing roles on the second contract.

1.06.15.02 Calculating the Equity Contribution

The equity contribution is determined by subtracting the outstanding mortgage balance of the property being traded, plus any transfer costs, from the lesser of either the property’s appraised value or the trade-in value agreed to by both parties.

1.06.15.03 Documentation Requirements

For real property, the transfer deed must be recorded.

In addition, the following documentation must also be obtained:

- A search of the land records to verify the ownership of the property and to determine whether there are any existing liens on the property.
- Proof of title transfer and satisfaction of any existing mortgage liens for which the borrower was liable.

1.06.16 Rent Credit for Option to Purchase

1.06.16.01 Overview

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 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 using a Single-Family Comparable Rent Schedule (Form 1007).

1.06.16.02 Documentation Requirements

The lender must obtain the following documentation:
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- 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 the lease.
- Copies of the borrower’s canceled checks or money order receipts for the last 12 months evidencing the rental payments.
- Market rent as determined by the subject property appraisal.

1.06.17 Cash Value of Life Insurance

1.06.17.01 Overview
Net proceeds from a loan against the 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.

The lender must assess repayment or additional obligation considerations to determine the impact on borrower 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 factored into the total debt-to-income ratio or subtracted from the borrower’s financial reserves.

1.06.17.02 Documentation Requirements
To document borrower receipt of funds from the insurance company, either a copy of the check from the insurer or copy of the payout statement issued by the insurer must be obtained.

1.06.18 Contributions by Interested Parties (IPCs)
Sellers or other interested third parties such as real estate agents, builders, or developers may contribute a percentage of the sales price towards actual closing costs, prepaid expenses, discount points and other financing concessions allowable by Fannie Mae and Freddie Mac.

<table>
<thead>
<tr>
<th>Occupancy Type</th>
<th>LTV/CLTV Ratio</th>
<th>Maximum IPC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal residence or second home</td>
<td>Greater than 90%</td>
<td>3%</td>
</tr>
<tr>
<td></td>
<td>75.01% - 90%</td>
<td>6%</td>
</tr>
<tr>
<td></td>
<td>75% or less</td>
<td>9%</td>
</tr>
<tr>
<td>Investment property</td>
<td>All CLTV ratios</td>
<td>2%</td>
</tr>
</tbody>
</table>
Contributions from these parties in-excess of these percentages of the sales price are treated as inducements to purchase and must be subtracted from the sales price.

Items typically paid by the seller are not considered contributions. Examples of these items are; real estate commissions, pest inspections, and fees paid to release a deed of trust.

### 1.06.19 Ineligible Funds

All the following are unacceptable source of funds for down payment, closing costs, or reserves:

- Foreign Assets
- Unsecured Borrowed Funds
- Seller Funded Down Payment Assistance
- Sweat Equity
- Undocumented funds
- Cash on hand
- Illegally obtained funds
- Funds held in “Bitcoin” or any other form of electronic currency
- Any funds derived from an illegal income source

### 1.06.19.01 Acceptable Reserves

In regard to satisfying minimum reserve requirements, the below asset types are acceptable:

- Checking or savings accounts;
- Investments in stocks, bonds, mutual funds, certificates of deposit, money market funds, and trust accounts;
- The amount vested in a retirement savings account;
- The cash value of a vested life insurance policy.

Note: Certain assets must be “discounted” when used for reserves. Refer to specific asset type section below for additional information.

### 1.06.19.02 Unacceptable Reserves

Specifically, regarding satisfying minimum reserve requirements, the below asset types are unacceptable:

- Funds that have not been vested;
- Funds that cannot be withdrawn under circumstances other than the account owner’s retirement, employment termination, or death;
Conventional Underwriting Guidelines

Section 1.06 Assets and Reserves

- Stock held in an unlisted corporation;
- Stock options and non-vested restricted stock;
- Personal unsecured loans;
- Interested party contributions (IPCs)
- Cash proceeds from a cash-out refinance transaction

- Funds held in “Bitcoin” or any other form of electronic currency
- Any funds derived from an illegal income source

1.06.20 Large Deposits

A large deposit is defined as a single non-payroll deposit or VOD Variance that represents amounts more than 50% of the borrower’s gross month income.

- Verification is limited to Purchase Transactions.
- If verification of a large deposit is not obtained, the available funds may be reduced by the unverified deposit.
- Combined Deposits – If only a portion of a large deposit can be verified the remaining unsourced deposit is then subject to the large deposit definition. If the remaining portion is less than 50% of the gross monthly income it does not need to be sourced.
- The underwriter may ask for verification of any deposit if there is any indication/suspicion that the funds are borrowed or are from an ineligible source.

Self-employed borrower gross income is the monthly qualifying income used for the self-employed borrower.

VODs with variances over the acceptable program limits stated above cannot be used and full bank statements must be provided.

Although Bitcoin (and other electronic currencies) are an ineligible source of funds – a deposit from an electronic currency account (liquidation/conversion) into a US currency/bank is acceptable and should follow Large Deposit documentation requirements.
Conventional Underwriting Guidelines

Section 1.06 Assets and Reserves

1.06.21 Reserve Requirements

1.06.21.01 DU Reserve Requirements
Reserves are calculated by DU.

For manual calculations (UPB: Unpaid Principal Balance):

- 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 (or omitted in DU on the online loan application).

1.06.21.02 LP Reserve Requirements
Reserves are calculated by LP.
1.07 Credit

1.07.01 Credit Report Requirements
A credit report submitted with a loan application must contain all credit information available in the accessed repositories. Additionally, for each borrower responsible for the debt, the report must contain all the information available in the credit repositories pertaining to

- credit
- residence history, and
- public records information

Note: Reporting is required for each borrower.

The accepted traditional credit report is the three-repository merged credit report, also known as a “tri-merged” credit report (TRMCR). Non-traditional credit is not allowed (may be possible with some government subsidized programs). Foreign credit is not allowed. If any of the bureaus are frozen, they must be unfrozen to pull credit and stay unfrozen until the funding of the loan.

A corrected credit report must supplement the TRMCR if the report does not verify legal actions such as bankruptcies, judgments, lawsuits, foreclosures, and tax liens.

For any open debt listed on the loan application, but not referenced on the TRMCR, credit information must be developed separately.

Incorrect Social Security Numbers and dates of birth will require a new credit report to be pulled. Major address inconsistencies and name extensions (Jr., III, etc.) must match throughout the file and may require a re-pulled credit report. Common shortening of names does not require a re-pulled credit report (e.g. Matt for Matthew).

1.07.02 Nontraditional Credit
Non-traditional credit in lieu of a traditional credit report is not acceptable on any conventional loan.

1.07.03 Age of Credit Documents
Credit documents, including income docs, asset docs, etc. cannot be older than 120 days from the Note date.
Conventional Underwriting Guidelines

Section 1.07 Credit

Credit reports cannot be older than 120 days from the Note date.

1.07.04 Credit Score Requirements

- All borrowers must have at least one valid credit score unless, on a loan with two borrowers, they can meet all the conditions below and a DU AUS Approval is obtained.
- When three scores exist, the middle of the three will be used as the qualifying credit score.
- When only two scores exist, the lower of the two will be used as the qualifying credit score.

Note that certain products with Mortgage Insurance may have specific tradeline requirements. See specific MI investor guidelines for further information.

1.07.04.01 Co-Borrowers with no score and AUS Approval (DU- AUS Approval)

If an AUS approval is obtained for a loan where one borrower has a credit score and the co-borrower doesn’t have a score, the loan is eligible if it meets all the following requirements:

- The property is a 1-unit primary residence and all borrowers will occupy the property
- The transaction is a Purchase or Limited-Cash-Out Refinance
- The loan amount meets the general loan limits (High Balance loans are ineligible)
- The borrower with a credit score is contributing 50% or more of the qualifying income.
- Reserves are to be determined by DU.

1.07.05 Inquiries

All credit reports used for underwriting must include all inquiries for a minimum of the most recent 90 days.

Any inquiry that is found within the most recent 90 days must be addressed with a specific explanation letter from the borrower; inquiries outside the 90-day timeframe do not need to be addressed even if reflected on the credit report.

The explanation letter must address the individual inquiry, the date, the reason for the inquiry, and the result. If a new debt was opened, the borrower must provide documentation to verify the payment and balance. The debt must then be added to the 1003, AUS and included in the DTI.

Inquires resulting from the subject mortgage application, for primary or secondary financing, do not require explanation. Should the customer have multiple applications for multiple properties an explanation will be required.
Conventional Underwriting Guidelines

Section 1.07 Credit

**NOTE:** FCM recommends the [specific inquiry letter](#) located on the FCM Knowledge Center be used to satisfy any credit inquiry explanations.

**1.07.06 Maximum Debt Ratio**
The maximum debt-to-income (DTI) ratio is evaluated by the AUS system.

**1.07.07 Housing History**
All loans must contain a 24-month history of residence.

**1.07.07.01 Purchases:**
- Payment history on all mortgage/housing trade lines will be assessed by AUS. For mortgages not reporting on the credit report, verification must be received and must confirm a 0x60 payment history.
- As of application date, all mortgages on the credit report, subject property and other REO, must be current, which means that no more than 45 days may have elapsed since the last paid installment date.

**1.07.07.02 Rate/Term Refinances:**
- Payment history on all mortgage/housing trade lines will be assessed by AUS. For mortgages not reporting on the credit report, verification must be received and must confirm a 0x60 payment history.
- As of application date, all mortgages on the credit report, subject property and other REO, must be current, which means that no more than 45 days may have elapsed since the last paid installment date.
- Refinance transactions where the existing mortgage being refinanced was modified are eligible with no additional restrictions.
- **Refinance must provide a net tangible benefit to the borrower in the form of at least one of the following:**
  - a lower P&I payment;
  - a lower interest rate;
  - a shorter amortization term OR
  - movement to a more stable product. Ex- from an ARM to FRM
Conventional Underwriting Guidelines

Section 1.07 Credit

1.07.07.03 Cash Out Refinances:

- Payment history on all mortgage/housing trade lines will be assessed by AUS. For mortgages not reporting on the credit report, verification must be received and must confirm a 0x60 payment history.
- As of application date, all mortgages on the credit report, subject property and other REO, must be current, which means that no more than 45 days may have elapsed since the last paid installment date.
- The borrower must have owned the property for at least 6 months.
- Refinance transactions where the existing mortgage being refinanced was modified are eligible with no additional restrictions.
- If listed, the property must be taken off the market by the loan disbursement date.
1.08 Liability Assessment

1.08.01 Open Charge / Revolving Accounts
If the credit report shows a revolving account with an outstanding balance but no specific minimum monthly payment, the payment must be calculated as the greater of:

- 5% of the outstanding balance, or
- $10

Note: If the actual monthly payment is documented from the creditor or a copy of the current statement reflecting the monthly payment is obtained, that amount may be used for qualifying purposes.

A borrower may pay a revolving account to a zero balance and exclude the payment from DTI. The account does not have to be closed.

PAID PRIOR TO CLOSING:
Accounts paid to zero prior to closing will require a credit supplement prior to closing in-order to verify a zero balance.

PAID AT CLOSING:
Accounts paid with proceeds from the closing will require the payoffs to be listed on the HUD. The payoff amounts may come from the borrower’s most recent monthly statement or an online printout/payoff dated within 10 days of closing. A credit supplement verifying a zero balance will not be required.

1.08.02 30-Day Charge Accounts

DU: 30-day accounts, or accounts where the balance is required to be paid off in full each month, do not require a monthly payment to be included in the debt-to-income ratio.

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, borrower funds to cover the account balance must be verified. The verified funds must be in addition to any funds required for closing costs and reserves.
If the borrower paid off the account balance prior to closing, proof may be provided of payoff in lieu of verifying funds to cover the account balance.

**LP:** regardless of the balance. In the absence of a monthly payment on the credit report, and if there is no documentation in the Mortgage file indicating the monthly payment amount, 5% of the outstanding balance will be considered to be the required monthly payment amount. Monthly payments on open-end accounts (accounts which require the balance to be paid in full monthly) are not required to be included in the monthly debt payment if the Borrower has sufficient verified funds to pay off the outstanding account balance. The funds must be in addition to any funds used to qualify the Borrower for the Mortgage transaction.

1.08.03 **HELOC Accounts**
If the actual payment cannot be determined on a Home Equity Line of Credit, a payment may be calculated using the greatest of 5% of the outstanding balance or $10.00.

1.08.04 **Lease Payments**
Lease payments must be included in the borrower’s recurring monthly debt obligations, regardless of the number of months remaining on the lease.

1.08.05 **Alimony, Child Support or Separate Maintenance**
When the borrower is required to pay alimony, child support, or maintenance payments under a divorce decree, separation agreement, or any other written legal agreement, and those payments must continue to be made for more than ten months, the payments must be considered as part of the borrower’s recurring monthly debt obligations (Alimony: may be treated as a liability OR a reduction in income for DU, but on LP the borrower’s income must be reduced by the alimony amount). However, voluntary payments do not need to be taken into consideration.

**Note:** For loan casefiles underwritten through DU, when using the option of reducing the borrower’s monthly qualifying income by the monthly alimony payment, under *Income Type*, the underwriter must enter the amount of the alimony obligation as a negative amount. If the borrower also receives alimony income, this amount should be combined with the amount of the alimony payment and entered as a net amount.

One of the following is required to document the payment and the number of remaining payments:
Conventional Underwriting Guidelines

Section 1.08 Liability Assessment

- A copy of a written legal agreement or court decree describing the payment terms for the obligation, the amount of the award and the period of time over which it will be received
- Any applicable state law that mandates the obligation document, which must specify the conditions under which payments must be made

Alimony, Child Support, or Separate Maintenance debts with less than 10 remaining payments may be excluded from the borrower’s debt ratio under certain circumstances. These payments may still be required by the underwriter if they deem the existing payment could have an adverse effect on the borrower’s repayment ability.

Generally underwriting will require the borrower have sufficient funds in reserves to pay off the debt in full. Note that it is not a requirement to pay off this debt but the existence of reserves adds a level of assurance that the borrower’s repayment ability would not be hindered by the existing debt.

1.08.06 Debts Paid by Others/Contingent Liabilities

Non-Mortgage Debt
If documentation is obtained that a non-mortgage debt has been satisfactorily paid by another party for the past 12 months (cancelled checks, bank statements with drafts), then the debt can be excluded from the DTI. The paying party does not have to be listed as a borrower on the obligation nor is it required that the liability be a joint loan or co-signed/guaranteed obligation.

Mortgage Debt
When a borrower is obligated on a mortgage debt – but is not making the payments, the payment may be excluded only if the payor is obligated on the debt (evidenced by the note) and 12 cancelled checks are provided showing the borrower is not paying the debt and no delinquencies have occurred in the 12-month payment history. The payor of the account cannot be an interested party to the subject transaction.

COURT ORDERED/ASSIGNED DEBT

If joint obligations are listed in the final divorce decree and/or separation agreement as being the responsibility of the ex-spouse then they can be omitted from the qualifying DTI calculation. The divorce decree or separation agreement must be finalized by the court and recorded.

Borrower is still liable for any adverse payment history or outstanding debt associated with these joint accounts that are dated prior to the divorce or separation agreement.
Conventional Underwriting Guidelines

Section 1.08 Liability Assessment

1.08.07 Loans Secured by Liquid Assets
To exclude payment from the DTI calculation on a loan secured by liquid assets (i.e., 401k/IRA accounts, CDs, stocks, bonds, marketable securities, etc.), the value or balance of the account must be sufficient to repay the loan obligation.

If the balance in the account is not sufficient, the loan is not fully secured. In the case where the account value is less than the loan balance, the transaction requires the payment to be included DTI calculation.

1.08.08 Business Debt
A borrower’s business tax returns should be analyzed for debts in the business name that may be personally guaranteed or paid by the borrower out of personal funds (Notes Payable, Interest Payments etc listed on tax returns/borrower’s business credit report). When a borrower personally guarantees business debt the debt must be included in the borrower’s personal debt obligations unless the following is documented:

- Business is stable and profitable as evidenced by the tax returns.
- Business/Borrower can prove that the business funds have paid the last 12 months payments without borrower’s personal funds.

FCM will require a signed affidavit from the borrower certifying the existence of personally guaranteed business debt. If notes/interest paid is listed on the business income documentation the underwriter reserves the right to request evidence the business debt is not personally guaranteed.

1.08.08.01 Personal Debt Paid by a Business
When a self-employed borrower claims that a monthly obligation that appears on his or her personal credit report is being paid by the borrower’s business, the lender must confirm that it verified that the obligation was actually paid out of company funds and that this was considered in its 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 (such as 12 months of canceled company checks), and
Conventional Underwriting Guidelines

Section 1.08 Liability Assessment

- the lender’s cash flow analysis of the business took payment of the obligation into consideration.

If there is a delinquency, acceptable payment history cannot be evidenced or the lender’s cash flow cannot support payment of the personal debt then it must be included in borrower’s DTI.

1.08.09 Financed Properties

FCM limits the number of financed mortgages depending on the occupancy type of the subject property. If the borrower is purchasing or refinanced a Primary Residence, there is no limit to the number of properties that may be financed. If the subject property is a Second Home or Investment Property the financed properties limit is 10. Once the borrower reaches a certain number of financed properties, and the subject property is a second home or investment property, there are specific requirements that must be met:

<table>
<thead>
<tr>
<th></th>
<th>DU</th>
<th>LP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financed Properties</td>
<td>7-10</td>
<td>6-10</td>
</tr>
<tr>
<td>Credit Score Required</td>
<td>720</td>
<td>720</td>
</tr>
</tbody>
</table>

The financed property limit applies to:

- one- to four-unit residential properties where the borrower is personally obligated on the mortgage(s) the total number of properties financed, not to the number of mortgages on the property
- the borrower’s principal residence if it is financed
- 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 on 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 (residential or commercial)
- ownership of a manufactured home on a leasehold estate not titled as real property (chattel lien on the home).
Conventional Underwriting Guidelines

Section 1.08 Liability Assessment

1.08.09.01 Multiple FCM Serviced Loans
FCM does not limit the number of loans a borrower may have serviced in FCM’s portfolio; however, additional management approval will be required if the borrower will have 4 or more loans serviced by FCM.

Cash-Out transactions where the borrower has 4 or more FCM serviced loans will require VP approval.

1.08.10 Installment Debt
All installment debts not secured by a financial asset with 10 or more remaining payments must be included in the borrower’s debt ratios unless otherwise excluded for another satisfactory reason.

Installment debts with less than 10 remaining payments may be excluded from the borrower’s debt ratio under certain circumstances. These payments may still be required by the underwriter if they deem the existing payment could have an adverse effect on the borrower’s repayment ability.

Generally underwriting will require the borrower have sufficient funds in reserves to pay off the debt in full. Note that it is not a requirement to pay off this debt but the existence of reserves adds a level of assurance that the borrower’s repayment ability would not be hindered by the existing debt.

Installment debt which does not list a payment on the credit report must have verification of the actual payment along with the term of the loan. Using percentages of outstanding balances to determine an estimated payment is not acceptable.

1.08.11 IRS Installment Agreements/Payment Arrangements
Borrowers with approved IRS installment agreements are eligible for financing. The installment agreement must be in writing and have a determined payment amount included in the borrower’s qualifying DTI. The following requirements must be met:

- There is no indication of a Notice of Federal Tax Lien has been filed against the borrower in the county which the subject property is located.

- The following documentation must be obtained:
  - An approved IRS installment agreement with terms of repayment, including the monthly payment amount and total amount due; and
Conventional Underwriting Guidelines

Section 1.08 Liability Assessment

- Evidence the borrower is current on the payments associated with the tax installment plan. Acceptable evidence includes the most recent payment reminder from the IRS, reflecting the last payment amount and date and the next payment amount owed and due date. At least one payment must have been made prior to closing.

1.08.12 Deferred Installment Debt
Deferred installment debts must be included as part of the borrower’s recurring monthly debt obligations. If the borrower’s credit report does not indicate the monthly amount that will be payable at the end of the deferment period, the borrower must submit copies of the payment letters or forbearance agreements so that a monthly payment amount can be determined and used in calculating the borrower’s total monthly obligations.

1.08.13 Student Loans DU Transactions
If a monthly student loan payment is provided on the credit report, the lender may use that amount for qualifying purposes. If the credit report does not reflect the correct monthly payment, the lender may use the monthly payment that is on the student loan documentation (the most recent student loan statement) to qualify the borrower. Income based repayment plan payments are acceptable.

For loans where payments reflect as $0.00 on the credit report, the following applies:

**Income Based Repayment Plan:**
- the lender may obtain student loan documentation to verify the actual monthly payment is $0. The lender may then qualify the borrower with a $0 payment.

**Deferred loans or loans in Forbearance:**
- 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.

1.08.14 Student Loans LP Transactions:
STUDENT LOANS IN REPAYMENT, DEFERMENT OR FOREBEARANCE

- If the monthly payment amount reported on the credit report is greater than zero, use the monthly payment amount reported on the credit report or other documentation in the file, or
Conventional Underwriting Guidelines

Section 1.08 Liability Assessment

- If the monthly payment amount reported on the credit report is zero, use .5% of the outstanding loan balance, as reported on the credit report.

STUDENT LOAN FORGIVENESS, CANCELLATION, DISCHARGE AND EMPLOYMENT-CONTINGENT REPAYMENT PROGRAMS

The student loan payment may be excluded from the monthly debt payment-to-income ratio provided the Mortgage file contains documentation that indicates the following:

- The student loan has 10 or less monthly payments remaining until the full balance of the student loan is forgiven, canceled, discharged or in the case of an employment-contingent repayment program, paid, or

- The monthly payment on a student loan is deferred or is in forbearance and the full balance of the student loan will be forgiven, canceled, discharged or in the case of an employment-contingent repayment program, paid, at the end of the deferment or forbearance period AND

- The borrower is eligible or approved for the student loan forgiveness, cancellation, discharge or employment-contingent repayment program, as applicable. Evidence of the eligibility or approval must come from the student loan program or the employer, as applicable.

1.08.15 “Paying Down” Accounts and “Paying Off” Accounts

Paying down debt for the purpose of qualifying for the loan is not acceptable.

Paying off debt at or prior to closing, either installment or revolving, is acceptable if:

- Funds used to pay off the debt are documented, sourced, and received from either the borrower’s own funds or other acceptable party.

1.08.16 Disputed Accounts

When the AUS issues a message stating that it has identified a disputed trade line and that trade line was not included in the credit risk assessment, the accuracy of disputed trade lines reported on the borrower’s credit report must be confirmed. If it is determined that the disputed trade line information is accurate, it must be ensured that the disputed trade lines are considered in the credit risk assessment by obtaining a new credit report with the trade line no longer reported as disputed and resubmitting the loan casefile to the AUS.
Conventional Underwriting Guidelines

Section 1.08 Liability Assessment

If the AUS does not issue the disputed trade line message, it is not required to

- further investigate the disputed trade line on the credit report, or
- obtain an updated credit report (with the undisputed trade line)

However, it is required to ensure that the payment for the trade line, if any, is included in the total expense ratio if the account does belong to the borrower.

1.08.17 Past Due Accounts
Delinquencies on consumer credit accounts are evaluated by the AUS system. The underwriter must still take these delinquencies into consideration when evaluating the entire file as a whole.

Note that Collection accounts and Past Due accounts are two separate classifications of debt. A collection account, by definition, is always past due and follows specific guidance found in the Collection/Charge-offs section below instead of the Past Due Account section.

1.08.18 Collections/Charge-offs
DU FILES: For one-unit, principal residence properties borrowers are not required to pay off outstanding collections or non-mortgage charge-offs – regardless of amount.

2-4-unit O/Occupied and 2nd homes collections and non-mortgage charge-offs totaling more than $5000 must be paid prior to or at closing.

For investment properties, individual collection and non-mortgage charge-off accounts equal to or greater than $250 and accounts that total more than $1000 in aggregate must be paid in full prior to or at closing.

Federal Debt as Collections: Federal debts, government student loans for example, must be paid off or brought current and payment added to liabilities in-order-to qualify for loan.

LP FILES: AUS will determine required collection payoff requirements for all occupancy/property types.

1.08.19 Judgments/Liens
Open judgments, garnishments, 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 also be maintained in the permanent loan file.
Payment arrangements, payment history, and/or subordination of the judgment or lien will not satisfy this requirement. All must be paid in full at or prior to closing with no exceptions.

### 1.08.20 Significant Derogatory Events

<table>
<thead>
<tr>
<th>Derogatory Event</th>
<th>Standard Waiting Period</th>
<th>Waiting Period with Extenuating Circumstances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bankruptcy – Chapter 7 or 11</td>
<td>4 years</td>
<td>2 years</td>
</tr>
<tr>
<td>Bankruptcy – Chapter 13</td>
<td>• 2 years from discharge</td>
<td>• 2 years from discharge</td>
</tr>
<tr>
<td></td>
<td>• 4 years from dismissal</td>
<td>• 2 years from dismissal</td>
</tr>
<tr>
<td>Multiple Bankruptcy Filings</td>
<td>5 years if more than one filing within the past 7 years</td>
<td>3 years from most recent discharge or dismissal date</td>
</tr>
<tr>
<td>Foreclosure</td>
<td>7 years</td>
<td>3 years</td>
</tr>
<tr>
<td></td>
<td>Additional requirements 3-7 years:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Max 90% LTV Cap</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Purchase of Principal Residence only</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• LCOR for all occupancy types per current guidelines</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• If a property is included in a bankruptcy and borrower submits documentation to show inclusion of mortgage in bankruptcy, bankruptcy waiting periods may be applied.</td>
<td></td>
</tr>
<tr>
<td>Deed-in-Lieu of Foreclosure, Preforeclosure Sale (Short Sale), or Charge off of Mortgage Account</td>
<td>4 years</td>
<td>2 years</td>
</tr>
</tbody>
</table>

If a property is included in a bankruptcy (not re-affirmed) and borrower submits documentation to show inclusion of mortgage in bankruptcy, bankruptcy waiting periods may be applied.

Refinances of the subject property included in bankruptcy are eligible if they were not reaffirmed in bankruptcy if proof of payment history and payoff can be obtained.

**NOTE:** For borrowers with previous foreclosures, the purchase of second homes or investment properties and cash-out refinances (any occupancy) are not permitted until a seven-year waiting period has elapsed.

Please see Exceptions for [Extenuating Circumstances](#), preapproval from underwriting must be obtained in order to use waiting periods with extenuating circumstances.

**Measuring the waiting period:**
Conventional Underwriting Guidelines

Section 1.08 Liability Assessment

The waiting period commences on the discharge/dismissal/date of deed/HUD date. The waiting period ends on either the Credit Report Date or the disbursement date of the new loan. This is determined by AUS findings. AUS will either give a feedback message measuring from the credit report date or instruct the lender to determine the eligibility using the disbursement date of the new loan.

1.08.21 Consumer Credit Counseling (CCC)
Borrowers who have experienced credit or financial management problems in the past may have elected to participate in consumer counseling sessions to learn how to correct or avoid such problems in the future. Whether borrowers have or have not completed participation in the sessions before closing on the mortgage transaction is not relevant since it is the borrower’s credit history that is of primary importance.

1.08.22 Modifications
If the subject property is being refinanced and the mortgage being paid off was modified/restructured, please refer to sections Rate/Term Refinance and Cash Out Refinance and follow standard guidelines for the transaction type, additional restrictions do not apply.

1.08.23 Authorized User Accounts
Credit report tradelines designated as authorized user tradelines are automatically taken into consideration in the AUS findings. However, the underwriter is still required to review credit report tradelines which the applicant has been designated as an authorized user in-order-to ensure the tradelines are an accurate reflection of the borrower’s credit history. If the underwriter believes the authorized user tradelines are not an accurate reflection of the borrower’s credit history, the underwriter should evaluate the borrower’s credit history without the benefit of these tradelines and use prudent underwriting judgment when making its final underwriting decision. In-order-to assist the underwriter in its review of authorized user tradelines, DU issues a message providing the name of the creditor and account number for each authorized user tradeline identified.

When ensuring tradelines are an accurate reflection of the borrower’s credit history, as a general rule, if the borrower has several authorized user accounts but only has a few accounts of his/her own, the following should be established:

- The relationship of the borrower to the owner of the account,
- If the borrower uses the account, and
- If the borrower makes the payments on the account.
If the authorized user tradelines belongs to another borrower on the mortgage loan, no additional investigation is needed. On the other hand, if the borrower has several tradelines in good standing and only a minor number of authorized user accounts, the underwriter could make the determination 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.

The underwriter is not required to review an authorized user tradeline that belongs to the borrower’s spouse when the spouse is not on the mortgage transaction.
1.09 Property

1.09.01 Geographical Restrictions
Most conventional products at First Community Mortgage are only restricted by the most recent standard lending footprint.

<table>
<thead>
<tr>
<th>STATE</th>
<th>GUIDANCE</th>
</tr>
</thead>
</table>
| Illinois | - The following guidelines apply for primary residence and second homes:  
  - Fully amortizing ARM loans will be acceptable ONLY if the following credit overlays are applied:  
    - For all AUS processed fully amortizing ARMs, the greater of the product qualifying rate or the fully amortizing, fully indexed rate must be input into DU and LP as the note rate for qualifying purposes.  
    - For traditionally underwritten fully amortizing ARMs, the borrower must be qualified at the greater of the product qualifying rate or the fully amortizing, fully indexed rate. |
| Maryland | - The following guidelines apply for primary residence and second homes:  
  - Fully amortizing ARM loans will be acceptable ONLY if the following credit overlays are applied:  
    - For all AUS processed fully amortizing ARMs, the greater of the product qualifying rate or the fully amortizing, fully indexed rate must be input into DU and LP as the note rate for qualifying purposes.  
    - For traditionally underwritten fully amortizing ARMs, the borrower must be qualified at the greater of the product qualifying rate or the fully amortizing, fully indexed rate. |
| Minnesota | - The following guidelines apply for primary residence and second homes:  
  - Fully amortizing 7/1 and 10/1 ARM loans will be acceptable ONLY if the following credit overlays are applied: |

Note that additional products used in conjunction with conventional products, such as THDA or Georgia Dream, may have their own proprietary lending territories.
For all AUS processed fully amortizing 7/1 and 10/1 ARMs, the fully amortizing, fully indexed rate must be input into DU and LP as the note rate for qualifying purposes.

For traditionally underwritten fully amortizing 7/1 and 10/1 ARMs, the borrower must be qualified at the fully amortizing, fully indexed rate.

Texas

- All Texas loans must include a survey in the file.

1.09.02 Title Commitment

- Amount of policy may not be less than the original principal balance of the mortgage.
- Named Insured must be: First Community Mortgage, Inc., ISAOA/ATIMA
- ICL/CPL must be loan specific and include the subject property address or borrower name.
- Final Title Policy Requirements:
  - ALTA standard (1990 ALTA policies are not permitted) or ALTA Expanded Coverage Residential Policy is acceptable in all states. The modified ALTA Short Form Residential loan policy approved by the State of Florida is acceptable on Florida properties only.
  - ALTA Endorsement 4 (condominium) – required on all condominium properties.
  - ALTA Endorsement 5 (PUD’s) – required on all PUD properties.
  - ALTA Endorsement 6 (ARM’s) – required on all ARM transactions.
  - ALTA Endorsement 8.1 (environmental hazards) – required on all properties.
  - ALTA Endorsement 9 (restrictions, encroachments, minerals) – required on all properties.
  - Title policy must include, as an informational note, (a) the recorded plat number(s), if any, and (b) the property parcel number(s), or tax identifying number(s), as applicable, if available.
  - Any Survey Exception must be deleted.
  - The legal description on the policy must conform to the legal description contained in the Security Instrument.
  - Florida properties require Florida Endorsement Form 9 (aka ALTA 9-06) as well as a property survey. If an existing survey is being utilized a Survey Affidavit must be completed.
  - Tax information including next due and amount to be included on the title commitment. For LP loans:
    - Real estate taxes must be based on the value of the land improvements plus the value of the land in calculating the monthly housing. The real estate tax amount included in the monthly housing expense must be based on the value of the improvements plus the value of the land.
**Section 1.09 Property**

- When the property is located in a jurisdiction where transfer of ownership causes or results in a recalculation of the amount of real estate tax the monthly housing expense must include an estimate of the recalculated real estate tax amount.
- When there is a tax abatement on the property, the reduced real estate tax amount may be used in the monthly housing expense calculation, provided that the mortgage file contains evidence of the tax abatement and the documentation shows that the tax abatement will remain in place for at least five years after the note date.

***underwriting, try to qualify the borrower on the purchase price*tilleage to meet Freddie requirements. If the borrower does not qualify using this calculation, please verify with the title company if the property is located in a jurisdiction where the transfer of ownership will cause in a recalculation of the amount of real estate tax as listed above. At this time, this only applies to LP loans**********

****The same amount of property taxes used to qualify must also be used to establish the borrower’s escrow account.****

**1.09.03 Hazard, Flood and Condo Insurance**

Please see FCM’s Insurance Policies and Requirements document for all insurance related information.

**1.09.04 Occupancy Types**

**1.09.04.01 Primary Residence**

A primary residence is defined as a property that will be occupied by the borrower for the majority of the calendar year.

The following tables describes circumstances in which the property would still be considered a primary residence even though the borrower will not be occupying the property.

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<thead>
<tr>
<th>Borrower Types</th>
<th>Requirements for Owner-Occupancy</th>
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</thead>
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<tr>
<td>Multiple borrowers</td>
<td>Only one borrower needs to occupy and take title to the property, except as otherwise</td>
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<tr>
<td>Parents wanting to provide housing for their handicapped or disabled adult child</td>
<td>If the child is unable to work or does not have sufficient income to qualify for a mortgage on his or her own, the parent is considered the owner/occupant.</td>
</tr>
<tr>
<td>Children wanting to provide housing for elderly parents</td>
<td>If the parent is unable to work or does not have sufficient income to qualify for a mortgage on his or her own, the child is considered the owner/occupant.</td>
</tr>
</tbody>
</table>

1.09.04.02  Secondary Residence or Second Home

A secondary residence is defined as a property that a borrower occupies in addition to his/her principal residence.

The following requirements must be met for secondary residences:

- Must be located a reasonable distance away from the borrower’s principal residence.
- 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 (Freddie will permit second homes with seasonal limitations for year-round occupancy provided the appraiser includes at least one comp with similar seasonal limitations to demonstrate the marketability of the subject...Must be run LP)
- The borrower must have exclusive control over the property.
- Must not be rental property or a timeshare arrangement.
- Cannot be subject to any agreements that give a management firm control over the occupancy of the property.
- If rental income is reflected on the Tax Return Schedule E the rental income cannot be used to qualify and the occupancy will be reviewed closely. (Freddie has specified that the property may be rented out on a short-term basis, but the borrower must keep the property securing the second home mortgage available primarily (more than half of the year) as a residence for the borrower’s personal use and it cannot be subject to any rent pools or agreements that require the borrower to rent the property, give a management company or entity control over the occupancy of the property or involved revenue sharing between any owners and developer or another party.)
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1.09.04.03 Investment Property
An investment property is defined as a property that is not occupied by the borrower as a principal or secondary residence.

When the borrower owns more than one financed investment property the subject investment property must be secured by either a 15, 20, or 30 year fixed loan or a 7/1 ARM.

1.09.05 Property Evaluation

1.09.05.01 Eligible Properties
First Community Mortgage accepts the following property types for conventional loans:

- One-to-four family detached
- Townhomes/PUDs
- Modular Homes
- Manufactured Homes
- Warrantable Condominiums
- Investment Property Condos
- Leasehold Estates run through DU
- Land Contract / Contract for Deed
  - Evidence the contract for deed was executed > 12 months ago
  - Cash Out not allowed
  - 12-month satisfactory private mortgage payment history via cancelled checks
  - Additional conditions may apply on these transaction types

- Mixed Use (Business/Non-Residential Use of Residence) DU ONLY
  - The property must be a one unit dwelling that the borrower occupies as principal residence
  - The borrower must be both the owner and the operator of the business
  - The property must be primarily residential in nature.

1.09.05.02 Ineligible Properties
First Community Mortgage does not accept the following property types for conventional loans:

- Co-ops
- Leasehold Estates run through LP
- Community Land Trusts
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<th>Berm Homes</th>
</tr>
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<td>Boarding Houses</td>
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<td>Tourist Houses</td>
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<td>Private Clubs</td>
<td>Working Farms</td>
</tr>
<tr>
<td>Bed and Breakfast</td>
<td>Hotel or Motel Condominium Conversions (or conversions of other similar transient properties)</td>
</tr>
<tr>
<td>Establishments</td>
<td>Properties with Appraisal ratings of: C5, C6 or Q6</td>
</tr>
<tr>
<td>Fraternity or Sorority Houses</td>
<td></td>
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<tr>
<td>Sinkhole Homes</td>
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</tbody>
</table>

1.09.05.03 Appraisal Requirements

- Collateral review requirements are determined by AUS Findings. PIWs (DU) and ACE (LP) Valuations are acceptable with eligible AUS collateral feedback messages. Automated Valuations are not acceptable on loans requiring MI or on Higher Priced (HP) loans. Red flags identified by other documents/reports in the file could warrant Underwriter’s request of Full Appraisal.

- Appraisals must reflect contract terms. If the contract terms change after appraisal is performed the appraiser must be given the new contract terms and must evaluate the changes for impact to marketability to update the contract terms on the appraisal.

- The following appraisal forms are required based on property type:
  - 1 unit primary & second home dwellings: Uniform Residential Appraisal Report (Fannie Mae Form 1004)
  - 2-4 unit primary dwellings: Small Residential Income Property Appraisal Report (Fannie Mae Form 1025)
  - 1-unit investment dwellings when using rental income: Uniform Residential Appraisal Report/Operating Income Statement/Single Family Comparable Rent Schedule (Fannie Mae Form 1004 & 1007)
  - 2-4-unit investment dwellings when using rental income: Small Residential Income Property Appraisal Report/Operating Income Statement/Single Family Comparable Rent Schedule (Fannie Mae Form 1025 & 1007)
  - Condominium units: Individual Condominium Unit Appraisal Report (Fannie Mae Form 1073)

- Appraisals are valid for one year from the date of inspection to the Note date. However, when appraisal reports are more than four months old on the date of the note and mortgage the appraiser must perform an update which includes:

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<th>Underwriting Guidelines</th>
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<td>Click Here for</td>
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</table>
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- An inspection of the exterior of the property and
- A review of the current market data to determine whether the property has declined in value since the date of the original appraisal.

- All property conditions, including repairs, alterations and/or required inspections must be reported within the appropriate section of the applicable Fannie Mae appraisal reporting form.
- See the New Construction and Identity of Interest sections for information regarding property inspections on these types of loans.
- Mixed Use Properties evaluations must include the following:
  - Appraisers provide an adequate description of the mixed-use characteristics of the subject property.
  - The mixed use of the property represents a legal, permissible use of the property under local zoning requirements
  - The market value of the property is primarily a function of its residential characteristics, rather than the business use or any special business-use modifications that were made.
  - Appraiser must comment the commercial/non-residential use must does not have an adverse effect marketability and habitability as a residence.
- If the contract is amended after the effective date of the appraisal in a way that does not affect the description of the property, then the lender is not required to provide the amended contract to the appraiser nor obtain a revised appraisal.
  - Some examples of amendments that do not require the lender to provide the amended contract nor obtain revisions to the already completed appraisal report include:
    - sale price,
    - transaction terms,
    - financing concessions,
    - seller-paid closing costs,
    - names or initials,
    - closing date, and
    - correction of minor clerical errors such as misspellings
1.09.05.04  Access to Property
There must be vehicular access to the property via an all-weather public or private street. If a private street is the only form of access there must be a permanent recorded easement and provisions for permanent maintenance of the street. If the private road is maintained by the HOA (PUD or Condo), evidence of this is acceptable.

1.09.05.05  Pest Inspections
Termite inspections are required on all conventional Purchase and Refinance transactions in the following situations:

- Appraiser notes a termite infestation (current or previous)
- Mandated by a local or state jurisdiction

If a termite letter shows there are any current infestations then treatment is required.

If a termite letter or appraisal notates any damage due to termites, FCM will require proof the damage was repaired or a licensed inspector, contractor, or structural engineer will need to verify the damage is minor. Also, the letter must clearly state the evidence observed has not affected the structural soundness of the home.

Termite inspection letters must be dated within 90 days of closing. Soil treatment letters must be dated within 12 months of the day of closing.

Note: If Termite Letter is paid on the HUD lender review of the Termite letter will be required.

1.09.05.06  Wells & Septic Systems

(1) Community Wells & Septic Systems
Community well and/or septic systems must be owned, operated, and maintained by a private corporation or a non-profit property owner’s association.

Connections to public systems are not required unless common and customary for the area.

(2) Shared Wells
Connections to public systems are not required unless common and customary for the area.
Conventional Underwriting Guidelines

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(3) Private Septic Systems
Waste water systems must be determined to be free of observable evidence of system failure. Certification can be provided by the local health department, a septic system professional, a qualified home inspector, or can be evidenced on the appraisal if completed by an FCM-approved appraiser. If the appraiser does not make mention of any issues with the septic, it can be deemed acceptable. A septic system test is only required when:

- Evidence of system failure is present,
- If mandated by local or state jurisdiction,
- If customary to area.

Connections to public systems are not required unless common and customary for the area.

(4) Private Wells
A test of the well water is required if the appraiser specifically mentions any of the following in the appraisal report or there is any other indication that the following conditions are present:

- Evidence of system failure is present,
- If mandated by local or state jurisdiction,
- If customary Mandated by local or state jurisdiction
- Knowledge well water may be contaminated
- Evidence of pipe corrosion
- Areas of intensive agriculture within ¼ mile of property
- Coal, mining, or gas drilling within ¼ mile of property
- Dump, junkyard, landfill, factory, gas station, or dry-cleaning operation within ¼ mile of property
- Unusual taste, smell or appearance of well water, or;

Connections to public systems are not required unless common and customary for the area.

1.09.05.07 Easements and or Encroachments
Customary public utility subsurface easements are acceptable as long as they do not extend under any buildings or other improvements.
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Above-surface public utility easements that extend along one or more of the property lines for distribution purposes or along the rear property line for drainage purposes are acceptable as long as they do not extend more than 12 feet from the property lines and do not interfere with any of the buildings or improvements or with the use of the property itself.

1.09.05.08 FEMA Disaster Areas

FEMA announces major disaster areas for specific counties after a significant event has occurred which the President of the United States has declared a disaster area. The FEMA website lists these disaster areas and has a searchable feature to determine the Incident Begin and End dates. The following procedures will be followed for any properties located in a county declared a disaster by the President of the United States.

To pass along the cost of the re-inspection to the borrower a Change In Circumstance form must be completed and submitted to FCM for approval within 3 days of the announcement by FEMA.

(1) If the original appraisal was performed ON or Before the Incident Period End Date:

- Property must be re-inspected by the original appraiser or, if not available, another licensed appraiser. The appraiser must provide the following commentary/evidence:
  - Property is free from damage and the disaster had no effect on value or marketability.
  - Photos provided of exterior only.

- If the re-inspection indicates damage, the extent of the damage must be addressed along with the following:
  - Completion of repairs is required as evidenced by Form 1004D/442, Appraisal Update and/or Completion Report prior to closing.
  - Photos are provided of interior, exterior and neighborhood.

(2) If the appraisal is performed after the Incident Period End Date:

- Appraisal must include written certification by the appraiser that:
  - Property is free from damage and the disaster has no effect on value or marketability.
Conventional Underwriting Guidelines

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- All Comparables should be post-disaster; however, if sufficient comparables are not available, the appraiser must provide current photos of the subject property and comparables. MLS photos or photos used for previous appraisals are not acceptable.

  - If appraisal indicates damage, the extent of the damage must be addressed, along with the following:
    - Completion of repairs is required as evidenced by Form 1004D/442, Appraisal Update and/or Completion Report, with photos, prior to closing.
    - Photos are provided of interior, exterior and neighborhood.

Additional Considerations:

All loans with a property inspection waiver that are located in a FEMA Declared Disaster Area will require a disaster inspection with exterior photos for a period of 90 days after the Incident Period End Date declared by FEMA.

1.09.05.09 Condominiums

A condominium is a multi-unit project that has individually-owned units, which may be either attached in one or more structures or detached from and each other and is essentially residential in use.

FCM does NOT allow non-warrantable condominiums under the standard product offerings.

Any transaction that falls outside of the parameters in the chart below will require a full review. Please note that all “new” projects require a full review regardless of LTV and Occupancy.
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Maximum LTV/CLTV/TLTV for a Limited/Streamlined Review

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<tr>
<th>Occupancy Type</th>
<th>Maximum LTV/TLTV/HLTV</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Projects NOT located in Florida</td>
</tr>
<tr>
<td>Primary Residence</td>
<td>90%</td>
</tr>
<tr>
<td>Second Home</td>
<td>75%</td>
</tr>
<tr>
<td>Investment Property</td>
<td>75%</td>
</tr>
</tbody>
</table>

**Full Eligibility** reviews must have the following documents at submission for the Condo Desk to review and process through Condo Project Manager.

- Condo Questionnaire-Long Form
- Budget
- Master Liability Policy
- Fidelity Insurance

For new projects, the following additional information is required:

- Master Deed/Covenants and Restrictions
- HOA By-Laws

Please Note, that not all new projects will be acceptable. New projects that are built in phases where FCM can warrant a single phase is acceptable. New Projects not able to be warranted by phase will not be approved.

**Limited/Streamlined Eligibility** reviews must have the following documents at submission for the Condo Desk to review.

- Condo Questionnaire-Short Form
- Master Insurance Policy
Projects Not Subject to Warrantability Review

- Site Condominiums
- 2-4 Unit Projects (New or Established)

1.09.05.10 Planned Unit Developments (PUDs)
A PUD is a mixed-use residential development of single-family dwellings, attached or detached, in conjunction with rental, condominium, cooperative or town house properties. A residential development should be processed as a PUD and the Deed should include a PUD RIDER if it has the following:

- The title commitment and legal description clearly show that the dwelling is part of a recorded Planned Unit Development (PUD). The appraisal must match the title commitment, but the commitment should be the ruling authority on the property type.

Legal Description Example:

```
Being Lot No. 9 on the Final Plat of Section Three, Lot 3, a Planned Unit Development, of record in Instrument No., Register's Office for County, Tennessee, to which plan reference is made for a complete legal description
```

If an HOA exists, Homeowner’s assessments must be subordinate to the mortgage. Provide one of the following items as documentation of HOA assessment subordination:

- PUD by-laws indicating all homeowner’s association assessments are subordinate to mortgage liens (At minimum, FCM must review the title page, table of contents and corresponding HOA lien subordination section reflecting the page(s) indicated in the table of contents) or
- Subordination agreement executed by a representative of the homeowner’s association or
- Title commitment stating that the title company will insure over any homeowner’s association assessment liens or
- Letter on letterhead from the title company indicating that PUD liens cannot take first lien position in the state in which the property is located or
- ALTA 9 or ALTA 5 title endorsement
- 60-Day letters may not be provided in lieu of one of the documents above
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Please see the previous section on insurance requirements for specific insurance guidelines on attached PUDs.

1.09.06 New Construction

1.09.06.01 Overview
New Construction includes any property where the Certificate of Occupancy was issued within the past year.

1.09.06.02 Refinances
Rate/Term refinances on transactions involving the payoff of interim financing and converting it to permanent financing do not have a seasoning requirement.

Cash-out refinances are allowed on New Construction where the borrower has had title to the property for at least 6 months and the construction financing is seasoned at least 6 months.

1.09.06.03 Appraisal Requirements for New Construction

• New construction properties must have at least one comparable from outside the subdivision. All builder sales must not be used in the same subdivision.

• New construction properties that are 90% complete, with only minor finish work remaining, may be appraised without the appraiser having plans and specifications.

• For new construction where the house is 100% complete at the time of the appraisal, the appraiser must take a clear photograph (in addition to the standard appraisal photos) of each diagonally opposite front and rear corner of the house to record adequate grading and drainage of the site.

Notes:

○ "Complete" means everything is complete including the installation of buyer preferences (flooring, appliances, etc.), utilities are on and fully functioning and all site improvements completed at the time of appraisal (Ready for Occupancy).

○ If the appraiser makes no repair or correction conditions, the appraisal serves as the final inspection.

• If the appraisal is ordered as “proposed construction” and is fully completed, a final inspection is still required regardless if property is 100% complete.

• If the appraisal is ordered as “new construction, existing” and is 100% complete, a final inspection is not required providing the appraiser states that “the dwelling was
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built in accordance with the submitted plans and specifications and drainage and grading are adequate.”

- Regarding Construction to Permanent Financing when the transaction is being treated as a refinance:
  - Regardless of when the lot was acquired, the LTV/CLTV/HCLTV is based off of the current appraised value.

1.09.06.04 Calculating Tax Estimates for New Construction

The borrower must qualify with the monthly payment based on improved property taxes, not on the vacant land.

Realistic estimates for the improved property taxes used for loan qualification purposes as well as setup of monthly escrow accounts must come from a reliable source such as:

- The Appraiser
- Comparable Sales Data
- The Title Company as determined by the Assessor’s Office

1.09.07 Declining Markets

If the appraisal indicates that the property is located within a declining market a detailed explanation by the appraiser on the effect of the declining market on the subject neighborhood values and how the appraiser determined the property to be in a declining market are required. Additional comparables may be required by the underwriter on a case-by-case basis. Two additional listings are required.

1.09.08 Right of Redemption Transactions

1.09.08.01 Overview

Certain state laws provide a “redemption period” after a foreclosure or tax sale has occurred, during which time the property may be reclaimed by the prior mortgagor or other party upon payment of all amounts owed. The length of the redemption period varies by state and does not expire automatically upon sale of the property to a new owner.

1.09.08.02 Property Restrictions

- Primary Residence Only
- 1-4 unit dwellings, Condos and PUDs Only
- No Manufactured Homes
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1.09.08.03  Underwriting Stipulations

- Surety Bonds Required – consult with your title company for further details
- Right of Redemption loans are subject to extended turn-times as 2nd level underwriting review is required.

1.09.09  Leasehold Estates

- All conventional leasehold estate transactions must meet Fannie Mae’s guidelines and be processed through Fannie Mae’s Desktop Underwriter (DU) or be traditionally underwritten. Leasehold estate transactions are not eligible for processing through Freddie Mac’s Loan Prospector (LP) automated underwriting system.
- The lease agreement must be reviewed by an underwriter.
- The lease must meet all of the following requirements:
  - The leasehold estate and improvements must constitute real property, be subject to a mortgage lien and insured by a title policy.
  - The lease must be valid and in full force and effect.
  - All ground rent payments, other payments or assessments must be current and the borrower must not be in default under any other provision of the lease, nor may the ground rent owner have claimed such a default.
  - The estate term must run for at least five (5) years beyond the mortgage maturity unless fee simple title will vest at an earlier date in the borrower or a homeowners’ association and must be assignable or transferable.
  - The lease must guarantee the lender the right to receive at least 30 days’ notice of default by the borrower and the option to cure the default or take over the borrower’s rights.
  - The lease must include provisions to protect the lender’s interest in the event of a property condemnation.
  - The lease must provide that the borrower will pay taxes, insurance and HOA dues related to the land and improvements.
  - The lease must provide that the leasehold can be transferred, mortgaged and sublet an unlimited number of times without restriction or upon payment of a reasonable fee and delivery of documentation to the lessor. The lessor may not require credit qualification on any assignee or sublessee.
  - The lease cannot contain default provisions allowing forfeiture or termination of the lease except for non-payment of the ground rent payments.
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- The lease may, but is not required to, include an option for the borrower to purchase the interest in the land (buyout the lease). There can be no time limit when the option must be exercised.
- The lease and option to purchase must be assignable.
- The lease must allow the borrower to retain voting rights in any homeowners’ association.
- Ensure FNMA’s first lien enforceability.

- Leasehold properties that do not meet the above requirements must follow one of the options outlined below.
  - A leasehold addendum must be prepared by the title company to eliminate or amend any deficiencies. The addendum must be signed by all parties (borrower and ground rent owner) at closing and evidence of recordation of the updated lease with addendum must be provided. OR
  - The leasehold must be bought out. The final title policy must reflect the leasehold and fee simple ownership, evidenced by a Fee Simple Warranty Deed.
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Section 1.10 Refinance Transactions

1.10 Refinance Transactions

Below are general guidelines specific to conventional refinance transactions. Please note that all of the previous guidance in the above sections apply to refinance transactions as well unless specifically stated.

First Community Mortgage offers the following types of refinance programs:

- Rate/Term Refinance
- Cash Out Refinance

1.10.01 General Overview

- The payment due in the month the loan is closing must be paid either prior to closing or included in the payoff amount at closing.
- As of application date, all mortgages on the credit report, subject property and other REO, must be current, which means that no more than 45 days may have elapsed since the last paid installment date.

1.10.02 Limited Cash-Out Refinances/ Rate and Term

1.10.02.01 Overview

Rate/Term Refinances must meet the following requirements:

- The transaction is being used to pay off an existing first mortgage loan 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.
- The subject property must not be currently listed for sale. It must be taken off the market prior to disbursement, and the borrowers must confirm their intent to occupy the subject property (for principal residence transactions).

See Subordinate Financing section for details regarding existing and new secondary financing.

1.10.02.02 Acceptable Uses

The following are acceptable in conjunction with a rate/term refinance transaction:

- Paying off the unpaid principal balance of the existing first mortgage (including prepayment penalties);
- Financing the payment of closing costs, points, and prepaid items.
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- LP: Cash back allowed up to the greater of 1% of the new refinance mortgage or $2,000.
- DU: receiving cash back in an amount that is not more than the lesser of 2% of the new refinance loan amount or $2,000
- DU ONLY: Buying out a co-owner pursuant to a court order (ie. Divorce, inheritance).
- Paying off a subordinate mortgage lien (including prepayment penalties) used to purchase the subject property.

1.10.02.03 Ineligible Transactions/Unacceptable Uses

When the following conditions exist, the transaction is ineligible as a limited cash-out refinance and must be treated as a cash-out refinance:

- no outstanding first lien on the subject property (except for single-closing construction-to-permanent transactions, which are eligible as a limited cash-out refinance even though there is not an outstanding lien on the subject property)
- the proceeds are used to pay off a subordinate lien that was not used to purchase the property
- the borrower finances the payment of real estate taxes for the subject property in the loan amount, but does not establish an escrow account
- the borrower finances the payment of real estate taxes that are more than 60 days delinquent for the subject property in the loan amount
- 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

1.10.02.04 Credit

- Payment history on all mortgage/housing trade lines will be assessed by AUS. For mortgages not reporting on the credit report, verification must be received and must confirm a 0x60 payment history.

1.10.02.05 Acquisition/Seasoning

Refinance must provide a net tangible benefit to the borrower in the form of at least one of the following:

- a lower P&I payment;
- a lower interest rate;
- a shorter amortization term OR
Conventional Underwriting Guidelines

Section 1.10 Refinance Transactions

- movement to a more stable product. Ex- from an ARM to FRM

*****LP***** The following requirements apply to all Freddie Mac Rate and Term Refinances:

- When an existing mortgage will be satisfied as a result of a refinance transaction, one of the following requirements must be met:
  - At least one borrower on the refinance mortgage was a borrower on the mortgage being refinanced; or
  - At least one borrower on the refinance mortgage held title to and resided in the mortgage premises as a Primary Residence for the most recent 12-month period and the mortgage file contains documentation evidencing that the borrower, either:
    - Has been making timely mortgage payments, including the payments for any secondary financing, for the most recent 12-month period; or
    - Is related to a borrower on the mortgage being refinanced; or
  - At least one borrower on the refinance mortgage inherited or was legally awarded the mortgaged premises (for example, in the case of divorce, separation or dissolution of a domestic partnership)

A Living Trust may be made irrevocable by a settlor’s death. To be an eligible borrower at the time of the refinance transaction, the borrower must continue to be a living trust that meets Freddie Mac’s revocability and, as applicable, other eligibility requirements.

In addition, a refinance mortgage that exceeds the thresholds under the Home Ownership and Equity Protection Act of 1994 and its implementing regulations is ineligible for purchase by Freddie Mac

1.10.02.06 Subordinate Financing

- When paying off an existing second mortgage on a rate/term refinance, proof that the second mortgage was used to acquire the property is required to be considered rate/term. A HUD-1 from the original transaction can be used to satisfy this condition.
- New subordinate financing is allowed on Rate/Term Refinances up to stated CLTV restrictions found on the Credit Score/LTV Matrix.
Conventional Underwriting Guidelines

Section 1.10 Refinance Transactions

1.10.02.07 Special Condo Project Eligibility
Condo Project Eligibility and Review is not required on a Limited Cash-out Refinance when the existing loan is identified as a Fannie Mae owned loan and the following requirements are met:

- The LTV is < 80% (CLTV, HCLTV ratios may be higher)
- The project has the required project-related property insurance and flood insurance coverage
- The project is not a condo hotel/motel, houseboat project or a timeshare or segmented ownership project.
- The loan must be entered with Project Type Code V

1.10.03 Student Loan Cash-out Refinance (DU ONLY)
The Student Loan Cash-out Refinance allows a borrower to pay off student loan debt with current home equity without paying cash-out loan level pricing adjustments.

1.10.03.01 Eligibility and Requirements:

- LTV, CLTV and HCLTV ratios are per the standard Cash-Out eligibility requirements.
- At least one student loan must be paid off. Loan proceeds must be paid directly to the student loan servicer at closing. Only student loans for which the borrower is personally obligated are eligible for payoff. Partial student loan payoffs are not acceptable.
- The loan may pay off a 1st mortgage lien, a purchase money 2nd and the qualifying student loans.
- The borrower is limited the lesser of 2% or $2K cashback at closing.
- The property cannot be listed for sale at the time of disbursement
- Payoff of taxes are ineligible unless an escrow account is established.
- Payoff of delinquent taxes is ineligible.
- Loan must be delivered with Special Feature Code 841.

1.10.04 Cash-Out Refinance

1.10.04.01 Overview
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;
Conventional Underwriting Guidelines

Section 1.10 Refinance Transactions

- Properties listed for sale must have been taken off the market prior to disbursement of the new mortgage loan.
- Financed MI is not allowed.

1.10.04.02 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;
- Paying off any outstanding subordinate liens of any age;
- LP: Special Purpose Cash-Out to pay co-owner pursuant to court order (divorce, death/inheritance).
- Taking equity out of the subject property that may be used for any purpose.

1.10.04.03 Credit

- A mortgage history with a minimum of 12 months is always required unless the property was acquired less than 12 months prior to application.
- Payment history on all mortgage/housing trade lines will be assessed by AUS. For mortgages not reporting on the credit report, verification must be received and must confirm a 0x60 payment history.

1.10.04.04 Acquisition/Seasoning

- The property must have been purchased (or acquired) by the borrower at least six months prior to the disbursement date (DU), Note date (LP) of the new mortgage loan, except if delayed financing guidelines are met. See Delayed Financing Exception below.
- There is no waiting period if the lender documents that the borrower acquired the property through an inheritance or was legally awarded the property (divorce, separation, or dissolution of a domestic partnership).

1.10.04.05 Subordinate Financing

- Existing secondary financing is allowed to be subordinated subject to CLTV restrictions listed on the Credit Score/LTV Matrix.
- All existing liens, including subordinate financing, must be seasoned at least six months and have an acceptable payment history.
Conventional Underwriting Guidelines

Section 1.10 Refinance Transactions

- If the secondary financing is an equity line, the maximum amount of the equity line is used in the CLTV calculation.

### 1.10.04.06 Delayed Financing Exception

Borrowers who purchased the subject property within the past six months (measured from the date on which the property was purchased to the disbursement date of the new mortgage loan) are eligible for a cash-out refinance if all the following requirements are met:

- The original purchase transaction was an arms-length transaction.
- The original purchase transaction is documented by a HUD-1 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 trustee may be substituted for a HUD-1 if a HUD-1 was not provided to the purchaser at time of sale.) The preliminary title search or report must confirm that there are no existing liens 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 HUD-1 for the refinance transaction must reflect that all cash-out proceeds be used to pay down, if applicable, the loan (unsecured or secured by an asset other than the subject property) used to purchase the property. Any payments on the balance remaining from the original loan must be included in the debt-to-income ratio calculation for the refinance transaction. **Note:** Funds received as gifts are used to purchase the property may not be reimbursed with proceeds of 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/HCLTV ratios for the transaction).
- All other cash-out refinance eligibility requirements are met and cash-out pricing is applied.
1.11 Special Programs

1.11.01 97% Standard Fannie (DU) and Home One (LP)

<table>
<thead>
<tr>
<th></th>
<th>97% Fannie</th>
<th>97% Freddie - HomeOne</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUS Approval</td>
<td>DU Approval Required</td>
<td>LP Approval Required</td>
</tr>
<tr>
<td>Eligible Transactions</td>
<td>Purchases and Limited Cash Out Refinances (LCOR)</td>
<td>Purchases and No-Cash Out Refinances</td>
</tr>
<tr>
<td>Eligible Borrowers</td>
<td>At least one borrower must be a first-time homebuyer for purchase transactions</td>
<td></td>
</tr>
<tr>
<td>Occupancy Requirements</td>
<td>All borrowers must occupy the property. (No Co-Signors or Non-Occupying Co-Borrowers)</td>
<td></td>
</tr>
<tr>
<td>Rate and Terms</td>
<td>Fixed Rate Only</td>
<td>15 and 30 Year Terms</td>
</tr>
<tr>
<td>MI Coverage</td>
<td>Standard 35% MI Coverage Applies. Custom MI is not allowed.</td>
<td></td>
</tr>
<tr>
<td>Property Type</td>
<td>1 Unit SFR, Condo, PUD</td>
<td></td>
</tr>
<tr>
<td>Income Limits</td>
<td>No Income Limits</td>
<td></td>
</tr>
<tr>
<td>Maximum Loan Limits</td>
<td>Conforming Loan Limit (No High-Balance or Super-Conforming)</td>
<td></td>
</tr>
<tr>
<td>Homebuyer Education</td>
<td>At least one borrower is required to complete homebuyer education on purchase transactions with LTV, CLTV or HCLTV ratios greater than 95% when all borrowers are first time homebuyers</td>
<td>Required if all borrowers are FTHB</td>
</tr>
</tbody>
</table>

Conventional Underwriting Guidelines
Section 1.11 Special Programs
Conventional Underwriting Guidelines

Section 1.11 Special Programs

<table>
<thead>
<tr>
<th>LCOR Transactions</th>
<th>Must be an existing Fannie Mae securitized loan.</th>
<th>Must be an existing Freddie Mac securitized loan</th>
</tr>
</thead>
</table>

1.11.02 FNMA High Balance

1.11.02.01 Overview
FNMA High Balance is a program designed as an outlet for transactions ran through DU with loan amounts greater than $484,350 on primary residence 1-unit properties located in markets eligible for high-cost loan limits. Please visit the County Loan Limits to determine if a market qualifies and the maximum limit for that particular market.

1.11.02.02 Loan Terms
- 15/30 Year Fixed Rate Only
- Primary, Second Home or Investment Property

1.11.02.03 Credit
- DU Approve/Eligible Only, LP is not acceptable
- Traditional Credit Only
- No Manual Underwrites

1.11.02.04 Property Eligibility
- Must be in a qualifying market. See County Loan Limits.

1.11.02.05 Appraisal Requirements
- Interior/Exterior Appraisal required on all loans regardless of AUS
- A field review is required for properties valued at $1M or more with an LTV/CLTV or HCLTV ratio greater than 75%.

1.11.03 FHLMC Super Conforming

1.11.03.01 Overview
FHLMC Super Conforming is a program designed as an outlet for transactions ran through LP with loan amounts greater than $484,350 on 1-unit properties located in markets eligible for high-cost loan limits. Please visit the County Loan Limits to determine if a market qualifies and the maximum limit for that particular market.
Conventional Underwriting Guidelines

Section 1.11 Special Programs

1.11.03.02 Loan Terms
- 15/30 Year Fixed Rate Only
- Primary, Second Home, or Investment Property
- Financed MI is not allowed.
- Maximum Loan Amount: $1M (Regardless of Multiple Unit County Limit)

1.11.03.03 Credit
- LP Accept Only, DU is not acceptable
- No Manual Underwrites
- Non-Occupying Co-Borrowers are only allowed with an Underwriter Exception.

1.11.03.04 Property Eligibility
- Must be in a qualifying market. See County Loan Limits.

1.11.03.05 Appraisal Requirements
- Per AUS

1.11.04 HomeReady Mortgage

1.11.04.01 Overview
HomeReady is a DU conventional community lending mortgage that offers underwriting flexibilities to qualified borrowers who meet specific income criteria.

1.11.04.02 Loan Terms
- See Credit Score/LTV Matrix for credit score and LTV/CLTV restrictions.
- 30 Year Fixed Term
- Purchase up to 97% / Limited Cash Out Refinance from 95.01-97% available if the current loan being paid off is owned by FNMA
- Owner Occupied
- SFR/PUD/CONDO/2-4 Unit/Manufactured up to 95%; 1 unit only eligible up to 97%
- DU Approve/Eligible Only, LP is not acceptable

1.11.04.03 Borrower Eligibility
Borrower Income eligibility is determined by AUS. It is determined by the subject property census tract and the appropriate income limit for that census tract. Only the income used to qualify is required to meet the income limit. FNMA has changed the income limits for all
Conventional Underwriting Guidelines

Section 1.11 Special Programs

HomeReady loans to not exceed 80% AMI or the property’s location (including properties in low-income census tracts). This is effective July 20, 2019.

The occupying borrowers may not have an ownership interest in more than two residential properties including the subject property, as of the note date. This is effective with loans closed on or after 05/15/2019. The additional reserves required for multiple financed properties are not applicable to HomeReady. DU will be updated to include the multiple financed property policy in a future release at which time this will be required for DU loan casefiles.

Non-occupant co-borrowers are allowed.

1.11.04.04  Borrower Contribution Requirements
There are no minimum borrower contribution requirements for a 1 unit residence, all funds may come from a gift, grant or secondary financing that meets Fannie Mae guidelines. For a 2-4 unit residence, the minimum borrower contribution is 3%.

1.11.04.05  Other Household Income Considerations
Boarder Income (relatives or non-relatives): Up to 30% of qualifying income allowed. Documentation for at least 9 months of the most recent 12 months (averaged over 12) and documentation of shared residency for the past 12 months. Boarder may not be obligated on the mortgage loan or have any ownership interest in the property.

1.11.04.06  Homebuyer Education
Homeownership education is required prior to note date for at least one borrower on purchase transactions when all occupying borrowers are first-time homebuyers, regardless of LTV ratio.

Homeownership education must be completed using one of the 3 following options:

Framework: The Education certificate needs to be provided by the borrower and retained in the file.

HUD Approved Non-Profit Housing Counseling Agency: The counseling recipient must receive both pre-purchase housing counseling and homeownership education that meets HUDs requirements as evidenced by a Certificate of Complete Pre-Purchase Housing Counseling (Form 1017) signed by both the counseling recipient and the HUD counselor.
Community Seconds or DPA Program by HUD Approved Agency: If the mortgage involves a community second or HUD approved DPA program that requires its own homeownership education course, the borrower is not required to enroll in the Framework program.

1.11.04.07 Mortgage Insurance Coverage Requirements:
Standard mortgage insurance only. Custom MI is not available.

<table>
<thead>
<tr>
<th>LTV</th>
<th>MI Coverage %</th>
</tr>
</thead>
<tbody>
<tr>
<td>85.01 – 97.00%</td>
<td>25%</td>
</tr>
<tr>
<td>80.01 – 85.00%</td>
<td>12%</td>
</tr>
</tbody>
</table>

1.11.05 Fannie Mae REO

1.11.05.01 Financing Benefits
The HomePath Properties are Fannie Mae Real Estate Owned (REO) properties that Fannie Mae has deemed eligible for the following financing flexibilities:

Interested Party Contributions (IPCs):
- For principal residences with LTV/CLTVs greater than 90%, Fannie Mae allows up to 6% interested party contributions (rather than the 3% standard per the Selling Guide).

NOTE: Loan must be delivered using special feature code SFC679 when IPC exceptions apply to the transaction.

Resale Restrictions:
- In the event the mortgaged property is subject to any resale restriction imposed by Fannie Mae as the property seller, the mortgage is eligible for sale to Fannie Mae, notwithstanding any Selling Guide restrictions on properties subject to resale restrictions.

HOMEPATH WEBSITE
Conventional Underwriting Guidelines

Section 1.11 Special Programs

1.11.06 Home Possible

1.11.06.01 Overview
Home Possible is a lending program designed as a responsible, low down payment mortgage option for first-time homebuyers and low and moderate-income borrowers. This program offers reduced MI coverage amounts.

HOME POSSIBLE WEBSITE

1.11.06.02 Loan Terms
- Max LTV/CLTV: 97%/105%
- Conforming and Super Conforming Loan Amounts are eligible
- 30 Year Fixed
- 1-4 Unit (1 unit eligible up to 97%)
- SFR, PUD or Condo and manufactured up to 95%
- Owner Occupied/Primary Residence Only
- Purchase and Rate/Term Refinance Only
- Financed MI is not allowed
- LP Accept/Eligible Only, DU is not acceptable
- Non-Occupant Co-Borrower allowed up to 95% LTV on one unit property

1.11.06.03 Borrower Eligibility
In determining whether a mortgage is eligible under the borrower income limits, the lender must count the income from all the borrowers who will be listed on the mortgage note, to the extent that the income is considered in evaluating creditworthiness for the mortgage loan.

The occupying borrowers may not have an ownership interest in more than two residential properties including the subject property, as of the note date. This is effective with loans closed on or after 08/01/2019. LPA will not be updated until 9/16/2019.

Borrower’s qualifying income, converted to an annual basis, must not exceed 80% of the AMI for the location of the Mortgaged Premises. This change will apply to all Home Possible Mortgages, including those secured by properties in low-income census tracts. HUD AMI can be found at the following website:

Area Median Incomes
Section 1.11 Special Programs

1.11.06.04 Borrower Contribution Requirements
There is no minimum borrower contribution requirement on a 1 unit Home Possible loan. For 2-4 units the minimum borrower contribution requirement is 3%.

Interested party contributions follow standard agency guidelines. Depends on the LTV.

1.11.06.05 Homebuyer Education
At least one occupying Borrower must participate in a homeownership education program before the Note Date in each of the following instances:

- For a purchase transaction where ALL occupying borrowers are First-Time Homebuyers

For 2-4 Unit Primary Residences Landlord education is required in the following instances:

- Purchase Transactions: At least one qualifying Borrower must participate in a landlord education program before the Note Date. Landlord education must not be provided by an interested party to the transaction, the originating lender or the Seller.
- Refinance Transactions: Landlord education is not required but is recommended for Borrowers who have not previously attended a program.

1.11.06.06 Reserves
- 1 Unit: No reserves required
- 2-4 Unit: 2 months reserves.

1.11.06.07 Mortgage Insurance
Mortgage Insurance Coverage Requirements:

Required MI coverage should always be confirmed by AUS findings.

<table>
<thead>
<tr>
<th>LTV</th>
<th>&lt;= 20 Year Fixed Rate</th>
<th>&gt;20 Year Fixed Rate, ARMs and Manufactured Homes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard</td>
<td>Standard</td>
<td>Standard</td>
</tr>
<tr>
<td>90.01 – 97%(^1)</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>85.01 – 90%</td>
<td>12%</td>
<td>25%</td>
</tr>
<tr>
<td>80.01 – 85%</td>
<td>6%</td>
<td>12%</td>
</tr>
</tbody>
</table>

---

1 The LTV for 1 unit Home Possible loans is 90.01–97%.
1 Conventional Underwriting Guidelines

Section 1.12 ARM Transactions

1 Non-Occupant Co-Borrowers and Manufactured Homes are limited to 95%.

1.12 Adjustable Rate Mortgage (ARM) Transactions

First Community Mortgage offers three different types of adjustable rate mortgages for Conforming Products and two different types for Non-Conforming Jumbo products. Each has unique properties as outlined below but all are based off the London Interbank Offered Rate (LIBOR) index. ARMs are acceptable through DU OR LP.

1.12.01 Conforming ARMs

<table>
<thead>
<tr>
<th>Program Code</th>
<th>ARM Type</th>
<th>Margins</th>
<th>First Adjustment Cap</th>
<th>Annual Cap after First Adjustment</th>
<th>Lifetime Cap</th>
<th>Qualifying Rate</th>
<th>INDEX</th>
</tr>
</thead>
<tbody>
<tr>
<td>C5/1ARM</td>
<td>5 Year ARM</td>
<td>2.25</td>
<td>2</td>
<td>2</td>
<td>5</td>
<td>Rate + 2%</td>
<td>LIBOR</td>
</tr>
<tr>
<td>C7/1ARM</td>
<td>7 Year ARM</td>
<td>2.25</td>
<td>5</td>
<td>2</td>
<td>5</td>
<td>Greater of FIR or Note Rate</td>
<td>LIBOR</td>
</tr>
</tbody>
</table>

FIR = Fully Indexed Rate = Index + Margin
Conventional Underwriting Guidelines

Section 1.13 Definitions

1.13 Definitions

Automated Underwriting System (AUS): General term for automated underwriting tools acceptable to First Community Mortgage, that includes:

- Fannie Mae’s Desktop Underwriter® and
- Freddie Mac’s Loan Prospector®

Combined Loan-To-Value or CLTV: The ratio calculated by adding the HELOC credit line limit to the mortgage amount plus any secondary financing and dividing that total by the value of the mortgaged premises.

Co-op or Cooperative Project: A structure of two or more Cooperative Units in which a borrower obtains the right to occupy one of the Cooperative Units by purchasing stock in the Corporation that owns the structure and by executing a Proprietary Lease for the Cooperative Unit.

Debt to Income or DTI ratio: A borrower’s DTI generally includes a “front-end” and “back-end” ratio. The front-end ratio, also known as a mortgage payment expense to effective income ratio, is calculated by taking the total mortgage payment and dividing it by the gross effective income. The back-end ratio, also known as the total fixed payments to effective income ratio, is calculated by taking the total obligations and dividing it by the gross effective income.

Extenuating Circumstance: Extenuating circumstances are nonrecurring 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 lender must substantiate the borrower’s claim. 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.).

The lender must obtain a letter from the borrower explaining the relevance of the documentation. The letter must support the claims of extenuating circumstances, confirm the nature of the event that led to the bankruptcy or foreclosure-related action, and illustrate the borrower had no reasonable options other than to default on their financial obligations.
Conventional Underwriting Guidelines

Section 1.13 Definitions

In certain circumstances, a job loss or divorce may qualify as an extenuating circumstance with additional mitigating factors outside the borrower’s control. The borrower’s circumstances must be unique and severe enough to cause a prolonged loss of income with no reasonable chance of timely recovery. The circumstances must be supported by documentation in the loan file. It should be documented that the borrower made every reasonable effort to avoid the derogatory event – ie. Tried to sell the house, obtained new job(s), depleted available resources such as 401K, savings, stocks/bonds, tried to rent the house etc.

All files with an extenuating circumstance exception should be pre-approved by underwriting prior to any approval being communicated to the borrower.

**Family Member:** A family member is a borrower’s 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.

**Fannie Mae:** The Federal National Mortgage Association, a federally chartered and privately-owned corporation, organized and existing under the Federal National Mortgage Association Charter Act, or any successor thereto.

**Federal Debt:** A Federal debt is defined as
- a Veterans Affairs guaranteed mortgage
- a Title I loan
- a Federal Student loan
- a Small Business Administration (SBA) loan
- delinquent Federal taxes, or
- a lien, including taxes, placed against the borrower’s property for a debt owed to the U.S.

**FHA:** The Federal Housing Administration

**First Time Homebuyer:** An individual is to be considered a first-time home buyer who (1) is purchasing the security property; (2) will reside in the security property as a principal residence; and (3) had no ownership interest (sole or joint) in a residential property during the three-year period preceding the date of the purchase of the security property. In addition, an individual who is a displaced homemaker or single parent also will be considered a first-time home buyer if he or she had no ownership interest in a principal residence (other than a joint ownership interest with a spouse) during the preceding three-year time.
Conventional Underwriting Guidelines

Section 1.13 Definitions

**Freddie Mac:** The Federal Home Loan Mortgage Corporation, a corporate instrumentality of the United States created and existing under Title III of the Emergency Home Finance Act of 1970, as amended, or any successor thereto.

**Gift Funds:** Gift funds are assets provided by a non-interested third party to the borrower.

**Identity-of-Interest or Non-Arm’s Length Transaction:** An identity-of-interest transaction is a transaction for the purchase of a principal residence between either party with familial or business relationship, or business affiliates. *Note:* An identity-of-interest transaction does not include an employer/employee transaction when the employee is purchasing the seller’s principal residence.

**Interested Party:** Interested parties include real estate agents, builders, developers, or anyone with an interest in the sale or refinance of the property.

**Loan-to-Value or LTV:** The loan-to-value of a mortgage loan at the time of its origination, which shall be the ratio, expressed as a percentage, that the mortgage loan bears to the lesser of (i) the appraised value of the mortgaged property at origination (as determined by a true and accurate appraisal that satisfies the procedural and substantive requirements of the underwriting guidelines) or (ii) if the mortgage loan was made to finance the acquisition of the mortgaged property, the sales price of the mortgaged property.

**Manufactured Home:** A manufactured home, including all accessions thereto, that is legally classified as real property under applicable state law.

**Monthly Payment:** The scheduled monthly payment of principal and/or interest, and any escrow payment, that is due each month on a mortgage loan.

**Mortgage:** The mortgage, deed of trust or other security instrument creating a first lien on an estate in real property.

**Mortgage Loan:** An individual Loan that is evidenced by a Mortgage Note and secured by a Mortgage and made in connection with the other documents included in the Mortgage Loan file (all of which are deemed included in the definition of "Mortgage Loan").

**Mortgaged Property:** The property pledged as security for the debt evidenced by a Mortgage Note.

**Mortgagor:** The obligor on a Mortgage Note.

**Non-Arm’s Length Transactions:** Non-Arm’s length transaction are purchase transactions in which there is a relationship or business affiliation between the borrower and the builder, developer, or seller.
Conventional Underwriting Guidelines

Section 1.13 Definitions

Non-occupying borrower transaction: A non-occupying borrower transaction is a transaction involving two or more borrowers where one or more borrower will not occupy the property as the principal residence.

Note: Document signed by a borrower as acknowledgment of the debt, and is, by inference, a promise to pay.

Self-employed borrower: A self-employed borrower is a borrower with a 25 percent or greater ownership interest in a business.

Third party contribution: A third party contribution is a payment by an interested third party, or a combination of parties, toward the borrower’s

- Closing costs, per ML 06-04
- Prepaid expenses
- Discount points, and
- Other financing concessions