



first community mortgage



a MORTGAGE

*Boutique*  
a division of First Community Mortgage



# Non-Conforming Prime Jumbo Guidelines

## Program

### Codes

NCJ15CB

NCJ30CB

NCJARM76CB

NCJARM106CB



first community mortgage

**Prime Jumbo  
Matrix**

Primary Residence						
Purchase, Rate & Term Refinance						
Property Type	Maximum Loan Amount	LTV/CLTV/HCLTV	Minimum Credit Score	Maximum Cash-Out	Months Reserves	Max DTI
SFR, PUDs, Condo, 1-Unit	\$1,000,000	80%	720	NA	12	43
	\$2,000,000	75%	720		18	41
	\$3,000,000	70%	760		24	41
		75%			36	
2-Unit	\$1,000,000	80%	720	NA	12	43
	\$2,000,000	75%	720		18	41
	\$3,000,000	70%	760		24	41
		75%			36	
3-4 Unit	\$2,000,000	70%	720	NA	18	43%
	\$3,000,000	65%	760		36	41%
Cash-Out Refinance						
SFR, PUDs, Condo, 1-Unit	\$1,000,000	70%	740	\$350,000	18	43%
	\$1,500,000	65%				
2-Unit	\$1,000,000	70%	740	\$350,000	18	43%
	\$1,500,000	65%				
3-4 Unit	Not Permitted					
Second Home						
Purchase, Rate & Term Refinance						
Property Type	Maximum Loan Amount	LTV/CLTV/HCLTV	Minimum Credit Score	Maximum Cash-Out	Months Reserves	Max DTI
1-Unit, PUDs, Condos	\$1,500,000	70%	740	NA	18	43%
Cash-Out Refinance						
Not Permitted						
Investment Property						
Purchase, Rate & Term Refinance						
Property Type	Maximum Loan Amount	LTV/CLTV/HCLTV	Minimum Credit Score	Maximum Cash-Out	Months Reserves	Max DTI
1-Unit, PUDs, Condos	\$1,500,000	65%	760	NA	36	40%
Cash-Out Refinance						
Not Permitted						

The above maximum LTV/CLTV/HCLTV should be reduced by 5% if the subject property is located in a depreciating market. Refer to Appraisal Evaluation/Depreciating Markets topic for additional requirements. Also see Depreciating Markets List.

The minimum loan amount is \$1 over the agency conforming loan limit unless noted otherwise

Loans must meet the Continuity of Obligation policy

Florida and Georgia Condominiums secured as investment property are not permitted



## **Loan Purpose**

### **Purchase**

- A purchase transaction allows proceeds to be used to:
  - Finance the purchase of a property.
  - Payoff an outstanding balance on an installment land contract, including any costs the borrower incurred for rehabilitation, renovation, or energy conservation improvements. If the financing exceeds the liens, the transaction must be considered a refinance.
  - Convert an interim construction loan or term-note into permanent financing if the borrower receives no cash from the settlement. If the permanent financing exceeds the recorded liens, the transaction must be considered a refinance.
  - Convert a lease option to purchase into permanent financing, as long as the borrower receives no cash back from the transaction.
- Note: The borrower may not be on title prior to the loan closing. The seller that is on title (the vested owner of record) must be the individual who executes the sales contract. Additionally, the seller must be on title prior to when the Closing Disclosure and closing docs are executed.
- Exceptions:
  - Corporate relocation transactions are excluded from this requirement. For a corporate relocation loan only, a third party relocation company may sign the sales contract and the Closing Disclosure as the seller. A copy of the fully executed Relocation Agreement is required.
  - If the transaction is a purchase transaction of a repossessed property where the seller is FNMA, FHLMC, bank, etc., it is acceptable for an individual representative of the “seller” to sign the sales contract and Closing Disclosure. For this type of transaction, we would rely on the title company to ensure that the individual is an authorized signer.
- LTV Calculations:
  - Calculate the LTV by dividing the loan amount by the lower of the sales price or the current appraised value.
  - Refer to Contract of Sale/Land Contract topic above for this type of purchase transaction.
  - Purchase Transactions for Existing Properties: The cost of a separate contract or bid for improvements to be made may not be added to the contract purchase price to calculate the LTV.
- Cash Back to Borrower
  - The borrower may not receive any cash back on a purchase transaction, unless the amount represents:
    - Reimbursement for the borrower’s overpayment of fees;
    - Reimbursement for costs paid by the borrower in advance (e.g., earnest money deposit, appraisal, credit report fees, etc.)
    - Legitimate pro-rated real-estate tax credit in locales where real estate taxes are paid in arrears.
    - Refunds that may be required in accordance with federal laws or regulations. The Closing Disclosure must clearly indicate the refund with a notation for the reason, and the loan file must include documentation to support the amount and reason for the refund.
    - If the borrower receives cash back for any of the above reasons, the underwriter must confirm that the minimum down payment or required borrower contribution has been met.



Pro-rated real estate tax credits cannot be considered when determining if the borrower has enough funds for the transaction.

- Pro-rated real estate tax credits cannot be considered when determining if the borrower has enough funds for the transaction.
- Proof that the funds were actually paid (e.g., canceled check or other acceptable means) must also be documented.
- **Tenant Rights**
  - In some jurisdictions, leases that predate the new mortgage hold superior claim to the existing mortgage, even if it has not been recorded. In these instances, the tenant has the right to remain in the property until the lease has expired—even if the subject property is subsequently sold. Therefore, if the purchase contract, appraisal, or title work indicates the subject property has an existing lease in place, the lease must be reviewed to make certain it does not contain a tenant rights provision as it could adversely affect our security interest.

## **Refinance**

- A refinance involves paying off an existing loan with the proceeds from a new loan, usually of the same size, and using the same property as collateral. Other reasons to refinance include taking equity out of the property, reducing the term of a longer mortgage, or switching between a fixed-rate and an adjustable-rate mortgage. If there are prepayment fees attached to the existing mortgage, refinancing becomes less favorable because of the increased cost to the borrower at the time of the refinancing. In order to decide whether a refinance is worthwhile, the savings in interest must be weighed against the fees associated with refinancing.
- For Rate/Term Refinances and Cash-Out Refinances, the LTV is calculated by dividing the loan amount by the current appraised value unless noted otherwise in the subsections within this section. However, there are situations where the LTV may need to be calculated by dividing the loan amount by the lesser of the appraised value or the sales price/acquisition costs. Refer to the following topics in this section for additional information:
  - Continuity of Obligation

## **Refinances: Cash-Out**

- A cash-out refinance transaction enables a borrower to pay off his or her existing mortgage by obtaining a new first mortgage that is secured by the same property or enables the property owner to obtain a mortgage on a property that does not already have a mortgage lien against it.
- A transaction that does not meet all of the criteria listed for a Rate/Term Refinance in this section must be treated as a cash-out refinance and must meet all the LTV/loan amount restrictions.
- Cash out transactions must meet the following requirements:
  - At least one borrower must have owned the subject property for a minimum of 6 months prior to the application date. (Note: There are no seasoning restrictions for doing two consecutive cash-out transactions.):
  - Borrower acquired the property through an inheritance or was legally awarded the property (divorce, separation, or dissolution of a domestic partnership there are no other seasoning requirements. Refer to Inherited Property requirements below.
  - If prior to closing the property is owned and held in a Limited Liability Corporation (LLC) that is majority-owned or controlled by the borrower, the time it was held in the LLC may be counted



towards meeting the borrower's six month ownership requirement. (Reminder: In order to close the new refinance transaction, ownership must be transferred out of the LLC and into the name of the individual borrower.)

- For properties in a leasehold estate, at least one borrower must have been a lessee on the ground lease or lease agreement of the subject leasehold estate for at least 6 months.
- For co-ops, at least one borrower must have held Cooperative Shares corresponding to the Co-op unit that is the subject of the Cooperative share loan for at least 6 months
- Continuity of Obligation must be met. Refer to the Continuity of Obligation topic in this section for complete information. Refer to Forbearance/Repayment Plan and Restructured Loans/Modification topics in Section 1508.2 Credit-Analysis.
- Cash-out is limited to the maximum amounts stated in 1502.2-Correspondent Non-Agency LTV Matrix.
- Except as required by applicable law, a Power of Attorney may not be utilized to sign a security instrument or note if the transaction is cash-out refinance. Refer to the Properties Listed for Sale topic in this section for information if the subject property has been listed for sale in the six months preceding the application date.
- Financing the payment of closing cost, points, and prepaid items is allowed. However, if real estate taxes are more than 60 days past due and are included in the new loan amount an escrow account must be established, unless prohibited by state law or regulation. In those instances, only, when the particular state law prohibits the lender from requiring an escrow account, the loan is still eligible as a cash-out refinance without an escrow account.
- This includes the payoff of any second mortgage, that is not permitted as outlined in the Rate/Term Refinance section, and transactions in which the loan proceeds exceed the maximum amount of funds that can be disbursed to the borrower per the rate/term refinance guidelines can be done as a cash out refinance.
- Inherited Properties
  - If a mortgaged property was inherited within the last 6 months, the following restrictions apply:
    - The owner must have clear title;
    - Title cannot be held in probate; and
    - Percentage of ownership by heirs must be demonstrated.
    - Documentation evidencing the inheritance must be obtained.

### **Refinances: Other Purposes**

- Proceeds from a rate/term refinance may also be used for the following purposes, as long as all other rate/term refinance guidelines and policies as defined in the referenced sections are met:
  - Buy out a divorced spouse, domestic partner's ownership interest in the subject property as defined in Buyout of Spouse, Domestic Partner or Affianced Interest topic in this section.
  - Payoff a land contract, or lease/rent with option to buy. Refer to the Contract of Sale / Land Contract or Lease-to-Own/Rent w/Option to Buy topics in this section.
- Existing HELOC/Fixed Rate Second Being Paid Off
  - Refer to the Rate/Term Refinance Loan Amount Calculation topic in this section for details.
- Adding a Borrower to the New Transaction
  - All borrowers listed on the new loan must be the same as those listed on the original loan. A new borrower may be added, and the transaction still will be eligible under the terms of a rate/term



refinance provided at least one of the original borrowers remains on the loan. However, all credit parameters (e.g., minimum score) must be met for the product/program selected.

- Removing a Borrower from the Transaction
  - The loan may still be eligible for a rate/term refinance if the borrowers have been divorced for 6 months or more and the remaining borrower has demonstrated the ability to manage the payments without the “absent” borrower’s income. Verification of timely payments for 6 months is required.

## **Refinances: Rate/Term**

- Eligibility Criteria
  - The policies outlined in this section apply only to the following conventional rate/term refinance transactions only.
    - There must be an existing mortgage secured by the property that will be paid off.
    - The transaction is not eligible as a rate/term refinance if the borrower completed a cash-out refinance transaction with a note date 30 days or less prior to the application date of a new refinance on the same property.
- Refer to Forbearance/Repayment Plan and Restructured Loans/Modification topics in Section 1508.2 Credit-Analysis.
- Loan Amount Calculation
  - The new loan amount is limited to:
    - Payoff the outstanding unpaid principal balance of the existing first lien, regardless of the loan originate date; and
    - Pay off any remaining balance due under a repayment plan, payment deferral or other loss mitigation program, as long as the funds are not subordinate financing; and
    - Financing of related closing costs and prepaid items\*; \*Prepaid Real Estate Taxes: The loan must be treated as a cash-out refinance and is subject to all cash-out policies, LTV’s, etc. if:
      - If the borrower finances the payment of real estate taxes for the subject property in the loan amount, but does not establish an escrow account; OR
      - The borrower finances the payment of real estate taxes for the subject property in the loan amount and the real estate taxes are more than 60 days delinquent (with or without establishing an escrow account).
  - However, if a particular state law prohibits a lender from requiring an escrow account, the loan is still eligible as a rate/term refinance without the escrow account.
- Note: Properties with transfer fees that are identified as exceptions on the title commitment may not be included.
  - Payoff of a subordinate loan that meets one of the following scenarios:
    - The subordinate lien was made within the last 12 months and all proceeds were used to purchase the property.
      - A copy of the Closing Disclosure signed by the borrower from the original sale must be obtained to verify that the entire amount being paid off was used to purchase the property
      - The payoff may also include any prepayment penalty that may be associated with the subordinate lien.



- If the subordinate lien is a home equity line of credit, the total amount of additional draws within the past 12 months may not exceed \$2000 (as documented by copies of home equity line statements).
- OR
  - The subordinate lien was made more than 12 months ago:
    - The payoff may also include any prepayment penalty that may be associated with the subordinate lien; and
    - If the subordinate lien is a home equity line of credit, the total amount of draws against the line during the past 12 months does not exceed \$2,000 (as documented by copies of home equity line statements); or
  - Cash back to the borrower may not exceed 1% of the principal amount of the new mortgage or \$5,000 whichever is less, as noted on the Closing Disclosure. Cash back on the Closing Disclosure may only exceed this amount by the amount that was paid outside of closing by the borrower, or due to refunds that may be required in accordance with federal laws or regulations as documented in the loan file. The Closing Disclosure must clearly indicate the refund with a notation for the reason, and the loan file must include documentation to support the amount and reason for the refund.
- Note: For Texas properties, a new refinance transaction that includes the payoff of an equity line of credit, the payoff of any loan that is a Texas Section 50(a)(6) loan, or provides any cash to the borrower at closing makes the new loan subject to Texas Section 50(a)(6) requirements and is not eligible.

### **Refinances: Technical Refinance**

- Technical Refinances are not permitted.
- If the mortgage proceeds are used to replenish the borrower's funds on a property that was purchased within the last 12 months the loan is considered a technical refinance. In most instances, the borrower did not have the time to obtain permanent financing due to the need to close quickly (for any number of reasons) and may have obtained short-term financing in order to do so.

### **Inherited Properties**

- If a mortgaged property was inherited within the last twelve (12) months, the following restrictions apply:
  - The owner must have clear title;
  - Title cannot be held in probate; and
  - Percentage of ownership by heirs must be demonstrated.
  - A five percent (5%) LTV/CLTV reduction must be applied to LTV/CLTV /HCLTV
  - Documented evidence of the inheritance must be obtained.

### **Continuity of Obligation**

- When an existing Mortgage on the subject property will be satisfied as a result of a refinance transaction (rate/term and cash out), 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 mortgaged premises as a primary residence for the most recent 12-month period and the mortgage file





contains documentation evidencing that the borrower has been making timely mortgage payment, including the payments for any secondary financing, for the most recent 12-month period; 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).
- The property was previously owned by an Inter vivos revocable trust and the borrower is the primary beneficiary of the trust
- Note: Continuity of Obligation requirements do not apply when there is no existing mortgage on the subject property.

### **First-Time Homebuyer**

- Agency guidelines define a first-time homebuyer as an individual who is purchasing the subject property as their primary residence and has had no ownership interest (sole or joint) in a residential property during the three-year period preceding the date of the purchase of the subject property.
- A displaced homemaker or single parent who has had an ownership interest in a primary residence during the preceding three years may also be considered a first-time homebuyer, if they meet the following requirements:
  - The ownership interest must have been in a primary residence jointly held with their spouse. If they owned a primary residence with anyone other than a spouse, or owned a second home or investment property during the three-year time period, they cannot be considered a first-time homebuyer.
  - The applicant's marital status may be (1) "unmarried" as long as they have one or more dependents; or (2) "separated", regardless of whether or not they have any dependents. If the marital status is "married", or "unmarried" and there are no dependents, the applicant cannot be considered a first-time homebuyer.
- Only one of the applicants has to qualify for "first-time homebuyer" status in order for the mortgage to be considered a mortgage to a first-time homebuyer. First-time homebuyer status is verified using the Declarations section on the Application.

### **Buyout of Spouse, Domestic Partner or Affianced Interest**

- A refinance that results from a divorce settlement in which one of the spouses is required to buy out the other's interest in a property is considered a rate/term refinance provided the borrower who acquires sole ownership of the property does not receive any cash back.
- We may also consider a buyout of the interests of a domestic partner, fiancée, or fiancé as a rate/term refinance transaction if all of the following conditions are satisfied:
  - Both parties owned the subject property jointly for at least 12 months preceding the date of the mortgage application. An individual who inherits an interest in the property does not have to satisfy this requirement.
  - Both parties are able to demonstrate that they occupied the property as their principal residence by providing an acceptable source of verification (e.g., driver's license, bank statement, credit card bill, utility bill, etc. that was mailed to the individual at the address of the mortgaged property).
  - Both parties must sign a written agreement that states the terms of the property transfer and the proposed disposition of the proceeds from the refinance transaction. The borrower who acquires sole ownership of the property must not receive any cash back from the proceeds of the refinance.





- The party who is buying out the other party's interest must be able to qualify for the mortgage under our standard underwriting guidelines.
- Texas Property: The division of the homestead property pursuant to a court order or an award in a divorce proceeding is considered a Texas Non Equity Loan that may be processed as a rate/term refinance. The borrower may not receive any cash back at closing.
- Transaction Type: All transactions may be originated as rate/term refinances, regardless of process type.

### **Contract of Sale / Land Contract**

- A land contract, also known as an installment land contract, contract for deed, contract sale, contract purchase, or in Hawaii, an Agreement of Sale, is a form of seller financing in which the seller retains title to the property while the buyer makes regular payments to the seller. Once the buyer pays the number of payments and/or amount specified in the contract, the seller conveys title to the buyer.
- An executed contract for deeds/land contracts must be seasoned for at least 12 months before the transaction is eligible for financing.
  - A mortgage in which the proceeds are used to pay the outstanding balance of a land contract or contract for deed may be Rate/Term Refinance Transaction only. The land contract/ or contract for deed must be executed more than 12 months preceding the mortgage application date.
  - Proceeds from the refinance transaction may include the sum of the outstanding balance of the installment sales contract and the costs incurred for rehabilitation, renovation, or energy improvements.
    - The loan file must include third-party documentation evidencing payments were made in accordance with the terms of the land contract or contract for deed for the most recent 12 month period.
    - A new appraisal is required and the LTV must be calculated using the appraised value of the new first mortgage transaction.
  - Purchase Transactions: If the land contract or contract for deed was executed within the 12 months preceding the mortgage application date, it is not permitted.
  - Cash-Out Refinance Transaction: Not Permitted.
- Note: The right to rescind will apply to a loan to rehabilitate or improve the borrower's principal dwelling

### **Lease-to-Own / Rent w/Option to Buy**

- A transaction in which the borrower holds a lease with an option to purchase the subject property must be processed as a purchase transaction, with the LTV based on the lesser of the purchase price or appraised value. Loans must be treated as a purchase transaction.
- The property seller may give the purchaser credit toward the down payment for a portion of previous rent payments the purchaser made under a documented rental purchase agreement. Refer to Section 1508.4- Assets/Source of Funds for additional requirements.



## **Credit**

### **Credit Requirements**

#### **Accuracy of Credit**

- For all mortgage loans, the lender is responsible for reviewing the credit report as well as all the credit information, to determine that the credit report meets FCM requirements.

#### **Age of Credit Documents**

- Credit documents may not be more than 120 days old at time of loan closing for existing and new construction.
- Credit documents include credit reports and employment, income, and asset documentation. The age of the documents is measured from the date of the document to the date the note is signed.
- For properties located in an “escrow state” only, the printed note date and actual closing/signing date may differ. In these instances, the Closing Disclosure should be used to determine the actual closing date for determining the age of credit documents.

### **Bankruptcy**

- To be considered for a mortgage loan, the borrower’s bankruptcy must have been dismissed or discharged (as defined below) and s/he must have reestablished a satisfactory credit history and demonstrated the ability to manage financial affairs prudently. (“Satisfactory” means that the most recent rating has a rating of “1”.) The bankruptcy should be fully discharged or dismissed as specified below.
- The mortgage application may not be approved before the following time periods have elapsed from the date of the application:
  - 4 years from the date the Chapter 7 or 11 bankruptcy was discharged or dismissed;
  - 4 years from the date a Chapter 12 or 13 repayment plan was dismissed or 2 years from discharge date. Note: The shorter waiting period based on the discharge date recognizes that borrowers have already met a portion of the waiting period within the time needed for the successful completion of a Chapter 12 or 13 plan and subsequent discharge. A borrower who was unable to complete the Chapter 12 or 13 plan and received a dismissal is held to a 4-year waiting period.
- A letter of explanation for the bankruptcy is required.
- The Lender may consider 2 years an acceptable interval for having re-established a satisfactory credit record when:
  - The previous action was a discharged or dismissed Chapter 12 or 13 bankruptcy, regardless of the reasons that contributed to the previous bankruptcy.
  - The previous action related to a deed-in-lieu or Chapter 7 or 11 bankruptcies resulted from extenuating circumstances. (If the borrower cannot provide satisfactory documentation of the extenuating circumstances, 4 full years must have elapsed.)
- Bankruptcy on the Same Mortgage
- If a mortgage debt was discharged through a bankruptcy, the bankruptcy waiting periods may be applied if the appropriate documentation to verify that the mortgage obligation that was discharged in the bankruptcy is obtained. Otherwise, the greater of the applicable bankruptcy or foreclosure waiting periods must be applied.
- Multiple Bankruptcy Filings



- A 5-year time period must have elapsed from most recent dismissal or discharge date for borrowers with more than one bankruptcy filing within the past 7 years. A satisfactory credit record must be re-established. All bankruptcies must be either dismissed or discharged.
- Note: Two or more borrowers with individual bankruptcies should not be considered cumulative. For example, if the borrower has one bankruptcy and the co-borrower has one bankruptcy, this is not considered a multiple bankruptcy.
- Documentation Requirements
- Borrowers who have had a bankruptcy closed within the past 7 years must provide the following:
  - Copies of the bankruptcy petition, schedule of debts, discharge or dismissal order and the document issued by the court showing the bankruptcy estate is closed.
  - Evidence to indicate that all debts not satisfied by the bankruptcy have been paid or are being paid.
  - Any other evidence necessary to support the determination that the borrower has reestablished and maintained an acceptable credit reputation (see Re-establishing Credit).

### **Borrower Explanations (LOX)**

- A written explanation from the borrower is required for the following:
  - All Significant Derogatory Information. The purpose for requiring a written explanation is to assist the underwriter in determining whether the Borrower's credit problems were due to extenuating circumstances (factors clearly beyond the control of the Borrower) or whether they reflect financial mismanagement (the Borrower's disregard for the payment of obligations when due). Refer to Credit/Analysis/Derogatory Credit for examples of significant derogatory credit.
  - Temporary Leave: The borrower must provide written confirmation of their intent to return to work and the agreed upon date of their return.
  - Gap in Employment: The borrower must provide a written explanation when there is a gap in employment of 30 days or more.
- The underwriter should determine if any other explanations are required. The following are all acceptable forms of documentation for the explanation:
  - Verbal conversation directly with the borrower (documented in the permanent loan file); or
  - Written explanation/letter sent via regular mail, email, or fax. Confirmation that the Written explanation came from the borrower may include the email address, a typed or signed name within the explanation document or an e-signature

### **Consumer Credit Counseling Agencies (CCCA)/Debt Management Services (DMS)**

- Consumer Credit Counseling Agencies (CCCA) and Debt Management Services (DMS) assist borrowers who may have had difficulties in managing their debt; it is often demonstrated by a history of delinquent accounts. Debt management plans may be administered by a not-for-profit agency such as consumer credit counseling agency (CCCA) or a non-affiliated for-profit debt prorating service.
- Note: Homeownership Counseling, which is designed to help first time homebuyers prepare for the financial responsibilities associated with home ownership, should not be confused with Consumer Credit Counseling. This section addresses Consumer Credit Counseling Agencies (CCCA)/Debt Management Services (DMS) only.
- The following scenarios ARE NOT considered added risk and should not be held against the borrower when considering them for a mortgage loan.



- The borrower is/has participated in Homeownership Counseling in preparation for purchasing a home.
- The borrower is/has participated in consumer credit counseling or debt management program but continues to manage their own finances.
- The borrower participated in consumer credit counseling or debt management program during which time the counseling agency made payments to creditors on the borrower's behalf. The following conditions must be met:
  - A minimum of 12 months must have passed since the borrower participated in the program.
  - The borrower has demonstrated the ability to manage credit since then.
  - The borrower has a satisfactory pay history on all accounts.
- The following conditions ARE considered adverse risk factors and must be considered accordingly:
  - The borrower is currently participating in credit counseling and making monthly payments to the Consumer Credit Counseling Agency or other debt pro-rating service instead of paying creditors directly.
  - The borrower has recently completed credit counseling or other debt service counseling program (less than one year has passed) during which time the counseling agency made payments to creditors on the borrower's behalf.

### **Credit History**

- The credit history reflects the manner in which a borrower manages their financial responsibility, current obligations, and monthly payments. Good credit must not be considered a compensating factor. It must be expected of each borrower applying for a mortgage.
- Changes in Credit Usage
- Recent changes in the borrower's use of credit may indicate they are having difficulty in maintaining accounts. The underwriter should review the age of all obligations to determine whether there has been a recent, significant increase in the number of open accounts and/or the number of outstanding balances.
- Refer to Borrower Explanations and Derogatory Credit topics in this section for more information.
- Authorized Users of Credit – All Loan Transactions
- Credit report trade lines that list a borrower as an "Authorized User" may only be considered as part of the borrower's credit history to meet minimum credit requirements if:
  - Another borrower in the current loan transaction is the owner of the trade line; or
  - The borrower can provide written documentation (i.e., cancelled checks) that s/he has been the actual and sole payer on the account for at least twelve months preceding the date of the loan application.
- If an authorized user's account is used to meet the minimum credit requirements, then both the payment history, including any late payments and the monthly obligation must be considered in the credit analysis and included in the DTI ratios

### **Credit Inquiries**

- When reviewing borrower credit history, new accounts and inquiries should always be considered. There may be red flags for multiple liens or other fraud schemes, or an indication that the customer's repayment ability is being compromised by new debt. Inquiries on the credit report generally reflect the borrower's requests for new or additional credit. Inquiries made for other purposes, such as general solicitations not initiated by the borrower or monitoring inquiries by current creditors, typically are not shown on the



credit report. The presence of many recent inquiries in combination with a significant number of recently opened accounts, high balance credit utilization, and/or delinquent accounts represent a high credit risk.

- If the credit report indicates that a creditor has made an inquiry within the previous 90-day period, then the Lender must determine whether additional credit was granted as a result of the borrower's request. A letter from the creditor OR a signed statement from the borrower OR a conversation with the borrower (which must be documented in the loan file) may be used to determine whether additional credit was obtained. Note: Letters of explanation that are e-mailed are not required to be signed, refer to the Borrowers Letters of Explanation topic in this section for additional requirements.
- Inquiries from a source that would not result in a debt included in the DTI calculation do not require written explanation from the borrower. Lender must verify the unpaid balance, the terms of repayment and the payment history (if applicable). The final loan application signed by the borrower(s) must include all debts that were verified, disclosed or identified during the loan application process. If new credit was obtained and there is a balance on the new account, the debt must be included in the list of debts and the calculation of DTI ratios, even if the account does not appear on the credit report.
- Note: If new credit is obtained after the loan has been approved, re-underwriting will be required.

### **Credit Report Alerts**

- Pursuant to the provisions of the Fair and Accurate Credit Transactions Act (FACT Act), consumers have certain rights to protect themselves from the risk of identity theft. Consumers who are victims of identity theft, or who believe they may become victims, or who are on active duty in the military may request that a credit reporting agency pass a fraud or active duty flag to users who request their credit report.
- The underwriter is responsible for reviewing each credit bureau report carefully to ensure there are no alerts or "red flags" which would require special attention.

### **Fraud or Active Duty**

- A consumer has the right to place a fraud or active duty alert on their credit bureau by following a procedure established by the bureaus. An alert means that someone may have used the consumer's identity without his or her consent.
- FCM prohibits loans to applicants who have a security alert in their credit file unless reasonable steps have been taken to verify the applicant's identity. We must follow the instructions provided by the consumer located in the consumer's credit report before an application can receive further processing, or the borrower may contact the consumer reporting agency and provide the appropriate instructions and identifying information to the credit reporting agency allowing the lender to re-pull a consumer report clear of fraud or active duty alerts. In some instances the consumer will need to be contacted by phone to verify identity.
- Reminder: The borrower may not be automatically declined due to the presence of such alerts.
- Address Indicators
- The credit reporting agencies indicate when the applicant's address provided by a creditor differs, or is a variation, from the address on the credit report. Often there is a simple and logical explanation. However, such discrepancies may be red flags for fraudulent activity.
  - Address Discrepancy Alert This alert occurs when the applicant's address is a variation of the address the credit bureau has on file or the credit bureau address history reflects other addresses reported during the same time period as the inquiry address.



- Address Mismatch Alert This alert occurs when the applicant's address does not show up on the credit bureau report. This indicates the inquiry address is a new address for the applicant's credit profile, as the address does not match or has never been reported to the credit bureau before.
- All discrepancies/mismatch addresses must be reviewed and resolved.
- Frozen/Locked Credit must follow Consumer Credit Bureau Block policy.

### **Credit Utilization**

- The lender must review the borrower's credit report to evaluate his/her use of revolving credit by comparing the current balance on each open account to the amount of credit that is available to determine whether the borrower has a pattern of using revolving accounts up to (or approaching) the credit limit.
- The higher the borrower's overall utilization of revolving credit the higher the amount of risk. (Note: The lack of adverse or derogatory credit information may not be used as an offset for high balance-to-limits or high overall utilization of revolving credit.)

### **Credit Worthiness**

- The underwriter must determine the credit worthiness of all borrowers. While credit score is a key factor used in determining credit worthiness, we recognize there are situations in which either the score is not available, (e.g., an international borrower lacking a credit history in the U.S.), the credit history is old, or there are too few trade lines available to score a loan. In these cases a manual, further evaluation of credit may be necessary. This section addresses the data that should be examined and considered while performing a judgmental/subjective credit evaluation. Refer to Section 1508.2- Credit/Decision Options/ Comprehensive Risk Assessment topic for additional information.
- Important: The underwriter has the right to request additional information if deemed appropriate even if an explanation is not normally required.

### **Deed-In-Lieu/Short Sale/ Pre-Foreclosure or Charge-Off of A Mortgage Account**

- The waiting period (i.e., the amount of time that must pass before the borrower is eligible for mortgage financing), which commences on the completion date of the above events, is a minimum of four years with the maximum LTV/CLTV/HCLTV permitted as defined by the product/program selected.
- Extenuating Circumstances: If the deed-in-lieu, short sale, pre-foreclosure or charge-off of a mortgage account was the result of documented extenuating circumstances, the waiting period is two years provided the borrower meets all requirements for re-establishing credit. The maximum LTV/CLTV/HCLTV is the maximum LTV permitted by policy
  - A deed-in-lieu is a transfer of title from a delinquent borrower to the lender in satisfaction of the mortgage debt to avoid foreclosure; also called a voluntary conveyance or typically identified on the credit report through Remarks Codes such as "Forfeit Deed-in-Lieu of Foreclosure."
  - A short sale, pre-foreclosure sale or charge-off of a mortgage account is a transaction where the mortgage lender agrees to accept a lower amount than is owed on the property. These are typically identified on the credit report through Remarks Codes such as "Settled for less than full balance than is owed on the property. These are typically identified on the credit report through Remarks Codes such as "Settled for less than full balance and "Foreclosure Initiated." The loan may or may not be delinquent.





- Examples of how short sales/pre-foreclosures or charge-off of a mortgage account may be identified on the credit report:
  - Special Comment Code AU (Account Paid-in-Full for Less than Full Amount Due)
  - \$0.00 Current Balance
  - Payment rating applicable to the contractual status of the loan at time short sale is processed (i.e. current, 30 days' delinquent, 60 days' delinquent, etc.).
- As a result of the "AU" reporting, credit bureaus display a corresponding comment on the consumer's credit report. The verbiage of that comment varies per bureau. The bureaus may display verbiage very similar to the actual AU definition, but may also display a comment, such as "settled". The actual "AU" code does not appear on the consumer's credit report. There is also not anything within the payment history section of the credit report that would refer to the short sale.
- Note: This section does not apply to deeded Timeshares.

### **Derogatory Credit**

- The presence of significant derogatory credit information dramatically increases the likelihood of a future default and represents a significantly higher level of default risk. Examples of significant derogatory credit events include bankruptcies, foreclosures, deeds-in-lieu of foreclosure, pre-foreclosure sales, short sales, and charge-offs of mortgage accounts.
- The lender must determine the cause and significance of the derogatory information, verify that sufficient time has elapsed since the date of the last derogatory information, and confirm that the borrower has re-established acceptable credit history.
- A written explanation for significant derogatory credit must be documented along with supporting exhibits as defined throughout this section.
- The underwriter should determine if a letter of explanation is required for minor derogatory credit or an isolated incident that is not representative of the borrower's overall credit history/ profile. The underwriter should explain in their rationale if a letter is not being required.
- Note: Mortgage payments missed during the time of a COVID-19 related Forbearance do not have to be considered as mortgage lates and do not have to be considered significant derogatory credit as outlined below.
- Significant Derogatory Credit
  - The following scenarios are examples of what may be considered "Significant Derogatory Credit" and, therefore, require a written explanation from the borrower.
  - There are several accounts showing recent late payments;
  - There are multiple 60- or 90-day late payments;
  - There is more than one 30-day late housing payment in the last 12 months;
  - There are more than two 30-day or more than one 60-day late housing payments within the most recent two years;
  - The number and size of the delinquent accounts are large in relation to the overall credit;
  - There are multiple episodes of late payments extending over a period of time;
  - The credit history shows derogatory credit information within the two most recent years combined with multiple revolving accounts with high balances-to-limits;
  - The public record information reveals several occurrences of derogatory credit information, including judgments, tax liens and/or collection accounts;





- There is a bankruptcy filing, foreclosure, pre-foreclosure sales, mortgage charge-offs, deed-in-lieu of foreclosure, short sale within the last seven years, or accounts that have been turned over to a collection agency.
- Identification of Significant Derogatory Credit Events in the Credit Report
- The Underwriter must review the credit report and the Declarations section of the loan application to identify instances of significant derogatory credit events. The Underwriter must also review the public records section of the credit report and all trade lines, including mortgage accounts (first and second liens, home improvement loans, HELOC's and manufactured home loans) to identify previous foreclosures, deed-in-lieu, pre-foreclosure sales, charge-offs of mortgage accounts, and bankruptcies. Finally, the Underwriter must carefully review the current status of each trade line, manner of payment codes, and remarks to identify these types of significant derogatory credit events.
- If significant derogatory credit events are not clearly identified in the credit report, the borrower must provide copies of appropriate documentation to establish the completion date of a previous foreclosure, deed-in-lieu or pre-foreclosure sale, or date of the charge-off of a mortgage account; confirm the bankruptcy discharge or dismissal date; and identify debts that were not satisfied by the bankruptcy. Debts that were not satisfied by a bankruptcy must be paid off or have an acceptable, established repayment schedule.
- Discrepancies
  - When a credit report does not include a reference of a debt the borrower reported on the loan application, separate written verification for each unreported debt is required. Accounts listed on the credit report as "will rate by mail only" or "need written verification" also require separate verification. If debt shows up on the credit bureau that was not on the application, no explanation is required. However, it should be included on the application and included in the debt ratios.
  - Written explanation may be required depending on the documentation process selected. Refer to Borrower Letters of Explanation topic in this section for more information.

## Disputed Credit Obligations

- Disputed trade lines or public records adverse to the credit profile require a written explanation from the borrower including evidence to support the dispute. If the account in question adds risk, such as stolen/fraudulent use of the account, the evidence must include documentation and verification of the account status (i.e. current balance, delinquency, etc.) from the creditor or credit bureau. Refer to the Borrower Letters of Explanation topic in this section for more information.
- Note: If the account or public record is medical, a letter of explanation and evidence is not required, as dictated in FCRA - Regulation V: Medical Information Privacy Act.

## Past Due Accounts

- An explanation by itself is generally not sufficient to allow a past due account to go unpaid. These are evaluated on a case-by-case basis. Refer to individual topics in this section for additional requirements.
- Incorrect Information
  - If a borrower states the information on the credit report is incorrect or does not belong to the borrower and the information reflected is deemed to be of material significance (e.g., delinquent credit obligation, public records or trade lines that do not belong to the borrower), the borrower must provide documentation from the creditor or the credit bureau evidencing that a dispute has been initiated for the identified account(s). All written letters of explanation must be signed by the



Borrower prior to close. Refer to the Borrower Letters of Explanation topic in this section for more information. A subjective review must be performed as part of the underwriter's risk analysis.

## **Evaluating the Credit Score**

- If using an external credit score, the underwriter should review the score in conjunction with the borrower's credit history requirements, keeping in mind that:
  - A high score does not mean the loan should automatically be approved. Rather, it means that the underwriter must determine that the mortgage satisfies our eligibility criteria and the borrower meets our overall underwriting standards.
  - A low score does not mean the loan will go into default (although statistically there is a higher likelihood of this occurring). However, the loan must have strengths to compensate for the low credit score.
  - A lack of a score due to little or no credit does not constitute a high credit risk. Rather, it means that the borrower has insufficient credit from the type of credit providers that generally report to credit bureaus.

## **Forbearance/Repayment Plan**

- Forbearance
  - A Forbearance plan suspends or reduces the amount of the regular monthly mortgage payment. At the end of the forbearance term, the borrower(s) is responsible for the balloon payment.
- Repayment Plan
  - A repayment plan is an arrangement in which a borrower(s) agrees to repay past due amounts while still making regularly scheduled payments.
- Borrower(s) who have been accepted into a Payment Deferral are considered current upon completion of the Payment Deferral.
- Borrowers(s) are eligible for new financing upon completion of the payment deferral under a Forbearance or Repayment Plan and if the following criteria are met:
  - All transactions:
    - At least 6 months have elapsed since the Forbearance or Repayment Plan was completed; and
    - Borrower(s) must have made the payments as agreed per the loan forbearance or repayment plan, and
    - Mortgage history must meet the mortgage history requirements per the product, program and/or process applied, and
    - Borrower(s) must meet all other requirements per the product, program and/or process applied.

## **Foreclosure**

- After 7 years have elapsed, the borrower may obtain a purchase mortgage pursuant to the eligibility requirements in effect at that time. A letter of explanation is required.
- When both a bankruptcy and foreclosure are disclosed on the loan application, or when both appear on the credit report, the bankruptcy waiting period may be applied if the borrower provides appropriate documentation to verify that the mortgage loan in question was discharged in the bankruptcy. Otherwise, the greater of the applicable bankruptcy or foreclosure waiting period must be applied.



- Note: This topic does not apply to deeded Timeshares.

### **Garnishments**

- A garnishment occurs when an employer or other asset holder is required to send/ apply borrower monies, wage, or property directly to a specific debt or creditor. This is often, but not always, brought about by the non-payment of a debt. The underwriter should find out the reason for the garnishment, document explanation (in writing or verified via telephone) and continue processing.
- If the borrower has a garnishment, the monthly debt should be included in the total debt ratio.
- Note: Garnishments do not need to be paid off prior to or at close.

### **Judgements & Tax Liens / Public Records**

- Borrower must pay off all delinquent credit—including delinquent taxes, judgments, charged-off accounts, tax liens and mechanics' or materialmen's liens—that have the potential to affect lien position or diminish the borrower's equity.
- Borrowers with previous judgments must provide evidence of payment in full or evidence the judgment no longer represents a claim against the borrower.
- The borrower must provide satisfactory written explanation along with any supporting documentation, as needed. Refer to the Borrower Letters of Explanation topic in this section for more information.
- Loan Proceeds may be used to pay off judgments or tax liens at closing by the title company; pay off must be documented on the Closing Disclosure.

### **Lawsuits**

- The fact that there is a lawsuit pending does not mean that the borrower is guilty of the claim. Until the court has made a ruling on the case, there is no judgment or lien. However, the type and extent of the lawsuit and whether it could impact our first lien position, may increase the risk, therefore the loan should be evaluated carefully before rendering a decision.
- A written explanation and a copy of the filed complaint pertaining to the lawsuit are required. Refer to the Borrower Letters of Explanation topic in this section for more information. Additional documentation may be required depending on the type of lawsuit and the borrower's involvement.

### **Minimum Tradelines**

- Traditional Credit
- The cumulative established credit history of all borrowers on the transaction needs to consist of a minimum of 4 trade lines (installment, revolving accounts, mortgages, etc.), one of which is open and has a minimum of 24 months history, the other 3 may be open or closed but must be rated for at least 12 months.
- Note: If there are less than 4 trade lines, or the trade lines do not meet the required payment history requirements as outlined or if there is no credit, there is insufficient data to determine credit behavior—even if the report includes a credit score.
- Non Traditional Credit
  - Non-traditional credit history is not permitted.



## **Payment of Past Mortgages / Rent**

- How the borrower has handled present and prior mortgage/ rent payments provides useful insight as to how the new mortgage will be managed. In addition to the new mortgage payment, the underwriter should also examine the payment history and the amount/ percentage the monthly payment will increase.
  - The credit report must contain the entire mortgage payment history. If the report covers activity for the previous 12 months or longer, we may rely on the credit report for the verification. If it does not, we must obtain the history directly from the mortgage servicer or get 12 months cancelled checks (front and back).
- Verification of Rental Payments:
  - A verification of rental history is required on all transactions via:
    - Copies (front & back) of twelve (12) months consecutive (one (1) payment per month) rental payment cancelled checks; or
    - Bank statements or direct payment records showing one (1) payment per month; or
    - Verification of rent; or
    - Residential mortgage credit report ("RMCR") or merged in-file report.
    - The rental payments must be current on the date of the loan application. (Refer to the Age of Credit Documents top in this Section for further requirements)
  - Borrowers unable to provide a complete twelve-month (12) mortgage/rental history are limited to owner occupied primary residences only.
  - If the landlord is related to the borrower, twelve months of cancelled checks must be provided.
  - The rental history must reflect 0 x 30 in the previous twelve (12) months.
- Note: Verifications performed by a party other than a professional management company are not permitted. The management company must be listed in the local telephone directory and the file must contain a copy of the list. If the listing is not available, 12 months canceled checks must be provided.
- Existing Mortgage Payment Requirements
  - A verification of mortgage history is required on all transactions and must contain current balance, status and payment amount verified via:
    - A third party or credit bureau; or
    - Verification of mortgage completed by the holder of the mortgage is acceptable.
    - On the date of the loan application, the borrower's mortgage payments (first and second) on the subject property must be current.
    - On the date of the loan application, the mortgage history must reflect 0 x 30 in the previous twelve (12) months. "Rolling" Mortgage late pays are not permitted.
    - In case of a recent refinance or account transfer, a combination of payment performance from multiple lenders for the same collateral may be used to complete the twelve-month (12) history requirements.
    - For a recent purchase, a combination of payment performance from a prior property or rental payments may be used to complete the twelve-month (12) history. A gap in mortgage/rental payment history of up to six (6) months is allowed by obtaining the most recent eighteen-month (18) history and providing written documentation explaining the reason for the gap.
- Refer to Forbearance/Repayment Plan topic in this section if borrower(s) have entered into a Payment
- Deferral Plan.



## Re-Establishing Credit

- Following are the requirements that the borrower must meet to re-establish credit after a significant derogatory event.
- Note: After a bankruptcy, foreclosure, deed-in-lieu of foreclosure, pre-foreclosure sale or charge-off of a mortgage account, the borrower's credit will be considered re-established if all the following are met.
- The waiting period for the event along with related requirements have been met.
- The borrower has met traditional credit as defined in Credit History/Minimum Trade Lines topic above
- Non-traditional credit or "thin files" are not permitted.

## Social Security Number

- All U.S. citizens, permanent resident global clients, and non-permanent global clients must have a social security number in order to be eligible for a loan.
- ITIN numbers are not permitted.
- Incorrect, Duplicate, and Multiple Numbers:
  - Red flags concerning the social security number are typically revealed on the credit report. Examples of red flags include:
    - Incorrect Number – Information associated with the social security number entered is not available.
    - Duplicate Numbers – Information reveals more than one individual associated with the same social security number.
    - Multiple Numbers – Information reveals an individual has credit listed under another social security number.
    - Deceased Borrowers – The person to whom the number was issued has been reported as deceased.
- If the accuracy of the information is in question, and the underwriter is unable to ascertain the correct number, the loan should be sent to Fraud for research and resolution. All investigations must be complete prior to the loan decision.
- Social Security Number (SSN) Validation Requirements
- Borrowers must have a valid social security number. Numbers may need to be verified with the Social Security Administration as indicated below:
- Effective for applications dated on or after June 1, 2010, any SSN issues (including invalid format, number not issued, borrower age or issue date discrepancies, number associated with deceased individuals, etc.) that cannot be resolved internally, must be validated with the Social Security Administration (SSA) using Form SSA-89 or Electronic Consent Based Social Security Number Verification (eCBSV) Service (direct validation by a third party is acceptable). If verification is required and obtained it should be noted in the loan file. If verification is required but the SSN cannot be validated with the SSA, the loan is not eligible for purchase.

## Taxpayer Identification Theft

- Taxpayer Identification Theft occurs when a taxpayer's social security number has been stolen and then used to file a forged tax return in an attempt to claim a fraudulent refund. This type of theft is most



commonly identified by tax transcripts that conflict with the information reported on the tax return, such as inconsistent income or the income on the transcript is significantly different than what is reported on the tax return. It may also be indicated when the IRS has rejected a tax transcript request due to reasons of “not able to process” or “limitation” or with another similar code and not a “no record found” or data mismatch response. The borrower may also provide an IRS victim notification or an extended fraud alert may be reflected on the credit report.

### **IRS Tax Transcript Rejects**

- If the IRS rejects a tax transcript request with reject code 10, IRS reject code 10 due to limitations, or IRS reject due to limitations, indicating the borrower may be a victim of taxpayer identification theft, the following steps must be taken:
  - The borrowers must contact the IRS at the number identified on the rejection letter.
  - The borrower must confirm they have no fraud or identity theft.
  - The underwriter must review the file to ensure there are no red flags present.
  - A LOX from the borrower OR documented rationale from the underwriter must be placed into the file confirming the borrower contacted the IRS and no ID theft.
  - Provided there are no red flags, and the file meets all of the above requirements, the file may move forward to approval/close. No further attempts at obtaining transcripts are required.

### **Confirmed Identification Theft**

- Once the determination has been made that a borrower is a victim of taxpayer identification theft, an exception to the transcript policy is not required if the following documentation is provided:
  - Proof identification theft was reported to and received by the IRS (form 14039), if available; OR
  - Copy of the notification from the IRS notifying the taxpayer of possible identity theft; OR
  - A copy of a police report or proof that the borrower filed a complaint regarding the identity theft with the Federal Trade Commission; AND
  - Bank statement or copy of check evidencing tax payment made or refund received for that year matches the 1040 amount (required unless the borrower is waiting on their refund due to the fraud issues); AND
  - Signed 4506-C (required)
- In addition to providing the above, underwriters should use discretion when assessing income credibility. This could include items such as the prior year tax transcripts or prior year tax return, police report, institutional written VOEs, bank statements supporting payroll deposits or any other documentation deemed supportive, based upon the specific situation. Any red flags raised by additional documentation should result in a referral to the Fraud Prevention and Investigation unit.

### **Unpaid Charge-Offs & Collections**

- The unpaid charge-off and/or collection is required to be satisfied as defined below. An explanation from the borrower is required. Refer to Borrower Explanations topic in this section for more information. Proceeds from a cash-out refinance transaction may be used to satisfy the unpaid charge-off and/or collection at closing.
- An account may be paid at closing, for a purchase or rate/term refinance transaction, if all of the following requirements are met:





- The payoff should be documented on the Closing Disclosure and match documentation in the loan file; and
  - The loan must contain documentation as to why the account(s) could not be satisfied prior to the loan closing; and
  - Under no circumstances may the proceeds of the loan be used to pay the unpaid charge-off or collection account unless the transaction is a cash-out refinance.
- The total balance of all outstanding collections is <\$2,000; or
  - If the total outstanding balance of all collections is >\$2,000, then 5% of the balance of each outstanding collection account for all borrowers must be included in the calculation of the total debt ratio.
  - The charge off has not reached a judgment or lien status; and
  - The borrower has documented evidence of the dispute if it is a disputed account.
- If none of the above criteria are met, then the collection/charge-off must be paid prior to or at loan closing.

### **Evaluating Borrower Credit Worthiness**

- Borrower creditworthiness consists of:
  - Borrower credit reputation, and
  - Borrower ability to repay the Mortgage (i.e., capacity)
- The underwriter must consider layering of risk in their evaluation of credit reputation. A stronger credit reputation may be required if either capacity or collateral is weak.
- Credit Reputation
  - The underwriter must determine that each borrower individually and collectively have acceptable credit reputations. An acceptable credit reputation is established by a history that, when viewed as a whole, evidences the borrower's willingness to make ongoing payments and ability to manage obligations as agreed.
- When manually underwriting with FICO scores, the underwriter must not use the following factors as offsets for weaknesses in the borrower's credit reputation because they have already been considered in creating the FICO score:
  - The absence of, or age of, derogatory information
  - The number/proportion of accounts paid as agreed vs. delinquent
  - The types of accounts paid as agreed vs. the types of accounts that are delinquent
  - Recent pay-down or consolidation of account balances
  - The length of the Borrower's credit history
  - Any combination of the above factors
- The underwriter must weigh the following factors to determine if the borrower's credit reputation is acceptable:
  - The type and amount of credit outstanding
  - How the borrower uses available credit, including revolving balance-to-limits
  - Recent changes in the number of open accounts or overall amount of credit outstanding
  - The payment history and status of all accounts
  - Any recent inquiries shown on the credit report
  - Any public record or collection items





- Adverse or derogatory credit information: Although adverse credit in and of itself does not mean the borrower's credit reputation is unacceptable; generally, the more recent the adverse or derogatory credit information the more likely it is significant. The underwriter must consider all of the following:
  - The number, timing and extent of the adverse or derogatory credit information
  - The number, type and size of accounts with adverse or derogatory credit information
  - Public record information, such as judgments and collection accounts
  - Other characteristics listed in this section
- Derogatory information is considered significant if any of the following exist:
  - There are several accounts showing recent late payments
  - There are multiple 60- or 90-day late payments
  - There is more than one 30-day late housing payment in the last 12 months
  - There are more than two 30-day or more than one 60-day late housing payments within the most recent two years
  - The number and size of the delinquent accounts are large in relation to the overall credit
  - There are multiple episodes of late payments extending over a period time
  - The credit history shows derogatory credit information within the two most recent years combined with multiple revolving accounts with high balances-to-limits
  - The public record information reveals several occurrences of derogatory credit information, including judgments, tax liens and/or collection accounts
  - There is a bankruptcy, foreclosure, short payoff related to a delinquent mortgage obligation or deed-in-lieu of foreclosure within the last several years.
- If the underwriter determines the derogatory information is not significant, s/he must provide documentation support their conclusion in the Mortgage file. If the underwriter decides the derogatory information is significant, s/he must determine whether the problems were due to extenuating circumstances or to financial mismanagement.
- Capacity
  - Another part of determining the borrower's creditworthiness is evaluating the borrower's capacity to repay the Mortgage and other monthly obligations. Based on the analysis, the underwriter must provide a well-reasoned conclusion that the borrower has the ability to meet current obligations, including the new mortgage.
  - Note: Underwriters should not use information already considered by DE to determine the capacity is acceptable.
  - The underwriter must determine capacity by analyzing the following factors:
    - Stable monthly income
    - Monthly housing expense-to-income and monthly debt payment-to-income ratios
    - Reserves and other liquid assets
    - Information about how the Borrower has paid past obligations
  - Based on his/her analysis, the Underwriter must provide a written, well-reasoned conclusion that the borrower has the ability to meet current obligations, including the new Mortgage.
  - The following characteristics specific to the Mortgage request may introduce an additional layer of risk that must be considered in evaluating capacity:
    - Payoff of a junior lien from the proceeds of a refinance Mortgage
    - Cash-out refinance mortgage
    - Borrower with low or no reserves



- When multiple risk factors are present, more conservative underwriting must be undertaken to assess whether the Mortgage is acceptable. The loan is not acceptable when all of the following conditions exist:
  - The transaction is a cash-out refinance; and
  - The DTI exceeds 42%; and
  - The FICO is less than 700; and
  - The CLTV/HCLTV is greater than 75%
- Debt Ratios
  - In general, for manually underwritten mortgages, the underwriter must evaluate the borrower's ability to timely pay all of their monthly obligations.
  - As a guideline, the monthly debt-to-income ratio should not exceed 36% of the borrower's stable monthly income. With compensating factors, the total debt ratio should not exceed 43%.

### **Compensating Factors**

- FCM is committed to ensuring that we make all of our credit decisions on a fair and equitable basis for all borrowers. The underwriter's role is critical to ensuring that the following compensating factors are applied fairly and consistently.
- As a general rule, loan exceptions should not be made unless the underwriter identifies attributes or circumstances that proportionately mitigate the incremental risk. These mitigating attributes and circumstances are referred to as "compensating factors." Compensating factors are positive loan characteristics that add strength to a loan profile. Strong compensating factors may allow a borrower to receive mortgage approval for the requested loan amount, even though the loan does not meet policy and/or lending parameters.
- For compensating factors to be acceptable, they must be reasonably related to the exception, and their mitigating value must be proportionate to the incremental risk posed by the exception. Exceptions, by their nature, must be infrequent; approval of exceptions must always be preceded by careful evaluation to determine whether compensating factors are sufficient to mitigate the incremental risk that results from the exception.
- For manually underwritten loans, the following factors may be considered in justifying total debt ratios above 36%, but not greater than 43%:
  - The property is an energy-efficient mortgage.
  - Borrower has probability for increased earnings based on education, job training, or length of time in a profession.
  - Borrower has demonstrated ability to carry a higher total debt-load while maintaining a good credit history for at least 12 months.
  - There is other verified income that is not included within the definition of "stable monthly income", such as documented rent paid by a related person living in the house.
  - Future expenses will be lower, such as child-support payments to cease for child soon to reach age of majority.
  - Verified liquid assets are substantial enough to evidence ability to pay regardless of income.

### **Recurring Debt**

- FCM considers any debt the borrower owes to be a liability. Debt is defined as borrowed money, the repayment of which may be either secured or unsecured, with various possible repayment schedules.



- The following items are examples of recurring debt. It is important to note that the debt may or may not need to be included in the borrower's debt-to-income ratios. Refer to individual topics listed to determine if the debt should be included.
  - Alimony / Maintenance
  - Borrowed Funds Against Financial Asset
  - Business Debt
  - Child Support
  - Contingent Liabilities (Co-Signed Debt)
  - Court Ordered Assignment of Debt
  - Deferred Loans
  - Demand Loans
  - Installment Loans
  - Leased Obligations
  - Mortgage Assumption
  - Net Rental Loss
  - Non-Reimbursed Business Expense
  - Overdraft Protection Account
  - Payroll Deductions
  - Real Estate Obligations: Departure Property
  - Real Estate Obligations: Verification of Mortgage Debt
  - Revolving Debt
  - Special Assessment
  - Student Loans
  - Subordinate Financing
  - Unsecured Loans
- Note: The recurring debts above must be verified on all purchase and refinance transactions.

### **Alimony & Maintenance**

- Monthly alimony obligation should be treated as a recurring debt. Acceptable sources of documentation include a copy of:
  - All page(s) of the final divorce decree, or
  - Signed court order, or
  - Property settlement, or
  - Separation agreement.
- If payments are being paid through the court, a letter from the court verifying the dollar amount is sufficient.
- Obligations that will end within the next 10 months do not need to be considered and may be omitted from the DTI ratio only if the remaining term of payments is verified by the above documentation. However, the size and number of remaining payments should not impact the borrower's ability to handle the new mortgage payment during the early period of the loan.

### **Borrowed Funds Against Financial Asset**

- The borrower may take a loan against a liquid asset that is secured by stocks, bonds, or any other investment account, life insurance policies, 401(k) accounts, CDs, or other financial assets. Although



information regarding the amount of the loan must be provided, the debt is not generally counted in the borrower's qualifying ratios if the loan instrument shows the asset as collateral for the loan, since the loan may be repaid by liquidating the asset. A financial institution must have made the loan. The borrower may only use assets in the account that exceed the loan balance to satisfy cash reserve requirements.

- Payments on installment debts secured by cryptocurrency must be included in the monthly debt ratio.

## **Business Debt**

- A business debt is a financial obligation of a business and can be the sole responsibility of the business or personally secured by the business owner, which makes that person also liable for the debt.
- If the debt is reflected on the borrower's personal credit report, the borrower is personally liable for the debt and it must be included in the debt-to-income ratios.
- Debts paid by the borrower's business do not have to be included in the debt-to-income ratios if:
  - The borrower provides 12 months canceled checks drawn against the business account; and
  - The account in question does not have a history of delinquency; and
  - Two year's personal, partnership, and/or corporate tax returns evidencing that business expenses associated with the debt support that the debt has been paid by the business must be obtained; and
  - The underwriter's cash flow analysis of the business took into consideration the payment of the obligation (included interest expenses, and taxes and insurance, if applicable, that one would reasonably expect to see based on the loan balance and age of the loan).
- Note: The debt must be included in the borrowers debt ratios, if the tax return analysis of the business does not reflect any business expense (including taxes and insurance, if applicable), equal to or greater than the amount of interest that one would reasonably expect to see given the amount of financing shown on the credit report and the age of the loan.
- If the debt is not included in the borrower's debt ratio, the loan must be reviewed to confirm income is independent of the borrower and the business can continue to cover the debt for the next three years.
- If the above requirements are not met, the payment needs to be included in the total debt ratio.
- In lieu of cancelled checks, a letter from a CPA providing specific account number(s) and verification that the business has paid the debt for the past 12 months is acceptable.

## **Child Support**

- Payments of child support are counted as recurring debts. Acceptable sources of documentation include a copy of:
  - Applicable page(s) and signature page of the divorce decree, or
  - Property settlement, or
  - Separation agreement.
- If payments are being paid through the court, a letter from the court verifying the dollar amount is sufficient.
- Obligations that will end within the next 10 months do not need to be counted in debt-to-income ratio. However, the size and number of remaining payments should not impact the borrower's ability to handle the new mortgage payment during the early period of the loan.
- Borrowers with current or previous past due child support must provide evidence that all past due payments are current unless the borrower is making the payments according to a court approved plan. In this case, the borrower must demonstrate that payments are current according to the plan.



## **Contingent Liabilities: Paid by Others**

- A contingent liability being paid by others may be excluded from the monthly debt payment ratio when meeting the following requirements:
  - **INSTALLMENT DEBT (not including mortgages), REVOLVING, OR MONTHLY LEASE PAYMENT:**
    - The most recent 12 months' cancelled checks or bank statements from the party making the payments,
    - There must be no delinquencies in the most recent 12 months, and
    - The party making the payments cannot be an interested party to the subject real estate or mortgage transaction
  - **MORTGAGE PAYMENT OR OTHER PROPERTY RELATED EXPENSES (taxes, insurance, homeowners association dues):**
    - The party making the payments must be obligated on the note,
    - The most recent 12 months' cancelled checks or bank statements from the party making the payments,
    - There must be no delinquencies in the most recent 12 months,
    - The borrower is not using rental income from the property to qualify, and
    - The party making the payments cannot be an interested party to the subject real estate or mortgage transaction.
  - **COURT-ORDERED ASSIGNMENT OF DEBT:**
    - When a borrower has outstanding debt that was assigned to another party by court order (such as under a divorce decree or separation agreement), regardless of whether the creditor has not released the borrower from liability, the lender is not required to count this contingent liability as part of the borrower's recurring debt obligations.
      - Lender must document the order with a copy of the appropriate pages from the divorce decree or separation agreement.
  - **Note:** The above policy for court ordered assignments of debt and property settlement buyouts should never apply to debt secured against the subject property. In these instances, debt must ALWAYS be counted in the debt ratio calculation.

## **Deferred Loans**

- Installment debts with deferred payments include debts on furniture, household items, and automobiles for which the initial payment is delayed for a period of time as part of a merchant's promotional campaign. For student loans refer to the Student Loans topic later in this section.
- For deferred installment debts, the payment amount that will be required once the deferment or forbearance period has ended must always be included as part of the borrower's recurring monthly obligations.
- If the credit report does not indicate a monthly payment at the end of the deferment period, the following documentation should be requested:
  - A direct verification from the creditor; or
  - A copy of the installment loan agreement obtained from the borrower.



## **Demand Loans**

- A demand loan has no monthly payment; it becomes due and is payable in full on a particular date. This type of debt may or may not be secured
  - If the notice is due within the next 2-years and the borrower does not have adequate reserves available to repay the obligation in full, the transaction should be treated as an installment loan. A minimum payment of 5% of the unpaid balance must be included in the debt-to-income ratio.
  - If the borrower does have adequate reserves available to pay the obligation in full, the debt should not be included in the debt-to-income ratio

## **Installment Debt**

- Installment debt is borrowed money that is repaid in several successive payments, usually at regular intervals, for a specific amount and for a specified term (e.g., an automobile or furniture loan).
  - Installment debts with monthly payments that extend beyond 10 months (and debts that are in a period of either deferment or forbearance for agency loans) must be included in the debt-to-income ratio for qualification purposes.
  - Even if the debt does not extend beyond 10 months, it must be noted whether the size and/or number of remaining payments will impact the borrower's ability to handle the new mortgage payment during the early period of the loan.
  - If debt is paid by the borrower's business, it does not need to be included as a liability if it meets the requirements in the Business Debt topic above.

## **Leased Obligations**

- A lease is a written document containing the conditions under which property (most often an automobile or land) is given to an individual for a specific period of time (term).
  - The monthly payment for the leased item should always be counted as a recurring debt regardless of the remaining term.
  - If lease is paid by the borrower's business, the debt does not need to be included as a liability if it meets the requirements in the Business Debt topic above.
- Pre-Paid Leases - If the borrower fully pre-paid the terms of their lease at the original time the Lease Agreement was executed, the monthly payment for the lease does not have to be included in his/her recurring debt obligations provided the borrower's assets are reviewed and no undisclosed obligations are reflected.
- The file should be documented with the terms of the lease and the Underwriters rationale for not including a monthly payment in the DTI.

## **Mortgage Assumptions**

- For a contingent liability on a Mortgage Assumption, the liability must be included in the DTI when the borrower has sold a property as an assumption without a release of liability being obtained.

## **Net Rental Loss / Negative Rent Income**

- If real estate is owned free and clear, only current real estate taxes, hazard insurance premiums, and homeowners' association fees must be included in the borrower's monthly expenses. The borrower must





supply a copy of the homeowner's insurance policy declaration page or other documentation that clearly evidences the current property is free of encumbrance.

- If any documents in the file indicate that the property has a mortgage, it must be verified and the payment history supplied. The amount of the negative cash flow calculated from the tax return must be included in the borrower's debt-to-income ratio. Refer to Section 1508.5-Employment & Income/Rental Income for details with regards to rent income.

### **Non-Reimbursed Business Expenses**

- When a borrower has non-reimbursed business expenses that are being analyzed, such as meals, gasoline, auto insurance and/or taxes, a recurring monthly debt obligation should be developed based on a 24-month average of the expenses (from Schedule A and IRS Form 2106 from the tax returns).
- Automobile depreciation may be netted out. Union dues shown as an expense on the 2106 do not need to be treated as a reduction to total income. The 24-month average should be deducted from the borrower's stable monthly income. Automobile loan payments and automobile lease payments that are included as non-reimbursed expenses on the tax returns may not be deducted from income. They must be included as recurring debts in the total debt ratio.
  - If the borrower claims a "standard mileage" deduction, multiply the business miles driven by the depreciation factor for the appropriate year as published by the IRS, and add that figure back to the calculation.
  - If the borrower claims an "actual depreciation expense" deduction, the amount the borrower claimed should be added back.
- Refer to [www.IRS.gov](http://www.IRS.gov) for depreciation factors.
- Note: Non-reimbursed expenses should be deducted from the income that is being used to qualify and should not be considered in the 20% tolerance between the income documentation provided by the borrower and the income documented on the IRS Transcript

### **Overdraft Protection Account**

- Overdraft protection is considered a revolving line of credit (given without the benefit of security) that is attached to a checking account. If there is a balance, count a minimum payment in the debt-to-income ratios.

### **Payroll Deductions**

- Any time a payroll deduction appears on the borrower's pay stub, the underwriter must determine if the deduction represents a debt that must be included in the debt ratio. Examples of such debts include, but are not limited to: Credit Union or employer loans, garnishments, child support, etc.
- The following information may assist in making the determination:
  - Monthly payment of the debt
  - Balance of the debt
  - Reason the debt is being deducted from payroll
  - All guidelines regarding the debt





## **Real Estate Obligations: Departure Property**

- The reserve requirements for the subject property from the Non-Agency LTV Matrix must be applied in addition to the Departure Property policies defined below:
  - Current principal residence is pending sale or up for sale but the transaction will not be closed (with title transfer to a new owner) prior to the new transaction (evidence that property is up for sale or pending sale is required):
    - The following reserve requirements must be met for all loans:
      - If the borrower can qualify with both properties in DTI, count both payments plus two months PITIA reserves for the departure property.
      - If the borrower cannot qualify with both properties in DTI:
      - If there is an accepted contract, a minimum of 6 months PITIA reserves on the departure property in addition to the reserves required for the transaction is required and payment on the departure property does not have to be included in the DTI.
      - If there is no contract on the departure property, a minimum of 24 months PITIA reserves for the departure property in addition to the reserves required for the transaction is required and the payment on the departure property does not have to be included in the DTI.
    - The current principal residence is being converted to a second home:
      - The PITIA for the current and proposed mortgage payments must be used to qualify the borrower for the new mortgage loan; and
      - Minimum of 6 months of PITIA reserves are required for the departure property in addition to the reserves required for the transaction.
    - The current principal residence is being converted to an Investment Property:
      - If the borrower qualifies with the PITIA for the departing property and the PITIA for the new proposed mortgage payment, the borrower must have six months PITIA reserves for the departure property in addition to the reserves required for the transaction.
      - To determine if rental income may be used to qualify, equity must be documented with one of the following:
        - A current appraisal (2055 or better), minus any liens. The appraisal may not be dated more than 180 days prior to the note date; or
        - By comparing the original sales price of the departure property to the current unpaid principal balance.
        - If 25% or more equity is in the departure property:
          - If the borrower has a documented two-year history of managing rental properties, 75% of the rental income can be used to calculate rental income. Refer to Calculating Rental Income: Non-Subject Property for complete information, and the following must be obtained:
            - A copy of the fully executed lease agreement; and



- Twelve months of PITIA for the departure property is required in addition to the reserves required for the transaction, and
- If the borrower does not have a 2 year history of managing an investment property a minimum 760 FICO is required
- If less than 25% equity in the departure property: rental income may not be used to qualify:
  - Both the current and the proposed mortgage payments must be used to qualify the borrower for the new transaction; and
  - 6 months of PITIA for the departure property in addition to the reserves required for the transaction

### **Real Estate Obligations: Verification of Mortgage Debt**

- For each mortgage liability where the borrower is currently an obligor on the note secured by real estate debt, a verification of mortgage must be obtained if the mortgage is not verified on the credit report.
- Note: If there is a new debt being incurred from a pending purchase transaction, the TIL, GFE, Loan Estimate or other alternative documentation from the lender should be obtained to verify the new monthly payment amount.
- If there are any mortgage interest deductions or payments on the borrower's personal tax returns (if tax returns are in the file) it must be determined if the borrower is obligated on an undisclosed mortgage, and if so, the mortgage must be verified.
- Real Estate obligations that do not meet the criteria for utilizing rental income as stated in the Rental Income section:
  - The PITIA must be included in the debt ratio for qualifying.
- Standard with Bridge Loans – refer to the Bridge Loans topic
- Note: "Current mortgage payments" as used below includes payments for bridge loan financing secured by the current residence. Reserve requirements must also include payments on the bridge loan, if applicable.

### **Revolving Debt**

- Revolving debt is an arrangement for credit in which the borrower is granted a credit limit and can use any amount up to the limit. Repayment is usually at regular intervals but not for a specified amount or term. Credit cards are an example of revolving debt.
- The following must be included in the debt-to-income ratio:
  - Minimum payment (from statement or credit report); or
  - The greater of 5% of the current balance, or \$10, if no payment is stated on the credit report. If multiple account payments are not reported, and/or the borrower's ratios are at the maximum permitted for the process selected, the underwriter should obtain actual minimum payments from the borrower's account statements to qualify the borrower.
  - Open 30-Day Charge Accounts: On all 30-day accounts, also referred to as open accounts (e.g., Diners Club, American Express), the full amount of the outstanding balance must be included in the debt payment ratio, or verification that the borrower has sufficient funds to pay off the outstanding account balance must be provided. The funds must be in addition to any funds **required for the transaction (cash to close, reserves, etc.)**.



- “Authorized User of Credit” Accounts: Payments on “Authorized User” accounts should always be included in the debt-to-income ratio unless written documentation (i.e. 12 months cancelled checks) is provided proving that the owner of the account is making the payments.
- Fees Paid Outside of Closing (POC): The applicant may charge the total fees due on a credit card, regardless of the amount. When more than 1% is charged and the borrower does not have sufficient liquid funds to cover the charge, then the credit card payment must be re-calculated and the new payment included in the DTI. To recalculate the new POC debt one of the following is required:
  - Credit Card Receipt: Obtain credit card receipt and use 5% of the POC amount in addition to the payment on the credit report for any current balance; or
  - Credit Card Statement with the POC Charge: Obtain a copy of the credit card statement showing the amount charged, the outstanding balance and the terms of repayment.
- Fees POC include lock-in fees, origination fees, commitment fees, credit report fees, and appraisal fees. Borrowers are not required to pay off these credit card charges on or before closing. Under no circumstances may credit card financing be used for the down payment.

### Special Assessments

- If the property is located in a special assessment district, the locality has the right to assess homeowners for the cost of developing utilities and various infrastructure facilities such as roads, sewers, etc. (e.g., “Mello Roos” school tax.)
- Any special assessment amounts indicated on the appraisal or in the title work must be included in the borrower’s total debt ratio, following the installment loan policy. If the underwriter learns that the special assessment district may be having financial difficulties, the underwriter should evaluate the borrower’s ability to repay the mortgage in the event additional assessments are imposed. If special assessments are in arrears, documentation must be obtained to show they have been paid, or that sufficient deposits to cover such amounts are being collected.

### Student Loans

- Repayment of all student loans must be included in the debt-to-income ratio.
- For deferred student loans, the payment amount that will be required once the deferment or forbearance period has ended must be included as part of the borrower’s recurring monthly obligations.
- To calculate the payment used for qualification. **In all cases, an amount greater than zero must be included in the monthly debt payment-to-income ratio for all student loans.**
  - Use the greater of the payment showing on the credit report or 1% of the outstanding balance of all of the loans reported, or
  - When student loan documentation is received use the monthly payment reflected on the student loan documentation, **as long as the payment reflected is greater than \$0**, which should include all loans showing on the credit bureau (i.e., a copy of the installment loan agreement or the most recent student loan statement)
    - **For Income Driven Repayment Plans: If documentation is received in the loan file and shows the payment will increase the higher payment must be used to qualify**



## **Unsecured Loans**

- Unsecured loans are personal loans that were given without benefit of security and have the same repayment terms as installment loans. Examples include signature loans, lines of credit on credit cards, and overdraft protection on checking accounts. Payments for unsecured loans must be included in the debt ratios.
- Note: Unsecured personal loans are not an acceptable source of funds for down payment, closing costs, or reserves.

## **Verification of Debts**

- For each liability, the underwriter must determine the unpaid balance, terms of repayment and borrower's payment history. All disclosed debt must be verified on the credit report or via separate credit verification. If a current liability is not reflected on the credit report, it must be verified via separate credit verification. If a current liability appears on the credit report but is not on the application, the borrower should provide a reasonable explanation for the undisclosed debt. Refer to Section 1508.2-Credit/Analysis/Borrower Explanations topic for more information. Documentation may be required to support the borrower's explanation.
- Note: Timeshare loans are treated as installment debt. Monthly maintenance fees/HOA fees must be included as a liability.

## **Forbearance/Repayment Plan:**

- Borrowers(s) are eligible for new financing upon completion of the payment deferral under a Forbearance or Repayment Plan and if the following criteria are met:
  - All transactions:
    - At least 6 months have elapsed since the Forbearance or Repayment Plan was completed; and
    - Borrower(s) must have made the payments as agreed per the loan forbearance or repayment plan, and
    - Mortgage history must meet the mortgage history requirements per the product, program and/or process applied, and
    - Borrower(s) must meet all other requirements per the product, program and/or process applied.



## **Income**

### **Gaps in Employment**

- Interruptions/gaps in employment of 30 days or more must be explained in writing.

### **Evaluating Employment and Income**

- Employment and income are essential ingredients to successful home ownership. Qualifying income should be stable, predictable, and likely to continue. The borrower must demonstrate the financial wherewithal to repay the proposed real estate transaction as well as other obligations.
- Sources of income may vary. Some receive primary income from only one source while others receive income from several different sources. Income documents must NOT be more than 120 days old at the time of closing for existing and new construction.
- The actual calculation used to determine the qualifying income must be documented in every loan file.
- Acceptable sources of income include:
  - Wage Earner Income: All non-self-employed borrowers who receive a W-2 at year end to summarize total earnings– includes hourly, weekly, biweekly, part-time, seasonal, bonus, commission, and tips/gratuity.
  - Self-Employed: Sole Proprietorship, Partnership, Corporations, and S-Corporations.
  - Non-Employed Income: Alimony/ Maintenance/Child Support/Separate Maintenance, Foster Care, Unemployment/Welfare/ADC, Disability/Worker's Compensation, Retirement/Pension, Social Security, Annuity, IRA, Military/VA Benefits, Trust, Interest & Dividend, Inheritance/Guaranteed Income, Note Receivables, Mortgage Differential/ COLA, and Rental.

Note: Income that is paid to the borrower in cryptocurrency may not be used for qualification.

- Income from sources other than the ones addressed in this chapter may be considered provided the borrower has received the income for at least 2 years and documentation supports that it will continue for at least 3 years. Documentation requirements are addressed in this chapter and in the Documentation Process fact sheets.

Note: The information in this section applies to all Documentation Processes and Program types unless noted otherwise in the individual fact sheets. If the fact sheet is silent, policies set forth in this section apply.

### **Income Analysis**

- All sources of income that are used to qualify the borrower must be verified. However, while there may be income streams that are not used to qualify the borrower (and therefore not verified), they must be considered in the overall evaluation of the borrower's credit worthiness.

### **4506-C Requirements**

#### **Filing the 4506-C**

- A 4506-C is required for the two most recent tax years on all transactions. The timing of 4506-C varies depending on the application date, disbursement date of the mortgage loan and when the borrower filed his/her tax returns. The 4506-C is based on the "most recent year's" tax return defined as the last tax filing.



- For wage earners, if the 4506-C confirms “No Transcripts Available” an additional 4505-C is not required for the same or a previous year.

### **Processing the 4506-C**

- All Borrowers whose income is used to qualify for the loan transaction must sign form 4506-C at closing, regardless of income type – salary, selfemployed, social security, etc.
- An additional 4506-C must also be signed prior to or at closing for each business tax return in the loan file that was used to calculate qualifying income (resulting in either a gain or loss); however it does not need to be processed and transcripts are not required for the business(s).
- If the underwriter identifies red flags when reviewing documentation in the loan file, a signed 4506-C should be obtained and processed prior to final approval.

Note: If the 4506-C is processed and transcripts from the IRS are received as part of the underwriting process, a signed 4506-C is not required to be in the loan file.

- It is imperative that the 4506-C be completed accurately and legibly to avoid delays and errors. The top portion of the 4506-C must be completed exactly as the borrowers filed their last tax return. Any 4506-C that is submitted with incomplete, inaccurate or illegible taxpayer information will be rejected. Alternative forms such as the 8821, 4506, or 4506-T are not permitted.

### **Evaluating the 4506-C**

- If the underwriter identifies red flags when reviewing documentation in the loan file, a signed 4506-C should be obtained and processed prior to final approval
- When federal income tax information is used to document income for qualifying purposes, the transcripts of the applicable federal income tax documents may be obtained. For example, Tax Return Transcripts for Form 1040, 1040A or 1040EZ or Wage and Income Transcripts for W2s; however, in certain instances, copies of the actual returns, schedules, or forms are needed because the tax return transcripts will not provide the detail required to qualify the borrower. For example, copies of Schedules B through F, Schedule K-1, Form 2106, or business returns would have to be obtained. These schedules or forms are not required if:
  - The income reflected on the applicable schedule transcripts is positive; and
  - The income supported by that schedule or form is not being used for qualifying.
- If the income documentation provided by the borrower is = 20% greater than the income documented on the IRS transcript, the Underwriter should perform an in-depth review to determine if the increase in income seems reasonable and if additional steps need to be taken. At a minimum a letter from the borrower explaining the difference must be obtained and retained in the loan file. Refer to Section 1508.2- Credit/Analysis/Borrower Letters of Explanation for more information. Additional documentation to support the explanation/increase should also be requested if necessary. Information reported on the tax transcripts should match information reported on the tax returns provided by the borrower. Note: All other current guidelines for analysis must also be followed.
- Important: Underwriter rationale for any variance per the above guidelines should be thoroughly documented.

Note: For documentation requirements related to Taxpayer Identification Theft refer to Section 1508.2- Credit/Analysis/Taxpayer Identification Theft topic for more information.





## **Taxpayer First Act**

- The use of the 4506-C (Request for Transcript of Tax Return, effective 9/2020) conforms with the Taxpayer First Act which permits taxpayers to designate return information recipients and generally prohibits the recipients from using the tax return information for a purpose other than the purpose for which the consent was granted. Refer to Section 2201 – Legal/Compliance for additional information on this topic.

## **Wage Income (01/29/23)**

NOTE: THE CORRESPONDENT NON-AGENCY JUMBO PROGRAM IS AVAILABLE ONLY TO SELLERS APPROVED FOR THE PROGRAM.

## **Evaluating Wage Income**

- Wage earner income is best defined as compensation for services paid by a person, business or organization at specified intervals and is commonly referred to as salary or wage earner income. The pay schedules of wage earners can be classified into 4 general categories.
  - Full Time: The borrower is a permanent employee of a company and works a standard workweek, usually totaling 35 to 40 hours a week. Hours and number of days may or may not vary.
  - Part Time: The borrower is a permanent employee of a company but the number of hours is not standardized, usually totaling less than 30 hours a week.
  - Temporary: The borrower is not a permanent employee of the company and therefore is not part of the company's permanent staff. Temporary employees usually work for a contracted, or "as needed" period of time only.
  - Occasional/Seasonal: The borrower works for a specified period of time on a specific job or project. Once completed, the borrower is on "standby" until they receive their next assignment. Examples of this type of worker include roofers, landscapers, union construction workers, and migrant farm workers.
- The type of pay schedule directly impacts how monthly qualifying income is calculated.
- Common types of stable wage earner income may include regular base earnings plus consistent and documented secondary income, such as overtime, commission and bonus, and additional part-time or seasonal employment.

## **Bonus Income**

- A bonus is money paid in addition to regular wages. Sometimes bonuses are paid on a regular basis throughout the year. Some employees also receive a guaranteed bonus—a promise or contract made by the employer as part of an incentive plan paid regardless of the company's profitability or the employee's performance. The nature of the bonus must be determined up front in order to include in qualifying income.
- The borrower must have a 2-year history of receipt to use as qualifying income and it must be likely to continue for the next three years. Earnings must be level or increasing; compensating factors must exist if decreases in the last year.
- Required Documentation:
  - Most recent YTD pay stub documenting at least 30 days of income. Paystub must be dated no earlier than 30 days prior to the application date, and must include all year-to-date income. If the paystub



does not include sufficient information to appropriately calculate income, additional documentation must be obtained; and

- 2 years most recent W-2s and/or 1099s; and
- There is no evidence from the employer that the income will no longer be received; and
- It is determined that the income is likely to continue based on an established earnings trend.
  - If the trend is stable or increasing, income can be averaged over the two year period.
  - If the trend was declining but has since stabilized and there is no reason to believe that the borrower will not continue to receive the income at the current level, the current, but lower stabilized amount must be used.
  - If the trend is declining, the income may not be stable and additional analysis must be performed to determine if the income should be used. Income should not be averaged over the period of decline. And
- Verbal Verification of Employment performed no more than 10 business days prior to the loan closing.

### Calculating Income

- The actual calculation used to determine all qualifying income must be documented in every loan file. See below for examples.
- Individuals either receive a fixed regular annual income (usually paid monthly, semi-monthly, biweekly, or weekly) or they may work and get paid by the hour, day, or week. All receive regular compensation in the form of a paycheck and year-end income is reported via a W-2. Each type of qualifying income is calculated differently.

Hourly:  $\text{Hourly Rate} \times \# \text{ of Hours} \times 52 \text{ weeks} \div 12 = \text{Monthly Base Income}$

Weekly:  $\text{Weekly Base Salary} \times 52 \text{ weeks} \div 12 = \text{Monthly Base Income}$

Biweekly:  $\text{Biweekly Base Salary} \times 26 \text{ weeks} \div 12 = \text{Monthly Base Income}$

Semi-Monthly:  $\text{Semi-Monthly Base Pay} \times 24 \text{ weeks} \div 12 = \text{Monthly Base Income}$

Monthly: Monthly Base Pay as shown (without overtime, bonus or commissions)

Annually:  $\text{Annual rate of pay (without overtime, bonus, commissions)} \div 12 = \text{Monthly Base Income}$

Variable Income Sources: This type of income should be calculated as follows:

YTD earnings from the paycheck stub

+ Wages from the W-2 for the previous year

÷ Number of months \_\_\_\_\_

= Average Monthly Income

- Monthly Base Income \_\_\_\_\_

= Average Earnings



- It is important to establish an earnings trend. Annual earnings that are level or increasing from one year to the next reflect income stability. However, if the earnings show a decline compared to the current year, there must be strong compensating factors to support using the income. If the borrower's employer is unable to predict whether the income will continue, it may be considered provided the employer does not specifically state that income is not likely to continue.
- If either the borrower or co-borrower is self-employed, in addition to the required wage earner income documentation, personal tax returns must be provided even if the income is not being used to qualify. The personal tax returns must be reviewed to determine if there is a "meaningful" business loss that may have an impact on the stable monthly income being used to qualify. Additional documentation may be needed to fully evaluate the impact of the business loss on the borrower's ability to repay.

Note: Income may be excluded if the borrower can qualify without it.

### **Wage Earner Income Documentation**

- Most recent YTD paystub or salary voucher documenting at least 30 days of income. Paystub must be dated no earlier than 30 days prior to the application date, and must include all year-to-date income. If the paystub does not include sufficient information to appropriately calculate income, additional documentation must be obtained.
- W-2: W-2s for the most recent 2 years regardless of how long the borrower has been on their current job. An IRS Wage and Income Transcript (W2 transcripts) may be used in lieu of the actual W-2 forms.
- Note: Income used to qualify must have a history of receipt and be expected to continue. A calculation worksheet must be documented in the loan file to show how the income being used to qualify was calculated.
- If either the borrower or co-borrower is self-employed, in addition to the required wage earner income documentation, complete tax returns for the most recent 2 years must be provided even if the income is not being used to qualify. The personal tax returns must be reviewed to determine if there is a "meaningful" business loss that may have an impact on the stable monthly income being used to qualify. Additional documentation may be needed to fully evaluate the impact of the business loss on the borrower's ability to repay.

### **Commission Income**

- Commission income is a fee or percentage paid to the employee for performing a service or is based on the dollar amount of the goods and/or the number of units a person sells. Some borrowers are paid a salary plus commission while others receive only commission pay. The borrower must have a two year consecutive history of receiving commission income and the commission income must be likely to continue for the next three years in order to use the income to qualify.
- Income may be subject to fluctuations from year-to-year. If there are large fluctuations, the borrower must provide a written explanation to support the increase or decrease in income and the appropriate adjustments made to average income used to qualify. Refer to 1508.-Credit/Analysis/Borrower Explanations for more information.
- Required Documentation
  - Most recent YTD pay stub documenting at least 30 days of income. Paystub must be dated no earlier than 30 days prior to the application date, and must include all year-to-date income. If the paystub



does not include sufficient information to appropriately calculate income, additional documentation must be obtained; and

- 2 years most recent W-2s; and
- Verbal Verification of Employment performed no more than 10 business days prior to the loan closing.

Note: If the file contains tax returns or tax transcripts they cannot be ignored.

## **Documenting The Transactions**

- This section addresses sources of documentation used to verify salary/wage earner income and the principle methods of validating its authenticity.
  - Pay Stubs
    - Pay stubs (or payroll statements) determine the qualifying income to be used in calculating the borrower's debt ratio. The pay stub must include the following information in order for it to be considered an acceptable form of verification:
      - Be computer generated (may not be handwritten)
      - Contain the company's name or employer tax I.D. that matches the W-2
      - Contain the name and/or social security number of the employee
      - Show the pay period covered
      - Be dated no earlier than 30 days prior to the application date
      - Show the year-to-date gross earnings
      - List all deductions
  - If the paystub does not include sufficient information to appropriately calculate income, additional documentation must be obtained. I.e., a written VOE (see next section) or 2-years tax returns must be obtained. Refer to the applicable Documentation Process and product/program fact sheets for specific requirements.
  - Statements must be reviewed to determine if there are deductions that should be included in the list of debt obligations. Some of the most common types of deductions are:
    - Credit union loans (if deduction is for repayment of a loan, payment should be included in list of debts).
    - 401k loan repayments: Debt is not included in the total debt ratios.
    - Alimony/child support payments (a mandatory requirement in some states, therefore a statutory deduction).
    - Wage Assignments/ Garnishments (due to tax liens, judgments for non-payment of debt, or loss of a court case).

Not all of the above deductions are necessarily obligations. The statement must be reviewed carefully to determine the nature of the deduction and if it should be included in the borrower's list of debt obligations.

- Military Income
  - To verify military base pay and entitlements, the most recent Leave and Earnings Statement (LES) is required.
- W-2s
  - A W-2 form is a summary of earnings statement that the employer prepares and sends to its employees at the end of the year. A photocopy of all W-2(s) is required to verify annual income and



employment. The IRS requires W-2's to be sent to employees by January 31 of the following year. If borrower has not received their W-2 prior to January 31, a YTD paystub(s) or military Leave and Earnings Statement may be used in lieu of the W-2 form(s) provided the documentation reflects the complete income earned in the previous calendar year.

- The W-2(s) must cover the most recent two-year period, and must clearly identify the borrower as the employee. "Most recent" W-2(s) is defined as the W-2(s) from all employers for the calendar year prior to the current calendar year/application date. For example, if the application is dated 2019, a 2018 & 2017 (if applicable) W-2s from all employers would be required.

Note: The final year-to-date paystub, provided it contains complete year-to-date information, or an IRS Wage and Income Transcript (W-2 Transcript), or a written VOE may be used in lieu of the actual W-2 form.

- If documents expire on or after January 1 of a new year, an updated W-2 from the previous year or year-end paystub will be required. See examples below:
  - Example 1: If the loan application date is in Dec 2020 and policy requires a YTD paystub and most recent year W2, a 2020 YTD paystub and 2019 W2 are required. If those docs expire before closing and no longer meet age of documentation requirements, then updated documentation is required, and a 2020 W2 and a 2021 YTD paystub should be obtained.
  - Example 2: If the loan application date is in Jan 2021 and AUS or policy requires a YTD paystub and most recent year W2, a 2021 paystub and 2020 W2 are required. If the 2021 paystub does not include sufficient information, such as 30-day earnings, a 2020 YTD paystub is required. If the borrower has yet to receive the 2020 W2, the final 2020 year-to-date paystub may be used if adequate information is provided, and the paystub meets age of documentation guidelines.

#### Schedules & Forms

- Although they may not be included in every instance, the following list of schedules and forms may also be required when other additional income is used to qualify.
  - Rental Income: Signed 1040s, Schedule E, Form 4562
  - Interest/Dividend Income: Signed 1040s, Schedule B
  - Farm Income: Signed 1040s, Schedule F, Form 4562

Note: Individual tax returns must be signed by the borrower unless one of the following alternatives is obtained:

- Documentation confirming that the tax returns were filed electronically (e.g., signed Form 8879, IRS e-file Signature Authorization or equivalent);
- A completed IRS form 4506-C (signed by the borrower) for the year in question; or
- IRS transcripts that validate the information on the unsigned tax returns.

Note: If tax returns are included in the loan file, the underwriter must review and consider in their credit evaluation. The underwriter may not disregard data in tax returns just because they are not required.

#### **Employees of a School District**

- Employees of a school district may be paid on a 9-month, 10-month, or 12-month basis. As such, a current year-to-date pay stub dated within 30 days of application may not be available. Income structure must be determined before calculating qualifying income. Although every effort should be made to obtain a copy of the borrower's most recent pay stub, if the borrower is on a pay schedule of less than 12 months, a copy of



their employment contract with the school district may be used in lieu of a current pay stub or it may be verbally verified directly with the school district HR department (conversation must be documented in the file). Contract must be valid and non-expired.

Note: Requirements to verify income remain as noted below.

#### Required Documentation

- Most recent YTD pay stub documenting at least 30 days of income. Paystub must be dated no earlier than 30 days prior to the application date, and must include all year-to-date income. If the paystub does not include sufficient information to appropriately calculate income, additional documentation must be obtained, or a copy of the Employment contract with the School District; and
- 2 years most recent W-2s; and
- Verbal Verification of Employment performed no more than 10 business days prior to the loan closing.

#### Self-Employed Income Documentation

- Individual: Complete tax returns for the most recent 2 years, including all W-2s and Schedules.
- Corp., S-Corp. & Partnerships: The most recent 2 years' business tax returns including all Schedules.
- Corp, S-Corp & Partnership: The YTD (year-to-date) P&L (profit and loss) and balance sheet are required when the application is dated more than 90 days after the end of the business' fiscal or calendar year end. YTD unaudited P&L statement and balance sheet for the business either:
  - Completed by the business's tax preparer; or
  - Completed by the borrower in addition to the following:
    - Evidence provided that the document has been viewed by the business's tax preparer, or
    - Evidence provided that the document has been viewed by an appropriate third party who is not affiliated with the loan transaction, or
    - Two months business bank statements to support the income on the P&L statement and balance sheet.
  - The year-to-date P&L and balance sheet are required when the application is dated more than 90 days after the end of the business' fiscal or calendar year end.
- Income Analysis Form

Note: Corporate income may not be used unless the borrower owns 100% of the business. (W-2 and 1099 earnings are eligible)

#### Evaluating Self-Employed Income

- A Self Employed Income Analysis Form must be completed on every transaction and retained in the permanent loan file. Examples of this form include Freddie Mac Form 91 or Fannie Mae Form 1084.
- An individual receiving income from any of the following sources must be qualified as self-employed:
  - Borrower has an ownership interest of 25% or more in a business. The business may be a sole proprietorship, a general partnership, limited partnership, corporation, or S-corporation. Loans must be coded as self-employed
  - Borrower relies on investments for income (e.g., interests, dividends, capital gains, or real estate).





- Borrower is a member of the clergy and files taxes as self-employed. (Additional guidelines apply if a portion of their income is for housing, which may be tax exempt—federal and state. Refer to Section 1508.5-Employment and Income/Other Income/Minister-Clergy topic for details.)
  - Borrower is a contract worker (1099 income)
  - Borrower receives income from the subject property seller or broker
- A 2-year self-employment history, which includes verifying the borrower has ownership in the business, is required to ensure that the income is stable. Less than 2-years may be considered provided the borrower has a recent 2-year history of successful employment in the same occupation (or a related field) and they have been self-employed for at least 1 full tax year. The borrower's most recent 2 years signed federal income tax returns, including all schedules, must reflect the receipt of income at the same or greater level in a line of business that provides the same products or services as the current business or in an occupation in which s/he had similar responsibilities to those undertaken in connection with the current business.
- Individual tax returns and business tax returns (when applicable) must be signed by the borrower unless using an acceptable alternative defined in Tax Forms.
- For individual tax returns, the underwriter may accept one of the following alternatives to the Borrower's signature on the tax returns:
  - Documentation confirming that the tax returns were filed electronically (e.g., signed Form 8879, IRS e-file Signature Authorization or equivalent);
  - A completed IRS form 4506-C (signed by the borrower) for the year in question; or
  - IRS transcripts that validate the information on the unsigned tax returns.

Notes: There are some self-employed borrowers who, although classified as such, may not own their own business per se. E.g., 1099 contract workers, borrowers relying on investments for income, borrowers who receive commission income, etc. In these instances, verifying the borrower has ownership in the business is not necessary.

- A self-employed individual's income is calculated based on the tax returns.
- Business tax returns are analyzed to assess the likelihood of continued personal income to the borrower. The cash flow of the corporation and an analysis of the trends experienced by the business are used to determine its viability. The inclusion of projected gross or net business income, retained earnings, or capital withdrawal generally may not be used when calculating qualifying income. This restriction applies to all businesses, including closely held corporations.
- If any of the borrowers are self-employed, their personal tax returns must be reviewed to determine if there is a business loss that may have an impact on the total qualifying income even if the income from the self-employed business is not being used to qualify.

Note: If personal or business tax returns are included in the loan file for a borrower or co-borrower(s), the underwriter must review and consider in their credit evaluation. The underwriter may not disregard data in tax returns just because they are not required.

### **Business Restructuring**

- It is not unusual for a business to change their structure to take advantage of various tax or business laws. Although the most common business conversion is from a sole proprietorship to something else, other conversions also occur. A conversion provides the business owner with more protection and less liability. A change like this doesn't necessarily mean the borrower is starting a new business. For example, a business begins as a sole proprietorship and then switches to a partnership, corporation, or S-corporation.



- The total length of the business' existence must be at least 2-years. Average income should be calculated using income from both business structures—the current as well as the previous—as long as it can be confirmed that the nature of the business remains the same. Additional adjustments may be required if the restructure occurred. Nevertheless, the result should be the same.

### Calculating Cash Flow: Partnership & S-Corporations

- Ordinary income, net rental income, and other net rental income reported on Schedule K-1 may be included in the borrower's cash flow provided:
  - The borrower can document ownership share (may use Schedule K-1);
  - The borrower can document access to the income; and
  - The business has adequate liquidity to support the withdrawal of earnings.

Note: Borrowers, who have less than 25% ownership, refer to 1508.5-Employment and Income/ Other Income section for requirements.

If	Then
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	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
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	Must confirm the following to include the income in the borrower's cash flow: <ul style="list-style-type: none"> <li>• The borrower can document access to the income (such as a partnership agreement or corporate resolution)—unless the borrower(s) own 100% of the business, in which case confirmation of access to the income is not required; and</li> <li>• The business has adequate liquidity to support the withdrawal of earnings</li> </ul>
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
Business tax returns are required	The type of business structure and analysis of the business returns as indicated in this section of Policy must be considered in accordance with requirements

- Business income may be used to qualify only if the following is documented and verified:
  - The income was distributed to the borrower, or
  - The business has adequate liquidity to support the withdrawal of earnings. If the Schedule K-1 provides this confirmation, no further documentation of business liquidity is required.
- It is important to select a business liquidity formula based on how the business operates. For example:
  - The Quick Ratio (also known as the Acid Test Ratio) is appropriated for businesses that rely heavily on inventory to generate income. This test excludes inventory from assets in calculating the proportion of current assets available to meet current liabilities. Quick Ratio = (current assets – inventory) / current liabilities



- The Current Ratio (also known as the Working Capital Ratio) may be more appropriate for businesses not relying on inventory to generate income). Current Ratio = current assets / current liabilities
- For either ratio, a result of one or greater is generally sufficient to confirm adequate business liquidity to support the withdrawal of earnings

### **K-1 Income w/ <25% Ownership**

- When a borrower receives K-1 income but has <25% ownership of a partnership, S corporation, or LLC, ordinary income, net rental real estate income and other net rental income reported on IRS Form 1065 or IRS Form 1120S, the income may be used to qualify the borrower provided:
  - The borrower can document ownership share (may use Schedule K-1);
  - The borrower can document access to the income; and
  - The business has adequate liquidity to support the withdrawal of the earnings.

### **K-1 Cash Distributions**

- If the Schedule K-1 reflects a stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, the Schedule K-1 income may be used to qualify, no additional documentation of access to the income or adequate liquidity is required.
- If the Schedule K-1 does not reflect a stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, additional review is required. In addition to the documentation requirements as listed below, the following must be documented and reviewed:
  - Evidence that the borrower has access to the income such as partnership agreement or corporate resolution confirming access to the income.
  - Evidence that the business has adequate liquidity to support the withdrawal of the earnings. The underwriter needs to determine what documentation is acceptable to determine that the business has the capacity to continue making cash distributions at the level of business income being used to qualify.

### **Schedule K-1 Guaranteed Payments to Partner**

- If the borrower has a 2 year history of receiving “guaranteed payments” from a partnership or an LLC, the payments can be used to qualify.

Note: If the borrower has less than a 2 year history of receiving “guaranteed payments” it may only be used to qualify IF the borrower has recently acquired a minimal ownership in a professional services partnership (i.e., medical practice or law firm) after having an established employment history with the partnership. The borrower’s partnership agreement and evidence of year-to-date income must also be obtained.

### **Documentation Requirements**

- 2 years most recent tax returns with Schedule E; and
- 2 years most recent Schedule K-1.
- Verification of the existence of the business is required as outlined in the Verifying the Existence of the Business topic in Section 1508.5-Employment and Income/Self-Employed.



## **Future Income**

- If the borrower is scheduled to begin employment after the loan closes, their Future Income may be considered as qualifying income following the guidelines below. Examples of this type of scenario are teachers whose contracts begin with the new school year, physicians beginning a residency or an employee relocating for a new job
- Future income is limited to loans that meet the following criteria:
  - Purchase transactions
  - Primary residence or 2<sup>nd</sup> home occupancy
  - The borrower is not employed by a family member or by an interested party to the transaction
  - Borrowers must document a minimum 2 year work/student history
  - Start date of employment must be within 90 days of the note date
- The following documentation must be obtained
  - Clearly identifies the employer and the borrower, is signed by the employer, and is accepted and signed by the borrower
  - Clearly identifies the terms of employment, including position, type and rate of pay, and borrower's start date
  - Is non-contingent. Note: If conditions of employment exist, all conditions of employment must be satisfied either by verbal verification or written documentation prior to closing. This confirmation must be documented in the mortgage loan file.
- In addition to the funds required for the transaction, the borrower must have verified sufficient reserves to cover all monthly liabilities (the subject PITIA payment and all monthly liabilities included in the DTI) for 3 months.

## **Employment Stability**

- A 2-year employment history must be reflected on the application. The purpose of reviewing employment history is to assure that the borrower has a history of receiving stable income from employment (and other sources) and that there is reasonable expectation that the income will continue to be received in the foreseeable future. If documentation indicates that the income will end within the next 3 years the income should not be used to qualify.

## **Frequent Job Changes**

- Frequent employment changes within the same line of work while continuing to advance in income or benefits is acceptable. Income stability takes precedence over job stability.
- However, there may be occasions that warrant a closer examination of employment and income. Example: Frequent changes in employment for reasons other than advancement (e.g., changing careers) or extended periods of unemployment may be indicative of an unsteady work history and income.
  - Borrowers with questionable employment histories must have financial strengths in order to be considered for maximum financing. Negative comments received from an employer may or may not be reason to decline the application, but circumstances must be investigated thoroughly before doing so.
  - Borrowers who work in certain industries may experience frequent job changes due to the nature of the work (e.g., seasonal or unskilled labor). In these instances borrowers should not be penalized provided they have demonstrated the ability to maintain a steady income and the changes have not



affected the borrower's ability to pay their obligations. Note: Often due to the nature of the work, LMI borrowers may change jobs frequently and still be able to demonstrate the ability to earn consistent and predictable income. In these instances, emphasize the continuous flow of income.

- Borrowers who have held the same position during their entire tenure should not be penalized. However, their potential for future increases may need to be taken into consideration in determining the type of mortgage that best meets their needs.

### **Re-entering the Workforce**

- A borrower's income may be considered effective and stable when recently returning to work after an extended absence if s/he:
  - Is employed in their current job for six months or longer; and
  - Can document a two-year work history prior to an absence from employment using:
    - Traditional employment verifications; and/or
    - W-2s or paystubs.

Note: An acceptable employment situation includes individuals who took several years off from employment to raise children, then returned to the workforce.

- Situations not meeting the criteria listed above may not be used in qualifying. Extended absence is defined as six months.

### **Newly Employed**

- Borrowers who are newly employed and have an employment and income history that covers less than the 2 most recent years may be eligible for a mortgage loan as long as the borrower was attending school, in a training program related to the new position, or in the military immediately prior to their current employment. Supporting evidence such as College transcripts or discharge papers are required to verify.

Note: When the borrower has less than a two-year history of receiving income, the underwriter must also provide a written analysis to justify the determination that the income used to qualify the borrower is stable.

### **Military Benefits**

- Military personnel may be entitled to different types of pay in addition to their base pay. The following may be considered stable income provided there is documentation verifying the income will continue for at least 3 years.
  - Flight Pay
  - Hazardous Duty Pay
  - Rations
  - Clothing Allowance (usually paid yearly)
  - Housing Allowances
  - Education benefits may not be used to calculate qualifying income.
- Obtain a copy of the borrower's last Leave and Earnings Statement (LES) to verify allotments, allowances, estimated time in service, and the amount of net and gross pay. Also, obtain and verify the following information from the borrower's latest Leave and Earnings Statement (LES):
  - Military Rank
  - Social Security Number



- Length of active service to date
  - Estimated remaining time at present location
- The tax-free income from housing (BAQ), rations, uniforms, food, flight pay, etc., can be used as income to qualify for the loan as long the income will continue for at least 3 years. Grossing up of this income is subject to standard guidelines.

### **Documentation Requirements**

- YTD LES documenting at least 30 days of income
- W-2's for the most recent two years
- In lieu of a verbal VOE, a Military Leave and Earnings Statement dated within 120 calendar days prior to the note date is required or verification through the online Defense Manpower Data Center.

Military Reserve: Income paid to military reservists may be used to qualify as long as the borrower has a 2-year history or receipt and the income is expected to continue for the next 3 years.

### **Individual Employed by an Interested Party in the Transaction**

- Tax returns must be obtained even if the borrower does not meet the definition of self-employed. However, they do not have to be treated or registered as a self-employed borrower.
  - Carefully examine loans with borrowers who are employed by interested parties to the property sale, purchase or financing of the transaction.
  - Borrowers who are employed by an interested party in the transaction must also provide 2-years tax returns, regardless of the percentage of ownership or type of income.

#### **Required Documentation:**

- Most recent YTD pay stub documenting at least 30 days of income. Paystub must be dated no earlier than 30 days prior to the application date, and must include all year-to-date income. If the paystub does not include sufficient information to appropriately calculate income, additional documentation must be obtained; and
- 2 years most recent personal tax returns with all W-2s; and
- Verbal Verification of Employment performed no more than 10 business days prior to the loan closing.

### **Individual Employed in a Family Owned Business**

- Tax returns must be obtained even if the borrower does not meet the definition of self-employed. However, they do not have to be treated or registered as a self-employed borrower unless they have 25% or more ownership in the business.
  - Carefully examine loans with borrowers who are employed in a family owned business, or whose employer is an interested party to the sale of the property.
  - Ownership in a family business must be established and verified, regardless of the percentage of ownership; therefore the most recent 2-years tax returns are required.





**Required Documentation:**

- Most recent YTD pay stub documenting at least 30 days of income. Paystub must be dated no earlier than 30 days prior to the application date, and must include all year-to-date income. If the paystub does not include sufficient information to appropriately calculate income, additional documentation must be obtained; and
- 2 years most recent personal tax returns and all W-2s; and
- Verbal Verification of Employment performed no more than 10 business days prior to the loan closing.

**Internet & Email Verifications**

- Downloads from the Internet are acceptable provided they meet all general guidelines outlined in this section. The existence of the web site from which the documents were derived must be verified. Documents that are downloaded from the Internet by the borrower must clearly identify the employer (as evidenced by corporate letterhead or logo), and the source of the information must be included on the Internet banner that is at the top of the document. Printed web pages must show the uniform resource locator (URL) address and the date and time printed.

Note: E-mail photographs or screen shot pictures via a phone of documents are permitted provided they are complete, legible and meet all requirements for electronic records.

**Overtime**

- Overtime is money paid to individuals who earn additional wages for time worked above and beyond the normal workday or workweek.
- The borrower must have a 2-year history of receipt to use as qualifying income and it must be likely to continue for the next three years. Earnings must be level or increasing; compensating factors must exist if decreases in the last year.

**Required Documentation:**

- Most recent YTD pay stub documenting at least 30 days of income. Paystub must be dated no earlier than 30 days prior to the application date, and must include all year-to-date income. If the paystub does not include sufficient information to appropriately calculate income, additional documentation must be obtained; and
- 2 years most recent W-2s and/or 1099s; and
- There is no evidence from the employer that the income will no longer be received; and
- It is determined that the income is likely to continue based on an established earnings trend.
  - If the trend is stable or increasing, income can be averaged over the two year period.
  - If the trend was declining but has since stabilized and there is no reason to believe that the borrower will not continue to receive the income at the current level, the current, but lower stabilized amount must be used.
  - If the trend is declining, the income may not be stable and additional analysis must be performed to determine if the income should be used. Income should not be averaged over the period of decline.
- and
- Verbal Verification of Employment performed no more than 10 business days prior to the loan closing.



## **Part Time, Seasonal & Secondary Income**

- Part-time, seasonal or second-job income may be used to qualify if it can be verified as having been received for the previous 2-years and if it has a strong likelihood of continuation. This income is considered uninterrupted if the borrower has held the same position for at least 2-years and employment is expected to continue for the next 3 years. (For example, someone who works at a department store only during the Christmas season, or who works summers in an amusement park demonstrate a consistency that is likely to continue.) Income is averaged over 2 years.
- For secondary income, it is acceptable for a borrower to have a history that includes different employers as long as the income has been consistently received. In no instance may the borrower have any gap in employment greater than one month in the most recent 12-month period unless the secondary employment is considered seasonal income.
- Occasionally, with extraordinary circumstances less than a 2-year history may be considered—but no less than 12-months—provided there is a strong likelihood income will continue. When the income used to qualify has less than a 2-year history the file must contain a written explanation and justification from the underwriter as to why the income was used to qualify.

### **Required Documentation:**

- Most recent YTD pay stub documenting at least 30 days of income. Paystub must be dated no earlier than 30 days prior to the application date, and must include all year-to-date income. If the paystub does not include sufficient information to appropriately calculate income, additional documentation must be obtained; and
- 2 years most recent W-2s; and
- Verbal Verification of Employment performed no more than 10 business days prior to the loan closing

## **Minister / Clergy Income**

- Ministers and other clergy members are typically paid a monthly base pay plus “other” income. The amount of “other” income may vary widely and may or may not be taxable income. Often, ministers are self-employed and/or have unreimbursed business expenses. Housing allowance is typical and may be considered with acceptable verification and documentation.
  - Review YTD paystubs and W-2s/1099s and personal tax returns to determine income. Review personal federal tax returns/IRS transcripts to determine unreimbursed business expenses which must be deducted from qualifying income if the tax returns reflect “other” income >25% of the borrower's annual employment income.
  - Documentation provided must show income has been received for most recent 12 months and likely to continue for the next 3 years.
  - If there is any indication that all or part of the income is not likely to continue, it should not be used to qualify the borrower.

## **Income Adequacy and Continuance**

- The borrower should have a history of generating steady income for at least 2 years and it must be likely to continue at the level used to qualify for at least the next 3 years. Stable monthly qualifying income must be:



- Recurring;
- Received regularly;
- Received in cash (includes check, wire-transfer, etc.) and paid tax on the income as evidenced by a U.S. tax return;
- Reasonable based on the source.

Note: The determination of income stability and continuance for all sources is based on the required documentation as defined in this chapter, and any other documentation contained in the file. The underwriter should focus on the borrower's past employment/ self-employment history, the history of receipt of other income, and the probability of continued consistent receipt of the income used to qualify the borrower. For each income source used to qualify, the underwriter must determine that both the source and the amount of income are stable.

- For all eligible income types, the underwriter may consider the income as long as s/he does not have any knowledge, information or documentation that contradicts a reasonable expectation of continuance or probability of consistent receipt for the next 3 years. While sources of income may vary, the borrower should have a consistent level of income despite changes in the sources of income.
- Other sources of income, such as certain types of disability benefits that do not have defined expiration dates may also be considered provided the documentation indicates the income type. If the income falls into that category and it does not have a defined expiration date, the underwriter may conclude that the income is stable, predictable, and likely to continue. In these instances, request for additional documentation from the borrower is not required.

### **Significant Increases or Decreases in Income Level**

- If the borrower has experienced a significant decrease in income, income should not be averaged using a previous higher level unless the decrease was due to a documented one-time occurrence that impacted the income level for a period of time, and the borrower's income level has returned to the amount they previously earned.
- If the borrower has experienced a significant increase in income, the underwriter must obtain sufficient documentation to determine that the increase was not due to a one-time occurrence, and that the income used to qualify is stable and likely to continue at the level to be used for qualifying.
- The focus of the underwriter's analysis should be on the qualifying income that is most likely to be received for the next 3 years.
- If the borrower has multiple sources of income, refer to each income type for documentation requirements.

### **Unacceptable Sources of Income**

- Income derived from any of the following may not be used in calculating qualifying income.
  - Any income derived from transactions in or related to the sale or production of marijuana, hemp or any cannabis products or derivatives, such as CBD products.
  - Any income that cannot be documented and verified
  - Capital withdrawals
  - Draw Income
  - Gifts, including Gift of Equity
  - Illegal Income/Income not listed on Tax Returns
  - Income from Foreign / Non-U.S. Sources
  - Retirement assets used as qualifying income



- Room/boarder rent
- Trade Equity
- Trailing Co-Borrower
- Any income derived from owning or controlling a VASP (Virtual Asset Service Provider), as defined in the VASP standard.
- Income that is paid in cryptocurrency

### **Evaluating Non-Employment Income**

- If the borrower intends to use income from other non-employed/non-self-employed sources to qualify, the income may be considered stable to the extent that it is consistent and it is likely to continue for the next 3 years based on the documentation received and the following:
  - There is no evidence from the employer that the income will no longer be received; and
  - It is determined that the income is likely to continue based on an established earnings trend.
    - If the trend is stable or increasing, income can be averaged over the two year period.
    - If the trend was declining but has since stabilized and there is no reason to believe that the borrower will not continue to receive the income at the current level, the current, but lower stabilized amount must be used.
    - If the trend is declining, the income may not be stable and additional analysis must be performed to determine if the income should be used. Income should not be averaged over the period of decline.

Note: Income that is paid to the borrower in cryptocurrency may not be used for qualification.

- Factors that should be considered in determining the likelihood of consistent payments include, but are not limited to the following:
  - Whether the payments are received pursuant to a written agreement, court decree, or law;
  - The length of time the payments have been received;
  - Eligibility criteria governing the continued receipt of the income, such as age of dependents or accumulation of assets.
- The purpose of this section is to address the various types of other non-employed income that may be used to qualify the borrower, the documentation used to verify the source and the principle methods of validating its authenticity. The Documentation Process used to process the loan will determine if income must be verified and what income documentation is required.
- As always, additional documentation may be requested if deemed necessary by the underwriter.

Note: The determination of income stability and its continuance for all sources is based on the required documentation as defined in this section. Unless there is evidence that the income will no longer be received, the underwriter should assume that it will continue. Other sources of income, such as certain types of disability benefits that do not have defined expiration dates may also be considered provided the documentation indicates the income type. If the income falls into that category and it does not have a defined expiration date, the underwriter may conclude that the income is stable, predictable, and likely to continue. In these instances, request for additional documentation from the borrower is not required.



### **Alimony/Separate Maintenance**

- Alimony/separate maintenance/spousal support can be considered a stable source of income provided the borrower has received the income for at least 6 months and the income will continue for at least 3 years.
- Alimony/separate maintenance/spousal support may be non-taxable. See the Tax Exempt/Non-Taxable Income guidelines in this section for additional information.

#### **Documentation Requirements**

- Deposit slips and/or bank statements/cancelled checks, court records or tax returns evidencing regular deposit of the funds covering 6 consecutive months; and
- Final divorce decree, legal separation agreement or court order evidencing amount, frequency, and 3 years continuance

### **Annuity**

- Annuity income is similar to pension and Social Security income except that it may not be payable for life.

#### **Documentation Requirements:**

- Copy of the most recent updated annuity renewal statement showing the effective date, amount, frequency, and 3 years continuance.

### **Auto Allowance / Expense Account Reimbursement**

- Auto and expense account reimbursement are paid by the employer to cover expenses incurred related to conducting business. FCM will consider using a portion of this income to qualify if the borrower has a 1-year history of receiving it and it can be reasonably expected to continue for 3-years.
- If the borrower reports automobile expenses on Form 2106 or personal tax returns, schedule C:
  - The amount of the auto allowance that exceeds the amount of monthly expenses is added to the monthly income; or
  - The amount of the expenses that exceeds the allowance should be included in the borrower's total monthly obligations.

Note: If the borrower uses IRS Form 2106 with "actual expenses" instead of the "standard mileage rate," the lender must look at the "actual expenses" section to identify the borrower's actual lease payments, and then make the appropriate adjustments.

- If the borrower does not report the allowance on either Form 2106 or Schedule C:
  - The full amount of the allowance should be added to the borrower's monthly income; and
  - The full amount of the lease or monthly payment for the automobile must be added to the borrower's total monthly obligations and included in the total debt to income ratio.
- Typically, auto allowance and expense account reimbursements are included with the W-2 earnings; therefore it is very important to make certain the income is not included twice. Refer to Employee Business Expenses (2106) in 1508.5-Employment & Income/ Tax Returns for additional information.

#### **Documentation Requirements**

- Most recent pay stubs covering past 30 days; and



- 2 years most recent W-2s; or
- 2 years most recent tax returns with all Schedules when auto allowances and/or expenses are reported on IRS Form 2106 or Schedule C.

### **Boarder Income**

- Boarder income may not be used to qualify.

### **Capital Gains/Losses**

- If a capital gain/loss appears to be a one-time occurrence, it does not have to be considered when calculating available income. However, gains/losses that are recurring may be considered. For example, an asset sold during the year might be income producing and could result in a reduction of future income. If income from this source represents a substantial portion of the borrower's income, review the tax returns along with the Schedule D and average it over 2- years. If earnings are consistent, a 2-year average will suffice. However, if income fluctuates substantially, a 3-year average will be necessary.
- Capital gain income should only be considered if there is evidence of sufficient assets remaining after closing to support continuance of the income, at the level used for qualifying, for at least the next 3 years.
- Exercising Stock Options
  - Although not typically used as qualifying income, stock options may be considered as qualifying income on occasion if the loan warrants. Only profits received from exercised stock options may be considered. The borrower must have a verified history of receiving income from executed stock options for at least 2-years and the likelihood of its continuance must be verified.

### **Documentation Requirements**

- 2 years most recent tax returns with Schedule D and W-2s or 1099's; and
- Proof of ownership of the asset (e.g., statements) evidencing sufficient value to support the continuance of capital gains; and
- It is determined that the income is likely to continue based on an established earnings trend.
  - If the trend is stable or increasing, income can be averaged over the two year period.
  - If the trend was declining but has since stabilized and there is no reason to believe that the borrower will not continue to receive the income at the current level, the current, but lower stabilized amount must be used.
  - If the trend is declining, the income may not be stable and additional analysis must be performed to determine if the income should be used. Income should not be averaged over the period of decline.

Note: Assets may not be in the form of cryptocurrency.

### **Child Support**

- Child support can be considered a stable source of income provided the borrower has received the income for at least 6 months and the income will continue for at least 3 years. Child support is non-taxable and can be grossed up. Follow the Tax Exempt/Non-Taxable Income guidelines in this section for applicable adjustments.





### **Documentation Requirements**

- 6 months court records, deposit slips, bank statements or cancelled checks evidencing regular deposit of the funds; and
- Proof of ages of the children for which child support is received; and
- Final divorce decree, legal separation agreement or court order evidencing amount, frequency and 3 years continuance

### **Disability – Workers Compensation**

- Disability and workers compensation varies and must be verified by obtaining a copy of the borrowers' disability policy or benefits statement. A statement from the insurance company or employer must confirm the borrowers' current eligibility for the disability benefit must also be obtained. If the benefits have an expiration date, the remaining term must continue at least 3 years from the date of the mortgage application. Generally, long term disability will not have a defined expiration date and may be considered to have a reasonable expectation of continuance. The requirement for re-evaluation is not considered an expiration date.
- If the payments will not continue for at least 3 years, refer to the Temporary Leave Income topic in this section for additional guidance.
- If the borrower is currently receiving short-term disability payments that will convert to long-term benefits within the next three years, the borrower must be qualified on the lesser amount of either the long-term or short-term disability payments.
- Disability and/or workers compensation benefits must be stable and expected to continue for at least 3 years. Non-taxable benefits can be grossed up provided it is verified as non-taxable.

Note: When the income is verified to be non-taxable, and its tax exempt status is determined likely to continue, the underwriter must develop an "adjusted gross income" for the borrower if the additional income is needed to qualify for the product, program or loan amount applied for. The previous year's tax rate must be used to calculate grossed up percentage. If the borrower was not required to file a tax return or they didn't have any tax liability on their tax return, a 25% tax rate must be used in the calculation. Refer to the Tax-Exempt Income/ Non-Taxable Income topic in this section for documentation requirements that must be obtained to determine if a particular source of income is non-taxable.

### **Documentation Requirements**

- Copy of Disability policy or Benefits Statement
- A statement from the benefits' payer (insurance company, employer, or other qualified and disinterested third party) confirming the borrower's current eligibility
- 2-months deposit slips and/or bank statements/cancelled checks evidencing regular deposit.

### **Foster Care**

- Foster care income is received from a state-or county-sponsored organization for the temporary care of one or more children. This income may be considered provided the borrower has a 2-year history of providing foster-care services under a recognized program, and is likely to continue for the next 3 years at a level that supports the amount of income needed for qualifying for the mortgage.

### **Documentation Requirements**



- Letters from the organization providing the income showing a 2 year payment history; and
- 2 years most recent personal tax returns; or
- 24-months deposit slips or bank statements/cancelled checks confirming regular deposit of the payments.

### **Gambling Winnings**

- Funds are usually considered as a lump sum distribution and therefore not considered income. However, if the borrower is a professional gambler and the earnings are from his/her self-employed business the income may be used for qualifying. The income must be documented and analyzed per the requirements outlined in 1508.5-Employment & Income/Self Employed Income section.
- Lottery winners will be considered on a case-by-case basis.

### **Documentation Requirements**

- 2 years most recent tax returns with all Schedules

### **Gift Income**

- Not permitted.

### **Inheritance & Other Guaranteed Income**

- Ongoing income received from inheritance or other guaranteed sources—such as prize earnings, or lottery winnings—may be used to qualify provided it can be verified that the income is regular and recurring. Typically, the borrower should have a documented history of receiving it for at least 2-years and verify that it will continue for at least 3 more years.
- A copy of the award letter confirming the amount, frequency, duration of payments, and evidence of receipt for the previous 2 years is required. Borrowers who do not have a 2-year history of receiving the income may still be considered contingent upon the terms of the payout. Example: The income is guaranteed to continue for the next 20 years but the borrower has only received one payment/installment.

### **Documentation Requirements**

- Copy of Award letter confirming amount, frequency, and duration of payments; and
- 2 years most recent tax returns with all Schedules.

### **Interest & Dividends**

- Interest and dividend income are reported on personal tax returns, Schedule B.
- In order for interest or dividend income to be used as qualifying income the borrower must have a 2-year history of receiving the interest or dividend income and the income must be expected to continue for the next 3 years. The assets from which the interest and dividend income was earned must also be verified via most recent bank statements. Any taxable interest or dividend income that is not recurring must not be used to qualify.
- Average interest and dividend income received for the last 2 years to calculate the qualifying income. If funds are used for the down payment and closing costs, the value of the assets should be reduced accordingly and the interest and dividends recalculated based on the reduced value.

### **Documentation Requirements**



- 2 years most recent tax returns with Schedule B; and
- Two month's asset account statements showing sufficient assets available to continue generating dividends and interest after closing; and
- Determine that the income is likely to continue based on an established earnings trend.
  - If the trend is stable or increasing, income can be averaged over the two year period.
  - If the trend was declining but has since stabilized and there is no reason to believe that the borrower will not continue to receive the income at the current level, the current, but lower stabilized amount must be used.
  - If the trend is declining, the income may not be stable and additional analysis must be performed to determine if the income should be used.
  - Income should not be averaged over the period of decline.

Note: Assets may not be in the form of cryptocurrency.

### **Investment Property**

- An investment property is an income-producing property that the borrower or co-borrower does not occupy. The subject property may be a 1-4 unit, condominium, or PUD. Rental income may be used to qualify.
- Rent Loss Insurance: Refer to Section 805.3-Rental Income.
- Occupying Tenant: For Purchase transactions, if the subject property is currently being rented, the rental agreement/lease must be reviewed to ensure that it does not contain any provisions that could affect our position as mortgagee. In some jurisdictions, a lease that pre-dates the mortgage has a superior claim to the mortgage, even if it has not been recorded. However, the tenant's rights will usually remain intact under the pre-existing lease. If the lease is not subordinated to the mortgage, each lease must be reviewed to ensure that any "rights to purchase"—and any other rights that could adversely affect the mortgagee's interest—have been formally waived by the tenant.
- Additional Requirements for Subject Investment Properties:
  - If rental income is not used to qualify, PITIA must be used in calculating the debt ratios.
  - When the subject property is an investment property and the borrower(s) own multiple investment properties, the borrower(s) must provide evidence of a minimum of 2 years' experience managing multiple investment properties.

### **IRS Form 4506-C**

- All borrowers whose income is used to qualify for the loan transaction must sign form 4506-C at closing, regardless of income type-salary, self-employed, social security, etc. An additional 4506-C must also be signed prior to or at closing for each business tax return that is in the loan file that was used to calculate qualifying income (resulting in either a gain or loss). Alternative forms such as the 8821, 4506 or 4506-T are not permitted

### **Third Party Verification Services Provider**



- Third party vendors may be used as an alternative method for verifying income, employment and assets. The verification must provide the same level of documentation defined in this fact sheet. If it does not, additional supplements must be obtained to meet documentation requirements.

### **Debt Payoff / Consolidation**

- Pay off of any debts must always be at the initiation and direction of the borrower; the lender may not dictate when and what accounts must be paid off.
- The borrower's history of credit use should be a factor in determining whether the appropriate approach is to include or exclude debt for qualification. As a rule of thumb:
  - Installment loans that are being paid off do not have to be included in the borrower's long-term debt.
  - Payoff of revolving debt to qualify is not permitted. The debt listed on the credit report must be used to calculate the DTI.
- If installment debt does not extend beyond 10 months, the Underwriter should review the borrower's debt to ensure that the size and/or number of remaining payments will not impact the borrower's ability to handle the new mortgage payment during the early period of the loan. A Borrower who increases debt and then periodically uses refinance or debt consolidation to reduce payments to a manageable level presents a higher risk and the qualifying ratios should be within guidelines.
- If all or any portion of the proceeds of the Mortgage is used to pay off or pay down existing debts (installment) in order to qualify for the Mortgage, payoff must be documented in the Mortgage file. Canceled checks, paid receipts and/or a copy of the Closing Disclosure form or other closing statement may be used to document the repayment.
- When the borrower pays off or pays down an existing debt in order to qualify, the source of funds used must be verified, and meet eligibility requirements for both purchases and refinances.

### **Debt-to-Income (DTI) Ratios**

- Monthly DTI (debt-to-income) ratio is the sum of the monthly Housing-to-Income (HTI) expense as defined above, plus all of the following, divided by the gross monthly income.
- Note: When a mortgage is secured by a second home or an investment property, the monthly principal, interest, taxes, and insurance installment for the mortgage is not considered part of the borrower's monthly housing expense; rather, it is considered one of the borrower's monthly debt obligations.
  - Payments on revolving debt.
  - Installment debt extending beyond ten months.
  - Monthly PITIA for second homes and other investment properties that are non-income producing real estate.
  - If rental income is not used to qualify the subject investment property PITIA must be used in calculating the debt ratios. Note: Operating expenses may be determined by calculating 25% of the gross rental income amount reflected on the Comparable Rent Schedule.
  - Current real estate taxes and all monthly insurance premiums for real estate owned that is free of any lien.
  - Optional Credit Insurance, if applicable.
  - Child support, alimony or separate maintenance payments extending beyond ten months.
  - Other consistent, recurring expenses as detailed in the next section of this chapter.



- For each liability, the underwriter must determine the unpaid balance, terms and the borrower's payment history. Generally, residential mortgage credit reports provide this information.
- Note: If the subject property is a second home or investment property and the borrower's primary housing expense is zero, the lender must verify that the

borrower does not have a primary housing payment/debt and document same in the file. Examples include written documentation verifying where the borrower resides indicating the borrower has no housing payment.

### **Housing-to-Income (HTI) Ratio**

- The monthly housing expense is the sum of the following monthly charges on the Borrower's Primary Residence:
  - Principal and interest for the mortgage that is secured by the occupant borrower's principal residence;
  - Monthly amounts for:
    - Any subordinate financing on the subject property (see calculation requirement below),
    - Hazard insurance (HO-6 if required for condominiums),
    - Real estate taxes,
    - Mortgage insurance premium;
    - And when applicable...
    - Home owner association dues
    - Optional Credit Insurance
    - Any owners' association dues (excluding any utility charges that apply to the individual unit),
    - Any monthly cooperative corporation fee (less the pro rata share of the master utility charges for servicing individual units that is attributable to the borrower's unit),
    - Leasehold payments (ground rent)
    - Special assessments
    - Monthly Flood Insurance Fee
    - Tax Abatements: The monthly real estate tax amount must be included if the abatement expires in 5 years or less (or 3 years or less for co-ops). For tax abatements less than 5 yrs (or 3 years or less for co-ops), the borrower must be qualified with the annual tax amount that will be required at the end of the expired tax abated year. (If the tax abatement is not recorded on title, evidence of the approved tax abatement must be documented in the loan file.)
  - The above amounts must be included in the debt ratio and reserve calculation, regardless of whether the amounts must be deposited into an escrow account.
  - For new construction properties, debt ratios should be calculated using the estimated real estate taxes based upon the completed property improvements, not the unimproved lot taxes. For existing properties, debt ratios should be calculated using the tax amount provided by the current tax bill, Title Commitment, DLS Screen Print or recent appraisal.
  - In the state of California for Purchase transactions and refinance transactions including where the property was purchased within the last 12 months, and taxes have not yet been fully assessed, debt ratios should be calculated using 1.25% of the lesser of the purchase price or appraised value.



However, if the underwriter determines that the actual tax rate is less than 1.25%, the actual tax rate may be used to calculate the debt ratios as long as documentation supporting the amount is in the loan file. Conversely, if the actual tax rate is higher than 1.25%, that amount must be used to calculate the debt ratio as well.

- Payment calculation for subordinate financing:
  - HELOC - Qualifying payment should be calculated using the fully amortizing principal and interest payment based on Prime + Margin (or 2% if margin is unavailable) + 2%, for the remaining term after the Interest Only period on the maximum line amount.
  - Fixed Rate/Closed End Second Mortgage- Qualifying payment is calculated using the principal and interest payment.

## **Qualifying Ratio**

We must have a reasonable belief that the borrower has the ability to repay the loan. We will not originate or purchase a loan based solely on the value of the real estate collateral. The analysis of a borrower's ability to repay will include appropriate review of income, debts, DTI ratios, disposable income, and credit worthiness.

## **Mortgage Differential / COLA**

- A mortgage differential/cost of living adjustment (COLA) is a type of incentive paid to relocating borrowers. During a period of high mortgage interest rates, employers will often offer mortgage differential or COLA to subsidize the employee's mortgage payments by paying all or part of the difference between the employees present and proposed mortgage payments.
- A mortgage differential/COLA is an acceptable source of income provided the employer verifies the terms, amount, and duration of the payments in writing. The payments must continue for at least 3 years. If the terms of the mortgage differential/COLA pay indicate a decline from year to year, the lowest of the scheduled payments during the three years after the mortgage closing should be used to qualify.
- This income may not be used to offset the new mortgage payment.

## **Documentation Requirements**

- Copy of the Agreement from the employer stating the amount and 3 years continuance.

## **Notes Receivable**

- Income from notes receivable may be used to qualify provided the income is regular and recurring. The borrower should have a documented history of receiving the income for at least 1-year and can verify that the income will continue for at least 3 years.

## **Documentation Requirements**

- A copy of the Note confirming the amount, frequency, and 3 years continuance; and
- Most recent 2 years' tax returns with Schedule B; or





- 12-months deposit slips and/or bank statements/cancelled checks evidencing regular deposit of the fund

Notes receivable income on newly executed notes, that do not have at least a 12 month history of receipt but has a minimum duration of 3 years, may not be used to qualify.

### **Public Assistance**

- Types of Public Assistance income include but are not limited to Social Security, Section 8 Housing Voucher, Food Stamps and SNAP. Public Assistance income may not be discounted or treated differently than wage income.
- It may be considered if the income is properly documented by letters or exhibits from the paying agency. The amount and frequency must be stated in the letters/exhibits and there is no statement that the income will not continue.

### **Documentation Requirements**

- 2 months deposit slips and/or bank statements/cancelled checks evidencing regular deposit of the fund if the assistance is already being received\*; and
- Receipt of Letters or Exhibits from paying agency showing amount, frequency, and 3 years continuance.

\*Note: A history of receipt is not required for newly obtained assistance.

1The Section 8 HCVP is available only to families that have been admitted to the HCVP and it is not offered by every Public Housing Agency (PHA).

- PHA's have discretion to determine whether to implement the HCVP in their jurisdiction. There must be a sponsoring PHA because they are the source of funds for this program. The program utilizes two different methods. The method used varies depending on how the PHA in each geographical area decides they want it to function. Loans must be coded using the Income Type of Housing Choice Voucher Program (Section 8) to identify. Housing Assistance Payment (HAP) Option: The first method is one in which the public assistance funds are sent directly to the borrower, and the borrower uses this money to help pay their monthly mortgage payments. A mortgage with a term of 30 years will receive income assistance for 15 years, and with a term of 15 years will receive income assistance for 10 years. For the elderly (62 or older) and disabled\* borrowers, there is no expiration of the benefits.
- Second Mortgage Option: The second method is one in which public assistance funds are used to pay a community second subsidy mortgage that is put in place by the PHA. The subsidy provided by the PHA provides significant down payment assistance for the borrower, which ultimately lowers the borrower's monthly mortgage payments. Unlike the first method, the money never passes through the borrower's hands, but the result is almost the same – the portion of the borrower's monthly mortgage payment is reduced. If the borrower is utilizing the Community Second Mortgage Option, there will be a subordinate lien with the PHA and the Community Second is paid directly by the PHA.
  - The term of the Community second is not to exceed 15-years and any interest, if applicable may not exceed the interest rate on the first mortgage.
  - Only subordinate financing provided by an approved Community Second is permitted. Non-Community Seconds are not permitted.



- Correspondents represent and warrant that the Community Second program complies with Fannie Mae guidelines, does not have a Negative Amortization financing structure, and does not have any special servicing requirements.
- Income may be grossed up for Agency salable 1st Mortgage programs; refer to Tax Exempt/Non-Taxable Income topic in this section for documentation requirements.

## **Restricted Stock**

- Restricted stock plans award an employee shares of stock as a form of additional compensation. However, the employee cannot take possession of the shares until vesting restrictions are met. Most commonly, the vesting restriction is met if the employee continues to work for the company for a certain number of years. Time-based restrictions may lapse all at once or gradually. If the recipient does not meet the conditions the company set forth prior to the end of the vesting period, the shares are typically forfeited.

Note: To avoid counting the income/asset twice, if restricted stock is used as income, any unvested shares of restricted stock cannot be used as an asset, nor can dividend interest or capital gains income from the same restricted stock be used.

- Restricted stock may be considered as qualifying income if the loan documentation supports. The borrower must have a verified history of receiving income from restricted stock for at least 24 months and the likelihood of its continuance must be verified.

## **Documentation Requirements**

- Documentation of receipt of restricted stock income for the most recent 2 years. E.g., 2 most recent year-end paystubs, W-2's that provide a breakdown of base pay and restricted stock, etc. and
- Documentation of the most recent 2 years of restricted stock awards. E.g., compensation awards letters, vesting schedule etc.
- Printout/screenshot verifying company is publicly traded and verifying the stock price on the date of application.

Note: Restricted stock received from a sign-on type award can be used towards establishing the history of receipt of RSU income, but those shares cannot be considered in the income calculation.

- Determine that the income is likely to continue based on an established earnings trend.
  - If the trend is stable or increasing, follow income calculation below.
  - If the trend is declining, the income may not be stable and additional analysis must be performed to determine if the income should be used.

## **Income Calculation**

- Typically, restricted stock income is calculated using the lower of:
  - An average of the prior 2 years RSU earnings or
  - The number of performance-based shares/units awarded over the last 2 years at the current employer multiplied by the current stock price on the application date at 70% and averaged over 24 months. See below for example.

Example:



- 2020 performance/refresh award of 100 shares
- 2021 performance/refresh award of 90 shares
- Stock price of publicly traded company on date of application \$200/share

100 shares + 90 shares = 190 shares x \$140 (share price at 70%) = \$26,600 / 24 months = \$1,108/month qualifying income.

### **Retirement Assets Used as Qualifying Income**

- Not permitted.

### **Retirement Pension**

- Retirement/pension income may be considered as long as the amount makes sense based on the information provided and time limits of its receipt seem reasonable. Pension income is reported via a 1099. This income can be either taxable or non-taxable and must be expected to continue for the next 3 years. Non-taxable benefits can be grossed up provided it is verified as non-taxable.

Note: When the income is verified to be non-taxable, and its tax exempt status is determined likely to continue, the underwriter must develop an “adjusted gross income” for the borrower if the additional income is needed to qualify for the product, program or loan amount applied for. The previous year’s tax rate must be used to calculate grossed up percentage. If the borrower was not required to file a tax return or they didn’t have any tax liability on their tax return, a 25% tax rate must be used in the calculation. Refer to the documentation requirements under theta-Exempt Income/ Non-Taxable Income topic below for additional information.

### **Lump Sum Distributions**

- Borrowers who have recently retired and opted to take a lump sum distribution are eligible to use the income as qualifying provided the borrower has transferred funds to an annuity or similar account that allows for regular withdrawals and the account is set up for regular withdrawals. A letter from the borrower’s financial advisor is required to verify the terms of the withdrawal.
- If funds are not set up in an account allowing for regular withdrawals, income may not be used to qualify.

### **Documentation Requirements**

- Copies of most recent 1 years’ 1099 or IRS W-2; or
- 2-months financial statements or bank statements evidencing regular deposit of the fund; or
- Statement from the organization providing the income; or
- Most recent 1 years’ Federal Tax Return

If retirement income is paid as a monthly distribution from a 401(k), IRA or Keogh retirement account, the income must continue for the next 3 years. The retirement accounts (IRAs, 401k, or Keogh) may be combined to determine the 3 years continuance. In addition the following apply:

- 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 nature of the assets.



Note: Unrestricted access is obtained by borrower arranging under Internal Revenue Code Section 72(t) for distributions and if the distributions are in a series of substantially equal periodic payments (not less frequently than annually) there shall be no associated income tax increase.

### **Royalty Payments**

- Royalty payments may be used to qualify if they have been received on a regular basis for the most recent 12 months and are likely to continue for the next 3 years.
- The income is verified by the most recent 2 years' personal tax returns, including Schedule E.

### **Documentation Requirements**

- 2 years' most recent tax returns with all Schedules, and
- Documentation that the income will continue for 3 years, and
- Obtain copies of the royalty contract, agreement or statement confirming amount, frequency & duration of the income.
  - Determine that the income is likely to continue based on an established earnings trend.
  - If the trend is stable or increasing, income can be averaged over the two year period.
  - If the trend was declining but has since stabilized and there is no reason to believe that the borrower will not continue to receive the income at the current level, the current, but lower stabilized amount must be used.
  - If the trend is declining, the income may not be stable and additional analysis must be performed to determine if the income should be used. Income should not be averaged over the period of decline.

### **Social Security**

- Social Security income, a type of public assistance, may not be discounted or treated differently than wage income. Social Security benefits or award statements are normally issued each year by the Social Security Administration to reflect cost of living adjustments. This income can be either taxable or non-taxable. The portion that is non-taxable can be grossed up provided it is verified as non-taxable income.

Note: When the income is verified to be non-taxable, and its tax exempt status is determined likely to continue, the underwriter must develop an "adjusted gross income" for the borrower if the additional income is needed to qualify for the product, program or loan amount applied for. The previous year's tax rate must be used to calculate grossed up percentage. If the borrower was not required to file a tax return or they didn't have any tax liability on their tax return, a 25% tax rate must be used in the calculation. Refer to the documentation requirements under Tax-Exempt Income/ Non-Taxable topic for additional information.

- Social Security income for retirement or long-term disability that the borrower is receiving from his/her own account/work record will not have a defined expiration date and must be treated as though income is "expected to continue".
- If Social Security benefits are being paid as a benefit for a family member of the benefit owner and the income has a defined expiration date due to recipient's age, the income may be used in qualifying; however, you must obtain evidence that the income will continue for at least three years from the date of the mortgage application.

**Documentation Requirements**

- Document regular receipt of payments, as verified by the following, depending on the type of benefit and the relationship of the beneficiary (self or other) as shown in the table below.

Type of Social Security Benefit	Borrower is drawing Social Security benefits from own account/work record	Borrower is drawing Social Security benefits from another person's account/work record
Retirement	<ul style="list-style-type: none"> <li>Most recent Social Security Administrator's (SSA) Award Letter OR</li> <li>SSA-1099 OR</li> <li>Most recent signed federal tax returns OR</li> <li>Proof of current receipt</li> </ul>	<ul style="list-style-type: none"> <li>Most recent SSA Award Letter;</li> <li>Proof of current Receipt; AND</li> <li>If Social Security income has a defined expiration date due to recipient's age, you must obtain evidence that income will continue for at least three years.</li> </ul>
Disability		
Survivor Benefits	N/A	
Supplement Security Income (SSI)	<ul style="list-style-type: none"> <li>Most recent Social Security Administrator's (SSA) Award Letter, and</li> <li>Proof of current receipt</li> </ul>	N/A

Note: If the borrower is presently employed but is anticipating retirement within the next 12 months, anticipated retirement income should also be taken into consideration. For newly established SSI benefits, a recently issued Social Security award letter reflecting the finalized terms may be used to document the income if the borrower will begin receiving payments on or before the first payment date of the subject mortgage as confirmed by the award letter. Verification of receipt is not required.

**Tax Exempt / Non-Taxable Income**

- A borrower with tax-exempt/non-taxable income should be evaluated in the same manner as a borrower who has a higher gross taxable income. Tax-exempt sources may include
  - Child support payments,
  - Social Security benefits,
  - Disability retirement payments,
  - Workers' compensation benefits,
  - Supplemental Nutrition Assistance Program (SNAP)
  - Public Assistance Payments
  - Section 8 Housing Payments
  - Tax Free Municipal Bonds
  - Section 8 Income may be considered. The payments may not be used to offset the monthly housing payment. The public agency that provides the payment must provide documentation that shows the amount and terms of the monthly payment received and if the income is nontaxable. Refer to Public Assistance topic in this section to determine if able to use Grossed Up income to qualify. The documentation must show that the payments are made directly to the borrower. If the Section 8 income is determined to be nontaxable it may be grossed up as described below.
  - Tax-exempt trust and inheritance income may be considered provided there is sufficient documentation to support the tax-exempt status.



- Verify that the particular source of income is tax-exempt and that both the income and its tax-exempt status are likely to continue. Acceptable forms of documentation include award letter, policy agreements, and account statements.
- If the income is verified to be non-taxable, and its tax exempt status is determined likely to continue, the underwriter must develop an “adjusted gross income” for the borrower if the additional income is needed to qualify for the product, program or loan amount applied for. The previous year’s tax rate must be used to calculate grossed up percentage. If the borrower was not required to file a tax return or they didn’t have any tax liability on their tax return, a 25% tax rate must be used in the calculation.
- Refer to the specific income types in this section to determine if the income may be grossed up.

### **Documentation Requirements**

- 1 year’s most recent tax returns with all Schedules; or
- Other documents showing that the income, or a portion is nontaxable

Note: If the borrower indicates in any way that s/he did not file a tax return and the 4506-C transcript confirms there is no filing, no additional documentation is required.

### **Temporary Leave**

- Temporary leave from work is generally short in duration and may be for family, medical, maternity, short-term disability, or other temporary leave that is acceptable by law or the borrower’s employer. During a temporary leave the borrower’s income may or may not be reduced or the borrower may not be paid during their absence from work. Leave is no longer considered temporary when the borrower does not intend to return to their current employer or they do not have a commitment from their current employer to return to work.
- The requirements and guidance for income while on temporary leave do not extend to employer-initiated actions such as furloughs and layoffs.

Note: Refer to the Legal section 2201 of this manual for information regarding Medical Information Privacy in the Fair Credit Reporting Act, including details regarding medical information that can or cannot be collected.

- Income used to qualify is determined by when the borrower will be returning to work:
  - If the borrower will return to work prior to the first mortgage payment being due, the borrower’s regular employment income that will be received upon their return to employment can be used to qualify.
  - If the borrower will not return to work prior to the first mortgage payment being due, the lesser of the borrower’s temporary leave income (if any) or their regular employment income may be used to qualify.
- Supplemental Income
  - If the borrower will not return to work prior to the first mortgage payment being due and the borrower’s temporary income is less than their regular pay, liquid assets may be used to supplement the temporary leave income. However, the total qualifying income (temporary leave





income plus supplemental income) may not exceed the borrower's gross monthly income that will be received upon their return to their current employer.

Supplemental Income = Available liquid reserves\* ÷ the number of months of supplemental income\*\*

\*Available liquid reserves: Total liquid assets reduced by the amount of funds needed to complete the transaction (down payment, closing costs, prepaids, other debt payoff, required reserves, etc.).

\*\*Number of months of supplemental income: The number of months from the first mortgage payment date to the date the borrower will begin receiving his/her regular employment income, rounded up to the next whole number.

- Qualifying Income
  - Total Qualifying Income = Temporary Leave Income + Supplemental Income

Note: Total qualifying income may not exceed the borrower's regular employment income.

Example:

Regular income amount: \$6,000 per month

Temporary leave income: \$2,000 per month

Total verified liquid assets: \$30,000

Funds needed to complete the transaction: \$18,000

Available liquid reserves: \$12,000

First payment date: July 1

Date borrower will begin receiving regular employment income: November 1  
Supplemental income  $\$12,000 \div 4 = \$3,000$   
Total qualifying income:

$\$3,000 + \$2,000 = \$5,000$

### **Documentation Requirements**

- Borrower must provide written confirmation of his/her intent to return to work and the agreed upon date of their return as evidenced by documentation provided either from the borrower, directly from the employer, or a third party as designated by the employer.
- There must not be any evidence or information from the employer indicating that the borrower does not have the right to return to work after the leave period; and
- Documentation from the current employer confirming the borrower's statutory right to return to work (or the employer's commitment to permit the borrower to return to work), containing the date of return, and the borrower's post-leave employment and income; and
- Documentation of the amount and duration of the borrower's temporary leave income, which may require multiple documents or sources depending on the type and duration of the leave period; and
- Documentation of the amount of the regular employment income that the borrower received prior to the temporary leave. This should include all eligible sources of income that could be used to qualify under normal circumstances (i.e., base pay, commissions, bonus, overtime, etc.); and



- Verbal verification of employment. If the employer confirms the borrower is currently on temporary leave, the borrower must be considered employed; and
- If supplemental income is being used to qualify, the liquid assets must be verified according to the documentation process type selected; and
- Underwriter's rationale must include how qualifying income was calculated.

### **Trailing Co-Borrower Income**

- Trailing co-borrower income may not be used to qualify the borrower.

### **Trust Income**

- Income from a trust may be used provided it is properly documented. The trust must have sufficient assets to maintain the same level of payments for the next 3 years. A copy of the trust agreement is generally required.

Note: Assets may not be in the form of cryptocurrency.

- Acceptable forms of verification include a copy of the trust agreement or the trustee's statement confirming the amount, frequency, duration of payments, and what portion if any is tax-free. Income must continue for at least 3 years.
- Lump-sum distributions made before the loan closing may be used for the down payment or closing costs if they are verified by a copy of the check or the trustee's letter showing the distribution amount. The lump-sum amount must be subtracted from the total funds to determine income requirements.
- Estates & Trusts: Income from estates and trusts can be very complex in nature; therefore, there must be documented evidence of the amount, frequency of receipt, and continuance for the next 3 years. Losses from estates and trusts must be analyzed for disallowed losses.

### **Documentation Requirements**

- Copy of Trust Agreement or trustee's statement that verifies the amount, frequency, and 3 years continuance; and
- Proof of receipt of income verified with a bank statement or equivalent documentation; and
- Evidence of sufficient assets to support the qualifying income for at least 3 years (e.g., letter from trustee, bank statements)

In Addition to the above the following must be obtained:

- For Variable Trust Payments
  - History of receipt showing 24 months payments documented with 2 years most recent tax returns with all Schedules
  - Income to be calculated using 24-month average
- For Fixed Trust Payments
  - 12-month history of receipt with a bank statement or equivalent documentation; or
  - If unable to document a 12-month history, the trust documentation must reflect fixed payments and
    - The borrower is not the grantor of trust, and
    - At least one payment must be received prior to closing shown in bank statement or equivalent documentation



- Income to be calculated using the fixed payment amount documented

### **Unemployment Benefits**

- Unemployment compensation associated with seasonal employment may be considered qualifying income if the borrower has a two-year history of receipt and the unemployment compensation is likely to continue for the next three years.

### **Documentation Requirements**

- YTD paystub or salary voucher documenting at least 30 days of income and
- 2 years most recent tax returns with all schedules evidencing proof of receipt of unemployment compensation for two years and
- Verify that the income is likely to continue (no evidence from the employer that the income will no longer be received and it is determined that the income is likely to continue based on an established earnings trend.)

### **United Nations Income**

- Borrowers who work for the United Nations receive wages but typically taxes are not deducted from the borrower's wages. The borrower is still responsible for paying taxes on the income but will do so when filing tax returns in their country of residence.
- If borrower's income is received in any currency besides U.S. dollars, the income is not permitted.

### **Required Documentation**

- Most recent YTD pay stub documenting at least 30 days of income. Paystub must be dated no earlier than 30 days prior to the application date and must include all year-to-date income. If the paystub does not include sufficient information to appropriately calculate income, additional documentation must be obtained; and
- Most recent 2 years W-2s, or comparable documentation appropriate for the country providing the income.

### **VA Benefits**

- Borrowers receiving VA benefits can use the income with proof the benefits will continue for at least three years from the date of loan application.
- Income must be documented with a letter or distribution from the VA.
- Education benefits may not be used to calculate qualifying income.

### **Documentation Requirements**

- Document the borrowers' receipt of VA benefits with a letter of distribution from the VA.
- Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage

### **Third Party Vendor Verification Services**

- Third party vendors may be used as an alternative method for obtaining a borrower's income verification for the eligible income source that require pay stubs and W-2's listed below. The verification must provide



the level of documentation required by the documentation process selected. For example, if the loan requires a 2-year income history, the verification documents must contain a full 2-year income history. If it does not (e.g., there are gaps within the report), additional documentation must be obtained from the borrower to complete the 2-year requirement e.g., W-2s). Refer to the applicable process fact sheet for complete requirements.

- The data from the third party vendor comes directly from the employer's payroll systems and contains year-to-date earnings as well as prior year's earnings just as it would be shown on a written VOE. These verifications are acceptable provided:
  - The borrower(s) provide consent to verify income and employment; and
  - The date of the completed verification is in compliance with the Age of Credit Documents and Federal Income Tax Returns (refer to 1508.2- Credit/Analysis/Age of Credit Documents); and
  - Discrepancies or conflicting information provided by the borrower or in the loan file versus what is reflected on the vendor report must be investigated and appropriately considered when calculating the borrower's income to qualify.

Note: Third party vendor verifications do not disclose deductions and garnishments, therefore, if the borrower discloses on the application they have payroll deductions (i.e. child support, alimony, 401k loan, etc.) then supporting documentation must be obtained from the borrower (e.g., court documents, legal filings, etc.).

- This does not replace the need to obtain a verbal employment verification ≤10 business days prior to close. However, it can be the resource for obtaining the verification within the required timeframe.
- The validated income document must be retained in the loan file and may not pre-date the application date. (The application date applies to the "initial application" taken face-to-face, mail, phone, or via internet.)
  - Verification Services for Income may be used for the following income types:
    - Base pay
    - Bonus
    - Overtime
    - Commission (<25% & ≥25% of the borrower's total income)
    - Verification Services for the 4506-C may be used for the following income types:
      - Commission (≥25%) of the borrower's total income
      - Social Security, Retirement (Pension, Annuity), and
      - Self- Employed Income (Sole Proprietor, Schedule C)
- Notes:
  - Military income is not eligible for Third Party Verification.
  - Verification Services may not be used if the Borrower is employed by someone who has an interest in the subject property. Additionally, the "Date Last Updated" field on the Income Verification report must comply with policy as it relates to the age of income documents. For example, if policy requires pay stubs covering the most recent 30-day period, the "Date Last Updated" must be dated within the past 30 days.
  - Only Social Security Retirement income may be verified via the Third Party Verification service. Social Security Disability Income (SSDI)

Supplemental Security Income (SSI) and survivor benefits are not eligible for Third Party verification.

## **Tips & Gratuities**



- Tips or gratuity income is compensation received in addition to the employee's straight salary or hourly wage. The borrower must have a 2-year history of receipt to use as qualifying income and it must be likely to continue for the next three years.
- Gratuities and tips can only be included in qualifying income if they are included in two years of taxable income. This income source is usually found on W-2s or 1040s. The income should be reported to the IRS. The employer must also indicate that the tip income will in all probability continue.

### **Required Documentation**

- Most recent YTD pay stub documenting at least 30 days of income. Paystub must be dated no earlier than 30 days prior to the application date and must include all year-to-date income. If the paystub does not include sufficient information to appropriately calculate income, additional documentation must be obtained; and
- 2 years most recent tax returns with all W-2s; and Note: The borrower may report additional tip income to the IRS using Form 4137, Social Security and Medicare Tax on unreported tip income, when filing his/her tax returns. This income may be used in qualifying if the most recent two years federal income tax returns with Form 4137 are obtained.
- Determine that the income is likely to continue based on an established earnings trend.
  - If the trend is stable or increasing, income can be averaged over the two year period.
  - If the trend was declining but has since stabilized and there is no reason to believe that the borrower will not continue to receive the income at the current level, the current, but lower stabilized amount must be used.
  - If the trend is declining, the income may not be stable and additional analysis must be performed to determine if the income should be used. Income should not be averaged over the period of decline;
- And
- Verbal Verification of Employment performed no more than 10 business days prior to the loan closing; and
- For First Mortgage transactions, either verbal or written confirmation with borrower's employer that tip income is likely to continue. (Written VOE may be required. If confirmation cannot be obtained, the income may not be used to qualify.)

### **Union Worker**

- Union workers are members of a specific trade union and are often skilled tradesperson (e.g., electricians, plumbers, roofers, etc.). Workers can work for a single employer on a long-term basis or for more than one employer throughout the year. At the completion of a job, the Union will then refer the individual to a new employer. During the individuals' course of employment with the assigned employer, they are paid directly by the employer, not the Union. Their jobs may be seasonal and it is not uncommon for individuals to receive unemployment during down time.
- If the borrower is in a line of work that is deemed seasonal (e.g., roofing) and is not working at the time of loan application or closing, they may still be eligible for financing. Verify that the borrower is a member of the union and in good standing. It is not necessary to verify the union dues or count them as a liability. If the borrower is a member of a local trade union and obtains employment via these means, income can be verified by the following:

### **Required Documentation**



- 2 years tax returns; or
- 2 years of W-2s and/or 1099s, or
- A VOE from the Union for earnings from all employers during the current year and a W-2 from prior year.

If the union work is paid with a 1099 and have expenses that may be deducted from the income used to qualify, s/he should be treated as a self-employed borrower, averaging the income over a 2-year period.

Note: This policy does not apply to borrowers who are employed by a traditional employer (e.g., GM, Ford, etc.), but rather are members of a trade union such as a carpenters union. Borrowers who are employed by a traditional employer would be considered wage-earner employees.

### **Variable Income**

- Certain types of income fluctuate and must be averaged in order to arrive at income that is used to qualify. Examples of variable income sources include hourly workers with fluctuating hours, or income that includes commission, bonus or overtime.
- Typically two years or more of receipt of the variable income is recommended; however, a shorter time period of 12 to 24 months may be considered as acceptable. Refer to the requirements for each individual source of income for additional details.
- It is also important to establish an earnings trend. The earnings trend must be evaluated and the amount that is most likely to continue for the next 3 years must be used to qualify. A borrower who has had different types of employment in the past may be considered to have stable income if the amount has remained at a consistent level (at a minimum), and changes have not affected the borrower's ability to pay their obligations.
- The frequency of the payment (weekly, biweekly, monthly, quarterly, or annually) must be determined in order to accurately calculate the monthly income to be used.
- The monthly year to date income calculation should be compared to prior year's earnings using the borrower's W-2's or signed federal income tax returns, as determined by the documentation required under the source of income. For an example of the calculation refer to the calculating income section of this chapter.

### **Verbal VOE**

- The purpose of a verbal verification of employment (VOE) is to: 1) confirm the borrower's current employer; and 2) confirm that the borrower's employment status has not changed. VOE is not required for previous employers.
- A verbal VOE must be performed no more than 10 business days prior to the loan closing on all loans regardless of the initial income/employment verification type used. Neither a pay stub nor a written VOE (Verification of Employment) Form may replace the verbal VOE except as noted below.
- Exception: A verbal VOE does not have to be performed if a written VOE is received from the employer and meets the following requirements:
  - Is dated within 10 business days of the closing; AND
  - Provides all employment information required on a Verbal VOE.

Note: If the employer will not verbally verify employment, a written verification or verification from a third party employment verification vendor may be obtained within the same time frame as indicated above for the verbal VOE.





- The phone number that the borrower provided as their employer's number must be independently confirmed by using the phone book, calling Directory Assistance, or through the internet via a resource such as "The Work Number". Contact with the employer must be documented in writing via the verbal VOE form and must contain the following information:
  - Borrower Name
  - Name of the borrower's employer
  - Name, title and department of the person who provided the confirmation (generally, this information should be provided by a Human Resource representative or the borrower's supervisor or manager)
  - Employer's telephone number and the source from which the number was obtained (e.g., directory assistance, phone book, etc.).
  - Statement that the borrower is or is not currently employed.
  - Other remarks that may be pertinent to the transaction.
  - Name and title of the individual who contacted the employer and the date the information was obtained; OR
- An email exchange with the borrower's employer from the employer's work email address within the same time frame as the verbal VOE requirements is acceptable.
  - The following guidelines must be followed:
    - The lender must conduct additional due diligence to confirm that the email address for the employer is accurate. Examples of due diligence include, but are not limited to, searches of domain name on employer website (review for match to employer email address), employer directory on the internet, or other professional networking or business profile websites.
    - The email must include borrower's name, and employer's name; the name, title and work email address of the individual contacted at the employer, the date of contact and borrower's current employment status.
    - Name and title of the employee who contacted the borrower's employer and obtained the e-mail verification.

Note: When the verbal verification is generated electronically by the employer or a third party the following information is not required to be reflected on the VVOE:

- Name, title and department of the person who provided the confirmation; or
- Name, title & phone number of the employer/employee requesting the information; or
- Employer's telephone number and the source from which the number was obtained.

As noted above, the verbal VOE must be performed within 10 business days prior to the loan closing.

If any electronic data base is used to obtain the verbal VOE, it is important to note that the completed date on the verification document may not be older than 35 days old prior to the closing date.

Union Workers: If the union facilitates the borrower's placement in each assignment and it is determined that the Borrower's employment and income history is stable, the verbal VOE may be obtained directly from the individuals union. This is applicable to both individuals who are employed at the time of closing, as well as those who are in between employers at the time of closing.

### **Written Verification of Employment (VOE) Form**



- A written VOE (Verification of Employment) may be used to verify income and employment. If a written VOE is used to verify income it must contain the following information:
  - Year-to-date earnings; and
  - Prior year's earnings.
- The VOE must be faxed or mailed to/from the lender directly to/from the borrower's employer. It may not be hand delivered, faxed, emailed, etc. by the borrower. The VOE must be completed, signed, and dated by the owner, partner or a Human Resource representative, along with the date and phone number.
- We will not accept forms that are completed by the borrower. If someone signs the VOE with the same last name as the borrower, their relationship to the borrower must be determined. (If a relative employs the borrower, refer to "Employed in a Family Owned Business" section of this chapter.)

### Evaluating Rental Income

- Rental income can be used as qualifying income provided the transaction meets all of the documentation requirements outlined in this section. Rental income may be generated from the following sources:
  - Subject property being financed is an owner-occupied 2-4 unit primary residence;
  - Subject property being financed is a single family investment property
  - Other investment property that the borrower currently owns that is not part of loan transaction.
- Rental income generated from a second home or single-family primary residence is not considered stable monthly income, may not be used to qualify the borrower, and may not be considered as a compensating factor to offset the total debt-to-income ratios.
- If rental income is not used to qualify the subject investment property, the full PITIA must be included in the debt to income ratio.
- Income Calculation for all categories:
  - If the amount is positive, it is added to the qualifying income.
  - If the amount is negative, it is added to the recurring debts.
- The income from rental / investment properties is determined based on if the borrower has a history of renting the subject and/or another property. The rental income will be reported on the IRS for 1040, 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 (IRS Form 8825) of a business tax return. If the borrower does not have a history of renting the subject or another property or if the tax returns do not accurately reflect the ongoing income and expenses of the property, fully executed current lease agreements may be used.
- The rental income calculation should be documented in the loan file. Examples of forms that may be used, but are not required, include Fannie Mae Form 1037, 1038, 1038A, 1039 or Freddie Mac Form 92.

### Calculating Rental Income on Non-Subject Property

- If the borrower is qualified using the full housing expense (rental income is not considered), documentation of net rental income is not required.
- Refer to the table below for all Non-Subject Property income verification requirements.

Does the Borrower Have a History of Receiving Rental Income from the Non-Subject Property	Documentation Requirements
Yes	<ul style="list-style-type: none"><li>• The two most recent federal tax returns with Schedule E; and</li><li>• If the property generating income does not appear on the most recently filed tax return, a current lease is required. Rental</li></ul>



	income must be documented based on requirements for Partial or No Rental Income on Tax Returns reflected below. Income should be calculated using 75% of the gross income.
No	<ul style="list-style-type: none"><li>Income/loss should be calculated by using 75% of the gross income and verified by current leases</li></ul>

- Signed leases may be used to determine the net rental income for an investment property not owned during the previous tax year. Refer to Partial or No
- Rental History on Tax Returns section for additional eligibility options.

Note: The rental payment on the lease must be in U.S. dollars (cannot be in cryptocurrency).

When using a lease agreement, the lease agreement amount must be supported by

- Form 1007 or Form 1025, as applicable, or
- Evidence the terms of the lease have gone into effect. Evidence may include:
  - Two months consecutive bank statements or electronic transfers of rental payments for existing lease agreements, or
  - Copies of the security deposit and first month's rent check with proof of deposit for newly executed agreements

The following additional requirement applies for when lease agreement(s) are used due to partial or no rental history on tax return:

- For Purchases the lease should be in the property sellers name as the landlord and for newly executed leases, the first rental payment due date must be no later than the first payment due date of the subject Mortgage.

#### Schedule E - Supplemental Income and Loss

Net Rental Income/Loss should be calculated as follows:

Gross Rents and Royalties Received (from the schedule E)

(-) Total Expenses (from the schedule E)

(+) Amortization/Casualty Loss/Non-recurring Expenses

(+) Insurance

(+) Mortgage Interest

(+) Taxes

(+) HOA fees

(+) Depreciation

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Total ÷ 12 to 24 (# of months based on the tax return review above) – monthly PITIA\* payment = Net rental income/loss per month

- \*If there is a HELOC secured by the property, the payment per the credit report may be used to calculate the monthly net rental income/loss.
  - If positive add to income, if a loss add to the liabilities. (Do not include the PITIA in the total obligations, as adding the loss is already taking it into consideration and we don't want to count it against the borrower twice)
  - This calculation should be documented in the loan file.
- If the current residence is being converted to a second home or investment property, refer to Liabilities: Real Estate Obligations: Departure Property for additional guidelines.

### Calculating Rental Income on Subject Property

- Rental/Investment Property Income/Loss – Subject Property
- If the borrower is qualified using the full housing expense (rental income is not considered), documentation of rental income is not required.
- When the subject property will generate rental income, one of the following forms must be used to support the income-earnings potential of the property:
  - Small Residential Income Property Appraisal Report (Fannie Mae form #1025 or Freddie form # 72)
  - Single Family Comparable Rent Schedule (Fannie form #1007 or Freddie form #1000)

Note: Leases must be current and fully executed, with a minimum original term of one year.

- Refer to the table below for all Subject Property income verification requirements.

Does the Borrower Have a History of Receiving Rental Income from the Subject Property? Yes/No	Transaction Type	Documentation Requirements
Yes	Refinance	Average the income/loss unless declining. Verify by use of form 1025/72 or 1007/1000 as applicable and either: <ul style="list-style-type: none"><li>• The two most recent federal tax returns with schedule E; or</li><li>• Current lease agreements that reflect consistent gross rental income if the borrower can document a qualifying exception (see Partial or No Rental History on Tax Returns below).</li></ul>
No	Purchase	Verify by use of form 1025/72 or 1007/1000 as applicable. <ul style="list-style-type: none"><li>• Copies of the current lease agreement(s), if property is currently rented.</li><li>• To calculate the monthly rental income amount for qualifying use 75% of the gross rental income reflected on the lease agreement or verified on form 1007, 1025.</li></ul>



No	Refinance	Verify by use of form 1025/72 or 1007/1000 as applicable. <ul style="list-style-type: none"><li>• Copies of the current lease agreements(s), if property is currently rented.</li><li>• To calculate the monthly rental income amount for qualifying, use 75% of the gross rental income reflected on the lease agreement or verified on form 1025/72 or 1007/1000.</li></ul>
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Note: The income approach on the appraisal and copies of the present lease(s), if applicable, must support the rental income used to qualify the borrower.

- If the borrower does not have a documented history of receiving rental income as noted above, refer to Partial or No Rental History section for additional eligibility options.

### **Partial or No rental History on Tax Return**

- This policy may be applied to refinance of a subject rental property or to other rental properties owned by the borrower.
- If the borrower is able to document (per the table below) that the rental property was not in service the previous tax year, or for only a portion of the year, qualifying rental income may be determined by using the following:
  - Schedule E Income and expenses, and annualizing the income (or loss) calculation; or
  - Lease agreement(s) to 75% of the gross rental income to be used in the net rental income (or loss) calculation.

Note: Leases must be current and fully executed, with a minimum original term of one year. The rental payment on the lease must be in U.S. dollars (cannot be in cryptocurrency).

- If the property was acquired during or subsequent to the most recent tax filing year
  - Then confirm the purchase date using the Closing Disclosure or other documentation
    - 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).
    - If acquired after the last tax filing year, Schedule E will not reflect rental income or expenses for this property.
- If the rental property was out of service for an extended period
  - Schedule E will reflect the costs for renovation or rehabilitation as repair expenses. Additional documentation may be required to ensure that the expenses support a significant renovation that supports the amount of time that the rental property was out of service.
  - Schedule E (Fair Rental Days) 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.
- It is determined that some other situation warrants an exception to use a lease agreement
  - The loan file must contain an explanation and justification to support using a lease agreement

### **Rental Income Reported Through a Partnership or S-Corporation**



- If the borrower is personally obligated on a mortgage debt (as evidenced by the credit report) and gross rents and related expenses are reported through a Partnership or an S-Corp, Form 8825 maybe used to calculate net rental income or loss for the property.
- The Partnership or S-Corp must be documented and analyzed according to the Employment & Income/Self-Employed Income/Partnership or Employment & Income/Self-Employed Income/S-Corp section.
  - Obtain Partnership or S-Corp business tax returns, including IRS Form 8825.
  - Analyze each property listed on Form 8825 as follows:

#### Form 8825- Rental Income and Expenses

Gross Rents

(-) Total Expenses

(+) Non-recurring Expenses

(+) Insurance

(+) Mortgage Interest

(+) Taxes

(+) HOA fees

(+) Depreciation

Total ÷ 12 or (# of months based on the tax return review) – monthly PITIA payment = Net cash flow

- If the net cash flow is positive, exclude the property PITIA from the borrower's monthly obligations.
- If the net cash flow is negative (not sufficient to offset the properties PITIA) the negative amount must be included in the DTI calculation.

#### **Contract Employees**

- Individuals who work on a contractual basis rather than as an employee, are treated as self-employed and must have a 2-year history in the same line of work. Because the individual may be released from employment at any time, or as specified in their contract, employment history is key in establishing income stability and the likelihood that it will continue.

#### **Required Documentation**

- 2 years most recent personal tax returns with all W-2s or 1099's; and
- Verification of the existence of the business is required as outlined in the Verifying the Existence of the Business topic in this section.

#### **Corporation**

- One or a group of individuals establishes a corporation for various tax and liability purposes. Documentation with original signatures of the borrower must be prepared in accordance with standard





accounting procedures. Cash flow is determined by taking taxable income minus total tax and adding back: depreciation, depletion or net operating loss deductions listed on the return.

- The corporation must report income and losses on IRS Form 1120 and individual owners may be paid by W-2 or 1099. Complete personal tax returns and corporate returns for the most recent two years must be included in the loan file.

### **Required Documentation**

- 2 years most recent personal and business tax returns with all Schedules and W-2s or 1099s (tax returns must reflect at least 12 months of self employed income); and
- Year-to-date unaudited profit and loss (P&L) statement and balance sheet for the business either:
  - Completed by the business's tax preparer; or
  - Completed by the borrower in addition to the following:
    - Evidence provided that the document has been viewed by the business's tax preparer, or
    - Evidence provided that the document has been viewed by an appropriate third party who is not affiliated with the loan transaction, or
    - Two months business bank statements to support the income on the P&L statement and balance sheet.
  - The year-to-date P&L and balance sheet are required when the application is dated more than 90 days after the end of the business' fiscal or calendar year end; and
- Income Analysis Form; and
- Verification of the existence of the business is required as outlined in the Verifying the Existence of the Business topic in this section.

Note: Corporate income may not be used unless the borrower owns 100% of the business.

(Note: W-2/1099 earnings are eligible.)

### **Documenting the Transaction**

- Generally speaking, if the borrower is self-employed, the business must have been in existence for at least 2-years (as stated on the application), although the underwriter may consider amounts less than 2 years—but not less than 12 months on most recent tax return—with documented extenuating circumstances. An explanation as to why self-employed income with a history of less than 2 years was used to qualify must also be documented in the loan. All letters of explanation must be signed by the Borrower prior to close. Refer to Section 1508.2-Credit/Analysis/Borrower Letters of Explanation for more information.

Note: If the application date is after the April IRS cutoff date, tax returns for the prior year or a copy of an extension must be obtained.

- A Self Employed Income Analysis Form must be completed on every transaction and retained in the permanent loan file. Examples of this form include Freddie Mac Form 91 or Fannie Mae Form 1084.

Note: If tax returns are included in the loan file for a borrower or co-borrower(s), the underwriter must review and consider in their credit evaluation any information. The underwriter may not disregard data in tax returns just because they are not required.



## **Farm income**

Provided it can be verified that it is stable, consistent, and recurring, cash flow for depreciation, amortization, casualty loss, depletion, or business use of home may be added back.

### **Required Documentation**

- 2 years most recent personal tax returns with Schedule F; and
- Income Analysis Form; and
- Verification of the existence of the business is required as outlined in the Verifying the Existence of the Business topic in this section.

Note: Hobby farms that are not the primary source of income must be reviewed for a loss on the tax returns.

## **Partnership**

- There are 2 types of partnerships—a general partner and a limited partner.
  - A general partnership indicates that the individual has full ownership interest and is totally liable for the business.
  - A limited partner's liability is limited to the amount of their investment only.
- The partnership must report its profit or loss on IRS Form 1065 and each partner's share of the profit or loss is reported on Schedule K-1 of the 1065. Complete signed and dated personal tax returns and partnership returns for the most recent two years must be included in the loan file.
- The cash flow of the partnership must be analyzed to assess the stability of the borrower's personal cash flow. This provides a snapshot of the business' ability to meet its short-term obligations. Analyzing the 1065 tax return and giving credit for ordinary income, depreciation, depletion and pension expenses determine cash flow. Discretionary losses should be excluded from the cash flow analysis if the business is a limited partnership and the borrower provides a copy of the partnership agreement stating that all subsequent contributions are voluntary. (Refer to the Calculating Cash Flow: Partnerships & S Corporations topic in this section.)

Note: Borrowers, who have less than 25% ownership, refer to Section 1508.5-Employment and Income/Other Income for requirements.

### **Required Documentation**

- 2 years most recent personal & business tax returns with all Schedules including Partnership return and K-1s (tax returns must reflect at least 12 months of self-employed income); and
- Year-to-date unaudited profit and loss (P&L) statement and balance sheet for the business either:
  - Completed by the business's tax preparer; or
  - Completed by the borrower in addition to the following
    - Evidence provided that the document has been viewed by the business's tax preparer, or
    - Evidence provided that the document has been viewed by an appropriate third party who is not affiliated with the loan transaction., or
    - Two months business bank statements to support the income on the P&L statement and balance sheet.
  - The year-to-date P&L and balance sheet are required when the application is dated more than 90 days after the end of the business' fiscal or calendar year end; and



- Income Analysis Form; and
- Verification of the existence of the business is required as outlined in the Verifying the Existence of the Business topic in this section.

### **S-Corporation**

- An S-corporation has the same legal characteristics as a corporation except income and/or losses pass through to the owners/shareholders in the corporation. It may be either the borrower's primary employment or an investment vehicle. Depreciation and depletion can be proportionately added back to the borrower's income since they are considered non-cash expenses.
- The S-Corporation must report income and losses on IRS Form 1120S and each partner's share of the profit or loss is reported on Schedule K-1 of the 1120S. Complete personal tax returns and corporate returns for the most recent two years must be included in the loan file.

Note: Borrowers, who have less than 25% ownership, refer to Section 1508.5-Employment and Income/Other Income for requirements.

### **Required Documentation**

- 2 years most recent personal and business tax returns with all Schedules and K-1s (tax returns must reflect at least 12 months of self-employed income); and
- Year-to-date unaudited profit and loss (P&L) statement and balance sheet for the business either:
  - Completed by the business's tax preparer; or
  - Completed by the borrower in addition to the following:
    - Evidence provided that the document has been viewed by the business's tax preparer, or
    - Evidence provided that the document has been viewed by an appropriate third party who is not affiliated with the loan transaction, or
    - Two months business bank statements to support the income on the P&L statement and balance sheet.
  - The year-to-date P&L and balance sheet are required when the application is dated more than 90 days after the end of the business' fiscal or calendar year end; and
- Income Analysis Form; and
- Verification of the existence of the business is required as outlined in the Verifying the Existence of the Business topic in this section.

### **Self-Employed Analysis Form**

- A Self Employed Income Analysis Form must be completed on every transaction and retained in the permanent loan file. Examples of this form include Freddie Mac Form 91 or Fannie Mae Form 1084.
- Refer to the Tax Return Analysis section of this chapter for more information regarding the review of tax returns.

### **Sole Proprietor**



- As an individual owner of a business, the sole proprietor has unlimited personal liability for the debts of the business. There is no distinction between the owner's personal assets and the assets used in the business. The success of this type of organization is solely dependent on the individual who owns it.
- The income, expenses and taxable profits are reported on the owner's personal tax returns, Schedule C. Complete personal tax returns for the most recent two years must be included in the loan file.
- When there is evidence of a large increase in net profits from the prior year, and the income is needed to qualify, additional information may be required to substantiate the income. The borrower must provide a detailed letter from their CPA explaining the cause of the increase along with an audited year-to-date Profit and Loss Statement.
- Non-recurring income must be deducted in the cash flow analysis, including any exclusion for meals and entertainment expenses reported by the borrower on Schedule C.
- The following recurring items claimed by the borrower on Schedule C must be added back to the cash flow analysis: depreciation, depletion, business use of a home, amortization, and casualty losses.

### **Required Documentation**

- 2 years most recent tax returns with all Schedules (tax returns must reflect at least 12 months of self-employed income); and
- Income Analysis Form; and
- Verification of the existence of the business is required as outlined in the Verifying the Existence of the Business topic in this section.

Note: Third party vendors may be used as an alternative method for verifying self-employed Schedule C income. The verification must provide the same level of documentation defined in this fact sheet. If it does not, additional supplements must be obtained to meet documentation requirements. Refer to

### **Verifying the Existence of the Business**

- Confirmation that the borrower's business remains open and in existence must be verified within 30 calendar days prior to the loan closing regardless of the borrower's ownership percentage in the business. Confirmation is not required if the business income is not used to qualify or if there is a business loss.
- Verification should include:
  - Documentation prepared/issued by from a third party, such as a CPA, regulatory agency, or applicable licensing bureau, if possible; OR
  - Obtaining a phone listing and address for the borrower's business using telephone book, the Internet or directory assistance. Internet sites such as 411.com, Chamber of Commerce sites and Manta.com where they allow the business owner to add their own information are not acceptable.
  - If the above items are not obtainable, the following alternative methods may be used:
    - A current statement of bond insurance (the insurance policy must be a minimum of 2 yrs. old); or
    - Evidence of workers compensation/liability insurance.
- The underwriting rationale must clearly state why the alternative method was used and how the verification confirms the existence of the business.
- For all of the methods of verification, the lender must document the source of the information obtained as follows:
  - Name and address of the business, and



- The entity contacted (if applicable), and
- The date the information is verified, and
- The name and title of the person who obtained the verification.

Note: At the underwriter's discretion, on a case-by-case basis, other sources may be used to verify employment but must be thoroughly explained and documented.

### Age of Federal Tax Returns

- For some types of income, FCM requires borrowers to provide copies of federal income tax returns (personal returns and, if applicable, business returns). The "most recent year's" tax return is defined as the last return scheduled to have been filed with the IRS.
- The timing of tax returns varies depending on the application date and disbursement date of the mortgage loan. The following table describes which tax related documentation to obtain depending on the application date and disbursement date of the mortgage.

Application Date	Note Date	Documentation Required
October 15 <sup>1</sup> , (current year minus 1) to April 14 <sup>2</sup> , current year	October 15 <sup>1</sup> (current year minus 1) to April 14 <sup>2</sup> current year	The most recent year's tax return is required. The use of a Tax Extension is not permitted
October 15 <sup>1</sup> (current year minus 1) to April 14 current year	April 15 – May 30	The most recent year's tax return is recommended; however, the previous year(s) is also acceptable. In the event the most recent year's tax return is not obtained, the loan file must include a completed and signed IRS Form 4506-C for transcripts of tax returns provided by the borrower.
All Applications	May 31 – October 31	The most recent year's tax return is required, OR if most recent year's tax return is not available, all of the following must be obtained: <ul style="list-style-type: none"><li>• A copy of IRS Form 4868 (Application for Automatic Extension of Time to File U.S. Individual Income Tax Return) filed with the IRS. (Refer to the Processing &amp; Analyzing The 4506-C section for requirements); and</li><li>• IRS form 4506-C transcripts confirming "No Transcripts Available" for the applicable tax year; and</li><li>• Returns for the previous two years.</li></ul>
All Applications	November 1 to April 14 (current year plus 1)	The most recent year's tax return (as defined above). Tax Extensions are not permitted.

<sup>1</sup> Or the April/October filing date for the year in question as published by the IRS

<sup>2</sup> Or the day prior to the April/October filing date for the year in question as published by the IRS



Note: For business tax returns, if the borrower's business follows a fiscal year (a year ending on the last day of any month except December), the dates in the chart above may be adjusted to determine what year(s) of business tax returns are required in relation to the application date/disbursement date of the new mortgage loan.

## **IRS Extensions**

- If the borrower has requested an extension to file their most recent tax returns, a copy of ALL applicable extension requests along with filed tax returns for the two prior years must be provided.
- Extension requests that exceed the October 15th filing date require verification of approval from the IRS.
- If the borrower's tax returns are not available due to an extension, examples of some factors and documentation to consider when using older tax returns to determine continued income stability, include, but are not limited to the following:
  - Form 4868 extends the filing date to October 15. The amount of tax liability disclosed on Form 4868 must be compared to the previous 2 years tax liability. Extension requests that reflect a lower tax liability than years' prior must be carefully reviewed and guidelines for declining income should be followed if applicable.
  - Review and analysis of current business activity through a review of the most recent financial statement that covers the period since the last tax return filing.
  - Review and analysis of current business activity through a review of at least the most recent three months of business bank statements
  - Signed IRS Form 941, Employer's Quarterly Federal Tax Return, for the prior calendar year and current calendar year quarter(s) that supports wages and other compensation documented on the most recent business tax return
  - Review of the W-2s, 1099s and/or K-1s from the most recent calendar year, if available

Note: At IRS discretion, tax extensions and/or reduced documentation requirements may be granted for extenuating circumstances, such as disaster impacted areas. Refer to IRS.gov for communications from the IRS for acceptable situations not meeting policy above. If the IRS communication supports not requiring documentation as required in policy above, a copy/screenshot of that communication should be included in the loan file.

## **Tax Forms**

- Form 1040: Individual Tax Returns
- Each tax return must include all schedules and must be signed by the borrower unless the lender has obtained one of the following signature alternatives:
  - Documentation confirming that the tax returns were filed electronically (e.g., signed Form 8879, IRS e-file Signature Authorization or equivalent);
  - A completed IRS form 4506-C (signed by the borrower) for the year in question; or
  - IRS transcripts that validate the information on the unsigned tax returns.
- Refer to the applicable income topic in this chapter for documentation and calculation of income.

## **Schedule A: Itemized Deductions**

- This form lists itemized deductions, including medical expenses, taxes, interest expenses, charitable contributions, casualty and theft losses, un-reimbursed job expenses and other miscellaneous deductions. For additional information regarding the treatment of Non-Reimbursed Business Expenses refer to



**Schedule B: Interest & Dividend Income**

- This form is used to determine the source and amounts of investment income, including tax exempt interest, non-taxable dividend distributions, and dividend income earned on stocks sold during the year. Refer to Section

**Schedule C: Profit or Loss from Business**

- This form is used to determine the business income or loss of a sole proprietorship.

**Schedule D: Capital Gains/ Losses**

- This form details gains or losses from investments such as stocks, bonds, etc.

**Schedule E: Supplemental Income and Loss**

- This form details supplemental income from rental properties, Partnerships, S-Corporations, estate and real estate mortgage investment conduits.

**Schedule F: Profit or Loss from Farming**

- This form is used to determine any business income from farming operations and is very similar to the Schedule C.

**Form 4562: Depreciation & Amortization**

- This form is used to claim a deduction for depreciation and amortization, make the election under section 179 to expense certain property, and provide information on the business/investment use of automobiles and other listed property.

**Form 2106: Employee Business Expenses**

- This form is used when the borrower is deducting expenses for their job. For additional information regarding the treatment of Non-Reimbursed Business Expenses and Auto Allowance/Expense Account Reimbursement

**Form 4868: Application for Automatic Extension of Time To File U.S. Individual Income Tax Return**

- This form used by individuals to request an automatic extension of time to file their federal income tax return

Although they may not be included in every instance, the following list of schedules and forms are often included in the review of the self-employed borrower's business.			
Sole Proprietorship	Partnership	Corporation	S-Corporation
Signed 1040	Signed 1040	Signed 1040	Signed 1040
Schedule A	Schedule A	Schedule A	Schedule A
Schedule B	Schedule B	Schedule B	Schedule B
Schedule C	Schedule C (if commission income)	Schedule C (if commission income)	Schedule C (if commission income)
Form 4562	Form 4562	Form 4562	Form 4562
Schedule D (if Capital Gains)	Schedule D (if Capital Gains)	Schedule D (if Capital Gains)	Schedule D (if Capital Gains)



Schedule E (if Rental Income)	Schedule E	Schedule E (if Rental Income)	Schedule E
Schedule F (if farm)	Schedule F (if farm)	Schedule F (if farm)	Schedule F (if farm)
	Form 1065	Form 1120	Form 1120S
	Schedule K1		Schedule K1
	Form 8582 (passive losses)	Form 8582 (passive losses)	Form 8582 (passive losses)

Form 4562 may be required to support any depreciation not listed on Schedule E

### Tax Return Analysis

- It is important to establish an earnings trend for both the borrower and their business that earnings remain level or increase, and the borrower reflects stability and consistency. However, a consistent decline in the business' gross income over 2 or 3-years could be a reason for concern, even if the borrower's current income and debt ratios meet guidelines. For example, the borrower's AGI as listed on the tax return may be increasing yearly because of items not related to the business (e.g., capital gains received from the sale of real estate), while the actual business income is declining yearly.
- Only income consistent with the documentation provided may be considered for loan qualifying purposes. Dramatic increases and/or decreases in earnings must be reviewed carefully. It may be necessary to obtain additional years tax returns to establish a consistency of earnings since large fluctuations are typical of some businesses.
- If the borrower needs to draw additional income from the business (and has the legal right), investigate whether the business is capable of producing additional income for the borrower's use. Withdrawal of cash may have a severe negative impact on the business and may lead to a negative cash flow. If this occurs, it may not be possible to confirm stable, ongoing income. Income retained in the business as cash flow to the borrower may not be considered unless there is evidence confirming the borrower has 100% ownership and that the withdrawal of funds will have no effect on the business' continued growth.



## **Assets**

### **Asset Documentation**

- Asset Documentation
  - Most recent bank statement(s) covering a two-month period for all accounts that are being used for down payment, closing costs, prepaids and reserves must be provided.
  -

### **Evaluating Funds to Close**

- The underwriter must verify that the borrower has adequate cash to cover down payment, including the earnest money deposit, prepaid/escrow items, closing costs, financing costs if paid by the borrower, and reserves, if required, as per program guidelines. Cash is defined as an asset that is or can readily be converted into cash in a short time frame (a.k.a., a liquid asset). Proof of liquidation is required for non-liquid assets used to pay the above items.
- When someone other than the borrower is paying any of the items listed above, the file must contain documentation showing the amount being paid and who paid it. If the payments are being made by an interested party to the transaction or funds from premium pricing are used, the transaction must meet the requirements of Section 1508.4- Source of Funds/ Interested Party Contributions.
- This section addresses various closing costs that may be required in the originations of a first mortgage loan and general requirements associated with those costs. A list of acceptable assets that may be used to finance funds to close are listed in 1508.4-Assets/Source of Funds section.

### **At-Closing Principal Curtailments**

- At-closing principal curtailments may not be used to make additional down payments or to reduce the loan amount for conventional. In these situations, the borrower will have two options: (1) close the loan "as-is" and make any desired principal curtailments after closing as permitted by the terms of the mortgage documents and subject to any applicable prepayment penalties; or (2) obtain underwriting approval for a loan amount change and, if necessary, redraw the closing package.
- Exception: Principal Curtailments are only allowed as a result of at closing excess premium rate credits. The amount must be identified on the Closing Disclosure and is limited to the amount of the excess premium rate credit.
- If the borrower receives more cash back than is permitted for a rate/term refinance and it is due to excessive premium rate credits, the lender can apply a curtailment to reduce the amount of cash back to the borrower to bring the loan into compliance with the maximum cash-back requirement. The maximum amount of the curtailment cannot exceed the lesser of \$2,500 or 2% of the original loan amount for the subject loan

### **Closing Costs**

- Closing costs are expenses that are incidental to the sale of real estate, such as loan fees, title fees, appraisal fees, etc. In most instances, closing costs that are paid by someone other than the borrower are considered contributions and subject to contribution limits. Also, any costs that are normally the responsibility of the buyer are considered concessions if the seller pays them or if the seller exceeds the maximum contribution limit.
- All other forms of payment or gifts related to the acquisition of the property, or to the payment of the financing terms are contributions and subject to our limitations (e.g., origination fees, discount points,



commitment fees, appraisal costs, interest shortfall, transfer taxes, stamps, attorneys' fees, surveys, title insurance, fees for the use of a real estate tax service, and credits to the purchaser from any interested party).

- Pro-rated real estate taxes cannot be considered when determining the funds required for the transaction. Although a pro-rated tax credit from the property seller can offset that portion of the charge for the establishment of the escrow account, the borrower must still verify sufficient funds for down payment, closing costs, prepaids and reserves, including the payment of pro-rated real estate taxes prior to closing. (Example: Borrowers closing costs and prepaids are \$5,000. The seller's portion of the pro-rated real estate tax credit to the borrower is \$2,000. This reduces the borrower's cash to close to \$3,000. The borrower must still verify the entire \$5,000 prior to closing).
- Pro-rated real estate tax credits cannot be used to meet the borrowers minimum required investment or down payment.

### **Refinance Transactions**

- Closing costs may be included in the loan amount.
- Note: "Fee Stacking" above the LTV is not permitted regardless of the product, program or documentation process type selected. This is not to be confused with refinance transactions where closing costs can be rolled into the loan amount. In these instances, the maximum loan amount, including any closing costs, may not exceed the maximum LTV/CLTV/HCLTV permitted for the transaction.

### **Down Payment**

- The greater the down payment the less risk the proposed loan may have. Generally, we require the borrower to use their savings or other liquid assets to make a minimum down payment.
- Note: Pro-rated real estate tax credits cannot be used to meet the borrowers minimum required investment or down payment.
- Deposit on Sales Contract

### **Saving Funds to Close**

- It is acceptable for the borrower to save part of the closing costs between the times of the application and closing provided the amount and time to save before closing is considered reasonable. The borrower must provide a written explanation as to how the funds will be saved and over what period of time.
- A monthly savings plan worksheet demonstrating how the funds will be saved is required. The worksheet must be included when submitting the file to Underwriting. It is critical that the amount is reasonable with respect to the borrower's previous savings history, the proposed time frame, and current income and expense levels. The underwriter has the final decision with regards to its reasonability. The funds must be held by a disinterested third party, such as a depository institution, escrow company, etc. (this does not include the builder or Realtor). All funds must be saved in accordance with the approved savings plan. The loan must be approved with a condition to verify the funds prior to closing.

### **Interest Rate Buydowns**

- An interest rate buy down is a payment to reduce the interest rate on a permanent or temporary basis. The seller, buyer, another third party, or some combination of these can provide funds.



- Note: The product, program, and documentation process type determine if buy down funds are permitted. Refer to applicable fact sheets for specific requirements.

### **Permanent Rate Buy Downs**

- Permanent interest rate buy downs are allowed on most transactions. Funds to finance the buy down may be supplied by the borrower, seller, or another third party. If someone other than the borrower the transaction provides the funds is subject to the contribution restrictions. Refer to 1508.4-Assets/Source of Funds/Interested Party Contributions for additional restrictions.
- Note: For all ARM products only the initial rate and the life cap are reduced, not the margin.

### **Temporary Buy Downs**

- Temporary interest rate buy downs are not permitted.

### **Prepaid Items**

- Prepaid items such as taxes, insurance, ground rent, etc. are expenses that are paid in advance and usually prorated upon the sale.
- The following prepaid settlement costs must be paid by the borrower:
  - Interest charges covering any period after the settlement date
- The borrower can use funds received as a gift from a relative to pay the remainder of the closing costs and the prepaid items subject to contributions restrictions.
- For refinance transactions, the amount needed to renew or establish the new escrow account can be included in the loan amount in order to pay the expense on the due date. However, there are certain restrictions with regards to payment of taxes in the new loan amount. Refer to the applicable
- Note: An escrow account is required for the payment of taxes, special assessments, hazard, flood, and/or mortgage insurance on most loan transactions, except as specified by policy or, in the case of a table funding, Correspondents, as prohibited by state law. Higher-Priced Mortgage Loans: Not Permitted

### **Reserves**

- Reserves are the amount of post-close liquid assets a borrower has remaining after the down payment and closing costs have been deducted. One month's reserve is equal to the monthly PITIA payment (based on the qualifying rate) as follows:
  - Principal and interest;
  - Hazard, flood, and mortgage insurance premiums (as applicable);
  - Real estate taxes;
  - Ground rent;
  - Special assessments;
  - Any owners' association dues (excluding any utility charges that apply to the individual unit);
  - Any monthly cooperative corporation fee (less the pro rata share of the master utility charges for servicing individual units that is attributable to the borrower's unit); and
  - Any subordinate financing payments on mortgages secured by the subject property.
- (Note: All of the above must be included in the calculation of reserves, even if borrower has waived escrows.)



### Acceptable Sources of Reserves

- Examples of liquid financial assets that can be used for reserves include:
  - Checking or savings accounts,
  - Investments in stocks, bonds, mutual funds, and Other Securities. Refer to Section 1508.4-Source of Funds/ Retirement Accounts for verification requirements.
  - Certificates of deposit: 100% of value less any early withdrawal penalties that should be deducted;
  - Money market funds and trust accounts;
  - The amount vested in a retirement savings account,
  - The cash value of a vested life insurance policy.
  - Stocks

### Unacceptable Sources of Reserves

- The following cannot be counted as part of the borrower's reserves:
  - Funds that have not been vested,
  - Funds that cannot be withdrawn under circumstances other than the account owner's retirement, employment termination, or death,
  - Stock held in an unlisted corporation,
  - Non-vested stock options
  - Notes or loans receivable from a privately-held company
  - Unsecured borrowed funds, including unsecured Employer-Assisted Housing benefits
  - Interested party contributions (IPCs)
  - Cash out proceeds

### Source of Funds Eligibility

- The accumulation of net worth, particularly in the form of assets, is a strong indication of creditworthiness. A borrower who accumulates net worth solely from earnings and savings demonstrates a strong ability to manage their financial affairs.
- This section addresses the various types/sources of assets that may be used to pay the down payment, closing costs, prepaids, and reserves, if required. It also addresses the documentation required to verify the asset and the principal methods of validating its authenticity.
- The following matrix identifies the various types of assets, the eligibility of the asset, and what the asset can be used for.
- Note: Although the asset type listed may indicate it is an eligible source of funds, they may only be eligible when certain limiting conditions are met. Refer to the topic discussion for full details.

Asset Type	Funds to Close	Funds for Debt Payoff	Reserves Requirement	Compensating Factor
Annuities	Yes	Yes	Yes	Yes
Borrowed Funds-Secured	Yes	Yes	Yes	Yes
Borrowed Funds-Unsecured	No	No	No	No
Bridge Loan Proceeds	Yes	Yes	Yes	Yes
Business Funds	Yes	Yes	Yes	Yes
Cash on Hand	No	No	No	No
Cash Out Proceeds from a Refinance	Yes	Yes	No	No
Checking, Savings, & CD Accounts	Yes	Yes	Yes	Yes





Community Assistance Program/Down Payment Assistance	No	No	No	No
Corporate Relocation Buyout	Yes	No	No	No
Corporate Sponsored Loans	No	No	No	No
Credit Card Reward Points	Yes	Yes	Yes	Yes
Cryptocurrency <sup>1</sup>	No	No	Yes	No
Custodial Accounts for Children or Others/(UTMA)	No	No	No	No
Disaster Relief Grant or Loan	Yes	No	No	No
Earnest Money Deposit	No	No	No	No
Employer Assisted Housing	No	No	No	No
Foreign Assets	Yes	Yes	Yes	Yes
Gift	Yes	Yes	No	No
Gift of Equity	No	No	No	No
Gift/Grant from Non-Profit (Secured & Unsecured)	No	No	No	No
Gift-Graduation	Yes	Yes	No	No
Gift-Wedding	Yes	Yes	No	No
Government Bonds	Yes	Yes	No	No
Individual Development Accounts (IDA)*	No	No	No	No
Inheritance	Yes	Yes	Yes	Yes
Interested Party Contributions-Financing Concessions	Yes	No	No	No
Land Equity	Yes	No	No	No
Lease to Own/Rent w/Option to Buy	Yes	No	No	No
Life Insurance Net Cash Value	Yes	Yes	Yes	Yes
Lender Paid Assistance	No	No	No	No
Loan Repayment Proceeds	Yes	Yes	Yes	Yes
Margin Loan	Yes	No	No	No
Non-Traditional Savings Plan	No	No	No	No
Pledged Assets	No	No	No	No
Pooled Funds	No	No	No	No
Proceeds from Sale of Home	Yes	Yes	Yes	Yes
Profit Sharing Plan	No	No	No	No
Real Estate Commission (Borrower's)	Yes	No	No	No
Retirement Account	Yes	Yes	Yes	Yes
Sale of Assets	Yes	Yes	Yes	Yes
Seller Derived Assistance	No	No	No	No
Stocks/Securities-Exercisable	Yes	Yes	Yes	Yes
Sweat (Work) Equity	No	No	No	No
Trade Equity	No	No	No	No
Trust Account	Yes	Yes	Yes	Yes
Unvested Restricted Stock	No	No	No	No
1031 (Like Property/Tax Deferred Exchange)*	Yes	No	No	No
529 Savings Plan	Yes	Yes	Yes	Yes



<sup>1</sup>In Order to use funds, asset must be liquidated, be held in a U.S. or state regulated financial institution and meet Sale of Assets and Large Deposit policy.

### 1031 Like Property Exchange

- 1031 Exchange—Tax Deferred or Like Property Exchange—is an exchange of real property in which no taxable gain or loss is recognized at the time of sale. Section 1031 of the Internal Revenue Code allows investors to defer the payment of state and federal capital gains taxes by exchanging one investment property with another, rather than selling it.
- A 1031 exchange is an investment property exchange therefore primary residences and second home transactions are not permitted. We will permit a 1031 tax deferred exchange to be used as the down payment for the purchase of an investment property with the following restrictions:
  - The 1031 exchange is properly documented and is in compliance with Internal Revenue Code Section 1031.
  - There is no subordinate financing.
  - A qualified intermediary must handle the loan closing. A qualified intermediary is an entity (usually a subsidiary of a title company) who enters into a written agreement with the taxpayer. The qualified intermediary cannot be an agent, attorney, accountant, investment banker or broker. This exchange agreement requires the qualified intermediary to acquire and transfer the relinquished property and to acquire and transfer the replacement property. The relinquished property is the property “sold” and the replacement property is the property “acquired”.
  - Copies of all closing documents—including the 1031 exchange agreement, settlement statement, and title transfer—and the purchase agreement on the relinquished property must be obtained.
  - Both purchase agreements on the relinquished and replacement properties must contain appropriate language to identify the 1031 exchange.

### 1029 Savings Plan

- Typically, a 529 College Savings Plan designed to help families pay for future expenses associated with college or other qualified post-secondary training is an eligible source of funds provided that the borrower is the owner of the account and the account is revocable.
- However, because there are penalties for early withdrawal or not being used for educational purposes, only the net value, after any withdrawal and/or tax penalties are deducted, may be considered.
- 529 Accounts must be verified by the following.
  - Most recent two months Statements
  - If the assets are required for closing, proof of liquidation is required
- If must be determined where the money is invested (stocks, bonds, mutual funds, etc.) to evaluate the effective net balance-see Stocks & Other Securities topic in this section

### Seller Accommodation

- If the borrower is purchasing a seller’s 1031 investment property to occupy as a primary residence, the borrower is accommodating the seller. Therefore the transaction is not considered a 1031 Tax Deferred



Exchange and is eligible for normal financing. The borrower's down payment less the equity from the exchange can be used for all or part of the down payment.

## **Annuities**

- An annuity is an investment vehicle that is typically managed by a life insurance company. Regular or lump sum deposits are put into an annuity and the asset grows tax-deferred until the owner starts taking withdrawals.
- The amount available for liquidation depends on the owner's age at distribution and whether or not the annuity is in the accumulation phase or distribution phase. The company managing the annuity may also charge various penalties, fees, etc. for withdrawals as well as tax implications.
- If the annuity is being used as income, it cannot be used for reserves, down payment, etc.
- The annuity asset may be used for closing costs, down payment and reserves as follows:
  - 70% of the current cash value, less any outstanding loans, should be used to calculate the amount of funds available; or
  - 100% of the current cash value can be used if it can be verified that the borrower is not subject to penalties, surrender charges, or taxes.
- If the asset is used for closing and/or down payment, proof of liquidation is required. Surrender Charges, penalties and fees imposed by the managing company as well as any outstanding loans should be deducted from the cash value prior to calculating the amount available for closing. If the asset is being used for reserves only, proof of liquidation does not need to be obtained; however, verification of the asset is still required.
  - A computer generated statement must always be obtained to verify the following:
    - The name of the company managing the annuity;
    - The name of the annuity owner;
    - The period covered and the current cash value;
    - Outstanding loans; and
    - Penalties, surrender charges and or fees.

## **Asset Verification Requirements**

- Assets must be verified to ensure the borrower has sufficient funds to complete the mortgage transaction and if required, adequate reserves after closing. Assets must be liquid, calculated, and documented.
- The Underwriter should review the source of funds for all large deposits made into accounts that will be used to fund the down payment, closing costs, or to establish required reserves. Refer to the Large Deposit section below for additional information.
- When the borrower is required to make a down payment, the source of assets must be seasoned for at least sixty (60) days before the date of the loan application
- The two most recent consecutive months' bank statements and/or other documents are required to verify assets to close. Verifications must be no more than 45 days old at the time of application AND no more than 120 days old at closing for existing or new construction.
- The most recent statement date should be used to determine the documentation expiration date. (E.g. May and April statements required. The May statement would be used to determine the document expiration date.) Quarterly asset statements must be dated within 90 days of the initial loan application. The underwriter should also make certain that qualifying assets used from the quarterly statement are not



counted twice (e.g., funds from the quarterly asset account transferred to a more recent/current verified account).

### Documentation Methods

- **Written Verification of Deposit (VOD) Form:** A written VOD may be used to verify deposits. The VOD must be faxed or mailed to/from Lender directly to/from the borrower's deposit institution. It may not be hand delivered by the borrower or loan officer.
- **Account Statements:** Copies of bank statements or investment portfolio statements that cover activity in the borrower's account(s) and, if applicable, copies of the most recent retirement account statement that is available, which may be obtained directly from the borrower. The statements must:
  - Clearly identify the borrower as the account holder;
  - Include at least the last four digits of the account number;
  - Include the time period covered by the statement/printout;
  - Include all deposits and withdrawals transactions (for depository accounts);
  - Include all purchase and sale transactions (for financial portfolio accounts); and
  - Include the ending account balance.
- **Internet Downloads:** Documents that are faxed or downloaded from the Internet must clearly identify the name of the institution and the source of information...for example, by including that information in the Internet or fax banner at the top of the document.
- **Letters:** A letter statement is usually generated when an attorney or trustee, insurance company, or employer manages the asset. The most frequent types of accounts that make use of letter statements include: trust funds for the benefit of the customer, cash value of life insurance, present value of an annuity or current value of a 401k.
- **Printouts:** Printouts obtained from a depository institution are acceptable. However, if the printouts do not contain all the information that is found on account statements (e.g., bank name, logo, account number, etc.). The printouts are only acceptable if they are signed and dated by a representative of the deposit institution.
- **Faxed Documents:** If the lender has not viewed or copied the original documents directly, the source of the information should be verified via telephone with the borrower's financial institution. The documents must clearly identify the institution and the source of the information must be included in the "fax" banner that is at the top of the document.
- **E-Mail:** If the lender has not viewed or copied the original documents directly, verify the source of the information via telephone.
- **Third-Party Verification Service Providers:** The borrower must provide the proper authorization for the lender to use this verification method. The verification must contain the same information and meet the same requirements as reflected on a Verification of Deposit or Account Statements as noted above. If any required information is missing, additional documentation to supplement the third-party verification must be obtained. Eligible asset types include:

Asset Types Eligible for Validation	Eligible for Third Party Verification Service
Checking, Savings	X
CD	X
Money Market	X
Stock	X
Mutual Funds	X



Retirement Accounts	X
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- Note: Truncated asset account numbers for bank and portfolio or investments accounts are permitted. At least the last four digits must be displayed on the loan application and on the asset documentation including verification reports.
- Regardless of the type of verification used to provide information, the documents must be complete, legible, and free of any alterations, erasures, “whiteouts”, or similar indications that changes have been made.
- The verification source must come from the borrower's bank depository, investment account, or other financial institution as applicable. The underwriter is responsible for the integrity and accuracy and should use good judgment in determining when the use of alternative documentation is appropriate for the loan transaction.

### Large Deposits/New Accounts

- For both refinance and purchase transactions deposits into accounts may be an indication of recently opened liabilities resulting from borrowed funds or an indication that funds used to cover closing costs, pre-pays, the down payment for purchase transactions, or reserves may be from an unacceptable source.
- Any liabilities resulting from borrowed funds must be considered when qualifying the borrower. A large deposit may be from cryptocurrency that was exchanged into U.S. dollars. The lender must obtain sufficient documentation to verify the funds originated from the borrower’s cryptocurrency account.

### Refinance Transactions:

- Except as specified below, documentation or explanation for large deposits is not required; however, any liabilities resulting from all borrowed funds must be considered when qualifying the borrower.
- When the borrower pays off or pays down an existing debt in order to qualify, the source of funds used must be verified. If the funds verified include a large deposit as defined above, the source of that deposit must be verified, unless the borrower has sufficient funds to pay off/down the debt without the large deposit.

### Purchase Transactions:

- The Source of funds must be explained and documented if the deposit is needed to meet requirements for Borrower’s cash to close and or reserves for the following:
  - A single deposit on the account statements that exceeds 50% of the total monthly qualifying income. If the source of a large deposit is readily identifiable on the account statement where the source of the deposit is printed on the statement, the underwriter does not need to obtain further explanation or documentation. If the source of the deposit is printed on the statement, but the Underwriter still has questions as to whether the funds may have been borrowed, the underwriter should obtain additional documentation.
- Note: When a single deposit includes both verified and unverified funds as defined above, only the unverified funds are used to determine the 50% requirement. (Example: The borrower has a monthly income of \$4,000 and an account at ABC Bank with a balance of \$20,000. A deposit of \$3,000 is identified,



but only \$2,500 is documented as coming from the borrower's federal income tax refund, leaving \$500 unverified [the deposit of \$3,000 minus \$2,500], which is 12.5% of the borrower's \$4,000 monthly income, falling short of the 50% definition of a large deposit. Therefore, in this example the full \$20,000 can be used to qualify.)

- The Underwriter should review the source of funds for all large deposits made into accounts that will be used to fund the down payment, closing costs, establishing required reserves, or if a borrower is paying off or paying down an existing debt to qualify. The purpose of this review is to determine if any deposits demonstrate the existence of debt that may not have been captured on the borrower's credit report or application or if the funds may have been acquired from an unacceptable source.
- If the large deposit is from another account belonging to the borrower, that account must also be verified to ensure that the funds into the account were properly sourced and in compliance with this Policy. To source a large deposit from another account belonging to the borrower, the complete one month's statement from the source account must be obtained for the month the withdrawal of the funds occurred. This does not change the number of months that are required per the AUS or documentation process.
- If the large deposit is from another account being verified for the loan, that account must also be verified after the withdrawal to assure that the funds are not counted twice.

### **Borrowed Funds**

- Borrowed funds include subordinate financing, as well as any monies borrowed from other sources, obtained for the specific intention of paying the down payment and/or closing costs.
- Borrowed funds that are secured by an asset represent a return of equity. Therefore, they may be used for the transaction. Assets that may be used to secure funds include certificates of deposit, stocks, bonds, automobiles, real estate, and life insurance policies. The underwriter must verify the value and ownership of the secured asset, the terms of the loan and the fact that it is a secured loan. Monthly payments for the loan must be considered as debt when qualifying the borrower. When the loan does not require monthly payments, the lender should calculate an equivalent amount and consider it as debt.
- Borrowed funds are subject to the following restrictions:
  - Funds must not be borrowed from the broker, developer, real estate professional, or a lender who is otherwise connected with the subject transaction.
  - Funds from a loan secured by real property owned by the borrower (other than the subject property) may be used as a source of the down payment. The debt must be included as a liability on the application. Refer to the appropriate topic in Recurring Debt for detailed calculations.
  - Payments for loans secured by the borrower's personal financial assets (such as life insurance policies, 401(k) accounts, CDs, stocks, bonds, etc.), in which repayment may be accomplished by liquidating the asset, do not have to be included in the debt ratio calculations if the loan instrument shows the asset as collateral for the loan. The loan secured by the financial asset must have been made by a financial institution. The borrower may not use the same asset to satisfy cash reserve requirements. However, they may use the portion of the asset remaining after the value of the asset plus any related fees have been reduced by the amount of the secured loan.
  - Unsecured loans are not permitted.
- The above applies to primary residences, second homes and investment properties.

### **Borrower Contribution Requirements/Minimum Down Payment**

- A minimum down payment from borrower's own funds is required as indicated below:





LTV, CLTV or HCLTV Ratio	Minimum Borrower Contribution Requirement from Borrower's Own Funds	
70% or less	Primary residence	The borrower must make a 5% minimum contribution from his or her own funds. See note below for additional clarification
Greater than 70%	Primary residence	The borrower must make a 10% minimum contribution from his or her own funds. See note below for additional clarification
All LTVs	Second home Investment properties	Borrower must make full down payment. Gift funds are not permitted

Note: If the borrower has the 5% or 10% minimum contribution in a non-liquid asset account (stocks, bonds, etc.), but is also receiving a gift for the transaction, the borrower may use the gift funds for their 5% or 10% minimum contribution in lieu of liquidating the assets. The non-liquid asset account must be verified per policy as evidence that the borrower has the 5% or 10% minimum contribution available.

## Borrowers Real Estate Commission

### Earned Real Estate Commission

- Earned real estate commission refers to the borrower's portion of a real estate commission earned from the sale of the subject property being purchased when the borrower is acting as their own real estate agent. Lenders may use the borrower's earned real estate commission as an eligible source of funds for down payment and closing costs provided the borrower is a licensed real estate agent and will receive a sales commission from the purchase of the subject property.
- Documentation Requirements
  - The lender must document the following:
    - the settlement statement must reflect the commission earned by the borrower, and
    - the earned commission amount must be credited towards the mortgage loan.

## Bridge Loans

- A bridge (or swing) loan is a form of second trust that is collateralized by the borrower's present home, which is usually for sale. By using funds from a bridge loan, the borrower can close on a new house before selling his/her existing home. There is not a specific limitation on the terms of the bridge loan.
- Generally, financing is acceptable if:
  - Borrower has the ability to carry the payment on the new home, the payment on other obligations, the payment on the current home and the payment on the bridge loan. If the repayment schedule for the bridge loan is not monthly, it must be converted to a monthly amount for qualifying purposes; and
  - Bridge loan may not be cross-collateralized against the new property.
- For additional information regarding how to treat the debt on the "departure property" refer to Real Estate Obligations: Departure Property.



## **Business Funds**

- If Business Funds are used for down payment, closing costs and/or reserves, all of the following conditions must be met:
  - Borrowers must provide verification from the other owners of the business that they have access to the funds UNLESS the Borrower is the sole proprietor or 100% owner of the business.
  - Regardless of the documentation required for the process type, two years' personal, partnership and/or corporate tax returns must be obtained, and the underwriter must perform a cash flow analysis to determine that the withdrawal of funds will not have a detrimental effect on the business.
  - The file must contain the underwriter's written analysis and conclusions. Note: Forms 1084/91, which are used to calculate income, not assets, do not satisfy this requirement.
  - Verification of funds in the account is required. (Note: Large deposits that are not in line with business revenue/income stream should be explained and verified.) Refer to Section 1508.2-Credit/Analysis/Borrower Letters of Explanation for more information.

## **Checking, Savings & CD Accounts**

- Money retained in bank (including credit unions, savings and loan associations, and savings banks) checking and savings accounts are the most common method of accumulating assets, but it may also be in the form of a Certificate of Deposit (CD).

## **Credit Card Reward Points**

- Credit card reward points that have been converted to cash prior to closing are acceptable funds for use towards closing costs, down payment, and financial reserves. The following requirements apply:
  - If the reward points are converted to cash and deposited into the borrower's depository account (checking or savings), no additional documentation is required unless the deposit is considered a large deposit. In that event, follow the requirements for evaluating large deposits.
  - If the reward points are converted to cash, but not deposited into the borrower's depository account, the lender must provide the evidence the reward points were:
    - Available to the borrower prior to the conversion, including verification of the cash value (for example, credit card reward statement prior to conversion); AND
    - Converted to cash prior to the closing of the loan.

## **Cryptocurrency**

- Cryptocurrency (e.g., Bitcoin, Dash, Ethereum, Litecoin, etc.) is a worldwide currency in which transactions are verified and records are maintained by a decentralized system using cryptography. Cryptocurrency is not reliant on any central authority, such as a government or bank to manage or maintain its value.
- Cryptocurrency may not be used to meet asset requirements (i.e., down payment, earnest money, closing costs, reserves or other investable assets). However, if the borrower liquidates the asset, s/he may use the funds received from the liquidation provided they meet "Sale of Asset" and "Large Deposit" requirements.

## **Verification**



- Bank statements serve to present a snapshot of the borrower's account of deposits, withdrawals, transaction activity and bank services. Although bank statements are typically generated on a monthly cycle, they may also be generated on a quarterly, semi-annual, or annual basis.
- Statements must clearly identify the borrower as the account holder and include the name of the issuing institution, account number, the period covered by the statement, and all deposits and withdrawals made during the period covered.
- CDs typically contain a forfeiture provision whereby a portion of the accumulated interest and possibly an early withdrawal fee are applied if the CD is liquidated early. The forfeiture of interest and/or withdrawal fee should be considered when using the asset for closing and/or reserves.

## **Corporate Relocation Buyout & Closing Cost Assistance**

### **Corporate Buyout**

- If funds from a Corporate Relocation Buyout are being used for closing, a copy of an executed buyout agreement along with the equity advance statement should be obtained.

### **Closing Costs Assistance**

- Most employers provide their transferring employees a benefit which covers normal and customary closing costs. This benefit is reflected on the HUD- 1/Closing Disclosure. This reduces the out of pocket costs for the employee and eliminates the need to get reimbursed for an expense after closing. The specific benefit is determined by the relocation agreement/corporate relocation package which should be obtained to verify the terms, etc.

## **Earnest Money**

- If the deposit is being used as part of the borrower's minimum contribution requirement, the lender must verify that the funds are from an acceptable source. Admissible verification includes:
  - Copy of the cancelled check and bank statement showing that the check has cleared; or
  - Copy of the cancelled check and Verification of Deposit (VOD). The VOD must indicate that the average balance for past two months was large enough to cover the amount of the earnest money deposit. Note: If the borrower has sufficient verified assets to cover earnest money deposit, the above verification is not required. Receipt of funds on the Closing Disclosure is sufficient evidence that funds have been received.
  - If the earnest money deposit is a gift and has been provided directly to the builder or real estate agent, verification of transfer of funds from the donor's account in a financial institution to the earnest money deposit holder is required.
- If it cannot be determined that the earnest money deposit was withdrawn from the borrowers account, additional documentation and evidence that the funds have actually changed hands should be provided.
- Note: Large earnest money deposits and deposits that exceed the amount customary for the area should be closely evaluated.



## Foreign Assets

- Funds that are currently held or sourced from an account outside of a U.S. Banking Institution may be allowed under the following circumstances:
  - All assets must be verified prior to the transfer and the funds must be seasoned and sourced per Correspondent Manual Section 806.2- Assets/Source of Funds/ Verifying Assets topic.
  - All assets being used for down, payment, closing costs, pre-pays and reserves currently held in an account outside of a U.S. Banking Institution must be translated into English, transferred into an account in the United States and verified in U.S. dollars prior to closing of the mortgage transaction.
  - Donor gift funds, given at closing, that are currently held in an account outside of a U.S. Banking Institution must be transferred into an Escrow/Closing Agent account in the United States. The funds must be verified in U.S. dollars at the time the funds are transferred and received in the U.S. and meet all the requirements of the Gift Funds topic below. Documents of foreign origin must be translated to English. Refer to Correspondent Manual Section 803-Borrower Information/Proof of Residency Status Verification Requirements for additional information.
  - It is important to look for patterns of behavior particularly when gift funds are involved. Some of the scenarios may include multiple transfers for smaller amounts and from various individuals instead of one wire transfer for the entire gift amount. It is important to pay attention to the amounts, account owner, etc.
  - China: Funds coming from the Peoples Republic of China (including but not limited to Hong Kong and Taiwan) are ineligible to be used in a mortgage transaction. This applies to the assets required for the transaction, including gift funds as well as the qualifying income. (See above requirements for accounts held currently outside the US)

## Gift Funds

- Gift funds cannot satisfy the minimum down payment from the borrower's own funds.
- Gifts are permitted in connection with a purchase or refinance of a primary residence.
- Gift funds are not permitted on a second home or investment property transactions.
- Down Payment
  - Refer to the Borrower Contribution Requirements/ Minimum Down Payment topic above for requirements unless specified otherwise in the program parameters.
    - The gift can be provided by the following:
      - Relative, which is defined as a borrower's spouse, child, or other dependent, or an individual who is related by blood, legal guardianship, marriage or adoption; or
      - Fiancé, fiancée, civil union, or domestic partner; or
      - Former relative, Godparent, or relative of a domestic partner
      - A trust, established by an acceptable donor as indicated above
- If gift funds are coming from outside of the U.S., refer to the Foreign Assets topic above for additional information.
- Acceptable Sources of Gift Funds
  - Large financial gifts from close family members can be considered if properly documented. Substantial cash gifts (\$1000 or more) from one individual must comply with standard gift documentation.
  - Gift funds may come from the following sources.



- **Wedding Gifts:** The following documentation must be obtained to verify funds:
  - A copy of a marriage license or certificate, and
  - Verification that gift funds were deposited within 90 days of the date of the marriage license or certificate.
- **Graduation Gifts:** The following documentation must be obtained to verify funds:
  - Evidence of graduation from an educational institution, such as diploma or transcripts that supports the date of graduation, and
  - Verification that gift funds were deposited within 90 days of the date of the graduation.
- **Funds Pooled From a Relative or Domestic Partner** residing with the Borrower: Can not be used to meet the borrower's minimum required down payment. However, funds from a relative or domestic partner may be used as outlined in the above gift policy.
- **Gift of Equity:** Not permitted.
- **Gift or Grant from a Non-Profit Organization:** Not permitted.

### **Gift Letters**

- The following information must be completed on a fully executed gift letter signed by the donor:
  - The actual or the maximum dollar amount of the gift.
  - The donor's name, address, telephone number, his/her relationship to the borrower.
  - Indicate that funds are a gift that does not have to be repaid.

### **Verification of Funds**

- The transfer of the gift funds to the borrower must be documented in one of the following ways:
  - Funds Received prior to closing: Transfer of funds from the donor's account in a financial institution to the borrower's account via either:
    - Copies of bank statements from both the donor and the borrower's accounts OR
    - Copy of a canceled gift check OR
    - Copy of the donor's withdrawal slip and the borrower's deposit slip, OR
    - Evidence of electronic transfer
  - Funds Received at Closing: If the donor does not intend to provide gift funds until closing, the following documentation must be obtained at the closing table:
    - Transfer of the funds from the donor's account in a financial institution to the settlement or closing agent via either
      - Copy of a cashier's check
      - Wire transfer confirmation
- Funds transferred using a third-party money transfer application or service are acceptable only when the documentation evidences that the funds were transferred using the application or service directly from the donor's bank account to the borrower's bank account or to the settlement or closing agent.



### **Gift of Equity**

- Not permitted

### **Government / U.S. Savings Bonds**

- US Savings/Government Bonds must be verified by the following:
  - A statement from a financial institution or the loan originator confirming review of the actual bonds and listing the serial numbers, date of maturity, type, amount and verifying that the borrower is the owner;
  - Proof of value from the U.S. Treasury Table;
  - Evidence of liquidation if the assets are required for closing.

### **Ineligible Source of Funds**

- The following sources of funds may not be used in the calculation of assets:
  - Borrowed Funds from the following sources:
    - Signature Loans
    - Lines of Credit on Credit Cards
    - Overdraft Protection on Checking Accounts
  - Cash-on-Hand
  - Cash advances from a credit card or other revolving account.
  - Community Assistance or Down Payment Assistance Programs
  - Corporate Sponsored Loans
  - Cryptocurrency
  - Disaster Relief Grant or Loan
  - Employer Assisted Housing (Secured & Unsecured)
  - Funds from Individual Development Accounts (IDA)
  - Gift of equity & wedding gifts.
  - Gifts which must be repaid in full or partially.
  - Gift/Grant from Non-Profit
  - Individual Development Account (IDA) (Including funds from an IDA)
  - Lender Paid Assistance
  - Non-Traditional Savings Plan
  - Pledged Assets
  - Pooled Funds
  - Proceeds from unsecured loans or personal loans
  - Salary / bonus advances received against future earnings
  - Seller Carrybacks
  - Seller Derived Assistance Programs
  - Subordinate Financing which contains any of the following:
    - Negative Amortization
    - Contains special Servicing requirements
    - Terms that restrict prepayments or provide for a prepayment penalty, except as indicated in Subordinate Financing





- Does not fully amortize under a level monthly payment plan when the maturity or balloon payment date is less than five years after the note date of the new first mortgage.
- Sweat Equity (includes donated goods and/or materials): Contribution to the construction or rehabilitation of a property in the form of labor or services rather than cash is considered sweat equity. Sweat equity may not be deducted from the construction costs, nor may it be used to offset the borrower's minimum down payment.
- Trade Equity

### **Inheritance**

- An inheritance, if appropriately documented, can serve as the borrower's down payment. The borrower must provide a copy of the will or a letter from the Trustee detailing the distribution of the estate. Borrower's receipt of funds must be verified prior to closing. Because the inheritance is considered the borrower's money, funds can be used for the borrower's minimum down payment.
- Gift letter policy does not apply.

### **Life Insurance Net Cash Value**

- The amount available for liquidation should be calculated using 100% of the cash/surrender value, less any outstanding loans or fees. If asset is required for closing proof of liquidation is required, regardless of the Documentation Process. Proof must be verified by the following:
  - Computer generated statement identifying the life insurance company
  - Identify the policy owner. Policy owner must be a borrower.
  - Evidence the period covered and the current cash/surrender value
  - Identify any outstanding loans and deduct them from the cash value/surrender value.

### **Loan Repayment Proceeds**

- In order to be considered eligible cash asset, funds received by the borrower from the repayment of a personal loan s/he extended requires the following:
  - A copy of the written agreement between the borrower and the recipient of the loan.
  - Verification that the borrower had the ability to lend the funds (cancelled check or bank statement showing withdrawal of funds).
  - Verification that repayment was made (evidence of funds withdrawn from the recipient's account) and proceeds deposited into the borrower's account prior to scheduling the close.

### **Margin Loan**

- There are times when the borrower does not want to liquidate their stocks. Although it can be for a number of reasons, it is often because it's not financially advantageous at that particular time. The borrower may use funds received from a margin loan secured by their stock portfolio to pay down payment and closing costs.
- Margin loans typically do not have a monthly payment therefore it is generally not included in the debt ratios. Repayment of the loan does not have to be considered.



## **Pledged Assets**

- The Dual Collateral Down Payment Option (a.k.a., pledged assets) permits the borrower to pledge marketable securities in their brokerage account (or a combination of marketable securities and cash) in lieu of a traditional down payment. The loan is secured by a first mortgage on the subject property and a third party securities account pledged to FCM.
- Note: The Pledged Assets Program is not permitted.

## **Pooled Funds**

- Pooled funds are not permitted.

## **Proceeds from Sale of Home**

- The proceeds from the sale of a currently owned home are a common and acceptable source for the down payment and closing costs on a new house.
- Funds escrowed at the time of contract/agreement and verified as paid may be considered as earnest money. If the contract calls for an additional deposit to be made within a certain period of time, an escrow letter verifying the date and payment of the additional funds is required.
- Remaining Down Payment: The Closing Disclosure or Seller's Closing Disclosure from the sale of the home showing sufficient net cash proceeds to consummate the purchase of the new home should be obtained before, or simultaneously with, the closing on the new home. (Note: The Closing Disclosure or Seller's Closing Disclosure does not need to be executed; however, it must reflect sufficient funds to complete the required funds needed to cover required costs.) Photocopies of sales contracts or listing agreements may not be used as an alternative form of verification.

## **Calculating Proceeds**

- If the borrower's current home is listed for sale—but has not yet been sold—s/he can be qualified on the basis of the anticipated equity. The following formula should be used to determine the amount of equity a borrower has in the house that is being sold:
  - $(\text{Sales Price} \times 90\%) - \text{all Mortgage Balances} = \text{Equity}$  If the sales price has not yet been established, the listing price should be used.
- Funds for down payment, closing costs, and reserves (if applicable) may come from an equity advance or buyout from the borrower's employer.

## **Retirement Accounts**

- Funds from an individual retirement account (IRA/Keogh) and/or an employer sponsored tax-favored retirement savings account (401k), the vested balance less any outstanding loans secured by the account may be used for the down payment, closing costs, and reserves provided the borrower has access to the fund(s). The underwriter must verify the ownership of the account and confirm that the account is vested and allows withdrawals regardless of current employment status. However, because there are severe penalties for early withdrawal (before retirement age), only the net value, after any withdrawal and/or tax penalties are deducted, may be considered.
- Retirement Accounts must be verified by the following:



- Most recent two months statements (For 401k accounts the statements must reflect the vested balance or percentage of vesting, any outstanding loans, the ending balance of the account and terms of withdrawals/loans. If the 401k account is used for reserves the terms of the retirement plan must show that the borrower is vested and that the plan will allow withdrawals regardless of the current employment status)
- Any outstanding loans must be subtracted prior to determining the vested balance;
- If the assets are required for closing, proof of liquidation is required.

### **Sale of Assets**

- Proceeds received from the sale of the borrower's personal assets may be considered as long as the borrower can provide evidence that s/he:
  - Owned the asset, for all asset types that are titled assets, for example automobile title;
  - Has documentation to support the value of the asset, as determined by an independent source, if the proceeds represent more than 50% of the total monthly income used in qualifying. The lesser of the estimated value (as determined by the independent source) or actual sales price must be used when determining the amount of funds for the transaction. For example, a borrower plans to sell their vehicle. The value as determined by an independent source is \$10,000; the sales price of the vehicle is \$12,000. Only \$10,000 can be added to the borrower's available funds, even if the sale has already occurred.
  - Can prove the transfer of ownership (a copy of a bill of sale or a statement from the purchaser); and
  - Provides the receipt of the purchase proceeds (deposit slips or bank statement)

### **Stocks & Other Securities**

- The net value of the stock (which includes mutual fund or other publicly traded security) should be calculated using 70% of the current market rate. Value is established using a current statement from the stockbroker, a photocopy of the stock certificate, accompanied by a dated newspaper, or Internet stock list. (Because value is difficult to establish we do not accept securities that are not publicly traded.) If assets are liquidated, the actual amount of documented liquidated assets may be used.
- Note: Stock options and non-vested restricted stock options are not eligible for use as reserves.
- Pledged stocks and/or bonds used as loan security or to offset a margin account are not considered liquid assets.
- The broker statement is an investor's account of all transactions and asset values within a set period. They list dividends received, interest earned or due, assets purchased and sold, and the value of assets owned during the period.
- Stocks/Securities statements must identify the following:
  - The institution or administrator
  - The account owner
  - The account number
  - All transactions, the period covered, any outstanding loans and the ending balance
  - For securities accounts, identify the stocks/securities
  - If the assets are needed for closing, proof of liquidation is required
  - If there is a margin account secured by stock/securities, the borrower's total assets must be reduced by the margin account's outstanding balance amount, plus any overdrawn amount.
- If the borrower does not receive a statement, the following must be provided:



- Photocopy of the stock certificate that identifies the ownership of the stocks by the borrower, number of shares/units owned, and identification numbers of the stock certificate, type, and entity name
- Current stock prices from a published source

### **Seller Derived Assistance Programs**

- Seller Derived Assistance is when the seller, or any other person or entity that is reimbursed directly or indirectly by the seller, or any other person or entity providing financing benefits from the transaction.
- Funds from Seller Derived Assistance programs are not permitted.



## **Appraisal Requirements**

### **General**

- Correspondents represent and warrant that any appraisal and all appraisal practices used in originating loans for sale to FCM
  - conforms to the requirements of the appropriate investor, including Fannie Mae, Freddie Mac, FHA, or VA;
  - comply with Appraiser Independence Requirements (AIR);
  - meet minimum standards established under Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) and
  - meet all and the Uniform Standards of Professional Appraisal Practice (USPAP).
- All appraisals submitted must include the appraiser's name (clearly typed) and signature. The appraiser must provide their typed certification or license number. Correspondents are responsible for monitoring the quality of their appraisals.

Note: Will accept transferred appraisals if they comply with all appraisal practices stated above.

### **Appraiser Independence Requirements**

- Based on the requirement for appraiser independence, FCM has implemented a zero tolerance policy regarding improper contact, comments, or instructions given to appraisers or appraisal management companies.
- Fannie Mae and Freddie Mac have issued appraisal independence requirements effective for all single-family mortgage loans originated on or after October 15, 2010.

### **HUD Appraiser Independence**

- Correspondents must comply with HUD's Mortgagee Letters #2009-28, #2009-29 and #2009-30 setting forth additional requirements around appraisals, among others: "To ensure appraiser independence, FHA-approved lenders are now prohibited from accepting appraisals prepared by FHA Roster appraisers who are selected, retained or compensated in any manner by a mortgage broker or any member of a lender's staff who is compensated on a commission basis tied to the successful completion of a loan.

### **Appraisal Standards**

- In compliance with the FIRREA standards, all appraisals must meet the following requirements:
  - Correspondents must comply with the appraisal requirements established by their primary regulatory agency and provide appraisals, which meet the minimum standards established by FIRREA, USPAP, and the regulatory agencies.
  - FCM requires that appraisals be completed by fully licensed or certified appraisers. All complex assignments, including anything over \$1,000,000 must be completed by a certified appraiser and a copy of the license must be included.
  - The appraisal must be typed and complete, with all appropriate boxes checked. The comment section should be fully utilized.



## **Appraisal Representations and Warranties**

- The Correspondent represents and warrants that any appraisal submitted with each Loan file is completed in accordance with all legal and agency/investor requirements for appraisals, and is submitted in support of the value of the property as represented in the Loan file, which is at least equal to the appraised value shown on the appraisal, and may be relied upon by FCM to support the required representations and warranties made in connection with the sale of the Loan to any investor regarding the property value.
  - The Correspondent further represents and warrants the following:
    - The appraiser who performed the appraisal on any Loan submitted for purchase is currently licensed by the state in which the property is located;
    - The appraiser has disclosed any services regarding the subject property performed by the appraiser within the prior three years as an appraiser or in any other capacity;
    - The license held is the appropriate license for the appraisal assignment involved;
    - The appraiser is qualified to handle the appraisal of the property type involved;
    - The appraiser is unrelated to anyone directly involved or compensated by the closing of this transaction;
    - The appraiser is a disinterested third party to the property transaction; and
    - There have been no monetary or other sanctions imposed on the appraiser by the state licensing authority.

## **Quality Control System**

- The Correspondent must have the necessary review process in place to continually evaluate the quality of the appraiser's work through normal underwriting reviews and spot-check field reviews. The Correspondent must notify FCM immediately if any spot check review reveals quality or value issues on any appraisal performed for any Loans purchased by FCM.
- FCM requires all Correspondents to have an acceptable Quality Control System in place prior to approval. Each system is reviewed and approved on the basis of its compliance with FCM's Quality Assurance Standards. Each Correspondent's Quality Control System is expected to contain stringent requirements for the approval of individual appraisers.
- Correspondents must continually evaluate the quality of an appraiser's work through normal underwriting review of appraisal reports, and a thorough spot-check field review of appraisals as part of its quality control system.

## **Unacceptable Appraisal Practices**

- The appraiser is expected to follow appropriate practices in the property valuation process. The development of a valuation conclusion that is based either partially or completely on any of the following is strictly prohibited: Race, color, religion, sex, handicap, familial status, or national origin of either the prospective owners or occupants of the subject property or of the present owners or occupants of the properties in the vicinity of the subject property; consideration of age or location of the property or age of the neighborhood in a manner that has a discriminatory effect; or that is based on any other factor that local, state or federal law deems as being discriminatory.
- In addition to the above, appraisals with any of the following deficiencies are not acceptable:
  - FCM will not accept an appraisal that has been readdressed or altered by the appraiser with the intent to conceal the original client.





- Unsupported opinion of market value;
- Improper selection of comparable sales;
- Unsupported adjustments in the sales comparison analysis;
- Inadequate analysis and reporting of, the sales history of the subject property and comparable sales;
- Lack of analysis reporting of, the listing, offering, or contract sale for the subject property; and
- Misrepresentation of the physical characteristics of the subject property, improvements, or comparable sales.

Note: The Appraiser may not have completed any undisclosed prior services to the subject property being considered for an assignment except for any prior appraisal services. The Appraiser must disclose at the time of the assignment and within the completed report, whether they are performing, or have performed, other services with regard to the property, such as property management, leasing, brokerage, auction, or investment advisory services, etc., so that we can determine potential conflicts, if any.

## **Appraisal Documentation**

### **General**

- The appraisal report forms are designed to provide a concise format for presenting both the appraiser's description of the subject property and the valuation analysis that leads to the opinion of market value. All forms and documentation must be completed in a manner that will clearly reflect the thoroughness of the appraiser's investigation and analysis, and provide the rationale for the opinion of market value. The appraiser's analysis should go beyond any limitations of the forms, and provide additional comments and exhibits when they are needed to adequately describe the subject property, document the analysis and valuation process, or support their conclusions. The extent of data collection, analysis and reporting must be determined by the complexity of the appraisal assignment.
- There are a number of ways to determine that the collateral is acceptable for the transaction. The forms vary depending on the underwriting method, the type of property, whether the borrower is purchasing the property as a residence or for investment purposes and the type of property inspection performed. All written appraisals and/or inspections need to be completed using standard Fannie Mae/Freddie Mac forms.

### **Age of Appraisals, Property Inspections and Property Inspection Waivers**

- Properties must be appraised or inspected (if that level of property fieldwork is recommended by DU or LPA) within the 12 months preceding the date of the note. Appraisals and property inspection must be updated as follows:
- Appraisals: If the appraisal will be more than 120 days old at the date of the note the appraiser must provide an update to validate that the property has not declined in value since the date of the original appraisal by inspecting the exterior of the property and reviewing current market data. (This policy applies to all appraisals, regardless of whether the property was appraised as new construction or existing construction.) If the property value has declined, a new appraisal report is required.
- For loans that receive an Approve/Eligible, follow the DU Findings Report; for loans that receive an Accept Credit Risk classification, refer to the LPA Feedback Certificate for Age of Appraisal requirements.
- If two appraisals are required the lower of the two appraised values or the sales price (if applicable) must be used to calculate the LTV/CLTV/HCLTV.



Note: For re-certification of value, if the appraisal used to establish value will be more than 120 days old on the note date, an exterior inspection of the property and review of current market data will be required. If the property value has declined, a new appraisal report is required.

NOTE: If the loan was closed, or a construction loan modified into permanent financing more than 90 days prior to being purchased, the seller must provide a new appraisal or an appraisal update dated within 90 days of purchase to support there hasn't been a decline in the subject's property value since the last valuation was performed. If there is a decline in the property's value, the loan is ineligible for sale.

## **Documenting & Transmitting Appraisal Data**

### **Electronic Preparation/Production of Reports**

- The appraiser may use computer software programs that are designed to reproduce Fannie Mae/Freddie Mac appraisal report forms—including programs that have “expandability” features that allow increases in areas of the forms that call for insertion of narrative comments. However, the sequence of the information—as well as all of the specific information (including the instructions, entries, directions, etc.)—must be exactly as it appears on the hard-copy form(s).

### **Electronic Transmission of Reports**

- FCM will accept an appraisal that is electronically transmitted by facsimile, internet connection, wireless transmission, or any other transmission using public or private telephone lines in lieu of traditional hard copy appraisal provided it is legible and meets all other policies outlined in this chapter. The report must include the appraiser's signature; however FCM will also accept a laser or digital signature from the appraiser on an original appraisal report. All other requirements with regards to the appraisal report form the photos and all exhibits must be met. If an electronic transmission of the appraisal is provided, it is not necessary to provide the original appraisal report or original photos, however computer generated pictures are required. (MLS photos are not acceptable.)

Note: Appraisals must be completed on forms that meet Fannie Mae, Freddie Mac and FCM's Uniform Appraisal Dataset, Uniform Collateral Data Portal, and Uniform Loan Delivery Dataset requirements.

## **Uniform Appraisal Dataset**

- The Federal Housing Finance Agency has directed Fannie Mae and Freddie Mac (the GSEs) to collect additional appraisal data for loans delivered to them. To comply with this requirement, the GSEs have created (1) a Uniform Appraisal Dataset (UAD) that defines all required fields and how fields should be completed in the appraisal report forms and (2) a Uniform Collateral Data Portal (UCDP) for submission of electronic appraisal data files to the GSEs.
- Effective for all appraisals dated on or after September 1, 2011, appraisers are required to provide UAD-compliant appraisal reports for the appraisal report forms listed below:
  - Uniform Residential Appraisal Report (Fannie Mae 1004 / Freddie Mac Form 70)
  - Uniform Residential Appraisal Report (Desktop) (Fannie Mae 1004 Desktop / Freddie Mac Form 70D)
  - Individual Condominium Unit Appraisal Report (Fannie Mae 1073 / Freddie Mac form 465)



- Exterior-Only Inspection Individual Condominium Unit Appraisal Report (Fannie Mae 1075 / Freddie Mac Form 466)
- Exterior-Only Inspection Residential Appraisal Report (Fannie Mae 2055 / Freddie Mac Form 2055)

Note: UAD-compliant appraisal reports must be completed on the correct form, which will be identified by “UAD Version 9/2011” in the footer of the form. For loans with application dates on or after 12/1/11, if the above appraisal forms were completed prior to 9/1/11, FCM requires that the appraisals be provided in a format that permits successful submission to the agencies’ Uniform Collateral Data Portals.

- Certain UAD Condition and Quality Ratings for exterior-only appraisals require appraisal upgrades to a full interior/exterior appraisal – refer to the individual appraisal forms in this chapter.
- FCM expects all Correspondent lenders to comply with the GSE requirements for UAD-compliant appraisal reports for loans that are submitted for purchase.
- Additional detailed information about the GSE’s UAD and UDCP requirements can be found at eFannieMae.com and FreddieMac.com.

### **Uniform Collateral Data Portal**

- The Uniform Collateral Data Portal (UCDP) is a portal through which lenders are required to electronically submit appraisal reports for conventional mortgage loans delivered to Fannie Mae and Freddie Mac.
- The following appraisal reports, including all exhibits, addenda (including the Market Conditions Addendum), and photographs must be submitted to each agency’s UCDP and receive a "Successful" status. Lenders must ensure that unaltered reports submitted by the identified appraisers are submitted to the UCDPs.
  - Uniform Residential Appraisal Report (Fannie Mae Form 1004 / Freddie Mac Form 70);
  - Small Residential Income Property Appraisal Report (Fannie Mae Form 1025 / Freddie Mac Form 72);
  - Individual Condominium Unit Appraisal Report (Fannie Mae Form 1073 / Freddie Mac Form 465);
  - Exterior-Only Inspection Individual Condominium Unit Appraisal Report (Fannie Mae Form 1075 / Freddie Mac Form 466);
  - Exterior-Only Inspection Residential Appraisal Report (Fannie Mae / Freddie Mac Form 2055);
  - Individual Cooperative Interest Appraisal Report (Fannie Mae Form 2090); and
  - Exterior-Only Inspection Individual Cooperative Interest Appraisal Report (Fannie Mae Form 2095);
- FCM requires appraisals to receive a Successful status from both Fannie Mae and Freddie Mac. Correspondent lenders must provide successful submission reports from both entities prior to purchase. All loan files must include two Submission Summary Reports (SSR), one from each agency. Both SSRs must include a Doc File ID (one Doc File ID is issued per property) and successful submission status.

For additional information, refer to eFannieMae.com or FreddieMac.com.

### **Uniform Collateral Data Portal (UCDP) Messaging**

- FCM requires both Freddie Mac and Fannie Mae’s SSR forms to be provided in each Correspondent’s closed loan package and they must contain a “Pass”. While some messages are considered a warning, if any critical messages are included in your SSR (determined to be “critical” by Fannie Mae or Freddie Mac), your



appraisal will be reviewed by FCM underwriters and additional documentation maybe required. Any loan received having 10 or more messages (warning and/or critical) will be carefully reviewed and suspended if additional documentation is needed.

- For up-to-date information regarding UCDP, as well as a current listing of critical and warning messages, refer to the Fannie Mae UCDP web page at: <https://www.fanniemae.com/singlefamily/uniform-collateral-data-portal> or to the Freddie Mac UCDP page at: [http://www.freddiemac.com/singlefamily/sell/uniform\\_collateral\\_data\\_portal.html](http://www.freddiemac.com/singlefamily/sell/uniform_collateral_data_portal.html). Each Correspondent Lender should carefully review this information.

### **Standard Appraisal Requirements**

- Standard appraisal requirements establish the value based on a thorough evaluation of both the interior and exterior of the subject property. It includes a quantitative sales comparison analysis and requires the assignment of a dollar value to reflect the market's reaction to any features of a comparable sale that differs from those of the subject property.
- The form(s) required to document this information, which are listed below, is dependent upon the property type, loan program and approval/documentation process selected.

Note: Fannie Mae and Freddie Mac form numbers are provided throughout this section. While Fannie Mae and Freddie Mac have assigned different form numbers, the forms themselves are the same. Freddie Mac does not publish appraisal forms for cooperative properties. Refer to Single Family/Forms & Documents at eFannieMae.com or Single Family/Forms and the Guide at Freddiemac.com for a visual sample of the forms.

### **Appraisals Used for Subsequent Transaction**

- Use of an appraisal for a subsequent transaction is permitted when the prior transaction has closed and provided the following requirements are met:
  - The subsequent transaction may only be a Rate/Term Refinance.
  - The borrower and the lender must be the same on the original and subsequent transaction.
  - The appraisal report must not be more than 12 months old prior to the note date of the subsequent transaction. (Policy regarding appraisal recertification still applies.)
  - Since the effective date of the prior appraisal report, the mortgage premises must not have undergone any significant remodeling/ rehabilitation, renovation or have been affected by disaster to the extent that the improvement or deterioration of the property would affect the marketability or market value.

### **Special Appraisal Requirements for REO or Foreclosed (FC) Properties**

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- Recent increases in property foreclosures (FCs) have resulted in some real estate owned (REO) properties being neglected and/or sitting vacant for extended periods of time before they are sold to new owners. In these cases, exterior-only appraisals or property inspection reports do not provide an accurate assessment of the condition of the property.
- For purchase transactions that are the result of the sale of an REO property, or the last transaction on the property being purchased was a FC, a full interior/exterior appraisal inspection is required.
  - Fannie Mae Form 1004 / Freddie Mac Form 70 is required for one-unit properties;
  - Fannie Mae Form 1073 / Freddie Mac Form 465 is required for units in condominium projects;



- Fannie Mae Form 2090 is required for units in cooperative projects.
- This requirement applies to all applicable conventional purchase transactions.

### **Borrower Appraisal Disclosure Requirements**

- If the appraisal format permitted for a loan transaction does not establish a value for the property, the borrower has the right to request that an appraisal be obtained at their expense.
- The appropriate disclosure (Freddie Mac Form 1149 or an equivalent document) must be provided to the borrower. If the borrower(s) agree(s) that the lender may approve their mortgage loan without obtaining an appraisal, the borrower(s) must sign the disclosure.
- This disclosure is required on all LPA loans when a Form 2070 Property Inspection Report is the recommended appraisal format.

### **1004 / 70: Uniform Residential Appraisal Report**

Fannie Mae Form 1004 / Freddie Mac Form 70

- Used for 1-unit properties (including those that have an incidental second unit or accessory apartment), units in planned unit developments, and condominium projects that consist solely of detached dwellings (site condominium).
- The appraiser must, at a minimum: (1) perform a visual inspection of the interior and exterior areas of the subject property; (2) inspect the neighborhood; (3) inspect each of the comparable sales from at least the street; (4) research, verify, and analyze data from reliable public and/or private sources; and (5) report their analysis, opinions, and conclusions.
- The following Exhibits are required with this appraisal:
  - A street map that shows the location of the subject property and of all comparables that the appraiser used;
  - An exterior building sketch of the improvements with dimensions, including calculations to show how they arrived at the estimate for gross building area. A floor plan sketch that indicates the dimensions is required instead of the exterior building if the floor plan is atypical or functionally obsolete, thus limiting the market appeal for the property in comparison to competitive properties in the neighborhood.
  - Clear, descriptive photos that show the front and rear of the subject property and a street scene of the subject property, and that are appropriately identified.
  - Clear, descriptive photos that show the front of each comparable sale and that are appropriately identified. (Generally, photos should be originals; however, if original photos cannot be obtained, copies of photographs from a multiple listing service or from the appraiser's files are acceptable if they are clear and descriptive and the appraiser provides a reasonable justification for using them.)
  - Photos should include any improvements, amenities, conditions, and external influences that materially impact market value or marketability.
  - Clear, descriptive interior photographs that show at minimum:
    - The kitchen;
    - All bathrooms;
    - Main living area of the property (such as living room, family room, dining room, all bedrooms, etc),
    - Basement, including all finished and unfinished rooms;





- Examples of physical deterioration, if present; and
  - Examples of recent updates, such as restoration, remodeling, and renovation, if present.
- Any other data necessary to provide an adequately supported opinion of market value.

### **1073 / 465: Individual Condominium Unit Appraisal Report**

Fannie Mae Form 1073 / Freddie Mac Form 465

- Used to report an appraisal of a unit in a condominium project or a condominium unit in a PUD based on an interior and exterior inspection of the subject property. The appraiser must, at a minimum: (1) perform a visual inspection of the interior and exterior areas of the subject property; (2) inspect and analyze the condominium project; (3) inspect the neighborhood; (4) inspect each of the comparable sales from at least the street; (5) research, verify, and analyze data from reliable public and/or private sources; and (6) report their analysis, opinions, and conclusions.
- (Refer to the Condominium, PUD & Co-op Properties chapter for specific requirements with regards to obtaining approval of the project itself.)
- The following Exhibits are required with this appraisal:
  - A street map that shows the location of the subject property and of all comparables that the appraiser used;
  - A sketch of the subject unit indicating interior perimeter unit dimensions rather than exterior building dimensions. Generally, the appraiser must also include calculations to show how they arrived at the estimate for gross living area; however, for a unit in a condominium project, they may rely on the dimensions and estimate for gross living area that is shown on the plan. If they include a copy of the plat with the appraisal report a sketch of the unit is not required. A floor plan sketch that indicates the dimensions is required instead of the exterior building if the floor plan is atypical or functionally obsolete, thus limiting the market appeal for the property in comparison to competitive properties in the neighborhood.
  - Clear, descriptive photos that show the front and rear view of the subject property and a street scene of the subject property, and that are appropriately identified.
  - Clear, descriptive photos that show the front of each comparable sale and that are appropriately identified. (Generally, photos should be originals; however, if original photos cannot be obtained, copies of photographs from a multiple listing service or from the appraiser's files are acceptable if they are clear and descriptive and the appraiser provides a reasonable justification for using them.)
  - Photos should include any improvements, amenities, conditions, and external influences that materially impact market value or marketability.
  - Clear, descriptive interior photographs that show at minimum:
    - The kitchen;
    - All bathrooms;
    - Main living area of the property (such as living room, family room, dining room, dining room, all bedrooms, etc.);
    - Basement, including all finished and unfinished rooms;
    - Examples of physical deterioration, if present; and
    - Examples of recent updates, such as restoration, remodeling, and renovation, if present.
- Any other data necessary to provide an adequately supported opinion of market value.





## **1004D / 442: Appraisal Update and/or Completion Report**

### **Fannie Mae Form 1004D / Freddie Mac Form 442 – Appraisal Update and/or Completion Report**

- This form is used to update a prior appraisal report's value estimate to ensure the property has not subsequently declined in value since the date of the original appraisal report and/or to provide a certification of completion of the "subject to" items from the original report. (This document consolidates the appraisal forms previously used for recertification of value and final inspection respectively.)
- The appraiser who provided the original appraisal report that the lender is using for the transaction should perform the appraisal update or completion report.
- If the original appraiser is not available and a substitute appraiser is selected, the appraiser must:
  - Be qualified to perform the appraisal update or completion report;
  - Review the original appraisal report; and
  - Indicate if they concur with the original appraiser's opinion of value.

Note: the file should be noted as to why the original appraiser was not used.

#### **Appraisal Updates**

- When performing an appraisal update, the appraiser must comply with all USPAP standards, and at a minimum:
  - Concur with the original appraisal report's conclusions;
  - Perform an exterior inspection of the subject property, (an interior inspection is not required unless there were additional changes to the interior of the property);
  - Research, verify, and analyze current market data in order to determine if the property has declined in value since the effective date of the original appraisal;
  - Provide a photograph of the front of the subject property.
- Note: An appraisal update is not acceptable and a new appraisal report is required if:
  - The original appraisal report indicates neighborhood values were declining;
  - The new update indicates that the value of the property has declined;
  - The property has been damaged/changed significantly since the prior appraisal report.

#### **Completion Reports**

- If the initial appraisal report was subject to completion per plans and specifications or repairs:
  - A completion report with an interior/exterior inspection is required if there were interior repairs; or
  - A completion report with an exterior-only inspection is required if there were only exterior repairs
  - If the property still has incomplete items that impact value, the report should include additional photos of those items along with a list of the items to be completed and the estimated cost to complete of each.

Note: If two appraisals were required for the loan, only one appraisal recertification and/or final inspection is necessary. The report that generated the value estimate used to calculate the LTV/CLTV/HCLTV should be used for the new recertification assignment.



## **1025 / 72: Small Residential Income Property Appraisal Report**

### **Fannie Mae Form 1025 / Freddie Mac Form 72**

- Used with all two-to-four-unit properties, including two-to-four unit properties located in a PUD project. (A two-to-four property located in either a condominium or cooperative project requires the appraiser to inspect the project and complete the project information section of the Individual Condominium Unit Appraisal Report or the Individual Cooperative Interest Appraisal Report and attach it as an addendum to this report.)
  - The appraiser must, at a minimum:
    - perform a visual inspection of the interior and exterior areas of the subject property;
    - inspect the neighborhood;
    - inspect each of the comparable sales from at least the street;
    - research, verify, and analyze data from reliable public and/or private sources; and
    - report their analysis, opinions, and conclusions.
- The following Exhibits are required with this appraisal:
  - A street map that shows the location of the subject property and of all comparables that the appraiser used;
  - An exterior building sketch of the improvements with dimensions. The appraiser must also include calculations to show how they arrived at the estimate for gross building area. A floor plan sketch that indicates the dimensions is required instead of the exterior building if the floor plan is atypical or functionally obsolete, thus limiting the market appeal for the property in comparison to competitive properties in the neighborhood.
  - Clear, descriptive photos that show the front of the subject property and a street scene of the subject property, and that are appropriately identified.
  - Clear, descriptive photos that show the front of each comparable sale and that are appropriately identified. (Generally, photos should be originals; however, if original photos cannot be obtained, copies of photographs from a multiple listing service or from the appraiser's files are acceptable if they are clear and descriptive and the appraiser provides a reasonable justification for using them.)
  - Photos should include any improvements, amenities, conditions, and external influences that materially impact market value or marketability.
  - Clear, descriptive interior photographs that show at minimum:
    - The kitchen;
    - All bathrooms;
    - Main living area of the property (such as living room, family room, dining room, all bedrooms, etc.);
    - Basement, including all finished and unfinished rooms;
    - Examples of physical deterioration, if present; and
    - Examples of recent updates, such as restoration, remodeling, and renovation, if present.
- Any other data necessary to provide an adequately supported opinion of market value.



## **1007 / 1000: Single-Family Comparable Rent Schedule**

### **Fannie Mae Form 1007 / Freddie Mac Form 1000**

- A Single-Family Comparable Rent Schedule (Form 1007/1000) is required with one-unit investment properties. The form, which is prepared by the appraiser as an attachment to the appraisal for a single-family investment property, is designed to present the information needed to determine the market rent for a conventional single-unit investment property.
- For loans processed via Modified/Standard and Agency Jumbo, this form must be obtained for all 1-unit investment property transactions, regardless of whether rental income is received or used to qualify the borrower.
- For loans processed via DU or LPA, the gross monthly rent for each rental unit must be documented in each loan, even when the borrower is not utilizing rental income to qualify or if the AUS does not require. Refer to the Desktop Underwriter and Loan Product Advisor, Fact Sheets for additional information.
- Refer to Section 805.4, Income Non-Employed for complete details.

### **Field Review Reports**

- The purpose of an appraisal field review report is to provide the lender with an opinion on the accuracy and adequacy of the appraisal report that is being reviewed. The field review report must be completed in accordance with USPAP standards.
- One of the following forms must be used:
  - Fannie Mae Form 2000 / Freddie Mac Form 1032 – One-Unit Residential Appraisal Field Review Report, for 1-unit properties
  - Fannie Mae Form 2000A / Freddie Mac Form 1072 – Two-to-Four Unit Residential Appraisal Field Review Report, for 2-4 unit properties
- Because the Field Review Report allows for changes to market value, the appraiser completing the appraisal review must be licensed in the state in which the property is located, have access to the appropriate data sources, and possess the knowledge and experience to appraise the specific subject property type in the applicable geographical location.
- If a field review or new appraisal is obtained, a FCM approved appraiser or agent that is not affiliated with the fee appraiser's firm/agency under scrutiny must complete the field review or new appraisal. If a change in value is warranted, the review appraiser must complete the assignment according to Standard 3 of the Uniform Standards Professional Appraiser Practice.
- When the Field Review Report has a different value from the original appraisal report, the lower of the original report, field review value or sales price (if applicable) must be used to calculate the LTV/CLTV/HCLTV.
- Exhibits: The following Exhibits are required to support each field review report:
  - A street map that shows the location of the subject property and of all comparables included in the appraisal report under review and any additional comparable sales provided by the review appraiser;
  - Clear, descriptive photographs (either in black and white or color) that show the front and a street scene of the subject property, and that are appropriately identified. (Photographs must be originals that are produced either by photography or electronic imaging);
  - Clear, descriptive photographs (either in black and white or color) that show the front of each comparable sale included in the appraisal report under review and any additional comparable sales



described in the appraisal field review report. Generally, photographs should be originals that are produced by photography or electronic imaging; however, copies of photographs from a multiple listing service or from the appraiser's files are acceptable if they are clear and descriptive

Note: Field reviews are required for certain agency jumbo transactions, as indicated in the Loan Product Advisor® For Agency Jumbo Loans fact sheets.

### Updating the Appraisal

- With the exception of desktop appraisals, if the appraisal report will be more than 120 days old on the date of the note and mortgage, or the date a construction loan is modified to permanent financing, the appraiser must inspect the exterior of the property and review current market data to determine whether the property has declined in value since the date of the original appraisal. This policy applies regardless of whether the property was appraised as proposed or existing construction.
  - If the appraiser indicates that the property has declined in value, a new appraisal is required.
  - If the appraiser indicates that the property has not declined in value, the appraiser should provide a certification to that effect on a Fannie Mae Form 1004D / Freddie Mac Form 442 form. Certification should be based on an exterior inspection of the property and knowledge of current market conditions. Refer to the 1004D / 442: Appraisal Update and/or Completion Report section above for additional requirements.
  - For desktop appraisals, if the effective date of the appraisal report will be more than 120 days on the note date, a new desktop appraisal is required.

Note: If two appraisals were required for the loan, only one appraisal recertification and/or final inspection is necessary. The report that generated the value estimate used to calculate the LTV/CLTV/HCLTV should be used for the new recertification assignment.

- Generally, the original appraiser should be the one to complete the recertification of value. However, a substitute appraiser may be used provided s/he review the original appraisal and certifies that the original appraiser's estimate of market value was reasonable on the date of the original appraisal report and is still supported on the recertification date. We should note in the file why the original appraiser was not used.
- "Recertification of value" may be prepared using proprietary software issued by the appraisal company and must contain all of the following data:
  - Property address
  - Whether or not the property has declined in value; if so, the reason for the decline
  - Current Market conditions
  - Verification that the exterior of the property has been re-inspected.

Note: FCM recognizes there are differences in nomenclature between Fannie Mae's and Freddie Mac's definition of "recertification" and an "update" as defined in the Uniform Standards of Professional Appraisal Practice (Advisory Opinion 3). FCM also recognizes that this request constitutes a new appraisal assignment and that the appraiser must meet all necessary reporting requirements of USPAP.

### Appraisal Waivers

- Not permitted for Non-Agency loans
- Value Acceptance (Appraisal Waiver) + Property Data and the Hybrid Appraisal: Are not permitted



## **Appraisal Evaluation**

- Evaluating an appraisal is important to determine that the collateral is acceptable for the loan transaction, and generally involves a three-stage analysis.
  - The general analysis in which the appraisal is reviewed to ensure that all spaces on the appraisal form have been completed, that the appraisal report has been dated, has been signed by the appraiser and that the appraiser's license/certificate number is listed.
  - The mathematical analysis of the appraisal report in which all mathematical calculations on the appraisal form are validated.
  - The specific analysis whereby each section of the report is reviewed for any unusual item that might adversely affect the value of the property.
- Generally, FCM adheres to Fannie Mae and Freddie Mac Single Family Guidelines. The purpose of this section is to provide a top line summary of the key factors that the appraiser must take into consideration when preparing the appraisal report and to provide a usable, working reference tool for underwriters and processors to review what is documented. More detailed parameters can be found in the Fannie Mae Single Family Selling Guide and the Freddie Mac Single Family Seller/Servicer Guide via All Regs.
- With respect to each appraisal or inspection of the subject property, the following requirements must be met:
  - All information that may affect the estimate of value or marketability must be provided to the appraiser with the appraisal or inspection request.
  - The appraisal or inspection report must be of professional quality and support all of the appraiser's assumptions, data, analyses, rationale and conclusions that were relied on in estimating the value and addressing the marketability of the subject property.
  - The information in the report must be accurate, consistent, understandable, fully supported and adequately documented.
- The appraisal must provide a market value based on the following:
  - The most probable price agreed to by a buyer and seller who are typically motivated, well-informed/advised and acting in their own best interest,
  - The property has been exposed in a competitive and open market for a reasonable time,
  - Payment is made in cash or equivalent, and
  - The price represents the normal consideration for the property, not affected by special or creative financing or sales concessions.

Note: Not all of the topics discussed will appear on every appraisal report form, but the material is presented in the general order in which the topics appear on most forms.

## **Uniform Appraisal Dataset (UAD) Condition and Quality Ratings**

- These requirements are effective for Uniform Residential Appraisal Reports (Fannie Mae 1004 / Freddie Mac Form 70), Individual Condominium Unit Appraisal Reports (Fannie Mae 1073 / Freddie Mac form 465), Exterior-Only Inspection Individual Condominium Unit Appraisals (Fannie Mae 1075 / Freddie Mac Form 466), and Exterior-Only Inspection Residential Appraisal Reports (Fannie Mae / Freddie Mac Form 2055) dated on or after September 1, 2011. Other appraisal reports may also be completed in a UAD-compliant manner.

### **UAD Condition Ratings**



- UAD-compliant appraisal report forms must include a UAD Condition Rating (C1, C2, C3, C4, C5, or C6) that best describes the overall condition of the subject property and each comparable property.
- The appraisal report must contain additional commentary, descriptions, and explanations to enable the appraisal reviewer to understand the property condition and quality.
- An appraisal may be completed subject to completion of repairs or alterations required for the subject property to be rated C4 or better, or C5 as permitted below. If the appraisal is completed subject to repairs or alterations, then the UAD Condition Rating must reflect the overall condition of the subject property after all repairs or alterations have been completed.

### **C6 Condition Rating**

- If a property has deficiencies or defects that are severe enough to affect the safety, soundness or structural integrity of the improvements, then the property's condition must be rated C6. A subject property with a UAD Condition Rating of C6 is not acceptable collateral. Exceptions to this policy are not permitted.

### **C5 Condition Rating**

- A property with a UAD Condition Rating of C5 (either “as is” or subject to completion of repairs) is permitted for Fannie Mae-salable loans only. These properties must not have any conditions that impact the safety, soundness or structural integrity of the improvements that are not repaired prior to closing or prior to delivery of the loan for purchase; work completion escrows are not permitted.
- A property with a UAD Condition Rating of C5 is not permitted for loans that must be sold to Freddie Mac, such as Home Possible loans.
- Exceptions to these policies are not permitted.
- Please note that any property, regardless of overall rating, that suffers from needed repairs or incomplete items that affect the safety, habitable, or salability of the property must be identified as “subject to” repairs.

### **UAD Quality Ratings**

- UAD-compliant appraisal report forms must incorporate a UAD Quality Rating (Q1, Q2, Q3, Q4, Q5, or Q6) that best describes the overall quality of the subject property and each comparable property.
- A subject property with an overall quality rating of Q6 is generally not acceptable collateral, unless all issues that caused the property to be rated Q6 are cured prior to closing or delivery. Items that may be required to be cured include modifying the property to make it habitable as a year-round residence; upgrading the electrical, plumbing, and other mechanical systems and equipment to meet community standards; correcting any substandard or nonconforming additions to the original structure; and curing any other quality-related items needed to make the property acceptable to typical purchasers in the market in which the property is located.
- An appraisal may be completed subject to repairs or alterations required for the subject property to be rated Q5 or better. If the appraisal is completed subject to repairs or alterations, then the UAD Quality Rating for the subject property should reflect the overall quality of the property after all repairs or alterations have been completed.

### **Condition and Quality Adjustments:**

- The appraiser must make appropriate adjustments for differences in condition and quality between the subject property and each comparable property to reflect the value, if any, of the differences in the





marketplace. If the appraiser makes an adjustment for differences in quality and condition between the subject property and a comparable property that have the same UAD quality or condition rating, or does not make an adjustment for properties that receive different quality and condition ratings, the appraiser is expected to provide a sufficient explanation for the basis and rationale for all adjustments.

Note: UAD-compliant appraisals may contain a separate attachment that provides a list of the abbreviated terms and their meanings. Work Completion

**Escrows are only permitted if they meet all eligibility criteria Escrow/Holdbacks section of this chapter.**

### **Purchase / Sales Agreement**

- All purchase money transactions must have a sales contract. The sales contract, at a minimum, must identify buyers, sellers, property address, and the sales price. Buyers and sellers must sign the contract, any addenda, and initial any changes made to either. Note: Computer generated strikeouts and changes do not need to be initialed by the buyer or the seller; initials may be made by each change or on the same page where the change is made.
- It must identify all borrowers as buyers unless the borrower is a co-signer. (Note: Additional buyers who are not listed as a borrower on our loan may be listed on the sales contract; they do not have to be removed from the sales contract.) Assignment of the sales contract is not an acceptable practice.
- The lender is responsible for providing a complete copy of the purchase/sales agreement to the appraiser with the appraisal request, as well as any amendments. If any information provided to the appraiser changes (e.g., sales contract amendment) the updated information must be provided to the appraiser prior to the completion of the appraisal report.
- It is not required to provide the appraiser with an updated sales contract after completion of the appraisal report unless the updated terms include the below:
  - Impacts the physical description or condition of the property,
  - The property is new construction and there are changes to plans and specifications,
  - Change to the sales price greater than the appraised value,
  - Financing concessions,
- 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:
  - Change to the sales price at or below the appraised value,
  - Seller-paid closing cost,
  - Names or initials,
  - Closing date and
  - Correction of minor clerical errors such as misspellings

### **Personal Property**

- Adjustments to the sales price may be required if there are personal items included in the sales contract that are not considered to be “real estate” and they are not ordinarily left with a home in this market. In these instances, the value of such items must be determined and, if they contribute “significant” value, deducted from the sales price before calculating the loan to value.
- If the personal items are insignificant, adjustments are not necessary—even if listed on the sales contract. Examples include pre-owned items such as:
  - Bar stools



- Fireplace tools
- Pool equipment
- Window air conditioning units
- Appliances
- Rugs
- Window treatments
- Satellite dish
- Above ground pool with decking attached

Note: Sometimes the seller will choose to leave behind personal items of value simply because it is not worth the trouble and expense to dismantle and transport (e.g. hot tub, above ground pool). In these instances there should be a statement signed by all parties to this effect and the appropriate adjustments to sales price, if required, must be documented.

- Reviewing the Purchase & Sales Agreement
- Compare the information on the contract with the information on the loan application, preliminary title, and disclosures.
  - Verify that the agreement lists the borrowers as "Buyer".
  - Verify that the seller is in title to the property.
  - Be sure that the receipt of deposit agrees with the amount on the application.
  - Verify that the purchase price agrees with the application purchase price under details of purchase section on the application. Also, verify the terms of any other financing to ensure it meets secondary financing requirements. The secondary financing payment must be included in debts when calculating the debt ratio.
  - The purchase price of the property and any earnest money deposit may not be designated in cryptocurrency.
  - Verify that the buyer and seller portions agree with the details of purchase section on the application. If the seller is to pay any closing costs on the buyer's behalf, they must be fully disclosed in the contract. Closing costs may be limited to a dollar amount or percentage of the purchase price, or to specific items.
  - The seller may pay all non-recurring closing costs up to the maximum provided in the Interested Party Contributions section of the Underwriting Chapter. Prepaid mortgage payments are not allowed.

### **Owner of Record**

- The lender must verify the owner of record, via information provided by the appraiser, a property sales history report, a copy of the recorded deed, the property tax bill, or the title commitment or binder:
  - For purchase transactions, the property seller listed in the sales contract must be the owner of record of the subject property
  - For refinance transactions, the borrower must be the owner of record of the subject property.
  - For transactions that pay off a land contract, the property seller is the vendor on the recorded land contract and must be the owner of record of the subject property. The borrower is the vendee on the recorded land contract.



## **Excess Land**

- A property with a significant parcel size or lot size should be identified and appraised in its entirety. The appraiser should not assume that only a reduced parcel size (e.g., 5 acres can be appraised). An appraisal of a large parcel should include a discussion about the actual parcel size and the typical parcel size for the neighborhood or area.
- There should be appropriate consideration for any excess land over the typical parcel size. Excess land may contribute value and an adjustment may be appropriate in the sales comparison grid. The appraiser should provide adequate support for any adjustment considered in the market grid for excess land.

Note: Montana properties with more than 30 acres, South Dakota properties with more than 30 acres, and Idaho properties with more than 80 acres are not permitted.

## **Appraisal Review**

- The following sections of the Appraisal Report contribute to the determination of the final value estimate:
  - Subject Property Section
  - Contract Section
  - Neighborhood Section
  - Site Section
  - Improvements Section
  - Sales Comparison Approach
  - Reconciliation of Value
  - Additional Comments
  - Cost Approach
  - Sales Comparison Approach
  - Income Section
  - PUD Information

## **Subject Property Section**

- The Subject Property must be residential based on the property characteristics, zoning and land use.
- The Subject Property Section of the appraisal report form is used to:
  - Identify and describe the location of the subject property, including the legal description, neighborhood, assessor's parcel number, map reference and census tract number;
  - Identify the borrower and the owner of record;
  - Provide information about property taxes and special assessments;
  - Indicate if the property is located within a PUD and the HOA fees;
  - Indicate the occupancy status of the property;
  - Describe the property rights to be appraised;
  - Indicate whether the appraisal assignment is for a purchase or refinance transaction;
  - Provide the Lender/Client name and address; and
  - Indicate whether the property is currently listed for sale or has been within the past 12 months, and report data sources, offering prices and dates.
- Property Address & Legal Description:
  - The appraisal must include the complete property address and legal description; a post office box number is not acceptable. For appraisals that are required to be completed using the Uniform



Appraisal Data Set (UAD), the format of the property address must conform to the United States Postal Service Address Standards. If a house number is not available, the legal description should be used. If the legal description is lengthy, the full description may be attached as an addendum to the appraisal report.

- **Property Rights Appraised**
  - The form of ownership in which the property is held—fee simple or leasehold—must be clearly documented. (Refer to Section 803 – Borrower Information and Section 505.1 - Property-Leaseholds for explanations of fee simple and leasehold interests.)
- **Leasehold Estates**
  - For leasehold estates, the appraiser must include a detailed description of the terms, conditions, and restrictions of the ground lease, and comment on any effect the terms of the lease have on value and marketability. The appraiser should use sales of similar properties with the same lease terms as comparable sales. If there are no comparable sales of leasehold properties, the appraiser should use sales of similar properties owned in fee simple as comparable sales
- **Market Data Research and Sources**
  - The appraiser must research market data from all reasonably available and appropriate sources of information for the location and property type being appraised—including public records transfer information, and if appropriate, data from local real estate brokers who are not active in the local multiple listing service and report on both reasonable marketing period and exposure time. Failure to consider all relevant data in the research and analysis stage may result in a poor quality appraisal that could have a discriminatory effect.
- **Contract Section**
  - Appraiser must review, analyze and provide comments on the impact of the terms of the contract for sale on the final estimate of value for purchase transactions. This section includes:
    - Contract price, date of the contract and whether the seller is the owner of record,
    - Amount of financial assistance (loan charges, sale concessions, gift, down payment assistance, etc.) to be paid by the seller or other interested party on behalf of the borrower,
    - Indicate data sources used.
- **UAD Requirements:**
  - For appraisals that are required to be completed using UAD, the appraiser must also indicate the type of sale – REO sale, short sale, court-ordered sale, estate sale, relocation sale, non-arms length sale, arms length sale, etc.

## **Neighborhood Section**

- The Neighborhood section provides information on the following:
  - Neighborhood Characteristics, including location in an urban, suburban or rural area; the percent the area is built up, and the growth rate.
  - Housing Trends for the subject property type, including whether Property Values are increasing, stable or declining; Demand/Supply and whether there is a shortage, over supply or if they are in balance, and Marketing Time - the length of time in months.
  - Price/Age Ranges, including low, high and predominant values
  - Present Land Use % - for various types of properties in the area
  - Neighborhood Boundaries
  - Neighborhood Description



- Market Conditions, including comments that support other conclusions in this section.
- The Neighborhood Section contains information supplied by the appraiser to identify the market area/neighborhood that is subject to the same influences as the subject property (based on common characteristics or trends). The comparable sale properties should contain similar characteristics as the subject property.
- This section is not used to rate or judge the market area/neighborhood. The common characteristics or trends that define a market area/neighborhood are those resulting from social, economic, governmental or environmental forces on the property values in the subject property's market area/neighborhood. Economic forces that must be considered include such things as the existence of vacant or boarded-up properties in the neighborhood, the level of essential local support services, etc. Examples of governmental forces that should be taken into consideration include the regulations, laws, and taxes that are imposed on properties. Environmental forces that must be considered include, among other things, the existence of a hazardous waste site on or near the property, the proximity of a property to an airport, etc.
- The characteristics/trends do not include racial composition or age of the neighborhood, and the appraiser must not make any reference to or take into consideration the race, color, religion, sex, age, marital status, handicap, familial status or national origin of any person (including the present or prospective owners or occupants of the subject property or properties in the vicinity), or any other basis that is prohibited by law. In addition, the appraiser may not improperly take into consideration any property modifications for handicapped persons, the age or location of the property, or the age of the neighborhood or census tract where the property is located.
- Neighborhood conditions must be reported in factual, specific terms and be impartial and specific in describing favorable or unfavorable factors in a neighborhood. The use of subjective terms or phrases—such as "pride of ownership," "no pride of ownership," "lack of pride of ownership," "poor neighborhood," "good neighborhood," "crime-ridden area," "affluent, desirable neighborhood or location," "undesirable neighborhood or location," etc. is expressly forbidden.
- The appraiser is not required to rate or judge the neighborhood, however, s/he is required to perform an objective neighborhood analysis by identifying:

### **Neighborhood Characteristics**

- This section describes the location as urban, suburban or rural, the percentage the neighborhood is built up, and the growth rate.
  - Location: Based on the subject property's neighborhood, the location is designated as 1) urban – city; 2) suburban- adjacent to a city; or 3) rural – country or beyond suburban. Property location is a fundamental characteristic that influences the value of residential real estate and is therefore a critical factor that must be considered in the appraisal process. However, it should never be the sole factor used to determine if the particular neighborhood is acceptable. UAD Requirements: The appraisal report form must include a rating of the location of the subject property and each comparable sale by providing a rating of either "Neutral" (N), "Beneficial" (B), or "Adverse" (A). The location rating is for the location of the subject property within the neighborhood or market area, and is not a rating for the overall neighborhood or market area. FCM will originate or purchase loans secured by one-to-four unit properties in all neighborhoods and in all areas—urban, suburban, or rural—as long as the property is acceptable as security for a mortgage based on its value and marketability. (Additional restrictions may be required if the subject property location is considered rural.) Both the appraiser and the underwriter must be sensitive to the varying



conditions that characterize different locations as well as the present and anticipated use of any adjoining properties. Conditions that are typical of certain types of locations may not be present in other locales. This does not mean that the conditions are unacceptable, rather that they must be viewed in context with the nature of the area in which the subject property is located.

- Built Up: The degree of development of a neighborhood (which is referred to as “built-up”) is the percentage of the available land in the neighborhood that has been improved. Percentage ranges are 1) over 75%; 2) 25% to 75%; and 3) under 25% and typically correspond with the location. The degree of development of an area may indicate whether a particular property is residential in nature. When underwriting a mortgage where the subject property is located in a rural or relatively undeveloped area, the characteristics of the property, zoning, and the present land use must be examined to determine whether the property should be considered residential in nature. FCM does not originate or purchase loans secured by:
  - Vacant land;
  - Commercial properties, industrial properties and other properties (shop-use) with non-residential use;
  - Properties with restricted use based on zoning laws (e.g., agricultural-type properties);
  - Properties with attributes that restrict its resale or value including special purpose properties.

Properties located on sites that are larger than those typical for residential properties in the area require special attention—particularly when evaluating the neighborhood description, zoning, the highest and best use determination, and the degree of comparability between the subject property and the comparable sales.

- Growth Rate: Reflects the current changes in the market area of the subject property’s neighborhood. Growth rate is reflected as rapid, stable or slow and usually corresponds with changes in land use.

### **Housing Trends**

- This section addresses Property Values in the neighborhood, Demand/Supply, and Marketing Time.
  - Property Values: Reflects the current status of changes in property values (sales price) in the subject property’s neighborhood. The appraiser must indicate whether property values in the subject neighborhood are “increasing,” “stable,” or “declining.” Maximum financing is acceptable when property values are stable or increasing. As a general rule, FCM does not offer maximum financing if property values are declining. Refer to the Depreciating Markets/Declining Values topic in this section for additional information relative to declining property values.
  - Demand/Supply: Reflects the current status of housing units available for sale in the subject property’s neighborhood, and is reflected on the appraisal as shortage, in balance or oversupply. FCM must be satisfied that the neighborhood will be acceptable to a sufficient number of buyers to support an active, ongoing market for the property. An oversupply of housing is not desirable since it indicates that properties are selling slowly or may indicate a neighborhood-wide or a citywide problem. In either case, the appraiser must comment on the reason for the oversupply and its effect on the value of the property.
  - Marketing Time: Reflects the average time it takes to sell a property in the subject property’s neighborhood. Marketing time is reflected as “under 3months”, “3-6 months”, or “over 6 months”. The appraiser should explain any changes that have occurred that might influence the marketability





of the properties within the neighborhood. When the marketing time is longer than six months, the reasons for the extended marketing period and its effect on value must be explicitly addressed.

## **Housing**

- This section provides information on the low, high and predominant price and age of housing in the neighborhood.
  - Price/Age Ranges: Reflects the most common or frequently found sales price of comparable properties in the subject property's neighborhood. Price range and the predominant price of properties in the subject neighborhood must be addressed. The appraiser must explain why the property is "over-improved" or "under-improved" for the area and comment on any adjustments that were made to reflect that condition. Isolated high and low extremes should be excluded from the range, which means that the predominant price will be that which is the most common or most frequently found in the neighborhood. The appraiser may state the predominant price as a single figure or as a range. When the subject property has a sales price (or value) that exceeds the upper price range, the property may be considered "over-improved" for the neighborhood. The property may also be considered as "under-improved" if the sales price (or value) is less than the lower price range. However, if subject is being renovated and is located in an urban area the property should not be regarded as over-improved if there is a strong market interest, since demand for this type of property can be strong. This will be indicated by the existence of comparable properties.
  - Predominant Age: The appraiser must indicate the age range and predominant age of properties in the subject neighborhood. The age range should reflect the oldest and the newest ages for similar types of residential properties and, in some cases, for competing properties. However isolated high and low extremes should be excluded from the range. The appraiser may state the predominant age as either a single figure or as a range (when considered more appropriate). The properties used to represent the age range and predominant age should be selected independently rather than relying on the same properties used to illustrate the price range and predominant price. The age of the property should be within the general age range of the neighborhood. Normally, neighborhoods are developed over a relatively narrow span of time so that most properties will fall within a particular age range. A property that has an age outside of the general age range may need to receive special consideration. Unless there is strong evidence of long-term neighborhood stability, a new dwelling in an old neighborhood may carry some marginal risk. Conversely, an old dwelling in a newly developed area is generally acceptable if renovation will result in its conforming to the neighborhood.
  - Present Land Use %: This section addresses the composition of the neighborhood based on the types of properties that comprise it. The appraiser should report separately the percentage of developed one-unit sites, two-unit sites, multi-family, commercial, and other uses. If there is a significant amount of vacant or undeveloped land the appraiser must also comment to that effect to assure that they have adequately described the neighborhood.
  - Land Use Change: If the land use is likely to change or is in the process of changing, the appraiser should indicate the anticipated new land use(s). If the area is undergoing transition, the changes should be described along with commentary about their effect on the marketability and value of the subject property. Typically, properties best maintain their value when they are situated in neighborhoods that consist of other similar units. However, some factors that are typical of a mixed-use or urban neighborhood can enhance the market value of a property through increased



buyer demand. When different land uses and property types are present in a neighborhood, that fact should be considered when performing the neighborhood analysis and defining the neighborhood boundaries.

- Neighborhood Boundaries: Neighborhood boundaries are identified by various physical characteristics (streets, bodies of water, land uses, types of dwellings, etc.).
- Predominant Occupancy: Another predominant factor that must be taken into consideration when performing the neighborhood analysis and defining the neighborhood boundaries is if the property is located in a neighborhood that is predominantly owner-occupied or tenant-occupied. To assure that any effects (positive or negative) of occupancy status will be reflected in the sales comparison analysis, comparable sales from within the same neighborhood should be used whenever is possible. Comparable sales that are outside of the subject neighborhood may require “neighborhood” or “location” adjustments to the sales comparison analysis for any sales that are not subject to this same neighborhood characteristic.
- Neighborhood Description: Neighborhood Description addressed by the types of structures and architectural styles in the neighborhood (detached, attached, row or townhouse, colonial, ranch, Victorian, etc.); current land use (single-family residential, commercial, industrial, etc.); typical site size (1/8 acre, 2 acres, etc.); or street patterns or design (one-way street, cul-de-sac, court, etc.)
- Market Conditions Factors that affect the value and marketability of properties in the neighborhood—addressed by things such as proximity of the property to employment and amenities, employment stability, appeal to the market, changes in land use, access to public transportation, adverse environmental influences, etc. The appraiser should collect pertinent data, make a visual inspection of the neighborhood to observe its physical characteristics and boundaries, and identify land uses including any signs that they are changing. The search of the subject market area should be extended as far as is necessary to assure that all significant influences affecting the subject’s value are reflected in the appraisal report. Things to look for when reviewing this section:
  - Is the location rural?
  - Is the neighborhood less than 25% built up?
  - Are the property values declining?
  - Does the demand/supply reflect an oversupply?
  - Is the marketing time over six months?
  - Is the sales prices/appraised value of the subject property within the neighborhood price range?
  - Does the sales price/appraised value exceed the predominant price?
  - Are there any land use changes that are likely to affect the subject property’s marketability?
  - Are there any adverse comments in the Neighborhood Section of the appraisal?
  - Are there any land use changes that are likely to affect the subject property’s marketability?
  - Are there any adverse comments in the Neighborhood Section of the appraisal?

## **Depreciating Markets**

- Declining Values: FCM continually monitors County/MSA property data from a number of sources to identify markets/areas that are experiencing appreciating or declining value trends. Based on this data, FCM can then establish restricted maximum LTV/CLTV/HCLTV ratios based on certain percentage changes quarter to quarter.



- For areas identified with “N/A in the MSA Number column and/or “Null” in the MSA Metro/Micro Area Name column on the Depreciating Markets List (Non-Agency Exhibit 1) spreadsheet, the County and State should be used to determine if the property is located in a Depreciating Market.
- The underwriter should examine the terms of the transaction requested by the borrower to ensure they are appropriate in light of the market trends. The following are examples of terms which should be given additional considerations:
  - Product Type: Is an interest-only product appropriate for the loan’s process and program in a declining market?
  - Maximum Financing: Is maximum financing (i.e., maximum program or process LTV) appropriate in a declining market?
  - Interested Party Contributions: Ensure that the appraiser is made aware of any seller contributions or concessions noted on the sales contract to ensure that the value is in no way inflated by these factors.
- Major discrepancies or concerns should be forwarded to FCM for review and reconciliation.

### **Depreciating Markets**

- Agency & Agency Jumbo Loans, including Home Possible, HomeReady, and FHA/VA transactions: Agency loans in depreciating markets follow agency guidelines, except FCM Florida condominium restriction applies. FHA/VA transactions follow FHA/VA guidelines. In addition to the policies addressed in this section, loans that require mortgage insurance are also subject to the declining markets policy of the MI provider.
- Non-Agency Loans: “Depreciating Markets” policy applies if the subject property is located in an area as indicated on the FCM Depreciating Markets list or if the appraiser/appraisal indicates that the property is “declining”. Refer to the Non-Agency Exhibit 1-Depreciating Markets for a list of depreciating markets/areas by county. The policy does not apply to Community Lending First Mortgage Programs. Note: If the property is located in a depreciating market the underwriter must manually adjust the maximum LTV/CLTV/HCLTV by 5%.

### **Site Section**

- The Site Section describes the subject property’s site (lot), current zoning, and that the subject property is of a size, shape and topography that is generally conforming and acceptable in the market area including competitive utilities, street improvements and other amenities. (1 acre = 43,560 square feet.)

Note: For appraisals on properties in condominium or cooperative projects, this section is the Project Site section and includes information on the site the project is located on.

- The subject property must be residential based on the property characteristics, zoning and land use.
- Things to look for when reviewing this section:
  - Is the zoning rated non-conforming or illegal?
  - Is the present use the highest and best use of the site?
  - Is the subject property in a special flood zone?
  - Are there any adverse comments in the Site Section?
  - Are there private roads/streets?
  - Are there community or privately held utilities?



- The property site should be of a size, shape, and topography that is generally conforming and acceptable in the market area. It must also have competitive utilities, street improvements, and other amenities. Since amenities, easements, and encroachments may either detract from or enhance the marketability of a site, the appraiser must comment on them if the site has adverse conditions or is not typical for the neighborhood. If there is market resistance to a property because its site is not compatible with the neighborhood or with the requirements of the competitive market, more conservative mortgage terms may be appropriate.
- Dimensions: This section provides the dimensions, area and shape of the lot. The subject property site should generally conform to and be acceptable in the market area in terms of size, shape, and topography.
- For large unsubdivided lots, the appraiser must include the actual size of the lot in the appraised value and not a hypothetical portion of the site. For example, the appraiser may not appraise only 5 acres of an unsubdivided 40-acre lot. The appraised value must reflect the entire 40 acres.
- View: For appraisal report forms that are required to be completed using the UAD, the overall view associated with the subject property and each comparable sale must be rated as either "Neutral" (N), "Beneficial" (B), or "Adverse" (A), and describe the overall effect on value and marketability of the view associated with the property. Appropriate adjustments must be made for differences in view between the subject property and each comparable property to reflect the value of the differences, if any, in the market.
- Zoning: The appraiser is responsible for reporting the specific zoning classification for the subject property. The appraiser must include a general statement to describe what the zoning permits—"one-unit," "two-unit," etc.—when s/he indicates a specific zoning such as R-1, R-2, etc. Appraiser must indicate if the improvements represent a legal conforming use; a legal, but non-conforming use (grandfathered); an illegal use under the zoning regulations; or whether there is no local zoning. If the property is marked as a legal, but non-conforming use (grandfathered), refer to Section 505-Property/Legal & Non Conforming Use topic for additional information.
- As a general rule, FCM does not originate or purchase loans on properties where the improvements do not constitute a legally permissible use of the land. However, exceptions may be considered as long as the property is appraised and underwritten in accordance with Section 505-Property criteria.
- Highest & Best Use: The highest and best use of a site is the reasonable and probable use that supports the highest present value on the effective date of the appraisal. For improvements to represent the highest and best use of a site, they must be legally permitted, financially feasible, and physically possible, and must provide more profit than any other use of the site would generate. All of these criteria must be met if the improvements are to be considered as the highest and best use of a site.
- However, the appraiser's analysis of the subject property should focus on the property as it is improved. The use of comparable sales should demonstrate that the improvements are typical and compatible with market demand for the neighborhood, and that the present improvements contribute to the value of the subject property so that its value is greater than the estimated vacant site value. If the appraiser indicates that the current improvements clearly do not represent the highest and best use of the site the loan may warrant decline.
- Utilities: The utilities of the property must be adequate and currently in service, meet community standards, typical for the market area, and be accepted generally by area residents. If there is market resistance to an area because of environmental hazards or any other conditions that affect well, septic, or public water facilities, the appraiser must comment on the effect of the hazards on the marketability and value of the subject property.



- If public sewer and/or water facilities—those that are supplied and regulated by the local government—are not available, then community or private well and septic facilities must be available and utilized by the subject property. If community facilities are used, the owners of the subject property must have the right to access those facilities, which must be viable on an ongoing basis. Private well or septic facilities must be located on the subject site. However, offsite private facilities are acceptable if the inhabitants of the subject property have the legal right to access them and if there is an adequate, legally binding agreement for their access and maintenance.
- FCM does not require well and septic certifications on every applicable conventional loan submitted for purchase. However, FCM reserves the right to request acceptable certifications if information contained in the file indicates there may be a problem.
- Lot: The property site should be of a size, shape, and topography that is generally conforming and acceptable in the market area. It must also have competitive utilities, street improvements, and other amenities. Since amenities, easements, and encroachments may either detract from or enhance the marketability of a site, the appraiser must comment on them if the site is not typical for the neighborhood.
- Some markets have properties built on lots called “flag lots”. These are simply lots that are shaped like a flag where only a small strip of land (the driveway) actually joins a road. These properties are acceptable, and we would prefer to have similar comps, but if none are available and it represents no resistance to the market, there is no issue.
- Off-Site Improvements: Off-site improvements include streets, alleys, sidewalks, curbs and gutters, street lights, etc. The subject property should front on a publicly dedicated and maintained street that meets community standards and is generally accepted by area residents. Off-site improvements should be typical for the market area. If a street does not meet city or state standards and/or it is not regularly maintained, extensive maintenance is often required. Consequently property values may decline.
- If a property fronts on a street that is not typical of those found in the community, the appraiser must comment on the effect of that location on the marketability and value of the subject property. The presence of sidewalks, curbs and gutters, streetlights, and alleys depends on local custom—if typical in the community, they should be present on the subject site.
- The appraiser must comment on any adverse conditions and address their effect on the marketability and value of the subject property.
- Community-Owned or Privately Maintained Streets (a.k.a., Private Road Maintenance Agreements): All properties must be readily accessible by roads that meet local standards. Additional documentation such as a Private Road Maintenance Agreement is not required to verify.
- Special Flood Hazard Areas: The appraiser must indicate on the appraisal report whether or not the property is located in a high-risk flood area. Properties that are located in high-risk areas may require additional insurance. Refer to Sections 908-Escrows and 910-Flood Insurance.

Note: The appraiser must indicate whether or not a property is located in a high-risk volcano area in the state of Hawaii. Properties that are located in areas that are deemed high-risk may not be saleable and/or additional insurance may be required.

- Adverse Site Conditions or External Factors: The appraiser must indicate if there are any easements, encroachments, environmental conditions, land uses, etc. that may negatively affect the subject property.





## Improvements Section

- The Improvements section should provide a clear, detailed, accurate and comprehensive description of the subject property's improvements with any recommended/required repairs, additional features/amenities, modernization described in detail with support data, if appropriate and necessary.

Note: For appraisals on units in condominium and cooperative projects, the appraisal report forms include a Unit Description section in lieu of an Improvements Section, as well as sections that provide information on the project.

- UAD Requirements: For appraisal reports that are required to be completed using the UAD, the appraiser is responsible for reporting on the condition and quality of the property as described below.
- The subject property should conform generally to the neighborhood in terms of age, type, design, and materials used for construction, and must be habitable as a year-round residence. FCM has no specific minimum square feet or living area requirements for properties. Properties with special energy efficient improvements should be addressed in the comments section by the appraiser and supported by the Energy Efficient Addendum.
- Properties with unusual layouts, peculiar floor plans or inadequate equipment or amenities generally have limited market appeal. Such properties require the appraiser to comment on the reasons for the limited market appeal.
- The appraiser must express an opinion regarding the condition of the improvements on the subject property in the comment section and if there are any environmental conditions, repairs of functional inadequacies that have an adverse effect on the subject property must also be addressed in the comment section.
- Things to look for when reviewing this section:
  - Is there a substantial difference between the actual age and the effective age of the subject property?
  - Are there any repairs, inspections, etc., needed/required for the subject property?
  - Are there any adverse comments in the Description of Improvements or Comment section?
  - Is there incomplete work that affects health, safety, soundness, structural integrity and/or livability issues (e.g., non-functioning bathrooms or kitchen, no utilities, empty swimming pool, stairs with no hand rails, etc.)? Note: Major concerns should be forwarded to FCM for review.
  - Does the gross living area square footage match the square footage used in the cost and/or comparative sales approach to value?
- Conformity to Neighborhood: Generally the subject should conform to the neighborhood in terms of age, type, design, and materials used for their construction. Underwriters should pay particular attention to loans where the appraiser notes there may be market resistance to a property or if the subject property represents special or unique housing for the subject neighborhood. In these instances, the appraiser must supply adequate information to develop a reliable opinion of market value.
- Over-improvements: These are improvements excessive in cost or size in relationship to land value or value of surrounding improvements. Often an over improvement can be identified by:
  - Lack of compatibility with other properties in the neighborhood's value range, i.e., a typical property;
  - Lack of truly comparable properties (significant adjustments to comparable sale properties are made);
  - Sales price or indicated value exceeds the neighborhood range;





- Sales price or indicated value is above the predominant range but is equal to the high range, could indicate the subject property is the high range.
- Year Built & Effective Age: Although we do not place restrictions on the age of the property, we rely heavily on the relationship between the actual and effective age, as it is a good indication of its condition. Regardless of the age of the residence, the improvements must be of the quality and condition that supports current occupancy and market demand.
- When adjustments are made to the appraisal for the year built, whether they are made for the actual age or the effective age of the subject property, the appraiser must provide an explanation for the adjustments and the condition of the property.
- Insulation & Energy Efficiency: Properties with special energy-efficient amenities—through the use of cost-effective design, materials, equipment, and site orientation to conserve nonrenewable fuels—should be listed in the “comments” area and supported by the Energy Efficient Addendum.
- Gross Living/Building Area: Appraisers are required to use the American National Standards Institute Measuring Standard (ANSI Z765-2021) for measuring, calculating, and reporting gross living area for detached single family and condominium units (Detached and Site Condos) that require interior and exterior inspections as of 4/01/2022.
- The ANSI Measuring Standard is not required to be used for assignments that do not include a full interior and exterior inspection or for condominiums, co-ops or 2-4 family properties that are otherwise apartment-style or multifamily buildings. Outbuildings and detached structures are not required to follow the ANSI Measuring Standard. However, individuals are encouraged to use the Standard whenever possible to ensure consistent reporting. Finished areas that are not included in the gross living area may be valued separately based on similar comparable sales. Where possible, GLA for comparable sales should also be adjusted to the ANSI Measuring Standard to ensure all properties are reported in a consistent fashion.
- Floor Plans & Layout: Properties with unusual layouts, peculiar floor plans, or inadequate equipment or amenities generally have limited market appeal (e.g., bedrooms on a level with no bath, or a kitchen on a different level from the dining room). Such properties require the appraiser to comment on the reasons for the limited market appeal, and, when necessary, make appropriate adjustments to reflect this in their overall analysis. On the other hand, if market acceptance can be demonstrated through the use of comparable sales with the same inadequacies, no adjustments are required.
- Incidental Second Units/Accessory Apartments: Must include similar comps.
- Room/Unit List: The individual appraisal form and the fieldwork required for the particular transaction will determine if and when this information is required.
- Foundation: Evidence of wood-boring insects, dampness or settlement must be addressed along with comment on its effect on the marketability and value of the subject property. Either satisfactory evidence that the condition was corrected or a professionally prepared report indicating that condition does not pose any threat of structural damage to the improvements must be provided prior to closing.
- Heating & Cooling Sources: All properties should have a permanent source of heat and if typical for the area, cooling, although FCM will consider an exception in the rare instance that it does not. (Note: Space heaters and similar sources are not considered permanent heat sources, even if affixed to a permanent wall.) The appraiser must comment on its absence and supply evidence that this is common, customary and compatible for the area; comps should reflect the same condition. Regardless, the property must still be habitable year round. If there is no heat source, refer the loan to a Risk Manager.
- Property Conditions: The appraiser must provide factual, specific terms with regards to the condition of the property as well as if the condition affects the value or marketability. Any needed repairs or any physical,



functional, or external inadequacies must also be identified. All detrimental conditions—even if that condition is typical for competing properties—must be identified along with an estimate of cost to cure; photo's may also be required.

- **Uniform Appraisal Dataset (UAD) Condition Rating:** Appraisals that must be completed using the UAD must include a UAD Condition Rating for the property (C1, C2, C3, C4, C5 or C6). A property that has a UAD condition rating of C6 is not acceptable and properties with C5 ratings are only acceptable as indicated in the Uniform Appraisal Dataset (UAD) Condition and Quality Ratings section above. Appraisals for properties with condition ratings of C1, C2, C3 or C4 may be subject to completion of repairs. However, if the property is not eligible for a work completion escrow, the work must be completed prior to closing, or delivery of the file for purchase.
- **Security Bars:** Properties with security bars will be considered unacceptable collateral unless they comply with local fire codes and they meet one of the following conditions:
  - There must be a "Quick Release" on at least one window in each bedroom; or
  - All bedrooms must have adequate egress to the exterior of the home or the exterior of the unit for condo and co-op properties (occupants of a bedroom must be able to get outside the home if there is a fire). Note: If an enclosed patio (solid walls) covers the bedroom window, it is possible that the bedroom won't qualify as a habitable bedroom.
- **Additions without Permits:**
  - If the appraiser identifies an addition(s) that does not have the required permit, the appraiser must comment on the quality and appearance of the work and its impact, if any, on the market value of the subject property.

Note: Appraisal may be made "subject to" on a case-by-case basis. The underwriter must ensure the borrower has sufficient funds available to complete renovations, repairs and/or construction in addition to normal assets and reserves required to close. If funds are not available, appraisal must be based on "as is" condition of the property. A final inspection is required to confirm repairs/work has been completed as specified and that it meets "subject to" value.

### **Project Information / Description Section**

- The Project Description section (for condominiums) or the Project Information section (for coops) includes the following information, as applicable for the project:
  - The data source used for condominium project information.
  - Project Description: detached, row or townhouse, garden, mid-rise, high-rise or other.
  - Number of stories, elevators, whether the project is existing, proposed or under construction, the year built and effective age.
  - General description of the exterior walls, roof, and parking amenities.
  - Information on the subject phase, and other complete or incomplete phases in the project.
  - Single entity total unit ownership more than 10%.
  - Primary Occupancy (principal residence, second home/recreational or tenant)
  - Information on who is in control of the Homeowners Association or is in control of the management of the cooperative corporation. Is the cooperative project part of a master association?
  - Completion status of the project, units, common elements and recreation facilities, adequacy of parking and whether the project was an existing building converted to a project.
  - Description of the common elements and recreational facilities, and whether they are leased, and if the project subject to ground rents.



- Commercial space in the project.
  - Condition of the property and quality of construction
  - Is the project typical for the marketplace, does it conform to the neighborhood, or are there any factors that impact marketability?
  - Additional fees other than regular monthly maintenance or assessment fees
- The appraiser is required to describe the project and comment on the effect of the project amenities on value and marketability.

### Project Analysis Section

This section in the condominium appraisal reports includes the appraiser's analysis of the condominium budget, information on fees other than regular HOA fees, how fees compare to similar projects, and whether there are any unusual project characteristics that impact value or marketability.

### Unit Improvements/ Description

- This section of the condominium or cooperative unit appraisals includes information on the subject property:
  - General description of the subject unit, the unit's amenities, appliances, car storage and utilities, and additional features, such as energy-efficient items.
  - Living area, and number and type of rooms.
  - Condition of the property, physical deficiencies or adverse conditions.
  - Conformity to neighborhood
- Appraiser is required to describe the unit and its features and provide comments on impacts to value and marketability.

### Valuation Section

- There are three methods used to determine the estimated market value or final valuation estimate when appraising residential property. The valuation section provides a means for the appraiser to develop and report in a concise format the estimate of market value—based on the applicable cost, sales comparison, and income approaches to value, as applicable for the property. In some cases additional supporting data may be required if the subject property is unique or has some other condition that affects value and marketability.
  - Sales Comparison Approach – In this section the appraiser analyzes the subject property in comparison to the most recent sales of similar properties that are subject to the same influences (location, market influences, financing terms, etc. This approach is the most indicative of market value.
  - Cost Approach -The Cost Approach is not required but may be completed for any appraisal. Appraisals that rely solely on the cost approach are not acceptable.
  - Income Approach – the Income Approach to value is required for appraisals of 2-4 unit properties; however, appraisals that rely solely on the income approach are not acceptable.

### Cost Approach

- Appraisals that rely solely on the cost approach as an indicator of market value are not acceptable.



- This approach may be appropriate for new or proposed construction, properties that are under renovation, properties with unique styles or construction, or properties that have functional obsolescence not typical for the market, and the appraiser must make proper adjustments, if applicable.
- Used mainly on new construction to compare cost within the market, the cost approach to value assumes that a potential purchaser will consider building a substitute residence that has the same use as the property that is being appraised. This approach, then, measures value as a cost of production. The reliability of the cost approach depends on valid reproduction cost estimates, proper depreciation estimates, and accurate site values. The cost approach to value method is the most effective when used with new construction or newly renovated properties. It typically offers no value and therefore is not used with attached properties, as it is not practical to construct only one unit as in attached PUDs, condominiums, or cooperatives.
- Things to look for when reviewing this section:
  - Is the land-to-value ratio typical for the market area?
  - Does the appraiser indicate any functional, physical or economic depreciation? If so, what are the appraiser's comments?

Note: The land-to-value ratio is determined by dividing the value of the land by the total value (land and improvements). The land-to-value ratio will vary based on the geographical area and if the ratio exceeds 30% the appraiser must comment on whether this is typical for the market area. Land/Value ratios are typically higher in beach front/water front properties or highly desired neighborhoods where few vacancies exist.

- As the effective age of a property increases, the reliability of the cost approach may decrease because depreciation estimates may be subjective. The appraiser should use his/her best judgment regarding the applicability of the cost approach when the subject property is older. If the appraiser does not use the cost approach in such cases, s/he must explain why it was not used and provide an estimated site value.
- The appraiser arrives at the indicated value of a property by estimating the reproduction cost of new improvements, subtracting the amount of depreciation from all causes, and adding his/her opinion of value for the site if were vacant and available to be developed to its highest and best use.
- Depreciation: means to lower the value. In appraising real property, there are three types of depreciation that may affect the final value estimate of the property.
  - Physical depreciation (which is traditionally referred to as physical deterioration) represents a loss in value that is caused by deterioration in the physical condition of the improvements. The appraiser will generally classify physical deterioration as "curable" which represent deferred maintenance and "incurable" which represents replacement. The appraiser should be specific with physical depreciation items and if necessary, make recommendations as to repairs, replacement, inspection, etc.
  - Functional depreciation (which is traditionally referred to as functional obsolescence) represents a functional obsolescence or a loss in value that is caused by defects in the design of the structure—e.g., inadequacies in such items as architecture, floor plan, or size and type of room. It can also be caused by changes in market preferences that result in some aspect of the improvements being considered obsolete by current standards.
  - External depreciation (which is traditionally referred to as economic obsolescence) represents an economic obsolescence or a loss in value that is caused by negative influences that are outside of the site, such as economic factors or environmental changes. The appraiser must comment on the reason for the external obsolescence or loss in value.



- In addition to the above, the reproduction cost estimate should reflect the cost of construction based on the current prices of producing a replica of the property being appraised—including all of its positive and negative characteristics. The appraiser's analysis and comments for the cost approach to value should be consistent with comments and adjustments mentioned elsewhere in the appraisal report.

### **Sales Comparison Approach**

- The Sales Comparison Approach is the most indicative of market value. The sales comparison approach to value (traditionally referred to as the market data approach) is an analysis of comparable sales of properties, contract offerings and current listings of properties that are the most comparable to the subject property in the same neighborhood/market area. This value approach is the most commonly used approach to value in mortgage lending.
- Things to look for when reviewing this section:
  - Are the comparable sale properties within one mile of the subject property?
  - Is the sales price of each comparable sale property within the general range of the estimated market value for the subject property?
  - Is there any seller or financing concessions on the comparable sale properties?
  - Is the Date of Sale with corresponding source (contract or settlement date and source of information) listed for each comparable sale property?
  - Are there any Date of Sale or Time Adjustments on the comparable sale properties?
  - Does the room count and gross living area reflect only above grade areas on the subject property and comparable sale properties? (Basements are not considered above-grade improvements and should not be included in the room count or gross living area.)
  - Are there any over-improvements between the subject property and the comparable sale properties?
  - Are there three comparable sale properties that have closed within the last six months?
  - If comparable sale properties are over six months old, has the appraiser provided comments for their inclusion in the report?
  - Are the comparable sale properties similar to the subject property in location, design, size, room count and amenities?
  - Has the subject property been sold in the last twelve months?
  - Are there any adverse comments in the Sales Comparison section?
  - Are the mathematical calculations correct? (Are the adjustments consistent on all comparables? To check the square footage adjustment, calculate the difference in the square footage of the subject property and the comparable and divide the difference into the dollar adjustment given for the square footage line adjustment.)
  - What is the dollar amount used for each comparable sale property's square footage adjustment, if appropriate? Does it appear reasonable?
  - If the property is New Construction, are there comparable sales from a different development? Each comparable sale must be analyzed by the appraiser for the similarities and differences between the comparable sales and the subject property. The appraiser's adjustments must reflect the market's reaction to the differences in the properties.
- The appraiser's analysis must take into consideration all factors that have an impact on value, recognizing that a well-informed/well-advised purchaser will pay no more for a property than the price they would pay for a similar property of equal desirability and utility if it were purchased without undue delay. This is





particularly important in a soft or declining market because the competing current listings and contracts probably reflect the upper-end value of the market for the subject property as the effective date of the appraisal.

### **Sale or Transfer History of Subject and Comparables**

- The appraiser must research, verify, analyze and report the following:
  - Any current agreement for sale on the subject property
  - Any offering for sale of the subject property in the twelve months prior to the effective date of the appraisal.
  - Any prior sales or transfers of the subject property for the three years prior to the effective date of the appraisal.
  - Any prior sales or transfers of each comparable sale for the year prior to the date of sale of each comparable sale.
- Data sources must be provided. The lender should analyze the subject and comparable properties' sales and transfer histories and evaluate the time elapsed between the acquisition dates, resale dates, or date of current resale contract, if applicable. If the sales histories indicate current or prior sale prices may be excessive, or resale dates occurred shortly after acquisition of the property, the appraisal report should provide evidence to support a rapidly appreciating real estate market, indicate if there were significant improvements that resulted in a corresponding increase in the property value, or there was a previous sale that was below market value due to a distress or tax sale.

### **Comparable Sale Properties**

- The Sales Comparison Approach includes the number of comparable properties currently listed for sale or sold within the past twelve months in the subject's neighborhood, and the applicable price ranges. Appraiser should comment if the subject property value is outside of these ranges.
- The appraisal should contain a minimum of three closed comparable sales to support value. Comparable sale properties are those that have sold and closed within the last six months. Comparable sales that are more than 6 months old must be accompanied by an appraiser explanation for their use. The properties should be located in the neighborhood area of the subject property and closely resemble the subject property in site, size, structure, number of rooms and amenities. If the appraiser utilizes comparable sales outside of the subject's neighborhood when closer comparable sales appear to be available, s/he must provide an explanation of why they used the specific comparable sales. Properties that are listed for sale and sales that have not closed may be added as additional comparables only.

### **Foreclosure and Short Sale Properties as Comparables**

- If a foreclosure sale or a short sale is used as a comparable, the appraiser cannot assume it is equal to the subject property and must identify and consider all differences, such as the property condition and whether any stigma has been attached to the property.
- All data and/or verification source(s) for each comparable sale must be identified. A single source may be used to gather the data and verifications if the source provides quality sales data that can be publicly confirmed or verified as a closed or settled transaction. Multiple sources may also be used if they are needed to adequately verify the comparable sales. The quality of the data available varies from source to source and from one locality to another.





### **Comparable Sales for Properties in Existing Established Subdivisions, Condos, or PUDs**

- Comparable sales from within the same subdivision or project as the subject property must be used if the subdivision or project has resale activity, since resale activity is the best indicator of value for properties in that subdivision or project. Note: Use of comparable properties located outside of the established subject neighborhood must be explained in the appraisal analysis, and the appraiser may not include sales that were influenced by the subject property's developer, builder or seller.

### **Comparable Sales for Properties in New or Recently Converted Subdivisions, Condos, or PUDs**

- If the subject property is located in a new (or recently converted) condo project, subdivision, or PUD, it must be compared to other properties in the same market area and to properties within the subject condo project subdivision, or PUD. This comparison should help demonstrate market acceptance of new developments and the properties within them. Generally, a subdivision is considered new when there are limited or no resales or the builder or developer is involved in the marketing or sale of the properties.
- At a minimum, the appraisal report for these properties must include the following:
  - At least one settled comparable sale from the subject condo project, subdivision, or PUD. (A resale is preferable if it is verifiable and does not involve the subject builder or developer).
  - At least one settled comparable sale from outside the subject condo project, subdivision, or PUD.
  - A third settled comparable sale can be from inside or outside of the subject condo project, subdivision, or PUD. Settled comparable sales or resales from within the subject condo project, subdivision, or PUD are preferable to settled sales from outside the condo project, subdivision, or PUD provided the builder or developer of the subject property is not involved in those transactions.
  - In the event there are no settled comparable sales inside a new condo project, subdivision, or PUD because the subject property transaction is one of the first units to sell, the appraiser may use two pending sales in the subject project, subdivision, or PUD in lieu of one settled sale. The appraiser must also use at least three settled comparable sales from projects, subdivisions, or PUDs outside of the subject project, subdivision, or PUD.
- If the subject property is part of a newly built or recently converted condo project, subdivision, or PUD that has 2-20 units and there are no settled or pending sales, the appraiser may use comparable sales from a competing project, subdivision, or PUD. The requirements in the following must apply.
- The appraisal report must...
  - Use competing projects, subdivisions, or PUDs of a similar size and type.
  - Explain why the comparable sales were chosen and demonstrate market acceptance.
  - Describe how the condo project, subdivision, or PUD chosen compares to the subject property.

Note: If the subject property is not the first unit under contract in the condo project, subdivision, or PUD, the appraiser must include one under contract sale from the subject's project, subdivision, or PUD as a supplemental exhibit.

- To meet the requirement that the appraiser utilize one comparable sale from inside the subject project, subdivision, or PUD, the appraiser may need to rely solely on the builder of the property they are appraising, as this data may not yet be available through typical data sources (for example, public records or multiple listing services). In this scenario, it is acceptable for the appraiser to verify the transaction of the comparable sale by viewing a copy of the settlement statement from the builder's file.



- When providing builder sales from competing projects that are not presently available through traditional data sources, the appraiser must verify the sale from the applicable settlement statement and indicate on the appraisal report that the settlement statement was the document utilized for verification. Additionally, the appraisal must include discussion and analysis of sales concessions and upgrades for the subject property relative to concessions and upgrades for each builder sale.
- Gross Living Area (1-unit properties): The gross living area is the square footage of the improvements excluding basements or improvements below grade (underground or partially underground). Above-grade gross living area is the most commonly used comparison for one-unit properties (including units in PUD, condominium, or cooperative projects). The following dimensions should be used to calculate above-grade gross living area.
  - Units in condominium or cooperative projects: The interior perimeter unit dimensions should be used to calculate the above-grade living space.
  - One-unit properties & units in a PUD: The exterior building dimensions per floor should be used to calculate the above-grade gross living area.
- Only finished above-grade areas should be used—garages and basements (including those that are partially above-grade) should not be included. A level is considered to be below-grade if any portion of it is below-grade—regardless of the “finish” or the window area of any room. Because rooms not included in the above-grade room count may add substantially to the value of a property, the appraiser should report the basement or other partially below-grade areas separately and make appropriate adjustments.
- To ensure consistency in the sales comparison analysis, the appraiser should compare above-grade areas to above-grade areas and below-grade areas to below-grade areas. However, the appraiser may deviate from this approach if the styles of the subject property or any of the comparables do not lend itself to such comparisons. Explanation for the deviation is required and a clear description of comparisons that were made is required.
- Gross Building Area (2-4 unit properties): The most common comparison for two-to-four unit properties is gross building area. Gross building area is defined as the total finished area (including any interior common areas, such as stairways and hallways) of the improvements based on exterior measurements. It should include all finished above- and below-grade living areas, counting all interior common areas, but not exterior common areas or unfinished areas.
- Adjustments to Comparable Sales: Each comparable sale that is used in the sales comparison approach to value must be analyzed for differences and similarities between it and the property that is being appraised. Analysis should be based on the market data for the particular neighborhood for the competing locations—not on predetermined or assumed dollar adjustments.
  - Proximity to Subject Property and Location: UAD Requirement: The proximity of the comparable sales to the subject property must be indicated in miles and include the applicable directional indicator (for example, “1.75 miles NW”).
  - Date of Sale or Time Adjustments: UAD Requirement: For each comparable sale, the appraiser should provide the month and year of the sales contract indicated with a “c” (for example, “c02/11”), and the settlement or closing date indicated with an “s”, (for example, “s04/11”). If the contract date is unavailable, appraiser may indicate “Unk” for unknown.
- Comparable sales must be adjusted to the subject property—except for sales and financing concessions, which are adjusted to the market at the time of sale. The appraiser should provide comparable sales that sold without concessions to support the adjustments made in determining the market reaction to the concessions. If comparable sales without concessions are not available, adjustments to comparable sales



with concessions must reflect the differences between what the comparable sales actually sold for with the concessions and what they would have sold for without the concessions. The appraiser's opinion of value must reflect the value of the subject property without the concessions. The appraiser must make appropriate adjustments for location, terms and conditions of sale, date of sale, and the physical characteristics of the property. If the appraiser determines that time adjustments are required, the adjustments must reflect the difference in market conditions between the date of sale of the comparable and the effective date of the appraisal for the subject property.

- The subject property is the standard against which the comparable sales are evaluated and adjusted. Thus, if an item in the comparable property is superior to that in the subject property, a negative adjustment is required to make that item equal to that in the subject property. Conversely, if an item in the comparable property is inferior to that in the subject property, a positive adjustment is required to make that item equal to that in the subject property. If an item in a comparable property is equal to that in the subject property, no adjustment is necessary.

### **Quantitative Sales Comparison Analysis**

- The quantitative sales comparison analysis requires the appraiser to assign a dollar value to reflect the market's reaction to any feature of the comparable sales that differ from those of the subject property. The proper selection of comparable properties minimizes both the need for, and the size of, any dollar adjustments. However, when there are no similar or truly comparable sales for a particular property—because of the uniqueness of the property or other conditions—the appraiser must select comparable sales that represent the best indicators of value for the subject property and make adjustments to reflect the actions of typical purchasers in that market. Dollar adjustments must reflect the market's reaction to the difference in the properties, not necessarily the cost of the difference.
- When a quantitative sales comparison analysis is used, the amount of the negative dollar adjustment for each comparable with sales or financing concessions should be equal to any increase in the purchase price of the comparable that the appraiser determines is attributable to the concessions.
- Value Adjustments: The addition or deduction of value to the comparable. It demonstrates the differences and similarities between the subject and the comparable.
  - A value adjustment on a single line item (referred to as a line adjustment) normally should not be more than 10% of the property's sale price. While line adjustments are no longer considered a standard measurement, they can be valuable in denoting unusual adjustments that may indicate a further explanation/justification is required.
  - The net adjustment is the total of all the value adjustments for a comparable sale property by adding all adjustments to that comparable property taking into account the plus (positive number or value additions) or minus (negative number or value deductions) and dividing it by the sales price of the comparable sale. The dollar amount of the net adjustments for each comparable sale should not exceed 15% of the sales price of the comparable.
  - The gross adjustment is the sum of all value adjustments to a comparable sale property without regard to whether the value adjustment is a plus or minus (positive or negative number) and dividing that by the sales price of the comparable sales price. The dollar amount of the gross adjustments for each comparable sale should not exceed 25% of the sales price of the comparable.
  - When the adjustments exceed either of the above, the appraiser must comment on the reasons for not using a more similar comparable. Individual adjustments that are excessively high should be explained by the appraiser and reviewed carefully by the underwriter. In some circumstances, the



use of comparables with higher-than-normal adjustments may be warranted, but the appraiser must satisfactorily justify his/her use of them.

### **Qualitative Sales Comparison Analysis**

- Some appraisals enable the appraiser to use a relative or qualitative sales comparison analysis instead of providing actual dollar adjustments to reflect the differences in features between each of the comparable sales and the subject property, by indicating the market's reaction to any significant variations for each feature listed in the "sales comparison analysis" grid. The "paired" data analysis comparison logic, which is consistent with the way that buyers and sellers typically evaluate the differences between properties, is similar to the logic required by other appraisal forms. However, in this case, the appraiser does not have to quantify and report the market's reaction by assigning a dollar value to each variation.
  - If a feature of a comparable sale is superior to, or more favorable than, the same feature for the subject property, the appraiser should report a negative (-) relationship.
  - If a feature of a comparable sale is inferior to, or less favorable than, the same feature for the subject property, the appraiser should report a positive (+) relationship.
  - If a feature of a comparable sale is equal to the same feature for the subject property, the appraiser should report an equal (=) relationship.
- In the overall comparison of the subject property and the comparable sales, the appraiser must take into consideration the value relationships for each of the features of the properties, and, for each comparable sale, the appraiser must indicate whether the property is superior, equal, or inferior to the subject property. In developing his/her opinion of the market value of the subject property, the appraiser should give the most weight to the comparable sales that are the most similar to the subject property based on the relative comparison analysis.

### **Income Approach**

- The Income Approach to value is required for appraisals of 2- to 4-unit properties, but may not be relied upon as the sole indicator of market value.
- When the income approach to value is used, the appraisal report must include the supporting comparable rental and sales data, and the calculations used to determine the gross rent multiplier.
- The income approach to value is based on the assumption that market value is related to the market rent or income that a property can be expected to earn. This approach is not generally appropriate in areas that consist of mostly owner-occupied properties since adequate rental data would not typically exist for the area. It is more frequently used in neighborhoods that consist of single-unit rental properties where there is a substantial rental market with available rental data.
- To arrive at the indicated value, multiply the total gross estimated monthly market rent for the subject property by a reconciled gross monthly rent multiplier. Appraisers must use their best judgment regarding the applicability of the income approach. However, an example in which the income approach may not be an appropriate indicator of value involves the appraisal of a two-unit property in a neighborhood that is dominated by owner-occupied two-unit properties. In such cases, the appraiser does not need to develop a gross monthly rent multiplier, but must still report the estimated market rent for the subject property.



## **PUD Section**

- The PUD section provides additional information on the planned unit development in which the subject property is located. If the subject property is not located in a PUD or subdivision, completion of this section is not required.
- Things to look for when reviewing this section:
  - Is the developer/builder in control of the homeowners' association?
  - What are the common elements?

## **Reconciliation of Value**

- It is the appraiser who must provide us with the final reconciliation. The reasonableness and reliability of each approach to value and the reasonableness and validity of the indicated values and the available data, then the selection of the approaches that were given the most weight determine the reconciliation of value. The reconciliation of value is not an averaging process; it is an ongoing process throughout the appraiser's analysis of the data.
- Typically, in appraising owner-occupied properties, the most reliable market data is the comparative sales approach because it reflects the current market acceptance of property values with current listings supporting the trend of increased, stable or decreasing values.
- Things to look for when reviewing this section:
  - Is the final value estimate based on "as is" or "subject to"?
  - Is the appraisal less than 120 days old?
  - Did the appraiser indicate any repairs were needed or recommended? Inspections?
  - Does the final value estimate support the sales price?
  - Is the appraisal signed and dated?
  - Is the appraiser's license or certification number on the appraisal report?
  - Is the appraiser on the watch list?

## **Lender Reconciliation of Multiple Opinions of Market Value**

- If the Lender provides multiple appraisal reports with conflicting values, either because the Investor or Loan Program requires it or there is a quality issue, a rationale for the second appraisal report including reconciliation as to why one value conclusion was deemed more appropriate than the other must be provided.

## **Appraisal Revisions**

- There are times when appraisal revisions are warranted (e.g., substantial changes in the terms of the sale, a substantial change in the building, plans/specifications, changes in legal description or boundaries, corrections requested by the underwriter, etc.). When a revision is warranted, the appraiser must describe in writing what revisions were made and provide a new original appraisal or addenda with original and/or digital signatures.
- All appraisal revisions must comply with Appraiser Independence Requirements (AIR); Fannie Mae Single Family Selling Guide and the Freddie Mac Single Family Seller/Servicer Guide via AllRegs, and Uniform Standards Professional Appraiser Practice.
- If a field review or new appraisal is obtained, a FCM approved appraiser or agent that is not affiliated with the fee appraiser's firm/agency under scrutiny must complete the field review or new appraisal. If a change





in value is warranted, the review appraiser must complete the assignment according to Standard 3 of the Uniform Standards Professional Appraiser Practice.

- If the initial appraisal report was not rejected, as discussed in the above section, but a second or subsequent appraisal report or an appraisal field review report is obtained, the lender must determine whether the opinions of market value are equally accurate and well-supported. If all of the appraisal/field reports are deemed accurate and well-supported, then the lowest of the opinions of market value must be used to underwrite the mortgage.

### **Prior Listings of the Subject Property**

- The appraiser must research and comment on whether the subject property is currently for sale or if it has been listed for sale within 12 months prior to the effective date of the appraisal citing data source, offering price and date. If the property is listed for sale more than once in the prior 12 months, the appraiser must cite each occurrence with data sources, offering prices and dates.

### **Supervisory Appraisers**

- Although the USPAP allows an appraiser who does not have the appropriate knowledge and experience to accept an appraisal assignment by providing procedures by which the appraisal can be completed, FCM requires use of appraisers who have the appropriate knowledge, experience and does not allow this USPAP flexibility.

### **Exhibits**

- The Exhibit section contains the mandatory supporting exhibits and may include other exhibits that the appraiser provides to assist in understanding the subject property's market area or unusual or positive factors regarding the subject property.
  - One of the more important exhibits is the appraiser's addendum, which is used to provide further explanation or justification for the inclusion of factors/improvements, exclusion of factors/improvements, or methodology used by the appraiser in the determination of the final value estimate. It is our responsibility to assess the risk related to factors/improvements and the determination of a lending value. The appraised value is the appraised value; however, the value used for determination of the loan-to-value, thus the loan amount to be financed is determined by the risk assessment.
  - The sketch and livable square footage calculation should be compared to the photographs and the written appraisal report.
  - The Statement of Living Conditions and Appraiser's Certification is a required form and there should be no changes to the form—only the blanks completed. Any applicable appraisal management company should be reported in this Appraiser's Certification section.
  - The location map should have the subject property's location as well as the comparable sale properties identified so the Credit Analyst can determine the proximity of comparable properties to the subject.
  - The plat map or survey should prove the boundaries of the subject property's site. Note: Although it is not required to be provided with all appraisal reports, a plat map or survey of the subject should be included if it is referenced in the appraisal report or requested by the underwriter to support legal or lot size information contained in the report.





- The photographs should include a front, rear and street scene of the subject property and the front of each comparable property. For FHA loans, oblique photos are required (front/side and rear/side).
- Things to look for when reviewing this section:
  - Do the addenda clarify/explain sufficiently to support the final estimate of market value?
  - Do the addenda contain any adverse comments?
  - Is there a sketch of the improvements?
  - Is there a street map that identifies the locations of the subject property and comparables?
  - Are there correct photographs?

### **Termite Certifications**

- If required, the termite (pest) inspection report must indicate that the subject property has been inspected and found to be free of active infestation from termites and other insects. If property damage is observed, any repairs required must be satisfactorily completed with evidence documented in the loan file prior to loan closing.
- If termite infestation/damage is noted on the Sales Contract or the Sales Contract Disclosure, the appraiser should address within the appraisal report and the underwriter must make the determination if an inspection is necessary.
- For conventional loans:
  - A termite inspection is required only if the appraiser addresses that there is an infestation problem.
  - If live infestation is present, treatment along with documented evidence of the treatment must be received prior to closing.
  - If minor and/or cosmetic damage is observed, a hold harmless agreement signed by the borrower must be received.
  - If major and/or structural damage is observed, a licensed contractor must determine the extent of the damage. Repairs must be satisfactorily completed with evidence received prior to closing.
  - If there is evidence of previous infestation, but no damage is observed, a hold harmless agreement signed by the borrower must be received.

### **Appraisal Requirement > \$2.0MM**

- If the loan amount is > \$2.0MM, 2 appraisals are required.
  - Ordering both reports from the same company, vendor, or agent is expressly forbidden. If two appraisal reports are required, FCM requires the two reports to be ordered from two different Appraisal Management Companies (AMC). Note: In some circumstances, that may not be possible, including in cases where a Correspondent Lender may only work with one AMC. In those instances, it may be necessary for one AMC to order the two appraisal reports. However, the independence of the appraiser/ appraisal process must be maintained at all times by all parties.
  - If two appraisals are required the lesser of the two values should be used to underwrite the transaction and determine LTV/CLTV/HCLTV, unless FCM reviews both and determines the higher value is more accurate.
- All appraisal reports that are more than 120 days old as of the Note/Mortgage require a recertification of value/update that includes an exterior inspection of the property and a review of current market data to confirm that the property has not declined in value since the date of the original appraisal.



## **Disasters - Natural & Man-made**

Widespread disasters can occur at any time with little or no warning. They may damage properties securing current or proposed loans.

Disasters may or may not be officially declared by a governmental body and can include, but are not limited to:

Natural:

Hurricanes/Tropical Storm/Tsunamis

Flood/Mudslides

Tornado

Forest Fire/Wildfires

Earthquakes

Pandemic Event

Man-Made:

Chemical Spills/Attacks

Biological Attacks

Terrorist Attack

Transportation Accidents

Nuclear Plant Accidents

Cyber Attacks

Correspondents must have a process in place for identifying disaster areas and potential impact to properties that are the subject of loans proposed for sale

Delegated and Non-Delegated Transactions:

When a property is located in a disaster impacted area, the Lender must take appropriate steps, including a property inspection, to determine if the transaction continues to meet policy. For loans located in a disaster area that are in the pipeline and have not closed, the Lender is responsible for determining whether the property was damaged by the disaster. If the Lender determines that the property has been damaged such that the damage impacts the safety, soundness, or structural integrity, the property is not acceptable as security for the Mortgage and the loan may not close. If a property is located in a condo or co-op project, both the conditions of the unit and the condition of the building in which the unit is located must be assessed.

### **APPRAISAL REQUIREMENTS FOR LOANS IN PROCESS**

Appraisal Not Yet Received	If the appraisal was not yet completed, a full appraisal with interior and exterior photos must be obtained
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Appraisal Has Been Received	<p>If we have an appraisal and the loan has not been purchased by, a Property Inspection or Property Condition Report is required to ensure the property has not been damaged.</p> <p>Acceptable report types are:</p> <ul style="list-style-type: none"><li>• Property Condition Report (PCR)</li><li>• Fannie Mae 1004D/Freddie Mac 442</li><li>• Form 2075 Property Inspection Report</li><li>• Form 2070 Property Condition &amp; Marketability</li></ul>
If Appraisal and Property Condition Report Reveals No Damage	If property was unaffected by the disaster, loan closing can proceed
If Appraisal or Property Condition Report Reveals Damage	<p>If there is evidence that the property sustained damage, both interior and exterior photographs must now be obtained so that the underwriter can determine the extent of the damage and the effect it may have on value. If the underwriter/Correspondent determines the extent of the damage is unacceptable by FCM standards, the loan may not be closed until the property has been repaired to acceptable standards and a completion certificate prepared by the original appraiser, with interior and exterior photographs provided. The value, for LTV purposes, may not exceed the value of the original appraisal. If value does exceed original appraisal, a new 1004 appraisal must be ordered from a different appraiser.</p> <p>If Damage does not affect the Safety, Soundness, or Structural Integrity of the Property AND Repair Items Are Covered by Insurance: Obtain documentation of the professional estimates of the repair costs and ensure that sufficient funds are available for the borrower's benefit to guarantee the completion of the repairs. Upon receipt and confirmation, the loan may close.</p> <p>If Damage is Uninsured or the Damage Affects Safety, Soundness, or Structural Integrity of the Property: The property must be repaired before the loan is closed.</p>

- Vendors may use differing proprietary forms for Property Condition Reports since Fannie Mae/Freddie Mac do not have standardized form for this event. Property Condition Reports must include, at a minimum, an exterior inspection and are typically completed by a licensed real estate professional or inspector. However, they may also be completed by the original appraiser or another licensed appraiser.
- When the subject property has been identified as being in a FEMA disaster area the above Appraisal Policies apply for 60 days following the disaster end date or through the FEMA issued end date, whichever is longer. If no end date has been issued by FEMA, follow the below policy for 60 days following the disaster incident date.
- Age of Credit Documents: All credit and capacity underwriting documentation, DU submission documents, and appraisal reports may be dated up to 180 days prior to the Note Date.
- Reminder: The Agency Rate/Term Refinance for Disaster Impacted Properties (refer to topic in Section 810-Eligible Transactions) permits the refinance/payoff of nonpurchase money subordinate liens that were obtained to finance disaster-related property repairs, and permits a higher cash-out amount to reimburse borrowers for documented out-of-pocket expenses for disaster-related property repairs.



## **Eligibility/Requirements**

### **Borrower Eligibility**

FCM will only purchase Loans extended to individual applicants/borrowers. Each transaction is limited to no more than four applicants/borrowers. When determining which applicants are considered to be primary and secondary, we use the order in which the applicants are listed on the application. An applicant is defined as one who applies for funds in the form of a loan secured by real property with the obligation of repaying the debt in full, with interest. The borrower is the individual obligated to repay the loan secured by the mortgaged premises. For a Loan to be eligible for purchase by FCM, the Loan applicant(s) must conform to certain eligibility requirements. These requirements adhere carefully to the Equal Credit Opportunity Act (ECOA). In no case will we use factors defined as “prohibited” by ECOA in determining an applicant’s eligibility

### **Borrower**

- CMI provides lending solutions for U.S. Citizens and non-U.S. Citizens. All non-U.S. citizen borrowers must have the legal right to be present in the United States. CMI considers a borrower to be “legally present” in the U.S. eligible for FCM mortgage lending programs if s/he has:
  - A valid Social Security Number (SSN)
  - A current approved immigration status or an accepted Visa; or
  - A current, valid employment authorization document (EAD), with an approved immigration status.
- Transactions with an ITIN are not eligible for purchase through the Correspondent Lending Channel or Trade Desk.
- Program eligibility is based on the borrower’s status (NPR or NR) and what type of income or income source is being used to qualify (Employment or
- Non-employment). Refer to the corresponding sections of the Correspondent Manual for additional requirements.
- There are individuals to whom credit cannot be extended under any circumstances. Loans to the following are not permitted:
  - Applicants acting as vendors providing services on their personal loan that is being originated or sold to FCM. Example: FCM-approved appraiser may not appraise the collateral property on their own loan.
  - Illegal Aliens: People residing in the U.S. without permission — illegal aliens — are not eligible for a FCM mortgage. Illegal aliens typically fall into one of two categories:
    - An individual who entered the U.S. illegally (includes individuals who have entered the U.S. by means of false documents).
    - An individual who entered the U.S. legally — as a Non-Permanent Resident — but remained after the period of time permitted for temporary residency.
  - Individuals with a Visa Classification of (A-1, A2, A-3 & C-1, C-2, C3, C-4) are not eligible
    - A-1 & A-2: Foreign Diplomatic Personnel, individuals with diplomatic immunity.
    - A-3: Employee of Foreign Government Official (usually referred to as attendants, servants, or personal employee of foreign government officials)
    - C-1: Aliens in transit
    - C-2 & C-3: Foreign government official in transit.
    - C-4: Aliens in transit without a Visa
  - Non-U.S. Citizens that do not meet eligibility requirements



## **Proof of Residency Status Verification Requirements**

- Non-U.S. Citizen applicants must provide proof of residency status (i.e., visa classification or EAD Category). FCM should always ask for and make a copy of a picture identification to verify a borrower's residency status.
- Determining Eligibility
  - The individual visa classification or EAD Category will determine the lending program for which the borrower is eligible. Refer to the Visa Classification Chart (Exhibit 12) and/or the EAD Code Definitions & Eligibility Chart (Exhibit 12A) for a list of visa classifications, category codes, descriptions, and mortgage eligibility. Detailed lending parameters for each classification/category (i.e., Permanent Resident, etc.) follow this list:
    - PR = Permanent Resident
    - NPR = Non-Permanent Resident
    - NR = Non-Resident
- Expired Visa
  - If an applicant's visa documentation or EAD has expired, the applicant must provide USCIS documentation to evidence that:
    - Applicant has applied for an extension prior to the expiration date of the visa or EAD; and
    - Evidence that the application for extension has been received by the USCIS.
- Non-English Speaking Applicants/Documents
- Documentation that is supplied by an applicant in a foreign language must be translated into English. The applicant or any interested party to the transaction may not translate the documents. The translated document must be submitted and attached to the original document or a copy of the original document in the loan file.

## **Determining Eligibility**

- The individual visa classification will determine the eligibility of the borrower. Refer to the Immigration Classification Chart in the Exhibits section as Exhibit 12.

## **Permanent Resident**

- A Permanent Resident (PR) is defined as an individual who, though not a U.S. citizen, is granted the right to work and live permanently in the United States. The U.S. Citizenship and Immigration Services (USCIS) refer to these individuals as immigrants.
- In addition to the above, refugees and others who are seeking political asylum — which is immigrating to, and seeking permanent residency in, the United States — also fall under the PR classification. The USCIS has special immigration programs that enable these individuals to seek (and accept) employment while they are in the process of obtaining their PR status. A process that generally takes two to three years.
- All PR are entitled to the same rights, products, programs, and lending parameters available to U.S. citizens.
- The mortgage must satisfy our basic underwriting guidelines — either standard guidelines or those that apply to borrowers who qualify for our community lending products — with respect to income stability and continuity, credit history, and cash reserves. The borrower must be employed in the United States — and the source of income must be verified and expected to continue for three years. A two-year credit and income history is required. However, additional credit, asset, and income references needed to make an informed credit decision may be obtained from a foreign country if the borrower has not been employed



two full years in the U.S. Only documentation that satisfies the same basic standards for authenticity, accuracy, and completeness that applies to other types of documentation should be considered.

- Evidence required to demonstrate one's legal right to live and work in the United States includes one of the following:
  - I-551: Permanent Resident Card (Alien Registration Receipt Card/"Green Card"); or
  - I-551: Conditional Permanent Resident Card (Conditional Alien Registration Receipt Card); or
  - Unexpired Foreign Passport: Must contain an unexpired stamp reading: "Upon endorsement, serves as temporary I-551 evidencing permanent residency for one year"
- This stamp serves as temporary evidence of permanent residence status. Also refer to the Proof of Residency Status Verification Requirements topic for further information.
- In addition to the above, an individuals with one of the following special visa classifications are also eligible for the same Permanent Resident guidelines:
  - Refugees
    - Form I-94 stamped with employment authorization, or;
    - Foreign Passport stamped "Admission for Permanent Residence" with an unexpired date or an Employment Authorization Document.
  - Asylee
    - Form I-94 stamped with employment authorization, or;
    - Copy of Employment Authorization document.

### **Non-Permanent Resident**

- A Non-Permanent Resident (NPR) is defined as an individual who is granted the right to live and work in the United States for a fixed period of time and for a specific purpose. The USCIS uses the word "non-immigrant" to describe these individuals.
- Note: There are certain visa and EAD Category types that the USCIS may classify as a NPR; however FCM may view the classification/category to present an excessive risk. In these instances, the borrower or co-borrower may not be eligible under the Non-U.S.Citizen guidelines, although they may be eligible under our Non-Resident program guidelines.
  - Refer to the Visa Classification Chart (Exhibit 12 in the Exhibits section 2400) for a list of visa classifications/category codes and mortgage program eligibility.
- Approved NPRs are eligible for financing under the same terms (product, transaction type, occupancy status, and loan-to-value ratio) that we offer to U.S. citizens and Permanent Residents, provided the following guidelines are met.
- An approved NPR borrower/co-borrower whose employment income (i.e. Wager Earner, Self-Employed, etc.) is used to qualify on the loan must:
  - Be legally present in the United States (Refer to the Borrower topic in this section.); and
  - Currently reside in the United States. However, there are no minimum requirements with regards to that length of time; and
  - Be employed in the United States. Source of income must be verified and expected to continue for three years; and
  - Have a two-year work history. Additional employment and income references may be obtained from a foreign country if the borrower has not been employed two full years in the U.S. Only documentation which satisfies the same basic standards for authenticity, accuracy, and completeness that applies to other types of documentation should be considered; and





- Satisfy our basic underwriting guidelines. Either standard guidelines or those that apply to borrowers who qualify for our community lending products — with respect to income stability and continuity, credit history, and cash reserves. Additional credit and asset references needed to make an informed credit decision may be obtained from a foreign country. Only documentation which satisfies the same basic standards for authenticity, accuracy, and completeness that applies to other types of documentation should be considered; and
- Provide evidence demonstrating their legal right to work in the United States, which includes:  
Employment Based Immigrant
  - A copy of an USCIS I-94 card/I-94 documents (Form I-94, Arrival/Departure Record is issued to aliens who are Admitted to the U.S, Adjusting their status while in the U.S., or Extending their stay) as provided through US Customs & Border Protection division website to prove their right to work in US; or
  - A copy of an Employment Authorization Document (EAD)<sup>1</sup> as evidenced by an I-766 card containing the applicant's photograph
- Family Sponsored Immigrant & Visa Lottery Winner
  - A copy of an USCIS I-94 card/I-94 documents as provided through US Customs & Border Protection division website to prove right to work in US; or
  - A copy of an Employment Authorization Document (EAD)<sup>1</sup>
- NACARA (Nicaragua, Cuba, Guatemala, El Salvador) Beneficiaries
  - A copy of an USCIS I-485 (Application to Register Permanent Residence or Adjust Status) or USCIS I-881 card; or (Application for Suspension of Deportation or Special Rule Cancellation of Removal)
  - A copy of USCIS Form I-797<sup>2</sup> issued by an USCIS Service Center as evidence of filing I-485 or I-881; or
  - A receipt from an USCIS District Office confirming USCIS I-485 or I-881 has been filed.
- 1 The Employment Authorization Document (EAD) contains a “category code” found on the face of the EAD. That category code refers to the regulation section which is the basis for issuing the EAD. The EAD Code Definition provides information regarding what categories of aliens or classes of admission (COA) fall under the particular EAD code. This category code/EAD code definition on the EAD card may be used to determine the Visa classification, if applicable. NOTE: Not all EAD Category Codes are tied to/associated to a Visa classification). Refer to the EAD Code Definitions & Eligibility Chart for translation of the category codes.
- 2 USCIS uses numerous types of Form I-797 to communicate with applicants/petitioners or convey an immigration benefit. Refer to the USCIS website for further information: <https://www.uscis.gov/forms/filing-guidance/form-i-797-types-and-functions>
- EAD’s with Category Code C33 (an alien who has been granted Deferred Action for Childhood Arrivals – DACA) are eligible for programs as an NPR. Note: As this category code does not have a corresponding Visa classification, it will not be found on the Visa Classification Chart.
- The Visa classification and/or EAD Category Code determines the lending program for which the borrower is eligible. Once the Visa classification or EAD Category Code has been determined, the Visa Classification Chart (Exhibit 12, in Section 2400) or EAD Codes & Eligibility Chart (Exhibit 12A) should be used to determine the program for which the borrower is eligible. If the EAD category code is tied to/associated to a specific Visa classification, documentation supporting that Visa is required.
- Refer to the Proof of Residency Status Verification Requirements section above.



- Reminder: The employment income of a borrower/co-borrower who has NOT been granted the right to work in the U.S may NOT be considered as qualifying income.
- An approved NPR borrower/co-borrower who is using non-employment income (i.e. checking, savings, money market, retirement, etc) to qualify for the loan must:
  - Be legally present in the United States. Refer to the Borrower topic above; and
  - Currently reside in the United States. However, there are no minimum requirements with regards to that length of time; and
  - Satisfy our basic underwriting guidelines. Either standard guidelines or those that apply to borrowers who qualify for our community lending products—with respect to credit history, and cash reserves. Additional credit and asset references needed to make an informed credit decision may be obtained from a foreign country. Only documentation which satisfies the same basic standards for authenticity, accuracy, and completeness that applies to other types of documentation should be considered; and
  - Provide evidence demonstrating their legal right to live in the United States, which includes:
    - Employment Based Immigrant/NACARA Beneficiary
      - I-485 (Permanent Resident Application) or I-881 (for NACARA beneficiaries from Guatemala and El Salvador); and
      - I-797 or receipt from an USCIS District office confirming the I-485 or I-881 has been filed.
    - Refugee/Asylee
      - I-485 with receipt from local USCIS office; and
      - I-94 or I-94 documents as provided through US Customs & Border Protection division website to prove right to work in US stamped with refugee or asylee status.
- Note: I-485 is required when a person has applied to adjust status or register for Permanent Residency.
  - Family Sponsored Immigrant
    - Approval on form I-797 for a form I-130 (Petition for Alien Relative) with receipt from local USCIS office; or
    - Receipt from local USCIS office showing form I-130 & I-485 filing.
  - Visa Lottery Winner
    - Confirmation from local USCIS office that I-485 has been filed; and
    - Copy of a letter from the State Department giving notification of selection as a visa lottery winner.

Note: Form I-797 referenced in the above Non-Permanent Resident section may contain a letter A, B, C, etc. For additional clarification refer to: <https://www.uscis.gov/i-797-info>.

### **Separated Borrower**

- If borrowers are separated, you must obtain the necessary documentation to determine the division of assets, liabilities, and potential obligations.
- If the borrower is legally separated, a copy of the legal separation agreement is required in order to exclude specific joint obligations that would otherwise be included in the borrowers qualifying ratios.
- If the borrower is not legally separated, additional documentation is not required; the borrower should be considered a married individual. All joint obligations must be included in qualifying ratios and the non-borrower spouse must sign the Security Instrument, if required by state law.



## **Living Trust/Inter Vivos Revocable Trust**

- An inter vivos revocable ("living") trust is a trust that:
  - An individual creates during their lifetime;
  - Becomes effective during their lifetime; and
  - Can be changed or canceled by its creators at any time, for any reason, during the individual's lifetime.
- A trustee of a living trust is the only trust entity that is eligible for consideration as an applicant for a mortgage loan. FCM will accept inter vivos revocable trusts as eligible borrowers for conventional first mortgages secured by 1-4 unit owner-occupied principal residences, 1-unit second homes, and 1-4 unit agency salable investment properties—which include condominiums, PUDs and coops—as long as the eligibility and documentation requirements outlined in this section are satisfied.
- Although there may be differences from one state to another in laws governing or affecting inter vivos revocable trusts, including the rights of beneficiaries under the trust, the lender is responsible for ensuring that the trust meets the requirements established in this section. Minor variances based on individual state law are acceptable provided, under relevant state law, FCM's rights are fully protected (thus assuring that full title to the property is properly vested should we need to initiate foreclosure proceedings). Title insurers must be willing to provide full title insurance coverage (without exceptions for the trust or the trustees) for the inter vivos revocable trusts in that state.

## **Definitions**

- **Beneficiary:** The party that benefits from the property held by the living trust. The primary beneficiary must be a grantor/trustor/settlor.
- **Grantor/Trustor/Settlor:** The person(s) who established or created the living trust and contributed the property directly to the trust. The use of the term grantor, trustor, or settlor depends on the state where the living trust was created or originated.
- **Inter Vivos Revocable Trust:** Inter vivos is the Latin term for "between the living." Therefore, it is a trust that an individual creates and which becomes effective during the creator's lifetime, but which can be changed or canceled at any time for any reason during his/her lifetime.
- **Revocable:** A living trust is referred to as "revocable" when the grantor/trustor/settlor can change or cancel it at any time, for any reason, while s/he is living. This ability to revoke the living trust is important because it allows the grantor/trustor/settlor, who would otherwise own the property directly, to retain control of the property.
- **Note:** Although it is not necessary that the living trust be called "revocable", FCM requires that a living trust be revocable and that the living trust agreement contain specific language giving the grantor/trustor/settlor the power to revoke it.
- **Trustee:** A person who holds or controls property and manages it for the benefit of another (the beneficiary). Under a living trust, the person who, according to the living trust agreement, has been granted the power to mortgage the subject property and administer the living trust. The trustee(s) must be or must include a grantor/trustor/settlor, or an institutional trustee (i.e., bank, trust company, attorney) that customarily performs trust functions under the laws of the state.



## **Trust Standards**

- There is no uniform or standard form for a living trust. The length and complexity of the living trust document depends on the laws of the state in which it was created, the attorney who prepares the document, and the specific assets and matters handled by the living trust agreement.

## **Eligible Borrowers**

- The borrower and co-borrower must qualify as individuals for the loan. The grantor/trustor/settlor (or at least one grantor/trustor/settlor, if there is more than one) must be a borrower or co-borrower.
- Eligibility Criteria for the Trust: The trust must be established by a natural person— solely by one individual or jointly by more than one individual. The trust will be considered as an eligible borrower if it meets the following:
  - It must be established by a written document during the lifetime of the individual establishing the trust and effective during their lifetime.
  - The individuals establishing the trust have reserved to themselves the right to revoke the trust during their lifetime.
  - The primary beneficiary must be the individual establishing the trust. If more than one individual establishes the trust jointly, there may be more than one primary beneficiary. The income or assets of at least one of the individuals must be used to qualify for the mortgage and sign the mortgage instruments.
  - The trust document must name one or more trustees to hold legal title to and manage the property that has been placed in the trust. The trustees must include either the individual establishing the trust (or at least one of the individuals, if there is more than one) or an institutional trustee that customarily performs trust functions in (and is authorized to act as trustee under the laws of) the relevant state.
  - The trustee must have the power to mortgage the property for the purpose of securing a loan to the party who is the borrower under the mortgage note.
- Eligibility Criteria for the Mortgage: A mortgage that has an inter vivos trust as the borrower must satisfy the following:
  - The property must be a 1-4 unit owner-occupied principal residence, 1-unit second home, or 1-4 unit investment property (agency salable). If the property is a primary residence, it must be occupied by at least one of the individuals establishing the trust (and whose income or assets are used to qualify for the mortgage).
  - Full title may be vested in the trustee's name or vested jointly in the trustee and in the name of an individual borrower or in the trustee of more than one inter vivos trust.
  - The title insurance policy must assure full title protection to FCM and must state that title to the property is vested in the trustee's name. It must not list any exceptions with respect to the trustee holding title or to the trust.
  - The mortgage must be underwritten as if the individual establishing the trust were the borrower or the co-borrower (if there are additional individuals whose income or assets will be used to qualify for the mortgage).
- California Properties: California Probate Code prohibits lenders from requiring disclosure of the beneficiary information (dispositive provisions) of the trust agreement. Therefore, the underwriter is not required to verify that the beneficiary is an applicant.



- Texas Properties: Inter vivos revocable trusts are not permitted for Texas Section 50(a)(6) loans.

### **Trust Documentation**

- Must retain in the Mortgage file:
  - A complete copy of the trust documents or a copy of the abstract/certification or summary; and
  - A copy of any trust documents that the title insurance company required in making its determination on the title insurance coverage.

### **Title Requirements**

- The title insurance policy must assure full title protection, and must indicate that title to the property is vested in the names of the trustee(s) of the living trust. The policy may not list any exceptions with respect to the trustee(s) or the living trust.
- The title may be vested jointly in the trustee(s) of the inter vivos trust and in the name(s) of an individual borrower(s) or in the trustee(s) of more than one inter vivos trust.

### **Reviewing the Living Trust**

- The Correspondent and/or their legal representative is responsible for ensuring that the trust meets the following requirement:
  - Date of the Trust
  - The living trust must have been established by a written document during the lifetime of the grantor/ trustor/settlor, and must have been effective during his/her lifetime.
  - Revocability
  - The living trust must be revocable, and that power must be clearly stated in the living trust agreement.
  - Beneficiary
  - The grantor/trustor/settlor must be the primary beneficiary. If the living trust is established by more than one grantor/trustor/settlor, there may be more than one primary beneficiary as long as all of the following apply:
    - The income or assets of at least one grantor/trustor/settlor is used to qualify for the loan; and
    - That grantor/trustor/settlor will occupy the property and sign the loan documents.

### **Trustee**

- The living trust agreement must name one or more trustees to hold title to and manage the property held by the living trust. The trustee(s) must include one of the following:
  - At least one grantor/trustor/settlor; or
  - An institutional trustee (i.e., bank, trust company, attorney) that customarily performs trust functions and is authorized to act as trustee under the laws of the state.
- The lender must examine either the trust agreement, or the abstract, certification or summary of the trust agreement and determine that the living trust addresses each of the following matters:
  - The trustee is authorized to borrow money, or purchase, construct or encumber realty.
  - The beneficiary either does not need to grant written consent for the trust to borrow money, or, if such consent is required, it has been granted in writing for purposes of the Mortgage.
  - The settlor has retained power to revoke or alter the trust.





- There is no unusual risk or impairment of lenders' rights (such as distributions required to be made in specified amounts from other than net income).
- Holding title in the trust does not diminish FCM's rights as a creditor, including the right to have full title vested to us should foreclosure proceedings have to be initiated to cure a default under the terms of the mortgage.
- The trustee(s) must have the power to mortgage the subject property for the purpose of securing a loan to the parties who are the borrower(s) under the Note. If the living trust agreement requires the beneficiary's consent to mortgage the property, it must be granted in writing.

### **Fictitious/Blind Trust**

A fictitious/blind trust is one established to protect the identity of a borrower. This is more common with actors, judges, etc. FCM does not allow borrowers to close using a fictitious/blind trust.

### **Signature Requirements**

- Each trustee of the living trust must execute the Note, Security Instrument, and any necessary addendum and/or rider. Each applicant must execute the promissory Note and any necessary addendum. In addition, each applicant must acknowledge all of the terms and covenants in the Security Instrument and any applicable rider and agree to be bound thereby by placing their signature after a statement of acknowledgment on such documents. Any other party that is required to sign either the Note or Security Instrument must also execute the applicable document(s).
- Correspondents that originate mortgages for properties that are in an inter vivos trust are responsible for making any modifications (including the use of different terminology, if appropriate) needed to conform the recommended signature forms below to those that are customary to state or local real estate requirements.
  - Note, & Any Necessary Addendum:
    - Each trustee of the living trust who is not both a grantor/trustor/settlor and an applicant (i.e., institutional trustee) must sign the Note, and any necessary addendum, using a signature block substantially similar to the following, inserted in the borrower's signature lines: "[Name of Trustee], Trustee of the [Name of Trust] Trust under trust instrument dated [Date of Trust], for the benefit of [Name of Beneficiary] Borrower."
    - Each trustee of the living trust who is both a grantor/trustor/settlor and an applicant (as in most cases) must sign the Note, and any necessary addendum, using a signature block substantially similar to the following, inserted in the borrower's signature lines: "[Name of Trustee/Individual], individually and as Trustee of the [Name of Trust] Trust under trust instrument dated [Date of Trust], for the benefit of [Name of Beneficiary] Borrower."
  - Security Instrument, & Any Necessary Rider:
    - All trustee of the living trust must sign the Security Instrument, and any necessary rider, using a signature block substantially similar to the following, inserted in the borrower's signature lines: "[Name of Trustee], Trustee of the [Name of Trust] Trust under trust instrument dated [Date of Trust], for the benefit of [Name of Beneficiary] Borrower."
    - The following acknowledgement should be added to the Security Instrument, and any necessary rider, after the signature lines and then signed by each grantor/trustor/settlor who is an applicant: "BY SIGNING BELOW, the undersigned, grantor/trustor/settlor of the [Name of Trust] Trust under trust instrument dated [Date of Trust], for the benefit of [Name





of Beneficiary], acknowledges all terms and covenants contained in this Security Instrument and any rider(s) thereto and agrees to be bound thereby.

\_\_\_\_\_(Seal)

Trust Grantor/Trustor/Settlor."

- Important: Signatures may not contradict the typed name and text below the signature line. The signature itself may not have any qualifiers, such as "trustee" or "settlor" unless it matches precisely with the typed name and text below the signature line. Below are examples of Acceptable and Unacceptable Signatures, these are not all inclusive. If the signature(s) varies from the typed name(s), the degree of variance determines whether the document is acceptable.

### **Acceptable Property Types**

- 1-Unit (attached, semi-detached and detached) on an individual lot
- 2-4-Units
- PUD (Planned Unit Developments)
- Condominiums\*
- Site Condominiums\*

\*Project approval may be required.

### **Unacceptable Collateral**

- Property that is not suitable for year-round occupancy regardless of the location;
- Unapproved non-conforming use property (does not include grand fathered use);
- Property with health, safety, and/or livability issues (e.g., non-functioning bathrooms or kitchens, no utilities, mud slide areas, etc.);
- Property with incomplete items or conditions that affect the safety, soundness or structural integrity of the property that are not completed or corrected prior to closing.
- Property with Chinese drywall, as noted by the appraiser. Chinese drywall is known to produce foul odors; causes metal to corrode more quickly than normal; leaves black corrosion on wiring or copper; and causes appliances and electronics with copper wiring to fail due to corroded copper wiring;
- Properties with unexpired redemption periods after a foreclosure or tax sale has occurred;
- Properties subject to private transfer fee covenants prohibited by 12 C.F.R. Part 1228 are ineligible if those covenants were created on or after February 8, 2011. (See Private Transfer Fees topic in this section for additional information.)
- Illegal use of the property;
- Manufactured housing (i.e., a structure such as a mobile or coach home that is built on a permanent chassis);
- 2-4 unit property that has an illegal additional unit or accessory apartment;
- Property is located in a high **flood zones A or V** (or volcano area) and does not have the proper flood/volcano insurance coverage as federally mandated;
- Property is on the island of Hawaii and is located within lava zones 1 or 2;
- Property located in an area that is deemed an environmental risk by a Phase III Report;
- Unique property in which the marketability cannot be established (e.g., dome, geothermal, log, or stilt home);



- Business, commercial, or agricultural use of the property that does not meet residential requirements (e.g., income producing property such as hotel, B&B, farming, etc.) except to limited extent defined under Mixed Use Property later in this section;
- Idaho properties with more than 80 acres, Montana properties with more than 30 acres, South Dakota properties with more than 30 acres;
- Timeshare, houseboat, segmented ownership project.
- Mobile home (including those that meet all the requirements of manufactured housing) or “Tiny” (portable) Homes;
- Residential dwelling consisting of five or more units;
- Condotel
- Agricultural/Rural property that does not conform to Fannie Mae guidelines.
- Community Land Trusts which are created to preserve long term affordable housing by purchasing homes in communities, then leasing the land using a long-term ground lease to low-income and moderate-income families at affordable monthly ground rents. Community Land Trust are managed by nonprofit entities, such as state, or local governments, counties, school districts, universities, or colleges. The ground lease includes provisions that require the continued use of the property for low-income and moderate income families in the future.
- Boarding Houses and Bed & Breakfast properties.
- Properties with Survey Exceptions
- Properties located on land that does not allow for FCM’s access for mortgage servicing purposes (e.g., foreclosure, etc.) except as modified by specific program fact sheets.
- Properties subject to PACE loans. Refer to Energy Efficient Property topic in this section for additional information.
- Properties with unacceptable UAD Property Condition or Quality Ratings. Refer to Section 501.1- Documentation/Uniform Appraisal Dataset topic for details.
- Property where there is marijuana being grown in the interior of the subject property (grow house), as identified by the appraiser (including locations where it is permitted by state law).
- Unimproved Land, Land Contracts, Lot Loans **except as permitted in the Multiple Parcels guidelines (topic in this section)**
- Co-ops

### **Illinois Land Trust**

- Land trusts are permitted in the state of Illinois only.
- A land trust is a simple arrangement under which a trustee holds title of record, but the beneficiary of the land trust holds all the rights over the property. A land trust is evidenced by a recorded deed placing the property in the land trust; and an unrecorded trust agreement, which spells out the terms, provisions, rights, and obligations of all the parties, involved. If the property is held in a land trust, the beneficiary retains complete control over the property. The trustee executes deeds, mortgages, and leases upon written direction from the beneficiary.
- The land trust is used to maintain an individual's privacy and keep the property ownership information from public record. It also provides for a simple succession of ownership and protects the property from many types of tax liens and judgments. The title report/commitment will not reflect our applicant as a



vested owner, but rather identify the trustee of the land trust. The land trust documentation should reflect that the property is held in a land trust with our applicant as the beneficiary.

- FCM will permit a mortgage to be secured by a property held in a land trust in the state of Illinois only, provided the following requirements are met:
  - All beneficiaries must be an individual.
  - The property must be secured by a 1-unit detached, condo or PUD, or 2-4 unit that is a primary residence or second home.
  - All beneficiaries must have sole power of direction over the land trust and trustee.
  - Each beneficiary must be an applicant and have their credit and income used to qualify the loan. All the beneficiaries who are applicants must be obligated as individuals under the terms of the note.
  - The mortgaged property securing the land trust should be the only asset of the land trust.
  - The trustee must be a corporation or financial institution customarily engaged in the business of acting as a trustee under a land trust (an individual is not acceptable as a trustee).
  - The underwriter must confirm that the land trust has fee simple ownership and is the sole owner of the property.
  - Mixed vesting (e.g., land trust and an individual) is not permitted.
  - Use of a power of attorney is not allowed.
  - An executed copy of the land trust agreement must be provided. The agreement must outline the conditions of the land trust and identify the trustee.
  - The term of the agreement must be equal to the term of the mortgage.
  - An executed copy of the agreement by the beneficiary and the trustee to notify FCM must be provided. (This protects FCM under the Note and mortgage from the transfer of beneficial interests in the land trust without the lender's knowledge.) The trustee and beneficiary must sign an agreement substantially in the form of the "Agreement by Beneficiary and Trustee to Notify Lender of Sale or Transfer of Interest" which amends the trust agreement between the beneficiary and the trustee.
  - To protect from the transfer of beneficial interest without its knowledge, the trustee and all beneficiaries must furnish a signed copy of an "Assignment of Beneficial Interest."

## Occupancy Types

### Primary Residence

- A primary residence is the borrower's main residence, where they live the majority of the year. It may be a 1-unit, condominium, co-op, PUD, or 2-4 unit property.
- Characteristics that may indicate the property is the borrower's primary residence include:
  - It is occupied by the primary wage-earner for the major portion of the year;
  - It is in a location relatively convenient to the owner's principal place of employment;
  - It is the address of record for such activities as federal income tax reporting, voter registration, occupational licensing, and similar functions.
  - The borrower must occupy the property within 60 days of closing. At least one of the borrowers must occupy and take title to the property, and execute the note and mortgage. Exceptions (e.g., active military personnel) will be considered on a case-by-case basis.



- FCM recognizes the special needs of a borrower looking to finance a home for a disabled adult child or an elderly parent who is unable to work or who may not have sufficient income to qualify for a mortgage on their own.
- **FCM additionally recognized military service members away on Active Duty**
  - Multiple Borrowers
    - Only one borrower needs to occupy and take title to the property, except as otherwise required for mortgages that have guarantors or co-signers
  - Parents or legal guardian wanting to provide housing for their handicapped or disable adult child
    - 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 or legal guardian is considered the owner/occupant.
  - Children wanting to provide housing for parents
    - If the parent is unable to work or does not have sufficient income to qualify for a mortgage on his or her own, the child is considered the own/occupant
  - **Military service members**
    - **A military service member borrower currently on active duty and temporarily absent from their principal residence because of military service is considered to be an owner occupant**
      - The borrower's temporary absence from the subject property must be verified by obtaining a copy of the borrower's military orders
      - The military orders must evidence the borrower will be absent from the subject property as of the date the owner occupancy must be established as required by the security instrument

## **Second Home**

- A second home is defined as 1-unit property (including condominiums, co-ops, and PUDs), unless otherwise indicated in a process or program fact sheet, that the borrower occupies for some portion of the year in addition to their principal residence. A borrower may have more than one second home.
- While second homes are often located in a vacation/resort area although not always, the property must be suitable for year round occupancy. A second home should not be in the same market as the borrower's primary residence. However, there are exceptions, such as:
  - Property located in a recreational area which is part of a metropolitan area (e.g., beach house), or
  - Property used to minimize commuting problems
- There are no specific mileage requirements with regards to the distance between the primary and second home. Good judgment must prevail and all of the following criteria must be considered for second homes:
  - Rental income received from the second home may not be used to offset the expense of a second home and cannot be used as qualifying income.
  - 2-4 unit properties are not eligible as a second home.
  - The property must be occupied by the borrower for some portion of the year
  - The borrower must retain exclusive control over the property.
  - The sales contract or appraisal must not reflect that there are timeshare arrangements or any other rental agreements that requires the property to be rented.
  - If the borrower utilizes a management company to assist in renting the unit when the borrower is not using it, the borrower may not give the management company complete control over the occupancy of the property.



## Leasehold Estates

- A leasehold arrangement is one in which there is separate ownership of the land and the improvements on the land. The landowner grants a lease to the owner of the improvements that gives the improvements owner the right to use the land in exchange for a rental payment. The ownership interest in the land is called the “fee interest” or “fee estate.” The ownership interest in the improvements coupled with the rights granted in the lease to use the land is called the “leasehold interest,” “leasehold estate,” or simply “leasehold.” The rental payment is called a “leasehold payment” or “ground rent,” and is usually paid annually. The lease is commonly for a term of 99 years or more, and is usually renewable.
- Ineligible:
  - Not permitted for Texas 50(a)(6) loans
- Eligible:
  - To be eligible, a leasehold estate must meet the following requirements:
  - In all respects, the lease or sublease must be valid, in good standing, and in full force and effect.
  - Binding and enforceable against the lessor and sublessor.
  - The leasehold estate and improvements must constitute real property, be subject to a mortgage lien, and be insurable by an acceptable lender’s title insurance policy.
  - For condo, PUD or cooperative projects, the homeowners association or the cooperative association must be the lessee under the ground lease.
  - The fee simple owner must not be the developer, an entity associated with the developer, or a hospitality entity.
  - The leasehold must be assignable/transferrable.
  - All lease rents, 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 lessor have claimed such a default.
  - Term: The term of the estate extends a minimum of 5 years beyond the maturity date of the mortgage. (This requirement does not apply if fee simple title will vest in the borrower, owners’ association, or a cooperative corporation at an earlier date.)
  - Recordation: The lease and any sublease, including all amendments, or a memorandum of lease or sublease, must be recorded.
  - The lease or sublease should provide for the following:
    - Priority of (as the leasehold mortgagee) first mortgage lien over all other liens—especially those for assessments to support common amenities.
    - Contain a provision that interest can be transferred, mortgaged, and/or sublet an unlimited number of times by the lessee—either without restriction or with payment of a reasonable fee and delivery of reasonable documentation to the lessor (owner of the land). The lessor may not impose any credit qualifying criteria on an assignee, transferee, mortgagee or sub lessee.
    - Contain provisions to protect FCM’s interest in the event of bankruptcy of any party to the lease, foreclosure, the property’s condemnation or destruction, such as the right to assume the lease and any renewal options, or acquire the lease in its own name or in the name of a nominee upon foreclosure or deed in lieu of foreclosure.
    - Contain a provision that the borrower will pay taxes, insurance, and owners’ association dues related to the land—in addition to those they are paying on the improvements.
    - If the lessor’s fee simple interest in the land is subject to any encumbrances or liens, or the lease requires the lessee to agree to the subordination of the lease to said liens or



encumbrances, the fee simple lienholder has executed and recorded a Non-disturbance and Attornment Agreement that contains the provisions indicated below.

- Provide for the leasehold mortgagee to approve any amendments to the lease that relate to the provisions described herein, the modification of the leasehold estate, or the termination or cancellation of the lease.
- Contain a provision that the borrower retains voting rights in any owners' association.
- Provide for the leasehold mortgagee to exercise any renewal options that may exist.
- Guarantee FCM the right to receive a minimum of 30 days' notice of any default by the borrower and to cure the default or take over the borrower's rights under the lease. In the event of bankruptcy of the lessor or lessee, the lessee must notify FCM in a timely manner.
- The lease must not:
  - Contain default provisions allowing forfeiture or termination of the lease except for nonpayment of the lease rents.
  - Contain provisions for termination of the lease in the event of damage to or destructions of the mortgaged premises as long as the leasehold mortgage exists.
  - Prohibit the leasehold mortgage from being insured under a hazard insurance policy or from receiving hazard insurance proceeds as either mortgagee or insurance trustee.
  - Prohibit the leasehold mortgagee from exercising renewal options.
- Sublease
  - The lessor may not require a credit review or impose any other qualifying criteria on transference, mortgage, or sublease.
  - The sublease must be signed by both the fee owner and the sublessor.
  - The sublease must contain a Non-disturbance and Attornment Agreement, by which the fee simple lienholder or the lessor agrees to accept the terms of the lease or sublease and not to interfere with the lessee's rights to use the leasehold estate.
  - The amount of the sublease payments is at least equal to the amount of the lease payments and is due no less frequently than the lease payments.
  - The leasehold estate and the mortgage must not be impaired by a title merger between the lessor and lessee, or by a sublessor's default.
- Lease With Option to Purchase:
  - Not permitted.
- Appraisal Requirements: The use of leasehold estates for residential properties must be an accepted practice in the area where the subject property is located and such properties must be readily marketable.
- Qualifying the Borrower: Any potential increase in rent payments must be taken into consideration when calculating the borrower's housing payments and debt ratios.
- Title Requirements: ALTA Form 13.1 or equivalent for all leasehold mortgages. The title insurance policy must include the value of the lessee's leasehold improvements as part of the insured estate. Refer to Correspondent Manual Section 902.1 – General Documentation Requirements for more information.

## Multiple Properties

- Subject is Primary Residence: For loans secured by primary residences, borrowers may not own or be obligated on a combined total of more than 5 financed residential properties, including the subject property. (Refer to the table below to determine if "other properties owned" should be included in limitation.)





- Subject is Second Home or Investment Property: If the subject property is a second home or investment property, typically each borrower individually and all borrowers collectively may not own or be obligated on a combined total of more than 4 financed residential properties (including the subject property) at the time of application (applies to either a single lender or several different lenders, including FCM).
- Refer to the table below to determine if “other properties owned” should be included in limitation.

Type of Property Ownership	Property Included in Limitation
Joint ownership of residential real estate. (This is considered to be the same as total ownership of an individual property.)	Yes
Ownership of commercial real estate	No
Ownership of multifamily property consisting of more than four dwelling units	No
Joint or total ownership of a property that is held in the name of a corporation or S-corporation even if the borrower is the owner of the corporation and the financing is in the name of the corporation or S-corporation	No
Joint or total ownership of a property that is held in the name of a corporation or S-corporation even if the borrower is the owner of the corporation; however, the financing is in the name of the borrower	Yes
Ownership in a timeshare	No
Obligation on a mortgage debt for a residential property (regardless of whether or not the borrower is an owner of the property on title)	Yes
Ownership of a vacant (residential) lot	No
Joint or total ownership of a property that is held in the name of an LLC or partnership where the borrower(s) have an individual or combined ownership in the LLC or partnership of 25% or more, regardless of the entity (or borrower) that is the obligor on the mortgage	Yes
Joint or total ownership of a property that is held in the name of an LLC or partnership where the borrower(s) have an individual or combined ownership in the LLC or partnership of less than 25% and the financing is in the name of the LLC or partnership	No
Joint or total ownership of a property that is held in the name of an LLC or partnership where the borrower(s) have an individual or combined ownership in the LLC or partnership of less than 25% and the financing is in the name of the borrower	Yes
Ownership of a manufactured home and the land on which it is situated that is titled as real property	Yes
Ownership of a manufactured home on a leasehold estate not titled as real property	No

Note: Properties owned or finance jointly by the borrower and co-borrower are only counted once.

2 months PTIA is required on each additional residential property with a lien (i.e., primary residence, second home and investment property).

### Condominium/PUD Project Approval

- A condominium project is a real estate project in which each unit owner has title to a unit in a building, an undivided interest in the common areas of the project, and sometimes the exclusive use of certain limited common areas.



- FCM originates mortgages on individual units within the project; we do not originate mortgages secured by condominium projects. However, the project in which the condominium is located may be required to meet specific project approval guidelines prior to the loan closing.

### **Project Eligibility**

- The quality of mortgages secured by units in condo, co-op, and planned unit development (PUD) projects can be influenced by certain characteristics of the project or by the project as a whole. Before delivering a loan secured by an individual unit in a project, the lender must determine that the project meets eligibility requirements.
  - The project is not an ineligible project and the lender is not aware of any change in circumstances since its review of the project that would make the project ineligible. See Section 610 – Project Eligibility for more information.
  - The project is not a newly converted non-gut rehabilitation project or a new or newly converted attached project in Florida. (These projects are only eligible via the PERS process.).
  - The project does not include any manufactured homes.
  - New or Established Project: The project meets the definition of a New Project or an Established Project as described later in this document and as required for the applicable project approval method.
  - Ownership of Project and Common Elements
    - The unit owners must have an undivided fee simple ownership or a leasehold interest in the land on which the project is located. Note: Any ground lease must meet the requirements in Section 808.1, Property Leaseholds.
    - The unit owners must be the sole owners of, and have the right to the use of, all common elements (buildings, roads, parking and amenities); the developer must not retain any ownership interest in the common elements. The common elements must be consistent with the nature of the project, be similar to common elements in other comparable condominium projects in the market.
  - Financing Limited Common Elements or Amenities. Non-realty items (such as boat docks or cabanas) must not be financed as part of a mortgage. Parking spaces that are real property purchased as part of the condo unit may be included when determining price and LTV. Property Insurance: The project must be covered by appropriate hazard, general liability, fidelity bond if more than 20 units, and, if applicable, flood insurance.
  - Title Insurance: In addition to standard title insurance requirements, the title policy includes the special title insurance requirements for units in a condominium project.
  - Documentation: Lender must retain all documentation relating to the project approval review.
  - Condo Located within a PUD: If a Condominium Unit is located within a PUD project, the property must meet both Condominium and PUD project eligibility and approval requirements.

FCM originates mortgages on individual condo, and PUD's; we do not originate mortgages secured by the condo/PUD project. However, the project in which the property is located may be required to meet specific project approval guidelines prior to the loan closing.

Condo Project Types	Project Type	Identification Criteria
	Established condo project	A project for which all of the following are true:



		<ul style="list-style-type: none"><li>• At least 90% of the total units in the project have been conveyed to the unit purchasers;</li><li>• The project is 100% complete, including all units and common elements;</li><li>• The project is not subject to additional phasing or annexation; and</li><li>• Control of the HOA has been turned over to the unit owners.</li></ul> <p>A project may also be treated as an established project with less than 90% of the units sold to unit purchasers, provided the deficit is the result of the developer holding back units for rent and the requirements below are met:</p> <ul style="list-style-type: none"><li>• Construction is 100% complete;</li><li>• The project is not subject to any additional phasing or annexation, and the HOA has been turned over to the unit owners;</li><li>• The developer's share of the units held back for rental is no more than 20% of the project's total units;</li><li>• HOA fees are paid current in developer-held units;</li><li>• There are no active or pending special assessments in the project.</li></ul>
	New condo project	<p>A project for which one or more of the following is true:</p> <ul style="list-style-type: none"><li>• Fewer than 90% of the total units in the project have been conveyed to the unit purchasers;</li><li>• The project is not fully completed, such as proposed construction, new construction, or the proposed or incomplete conversion of an existing building to a condo;</li><li>• The project is newly converted; or</li></ul>



		<ul style="list-style-type: none"><li>The project is subject to additional phasing or annexation.</li></ul>
	Site condos	Site condos are treated the same as detached condos
	Two-to-Four-Unit Condo Project	Attached or detached
Project Review Types	If a condominium unit secures the loan, the project in which it is located must be approved prior to the loan closing. The Condo and Co-Op Decisioned Project Lists will need to be reviewed by FCM underwriting.	
	Attached condo unit in a new or newly converted project, including an attached unit in a condo project that includes a mixture of attached and detached units	Full Review or CPM Review
	Attached condo unit in an established project, including an attached unit in a condo project that includes a mixture of attached and detached units	Based on the LTV, CLTV, and HCLTV ratios, occupancy, and location (projects in Florida), these projects may be reviewed using a Limited Review. Projects not meeting the Limited Review criteria must be reviewed using a: <ul style="list-style-type: none"><li>Full Review or CPM Review</li></ul>
	Attached unit in a new or established two-to four-unit condo project	Two- to four-unit condo projects may be reviewed using a Limited Review. Projects not meeting the Limited Review criteria must be reviewed using a Full Review.
	Detached condo unit in a new or established project, including a detached unit in a condo project that includes a mixture of attached and detached units	Project review is not required for a detached condo unit that meets Fannie Mae/Freddie Mac and FCM criteria including the following: <ul style="list-style-type: none"><li>The project and the unit are in compliance with all other requirements for property eligibility and appraisal standards.</li><li>The project and the unit have the required insurance as described in the Project Eligibility and Insurance Requirements sections of policy.</li></ul>



		<ul style="list-style-type: none"><li>• The detached unit is not a manufactured home and the condo project contains no manufactured homes.</li><li>• The project is not a condominium hotel, houseboat project, timeshare project, or project with segmented ownership.</li><li>• The project is in compliance with the requirements for priority of common expense assessments.</li><li>• The Condo Unit must be covered by a title insurance policy that complies with requirements described in the Insurance, Title &amp; Escrow Requirements.</li></ul> <p>Project Code: Fannie Type V or Freddie Mac Type V must be assigned to Detached Condos.</p>
	New or established two- to four-unit condo project	<p>Project review is not required for new and established condo projects that consist of no more than four units provided the following requirements are met:</p> <ul style="list-style-type: none"><li>• Property eligibility requirements are met as defined in Section 808-Property/Acceptable Property Types.</li><li>• The project is not a condo hotel or motel as described in Policy. The project is not a houseboat project, timeshare project, or project with segmented ownership and does not include manufactured homes.</li><li>• Priority of common expense assessments requirements are met.</li><li>• The appraisal must meet all applicable appraisal requirements.</li><li>• Insurance requirements including all provisions applicable to projects are met.</li><li>• The Condominium Unit must be covered by a title insurance</li></ul>



		<p>policy that complies with requirements defined in Policy.</p> <ul style="list-style-type: none"><li>• If a Condominium Project is on a leasehold estate, the lease must comply with the requirements reflected in Policy.</li><li>• Loans must also be assigned Project Type V to identify project review has been waived.</li></ul>
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### Limited Review

- Limited Review guidelines allow the lender to evaluate and approve condo projects using limited documentation. Eligibility is based on specific loan level criteria, including LTV, occupancy, geographic location and the method by which the loan is evaluated and decisioned.
  - If property is an established project a limited review can be performed if the project is 100% complete including common areas.
  - If the property is a detached condo, a limited review is acceptable on primary residences, second homes and investment properties when manually underwritten
  - New and newly converted Attached Condo Projects in Florida must be reviewed under Fannie Mae PERS – Project Eligibility Review Service.

### Project Approval and Delivery Requirements

- Correspondents represent and warrant that the Condo project meets all guidelines.
- Correspondent lenders must document the condo project type, project name and if applicable, the CPM project ID# on the Uniform Underwriting and Transmittal Summary form (Fannie 1008/Freddie 1077). Correspondents represent and warrant that the project was approved within 6 months preceding the date of the note and that the loan was delivered within 7 months of the project approval date.
- If the project appears on Fannie Mae’s Condo/Co-op List, attach a copy of the list with the project name circled or highlighted. For projects approved using Fannie Mae’s CPM, attach a copy of the CPM Project Approval Certification.
- Correspondents must check Fannie’s Condo Project Manager (CPM) list for projects with five or more attached units for DU and manually underwritten loans. For Agency loans, all projects listed as “Unavailable” are not eligible for sale. For Non-Agency loans, a project with an “Unavailable” status for deferred maintenance/structural integrity is ineligible. Projects listed as “Unavailable” for any other reason, should be reviewed against standard guidelines for eligibility.
- For projects on FCM’s Condo/Co-op List, the closing must occur within 6 months of the Status Date, and prior to the earliest document expiration date; otherwise, a project approval update will be required

### Significant Deferred Maintenance

- Significant Deferred Maintenance: For projects with five or more attached units: If the project has significant deferred maintenance, or has received a directive from a regulatory authority or inspection agency to make repairs due to unsafe conditions, the project is not eligible. The project will remain ineligible until the required repairs have been made. Acceptable documentation may include, but is not





limited to, a satisfactory engineering or inspection report, certificate of occupancy, or substantially similar document. Significant deferred maintenance includes deficiencies that meet one or more of the following criteria:

- Full or partial evacuation of the building to complete repairs is required for more than seven days or at an unknown period of time;
- The project has deficiencies, defects, substantial damage, or deferred maintenance that:
  - Is severe enough to affect the safety, soundness, structural integrity or habitability of the improvements; or
  - The improvements need substantial repairs and rehabilitation, including many major components; or Impedes the safe and sound functioning of one or more of the building's major structural or mechanical elements, including but not limited to the foundation, roof, load bearing structures, electrical system, HVAC, or plumbing.
- The postponement of normal maintenance, which cannot reasonably be resolved by normal operations or routine maintenance and which may result in any of the following:
  - Advanced physical deterioration,
  - Lack of full operation or efficiency,
  - Increased operating costs,
  - Decline in property value,
  - Any mold, water intrusions or potentially damaging leaks.
- Projects that have failed to obtain an acceptable certificate of occupancy or pass local regulatory inspections or recertifications are not eligible. Violations of any federal, state or local law, ordinance or code relating to zoning, subdivision and use, building, housing accessibility, health matters or fire safety are not eligible. This includes failure by the HOA to schedule an inspection required by the applicable jurisdiction.

Note: The following repairs are not considered to be significant and include:

- Routine maintenance or repairs that a homeowner's association (HOA) undertakes to maintain or preserve the integrity and condition of its property
- Work that is preventative in nature
- Accomplished within the project's normal operating budget
- Typically completed by on-site staff
- Focused on keeping the project fully functioning and serviceable
- If damage or deferred maintenance is isolated to one or a few units and does not affect the overall safety, soundness, structural integrity, or habitability of the improvements
- Minor deficiencies with a cost of \$3000 or less per repair item.

### **Attached Condo Units**

- Maximum LTV/CLTV/HCLTV:
  - All states except Florida, DU Approve/Eligible, LPA Accept Loans and Non-DU or LPA Decisioned Loans (DE, Manual): Primary Residence: 90%/90%/90%\*  
Second Home: 75%/75%/75%  
Investment: 75%/75%/75%
  - Florida: All Attached Projects Primary Residence: 75%/90%/90%  
Second Home: 70%/70%/70%



Investment: Not Allowed

- Eligibility: Refer to Condo Project Types topic for requirements.

### **Detached Condo Units**

- Detached units located in a project with a mix of attached and detached units.
  - Detached condominiums consist of units that physically resemble a traditional detached single-family dwelling. The project must be established.
  - Maximum LTV/CLTV/HCLTV: Refer to the LTV/CLTV/HCLTV for the Process type selected.
  - Eligibility:
    - Primary residence, second home or investment property.

### **Documentation Requirements**

- Appraisal
  - Follow Appraisal guidelines
- Projects Consisting of Five or More Attached Units – ALL Limited Reviews
  - Project must be reviewed against Fannie's Condo Project Manager (CPM). For Agency loans, all projects with an "Unavailable" status are ineligible. For Non-Agency loans, a project with an "Unavailable" status for deferred maintenance/structural integrity is ineligible. Projects listed as "Unavailable" for any other reason, should be reviewed against standard guidelines for eligibility.
  - Project must not have any significant deferred maintenance or unsafe conditions\* These projects are not eligible until the required repairs have been made and documented. Documentation would include, but not be limited to, satisfactory engineering or inspection report, certificate of occupancy, or other substantially similar documentation.
  - Project documentation required:
    - Completed Condo Limited Review Questionnaire
    - Six months of the project's HOA meeting minutes If meeting minutes are unavailable, financial statements for the project, either audited or prepared by a professional management company, should be reviewed to determine if there is deferred maintenance or repairs necessary due to unsafe conditions.
    - If there are any current special assessments, or planned special assessments, they must be reviewed to determine acceptability. Must document the reason for the special assessment, the total amount assessed and repayment terms, and documentation to support there is no negative impact to the financial stability of the project. The borrower must be qualified with any outstanding special assessment. The lender is expected to obtain the financial documents necessary to confirm the association has the ability to fund any repairs. If the special assessment is related to safety, soundness, structural integrity, or habitability, all related repairs must be fully completed or the project is not eligible. Additionally, if the lender or appraiser is unable to determine that there is no adverse impact, the project is ineligible.

\*Deferred maintenance as outlined in Deferred Maintenance section above.

Note: Underwriter discretion should be used in determining if the project has significant deferred maintenance, but should be referred to the FCM Condo/Co-op Project Decision Team if necessary.



## **Project Coding**

- One of the following Project Type codes must be assigned:
- Limited Review – Established Project (including Freddie Mac 2-4 Unit Projects)
  - Q (Fannie Mae)
  - H (Freddie Mac Streamline Review)

## **CPM Expedited Review**

- Expedited Project Review process is followed when the transaction does not meet the Limited Review criteria, Lender Full Review criteria and the project is not listed on the Fannie Mae Accepted Condominium Development list.
- Projects that have been reviewed and accepted by Fannie Mae are on the Fannie Mae-Accepted Condominiums project list at <http://www.efanniemae.com/>.
- If the project is new, or if it is not on the list and the loan does not qualify under the Limited Review process, the project may be submitted to Fannie Mae's Condo Project Manager (CPM) system. CPM is an online approval process that also tracks the status of delegated project reviews. CPM is available on line at [www.eFannieMae.com](http://www.eFannieMae.com).
- New and newly converted Attached Condo Projects in Florida must be reviewed under Fannie Mae PERS – Project Eligibility Review Service.

## **Overview**

- A Condominium project is a real estate project in which each unit owner has title to a unit in a building, an undivided interest in the common areas of the project, and sometimes the exclusive use of certain limited common areas. FCM originates mortgages on individual units within the project. FCM does not originate mortgages secured by Condominium projects.

## **Delivery Requirements**

- Condo Project Manager's project certification is valid for six months for new projects, or one year for established projects.
- Lenders may recertify the project by updating the project data in CPM as needed.

## **General Condo Eligibility Requirements**

- The following requirements apply for all project approvals:
  - Project Eligibility:
    - The project is not an ineligible project as outlined in Project Eligibility section 610 of this manual, and the lender is not aware of any change in circumstances since its review of the project that would make the project ineligible.
    - The project is not a newly converted non-gut rehabilitation project, a new project that contains any units with less than 400 square feet, or a new or newly converted attached project in Florida. (These projects are only eligible via the PERS process.).
    - The project does not include any manufactured homes.
    - New or Established Project: The project meets the definition of a New Project or an Established Project as described in Section 601 Project Approval this manual, as required for the applicable project approval method.



- Ownership of Project and Common Elements
  - The unit owners must have an undivided fee simple ownership or a leasehold interest in the land on which the project is located.
- Note: Any ground lease must meet the requirements for Leaseholds in Section 808.1.
  - The unit owners must be the sole owners of, and have the right to the use of, all common elements (buildings, roads, parking and amenities); the developer must not retain any ownership interest in the common elements. The common elements must be consistent with the nature of the project, be similar to common elements in other comparable condominium projects in the market and must not be subject to a lease between the unit owners, the Homeowners Association and any other party.
- Resale Restricted / Deed-Restricted Properties –Refer to the Resale Restrictions topic in the Property Section 808.
- Environmental Hazard Assessment: Not required unless the lender identifies an environmental problem through the project review process. Correspondents represent and warrant that the properties that are the collateral for loans submitted for purchase are free of environmental risk. FCM reserves the right to decline to purchase, or to require repurchase of loans that are subject to environmental risk factors.
- Financing Limited Common Elements or Amenities. Non-realty items (such as boat docks or cabanas) must not be financed as part of a mortgage. Parking spaces that are real property purchased as part of the condo unit may be included when determining price and LTV.
- Property Insurance: The project must be covered by appropriate hazard, general liability, fidelity bond if more than 20 units, and, if applicable, flood insurance. Refer to the Insurance Requirements section 608.
- Title Insurance: In addition to standard title insurance requirements, the title policy includes the special title insurance requirements for units in a condominium project. Refer to General Documentation Section 902.1 for more information.
- Documentation: Lender must retain all documentation relating to the project approval review

### **Condo Located Within a PUD**

- If a Condominium Unit is located within a PUD project, the property must meet both Condominium and PUD project eligibility and approval requirements.

### **LTV/CLTV/HCLTV – Geographic Restrictions**

- Florida – all attached projects
  - Primary Residence: 75% / 75% / 75%
  - Second Home: 70% / 70% / 70%
  - Investor: Not Permitted
  - New and newly converted Attached Condo Projects in Florida must be reviewed under Fannie Mae PERS – Project Eligibility Review Service.

### **Additional Eligibility Criteria**

- CPM Expedited Review Eligibility Requirements (For All Projects)
- Lenders enter project information into CPM, which applies automated business rules to determine if a project is eligible under Fannie Mae's guidelines for this process.



- The project must meet the General Project Eligibility Requirements indicated in this fact sheet. Note: Presale and investor concentration may be more flexible than Lender Full Review requirements.
- No more than 15% of the total units in a new or established project may be 30 days or more delinquent on condominium/HOA fee payments
- Budget. With the exception of 2-4 unit properties, lenders must review the homeowners' association actual budget for established projects or the projected budget for new projects and determine the following:
  - The budget is adequate (includes allocations for line items pertinent to the type of condo)
  - The budget provides for the funding of replacement reserves for capital expenditures and deferred maintenance (at least 10% of the budget); and
  - The budget provides adequate funding for insurance deductible amounts, as evidenced by a separate line item, or included in reserve funds.
- New Projects (Except for 2-4 Unit Projects)
- CPM may be used to obtain project approval for new projects under the Expedited Review Process. When submitting a project for approval using CPM, the project must be analyzed to make sure the following requirements are met:
  - The project was created and continues to exist in full compliance with applicable state, jurisdictional, and all other applicable laws and regulations.
  - For new projects, CPM will base its project review decision on the pertinent project data input into the system. While Fannie guidelines call for a minimum 51% presale, CPM may allow broadened eligibility criteria on a project-level basis with reduced presale requirements.
  - For new projects, CPM project approval will be valid for a period of six months. The project may be eligible for an extension of project approval certification upon submission of updated project data.
  - Project Legal Documents. The project documents must state, or state law must provide, that:
    - Amendments that have a material adverse impact on first lien mortgagees must be agreed to by mortgagees that represent 51% of the units subject to first lien mortgages.
    - Any action to terminate the legal status of the project or use insurance proceeds for any purpose other than to rebuild must be agreed to by mortgagees that represent 51% of the units subject to first lien mortgages. Note: The documents may allow approval to be assumed when the mortgagee of record fails to submit a response to a written proposal for an amendment within 60 days of receipt of notice, provided it was sent via certified, registered or return receipt mail
    - The mortgagee/guarantor must have the right to timely written notice of condemnation, casualty loss, 60- day delinquencies in payment of assessments, lapse/cancellation or material modification of the HOA insurance policies, or any action that requires consent of a percent of the mortgagees.
    - The project documents must not give a unit owner or any other party priority over any rights of the first mortgagee in the case of payment of proceeds from termination or insurance proceeds or condemnation awards for losses to or a taking of condo units or common elements.
  - Waiver of Right of First Refusal: Any right of first refusal in the Condominium Project Documents may not adversely impact the rights of a mortgagee or its assignee to:
    - Foreclose or take title to a Condominium Unit pursuant to the remedies in the Mortgage, or



- Accept a deed or assignment in lieu of foreclosure in the event of default by a mortgagor, or
- Sell or lease a unit acquired by the mortgagee or its assignee.

When a homeowners association retains the right to provide a substitute buyer or to have the first option to purchase a unit, that right cannot be exercised in any way that could be interpreted as unlawful discrimination, or impair marketability of the units in the project.

- Established Projects and All 2-4 Unit Projects
- For established and 2-4 unit projects, FCM is not required to use CPM for project evaluation however it may be used as an alternative to manual underwriting. If the Expedited Review Process is used without the aid of the CPM, the project must meet the following criteria:
  - The project meets the General Project Eligibility Requirements indicated in this fact sheet.
  - If the subject property is an investment property, attached units (including 2-4 unit projects), at least 50% of the total units in the project must have been conveyed to principal residence purchasers or second home purchasers.
  - This does not apply if the subject mortgage is a principal residence or second home.
  - Amenities may be incomplete without requiring acceptable completion assurance provided the incomplete items are minor and have nominal impact on marketability per the appraisal.
  - Control of the homeowners' association must have been turned over to the unit purchasers (not required on 2-4 unit condominium projects).

### **Documentation Requirements**

- Completed Condo/PUD Project Questionnaire
- Insurance: Refer to the General Condo Project Eligibility Requirements section in this fact sheet.
- Appraisal
  - Appraisal format as determined by DU/LPA is acceptable. If an appraisal is not required by the AUS, alternative documentation must be obtained to perform project review and warrant that all project eligibility criteria are met.
- Public Offering plan or equivalent, including all amendments for new and newly converted projects;
- New conversions require an Architect or Engineer's Report;
- First full year's operating budget and/or most recent audited financial statements. (Not required for 2-4 unit projects.)
- Ground lease, if applicable

Reminder: lenders must document the condo project type, project name and if applicable, the CPM project ID# on the Uniform Underwriting and Transmittal Summary form (Fannie 1008/Freddie 1077).

### **Fannie Mae PERS**

- Fannie Mae reintroduced their project review function under the name of PERS – Project Eligibility Review Service.

NOTE: Lenders will be charged a fee for any project submitted to PERS, regardless of the final decision.

### **Delivery Requirements**

- Projects with Final Project Acceptance will be valid until the expiration date.





- The note date must be prior to the expiration date of the project certification.
- There is no delivery timeframe tied to this review process.

### **General Condo Eligibility Requirements**

- Fannie Mae determines project eligibility

### **Eligibility Criteria-Florida**

- New Projects in Florida: All new or newly converted attached projects in Florida require mandatory submission to Fannie Mae's PERS process.
- Must check the PERS approved project list at [eFanniemae.com](http://eFanniemae.com).

### **Eligibility Criteria**

- The use of the PERS service is optional in all cases except the following projects that must be submitted to PERS to determine eligibility:
  - Attached, new and newly converted condo projects located in Florida;
  - Newly converted, non-gut rehabilitation condo projects; and
  - The Correspondent must perform a basic review to determine if the project satisfies Fannie Mae's eligibility requirements prior to submission for PERS review.
  - Lender must ensure that the developer, builder, management company, or HOA will continue to provide project information to Fannie Mae as requested without charge. If the information is not provided, Fannie Mae reserves the right to withdraw its PERS approval.
  - Lenders must provide evidence of project approval for the above-indicated new or newly converted projects, for which, Fannie Mae PERS approval is required

### **Documentation Requirements**

- Project Eligibility Review Service Document Checklist (Fannie Mae Form 1030)
- Application for Project Approval (Fannie Mae Form 1026)
- Warranty of Condominium Project Legal Documents (Fannie Mae Form 1054) with attached attorney review.
- Completed Condo/PUD Project Questionnaire
- Insurance: The project must be covered by appropriate hazard, general liability, fidelity bond if more than 20 units and, if applicable, flood insurance as shown in Section 608.
- Appraisal
- Public Offering Plan or equivalent (e.g., the Declarations, CC&Rs, the Master Deed and Bylaws) and any amendments
- Engineer's or Architect's Report for newly converted projects.
- Ground lease, if applicable. Any ground lease must meet the requirements in the Leasehold Estates Section 808.1 of this manual.
- Waiver of Right of First Refusal: Verification is only required if it is brought to FCM's attention that our rights may be impaired.

Lender must retain all documentation related to the condo project review.

**Project Coding**

T: Fannie Mae Review

	Lender Full Review	Established Projects	New Projects
Description	<p>The Lender Full Review process will be performed by the Condo Project Decision Team upon their receipt of all required project documentation from the requesting channel.</p> <p>The Lender Full Review process must include the Fannie Mae CPM Review, for those projects that do not qualify for approval under the Limited Review guidelines.</p> <p>Lender Full Review project approvals are valid for 6 months.</p> <p>NOTE: LPA processed loans where New or Established Project review was completed do not require a CPM number.</p>	X	X
Project Approval and Delivery Requirements	<p>Correspondents represent and warrant that the condo project meets all FCM and Agency guidelines. Correspondents must also represent and warrant that the project was approved within 6 months preceding the date of the note and that the loan was delivered within 7 months of the project approval date. For projects on FCM's Approved/Declined Condo, Co-op &amp; PUD List, the closing must occur within 6 months of the Status Date, and prior to the earliest document expiration date; otherwise, a project approval update will be required.</p> <p>Correspondent lenders must document the condo project type, project name and, if applicable, the CPM project ID# on the Uniform Underwriting and Transmittal Summary form (Fannie 1008/Freddie 1077).</p> <p>If the project appears on FCM's Approved/Declined Condo, Co-op &amp; PUD List or on Fannie Mae's CPM list, the correspondent may provide a copy of the list with the project name circled or highlighted or a copy of the Fannie Mae CPM Project Acceptance Certification.</p> <p>LPA processed loans where New or Established Project review was completed do not require a CPM number.</p> <p>Conventional loans where reciprocal review was completed a CPM number is required.</p> <p>DU/Standard processed loans where Expedited Review New (R) or Established (S) or Fannie Mae Review (T) review was completed the project must</p>	X	X



	appear on Fannie Mae's CPM list and the Correspondent must provide the CPM number. For projects on FCM's Approved/Declined Condo, Co-op & PUD List, the closing must occur within 6 months of the Status Date, and prior to the earliest document expiration date; otherwise, a project approval update will be required.		
Eligibility Criteria: All	The project must meet the General Project Eligibility Requirements outlined in Section 601 including the definition of a new or established project.	X	X
	The project must not be an ineligible project. Refer to Project Eligibility for a summary of guidelines	X	X
	No more than 15% of the total units in a new or established project may be 60-days or more delinquent on condominium/HOA fee payments.	X	X
	The project must be located on one contiguous parcel of land, but may be divided by a public street. The structures within the project must be within a reasonable distance from each other.	X	X
	<p>Ownership of Project &amp; Common Elements: Common elements must not be subject to a lease between the unit owners, the Homeowners Association and any other party.</p> <p>Unit owners must have the sole ownership in and the right to the use of the common elements. A project with shared amenities is eligible if two or more HOAs share the amenities for the sole use of the unit owners, and the HOAs have an agreement specifying:</p> <ul style="list-style-type: none"> <li>• A description of the shared amenities and the terms of the unit owners' permitted use of the amenities,</li> <li>• How the shared amenities will be funded, managed, and maintained, and</li> <li>• The method for resolving disputes between the HOAs regarding the shared amenities. The developer must not retain any ownership interest in the common elements, except as unit owner.</li> </ul>	X	X
	The structures within the project must be within a reasonable distance from each other.	X	X
	Common elements and facilities, such as recreational facilities and parking, must be consistent with the	X	X



	nature of the project and competitive in the marketplace.		
	<p>Significant Deferred Maintenance: For projects with five or more attached units: If the project has significant deferred maintenance or has received a directive from a regulatory authority or inspection agency to make repairs due to unsafe conditions, the project is not eligible. The project will remain ineligible until the required repairs have been made. Acceptable documentation may include, but is not limited to, a satisfactory engineering or inspection report, certificate of occupancy, or substantially similar document. Significant deferred maintenance includes deficiencies that meet one or more of the following criteria:</p> <ul style="list-style-type: none"><li>• Full or partial evacuation of the building to complete repairs is required for more than seven days or at an unknown period of time.</li><li>• The project has deficiencies, defects, substantial damage, or deferred maintenance that<ul style="list-style-type: none"><li>○ Is severe enough to affect the safety, soundness, structural integrity, or habitability of the improvements; or</li><li>○ The improvements need substantial repairs and rehabilitation, including many major components; or</li><li>○ Impedes the safe and sound functioning of one or more of the building's major structural or mechanical elements, including but not limited to the foundation, roof, load bearing structures, electrical system, HVAC, or plumbing.</li></ul></li></ul> <p>Significant Deferred Maintenance (continued):</p> <ul style="list-style-type: none"><li>• The postponement of normal maintenance, which cannot reasonably be resolved by normal operations or routine maintenance and which may result in any of the following:</li><li>• Advanced physical deterioration,<ul style="list-style-type: none"><li>○ Lack of full operation or efficiency,</li><li>○ Increased operating costs</li><li>○ Decline in property value</li><li>○ Any mold, water intrusions or potentially damaging leaks.</li></ul></li></ul> <p>Projects that have failed to obtain an acceptable certificate of occupancy or pass local regulatory</p>	X	X



	<p>inspections or recertifications are not eligible. Violations of any federal, state, or local law, ordinance or code relating to zoning, subdivision and use, building, housing accessibility, health matters or fire safety are not eligible. This includes failure by the HOA to schedule an inspection required by the applicable jurisdiction.</p> <p>Note: The following repairs are not considered to be significant and include:</p> <ul style="list-style-type: none"><li>• Routine maintenance or repairs that a homeowner's association (HOA) undertakes to maintain or preserve the integrity and condition of its property.</li><li>• Work that is preventative in nature.</li><li>• Accomplished within the project's normal operating budget.</li><li>• Typically completed by on-site staff.</li><li>• Focused on keeping the project fully functioning and serviceable.</li><li>• If damage or deferred maintenance is isolated to one or a few units and does not affect the overall safety, soundness, structural integrity, or habitability of the improvements.</li><li>• Minor deficiencies with a cost of \$3000 or less per repair item.</li></ul>		
	<p>If the subject property is an investment property, attached units, at least 50% of the total units in the project must have been conveyed to owner-occupant principal residence or second home purchasers. This does not apply if the subject mortgage is a principal residence or second home.</p> <p>Financial institution-owned REO units (FCM or otherwise) that are for sale, not rented, may be counted as owner occupied units to meet the 50% requirement.</p>	X	
	<p>Project Budget Requirements: Lender must review the actual operating budget to determine if it:</p> <ul style="list-style-type: none"><li>• Includes appropriate allocations for line items pertinent to the type and status of the condo;</li><li>• Provides for the funding of replacement reserves for capital expenditures and deferred maintenance (at least 10% of the budget); and</li><li>• Provides adequate funding for insurance deductible amounts.</li></ul>	X	X



	<p>Non-Agency Loans Only: A Reserve Study in lieu of calculating the replacement reserve of 10% may be used provided the following conditions are met:</p> <ul style="list-style-type: none"><li>• A copy of an acceptable reserve study is retained in the project file.</li><li>• Completed within 3 years of project approval.</li><li>• Prepared by an independent 3rd party that has expertise in completing reserve studies.</li><li>• The study demonstrates that the project has adequate funded reserves that provide financial protection for the project equivalent to the standard reserve requirements.</li><li>• The study demonstrates that the project's funded reserves meet or exceed the recommendations included in the reserve study.</li><li>• Project financial statements must be obtained to demonstrate that the project is collecting sufficient funds necessary, as outlined in the reserve study. If the reserves are insufficient, the project is not eligible.</li><li>• If the project was a gut rehabilitation project, all rehabilitation work involved in a condo conversion must have been completed in a professional manner.</li><li>• "Gut rehabilitation" refers to the renovation of a property down to the shell of the structure, including the replacement of all HVAC and electrical components (unless the HVAC and electrical components are up to current code).</li><li>• For a conversion that was legally created during the past three years for Fannie Mae (five years for Freddie Mac), the architect's or engineer's report (or functional equivalent), that was originally obtained for the conversion must comment favorably on the structural integrity of the project and the condition and remaining useful life of the major project components, such as the heating and cooling systems, plumbing, electrical systems, elevators, boilers, roof, etc.</li></ul> <p>Note: If the project is a newly converted non-gut rehabilitation project with more than four residential units, it's ineligible for lender review.</p>		
	Utilities. The individual units should be separately metered, although this is not required. If they are not,	X	X





	having multiple units on a single meter must be common and customary in the local market and the budget must include adequate funding for utility payments.		
	Project Management. The project must be well-managed and, if professionally managed, the contract should be for a reasonable term and the termination provision must not require a penalty payment or advance notice of more than 90 days.	X	X
New or Newly Converted Projects	Project must meet the General Project Eligibility Requirements (including the requirements for a New Project), and meet the Lender Full Review General Eligibility requirements indicated above.		X
	The project must have been created and continue to exist in full compliance with applicable state, jurisdictional, and all other applicable laws and regulations.		X
	Assessments. The HOA assessments must begin on a specific date, and once established, the developer must be responsible for the assessments attributable to the unsold units.		X
	Completion Status. The project, or the subject legal phase, must be “substantially complete.” This means that a certificate of occupancy (or other substantially similar document) has been issued by the applicable governmental agency for the project or subject phase and that all the units in the building in which the unit securing the mortgage is located are complete, subject to the installation of “buyer selection items” such as appliances. Individual units must be available for immediate occupancy at loan closing.		X
	Presales. At least 50% of the total units in the project or subject legal phase must have been conveyed or be under a bona fide contract for purchase to owner-occupant principal residence or second home purchasers, not including the developer or its successor. <ul style="list-style-type: none"> <li>For a specific legal phase (or phases) in a new project, at least 50% of the total units in the subject legal phase(s), considered together with all prior legal phases, must have been conveyed (or be under contract to be sold) to</li> </ul>		X



	<p>owner occupant principal residence or second home purchasers, not including the developer or its successors.</p> <ul style="list-style-type: none"><li>For the purposes of this review process, a project consisting of one building cannot have more than one legal phase, and any one building in a project comprised of multiple buildings cannot be subject to more than one legal phase.</li></ul>		
	All rehabilitation work involved in a condominium conversion must have been completed in a professional manner.		X
	Gut conversions require an engineer's report if the conversion took place in the last 3 years regardless of whether the definition of "new" or "established" is met	X	X
	Non-gut conversions are considered "new" until all requirements for Established projects are met such as unit sale, HOA control, etc.	X	X
	Lender must verify that all necessary repairs are complete and replacement reserves are identified for all capital improvements and noted as adequate by the party evaluating the project. The appraiser or other licensed professional must state that the project is structurally sound, and the conditional and remaining useful life of the major project components (roof, elevators, mechanical systems, plumbing, electricity, etc.) are sufficient to meet the residential needs of the project.		X
	<p>Project Legal Documents. The project documents must state, or state law must provide, that:</p> <ul style="list-style-type: none"><li>The project documents must state, or state law must provide, that: Amendments that have a material adverse impact on first lien mortgagees must be agreed to by mortgagees that represent 51% of the units subject to first lien mortgages.</li><li>Any action to terminate the legal status of the project or use insurance proceeds for any purpose other than to rebuild must be agreed to by mortgagees that represent 51% of the units subject to first lien mortgages.</li></ul> <p>Note: The documents may allow approval to be assumed when the mortgagee of record fails to submit a response to a written proposal for an amendment</p>		X



	<p>within 60 days of receipt of notice, provided it was sent via certified, registered or return receipt mail.</p> <ul style="list-style-type: none"><li>• The mortgagee/guarantor must have the right to timely written notice of condemnation, casualty loss, 60-day delinquencies in payment of assessments, lapse, cancellation or material modification of the HOA insurance policies, or any action that requires consent of a percent of the mortgagees.</li><li>• The project documents must not give a unit owner or any other party priority over any rights of the first mortgagee in the case of payment of proceeds from termination or insurance proceeds or condemnation awards for losses to or a taking of condo units or common elements.</li></ul>		
	<p>Waiver of Right of First Refusal: Any right of first refusal in the Condominium Project Documents may not adversely impact the rights of a mortgagee or its assignee to:</p> <ul style="list-style-type: none"><li>• Foreclose or take title to a Condominium Unit pursuant to the remedies in the Mortgage, or</li><li>• Accept a deed or assignment in lieu of foreclosure in the event of default by a mortgagor, or</li><li>• Sell or lease a unit acquired by the mortgagee or its assignee.</li></ul>		X
	<p>Marketing Plan. The sale program must comply with all laws relating to advertising and sale of real estate, form and content of sales agreements, and method for handling deposits connected with a sale.</p>		X
	<ul style="list-style-type: none"><li>• Completed Condo/PUD Project Questionnaire</li><li>• Appraisal-See appraisal section</li><li>• Current budget.</li><li>• Public Offering Plan or equivalent (e.g., the Declarations, CC&amp;Rs, the Master Deed and Bylaws) and any amendments for new and newly converted projects</li><li>• Engineer's or Architect's Report for newly converted projects.</li><li>• Ground lease, if applicable.</li></ul> <p>Projects consisting of five or more attached units have these additional requirements:</p> <ul style="list-style-type: none"><li>• Project must be reviewed against Fannie's Condo Project Manager (CPM). For Agency loans, all projects with an "Unavailable" status</li></ul>	X	X



	<p>are ineligible. For Non-Agency loans, a project with an “Unavailable” status for deferred maintenance/structural integrity is ineligible. Projects listed as “Unavailable” for any other reason, should be reviewed against standard guidelines for eligibility.</p> <ul style="list-style-type: none"><li>• Project must not have any significant deferred maintenance or unsafe conditions. * These projects are not eligible until the required repairs have been made and documented. Documentation would include, but not be limited to, satisfactory engineering or inspection report, certificate of occupancy, or other substantially similar documentation.</li><li>• Additional project documentation required: Six months of the project’s HOA meeting minutes. If meeting minutes are unavailable, financial statements for the project, either audited or prepared by a professional management company, should be reviewed to determine if there is deferred maintenance or repairs necessary due to unsafe conditions.</li><li>• If there are any current special assessments, or planned special assessments, they must be reviewed to determine acceptability. Must document the reason for the special assessment, the total amount assessed and repayment terms, and documentation to support there is no negative impact to the financial stability of the project. To determine that the amount budgeted to be collected year to date has been collected, the financial statement should be dated within 90 days of the project review date and any shortfall between the budgeted and actual year to date amounts for the special assessment must not be more than 5%.The borrower must be qualified with any outstanding special assessment per the installment loan policy. The lender is expected to obtain the financial documents necessary to confirm the association can fund any repairs. If the special assessment is related to safety, soundness, structural integrity, or habitability, all related repairs must be fully completed, or the project is not eligible. Additionally, if the lender or appraiser is unable to determine that there is no adverse impact, the project is ineligible.</li></ul>		
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	<p>*Deferred maintenance as outlined in Eligibility section.</p> <p>Note: The condo/co-op project review team will make the determination regarding the impact of any deferred maintenance on the project.</p>		
Project Code	<p>Lender Full Review-New Projects:</p> <ul style="list-style-type: none"><li>• Fannie Mae Type R</li></ul> <p>Project Code</p> <ul style="list-style-type: none"><li>• Freddie New Project – J</li></ul> <p>Lender Full Review – Established Projects:</p> <ul style="list-style-type: none"><li>• Fannie Mae Type – S</li><li>• Freddie Established Project – I</li><li>• Freddie 2-4 Unit Project – L</li><li>• Freddie Detached Project – K</li></ul> <p>Correspondents represent and warranty that the full review does not include any exceptions to Fannie Mae or Freddie Mac guidelines.</p>		

### PUD Project Requirements

- A planned unit development (PUD) is a real estate project or subdivision in which each unit owner holds title to a lot and the improvements on the lot, and there is common property and improvements that are owned and maintained by a homeowners' association for the benefit and use of the individual PUD units. The homeowners pay a fee to the homeowners' association to maintain the Common Elements for their benefit. Common Elements include but are not limited to parking lots, walkways, lighting, elevators, boilers, hallways, foyers, and legal ingress and egress to individual units, and Amenities such as swimming pools, spas, gardens, beach access, golf courses or golf club memberships, and ski areas or ski passes. PUD projects are classified as Type E (established PUD projects) or Type F (new PUD projects). Zoning is not a basis for classifying a project or subdivision as a PUD.

### Eligibility Criteria

- For a project to qualify as a PUD, the homeowners' association must require automatic, non-severable membership for each individual unit owner, and provide for mandatory assessments. Zoning is not a basis for classifying a project or subdivision as a PUD.
- Once the project is classified as a PUD, additional project review is based on the unit or project characteristics as indicated in the following sections.
- Number of Units: Subject properties with more than 2 units are not eligible. Note: 2-unit PUD properties are subject to the policies, pricing and parameters applicable for 2-unit properties. A 1-4 Unit Rider is required on all investment and 2 Unit PUD properties.
- The Correspondent must represent and warrant that the PUD project meets FCM guidelines.

### Approved Project List

Must represent and warrant that the PUD project meets FCM guidelines



### **Condo Located Within a PUD**

- If a Condominium Unit is located within a PUD project, the property must meet both Condominium and PUD project eligibility and approval requirements.

### **Type E PUD**

- A Type E PUD classification applies to any established PUD project in which control of the homeowners association has been turned over to the unit purchasers. There is no specific length of time that the unit purchasers must have been in control.
- Lenders must document the PUD project type on the Uniform Underwriting and Transmittal Summary form (1008).
- Project Review is not required for:
  - Attached or Detached units
- Note: Although review is not required, Type E must be assigned to the project and underwriter must confirm required insurance coverage is in place, as indicated in the Insurance Requirements section below. Refer to the Priority of Common Assessments section below for additional requirements.
  - The Correspondent must represent and warrant that the PUD project meets FCM guidelines.
  - Lender must review the appraisal report and the Condo/PUD Project Questionnaire in order to warrant that the following eligibility criteria are met:
    - The appraisal of the unit meets all appraisal requirements outlined in the Property and Appraisal section of the Origination Administration Policy Manual.
    - The individual unit securing the mortgage is 100% complete.
    - The project is not an ineligible project, as indicated in the Ineligible Criteria of this fact sheet.
    - The Homeowners Association owns the Common Elements including Amenities, and unit owners have the rights to their use.
    - The individual unit securing the mortgage has the required insurance coverage as indicated in the Insurance Requirements section of this fact sheet.
    - The PUD Project must be in compliance with priority lien requirements outlined in Project Eligibility and Insurance Requirements.

### **Type F PUD**

- A Type F PUD classification applies to projects that the homeowners association is still controlled by the developer, regardless of the status of the construction - proposed, completed, or under construction.
- Lenders must document the PUD project type on the Uniform Underwriting and Transmittal Summary form (1008).
- The Correspondent must represent and warrant that the PUD project meets FCM guidelines.
- Project Review is not required for:
  - Attached or Detached units
- Note: Although review is not required, Type F must be assigned to the project and underwriter must confirm required insurance coverage is in place, as indicated in the Insurance Requirements section below. Refer to the Priority of Common Assessments section below for additional requirements.





- Lender must review the appraisal report and the PUD Project Questionnaire in order to warrant that the following eligibility criteria are met:
  - The appraisal of the unit meets all appraisal requirements outlined in the Property and Appraisal section of the Origination Administration Policy Manual.
  - The individual unit securing the mortgage is 100% complete.
  - The project is not an ineligible project, as indicated in the Ineligible Criteria of this fact sheet.
  - The Homeowners Association owns the Common Elements including Amenities, and unit owners have the rights to their use.
  - The project does not include any multi-dwelling units that represent the security for a single mortgage.
  - The individual unit securing the mortgage has the required insurance coverage as indicated in the Insurance Requirements section of this fact sheet.
  - The PUD Project must be in compliance with priority lien requirements outlined in Project Eligibility and Insurance Requirements

### **Insurance Requirements**

- The requirements described in this section apply to the project itself. This is in addition to all standard insurance requirements for the individual unit.
- Hazard & Flood Insurance
- If hazard and flood insurance coverage for the PUD unit are included under the project's master policy, a copy of the master policy must be obtained, regardless of whether the unit is attached or detached.
- For detached PUD properties:
  - If hazard and flood insurance coverage for the PUD unit are not included under the project's master policy, the same type of insurance that is required for a single-family dwelling is required for the individual PUD unit.
  - It is not necessary to obtain a copy of the project's master policy if it covers only the common elements. The Lender must verify that each individual unit is covered by the appropriate hazard and, if applicable, flood insurance policy.
- For attached PUD properties:
- When a first mortgage is secured by a unit in a PUD project, and the legal documents for the project allow for blanket insurance policies to cover either (1) the common elements or (2) both the individual units and the common elements, the lender must verify that the homeowners' association is maintaining a "master" or "blanket" policy that provides for premiums to be paid as a common expense. The insurance policy must at least protect against fire and all other hazards that are normally covered by the standard extended coverage endorsement, and all other perils customarily covered for similar types of projects, including those covered by the standard "all risk" endorsement. If the policy does not include an "all risk" endorsement, a policy that includes the "broad form" covered causes of loss will be acceptable. The policy must meet the requirements described below:
- Note: The following are not permitted with respect to master or blanket project insurance:
  - A blanket policy that covers multiple unaffiliated associations or projects, or
  - A self-insurance arrangement whereby the owners' association is self-insured or has banded together with other unaffiliated associations to self insure all of the general and limited common elements of the various associations.



- (Note: Affiliated projects include those that are under the same master association or share the use of common facilities that are either owned individually or as part of a master association/development. Multiple PUD projects that do not have one of these characteristics, but are managed by the same management company, are considered unaffiliated.);
- PUD common elements — The homeowners' association must maintain a property insurance policy, with premiums being paid as a common expense. The policy must cover 100% of the replacement cost of all of the common element buildings and any other common property except for those that are normally excluded from coverage, such as land, foundation, excavations, etc. Fixtures and building service equipment that are considered part of the common elements, as well as common personal property and supplies, should be covered.
- Individual Units - Individual insurance policies are also required for each unit mortgage in a PUD project if they are not covered under the project's blanket insurance policy. If the project's legal documents allow for blanket insurance policies to cover both the individual units and the common elements, blanket policies will be accepted in satisfaction of its insurance requirements for the units.
- Named Insured - The project's master or blanket insurance policy must show the homeowner's association as the named insured.
- Minimum Required Coverage and Maximum Deductible Amounts - Refer to the Insurance Section 608.
- HPML Loans – Units in PUD projects are not exempt from the escrow impound requirements, and an escrow account must be established for property-related insurance premiums. However if the homeowners association provides the only property-related coverage for the individual unit, the borrower is not eligible for an HPML loan as we do not escrow for HOA dues.
- Special Endorsements
  - Inflation Guard Endorsement, when it can be obtained.
  - Building Ordinance or Law Endorsement, if the enforcement of any building, zoning, or land-use law results in loss or damage, increased cost of repairs or reconstruction, or additional demolition and removal costs. (The endorsement must provide for contingent liability from the operation of building laws, demolition costs, and increased costs of reconstruction.), and
  - Steam Boiler and Machinery Coverage Endorsement, if the project has central heating or cooling. This endorsement should provide for the insurer's minimum liability per accident to at least equal the lesser of \$2MM or the insurable value of the building(s) housing the boiler or machinery.) In lieu of obtaining this as an endorsement to the commercial package policy, the project may purchase separate stand-alone boiler and machinery coverage.
- For Attached and Detached PUD Properties:
- If the policy has a coinsurance clause, inclusion of an Agreed Amount endorsement or selection of the Agreed Value Option (which waives the requirement for coinsurance) is considered acceptable evidence that the 100% insurable replacement cost requirement has been met. If an Agreed Amount/Agreed Value provision is used, the Agreed Amount must be no less than the estimated replacement cost.
- If the policy includes a coinsurance clause, but the coinsurance provision is not waived, the policy is still eligible if evidence acceptable to the lender confirms that the amount of coverage is at least equal to 100% of the insurable replacement cost of the project improvements. This evidence (documentation) must be maintained by the lender.
- Liability Insurance: Not required.
- Fidelity Insurance



- If the calculated amount of funds that triggers the requirements for fidelity or employee dishonesty insurance coverage is less than or equal to \$5,000 then fidelity insurance is not required
- Title Insurance
  - The title insurance policy must include an ALTA Form 5 endorsement or equivalent.

### **Document Requirements**

- Appraisal: See appraisal section
- Insurance: Evidence of all required insurance

Note: Documentation relied on to perform the project review must be retained in the loan file.

### **Coding**

- Project Classification:
  - Type E - established PUD projects
  - Type F - new PUD projects

### **Insurance Requirements-Condominium & PUD Projects**

- Must verify that the unit is covered by the project's blanket hazard and flood insurance policies. All coverages must be consistent with local, state, and federal insurance laws. This is in addition to all standard insurance requirements for the individual unit.
- Proof of insurance should be obtained up-front and included in the project review package to avoid closing delays.

### **Hazard Insurance**

- Hazard insurance provides coverage that compensates for physical damage—by fire, wind, or other natural disasters— to the property. Refer to the Insurance and Taxes sections of this manual.
- PUD projects, refer to the Planned Unit Developments (PUD)

Note: For Higher-Priced Mortgage Loans secured by PUD properties, where hazard insurance coverage is provided by the HOA, there are additional requirements that apply – refer to section 915-Higher Priced Mortgage Loan for details.

- Condominium and Cooperative projects:
  - Detached Condominiums: The property may be covered by the type of hazard insurance required for single-family detached dwellings. For flood insurance, refer below. The common elements must be covered by the project's master or blanket insurance policy, unless otherwise indicated in the project's governing documents.
  - Policy Type: "Master" or "Blanket" Policy with premiums part of common expense unless property is a detached condominium and eligible for single-family coverage; or, for projects with legal documents that allow for the individual unit owners to obtain their own hazard insurance policy and allow for a blanket insurance policy to cover the project's common elements, FCM will accept two policies to satisfy the coverage requirements. Lender must verify that both the project and the individual unit are covered by the required hazard insurance policy. Note: The following are not permitted with respect to master or blanket project insurance:
    - A blanket policy that covers multiple unaffiliated condominium associations or projects; OR



- A self-insurance arrangement whereby the owners' association is self-insured or has banded together with other unaffiliated associations to self-insure all of the general and limited common elements of the various associations. (Note: Affiliated projects include those that are under the same master association or share the use of common facilities that are either owned individually or as part of a master association/development. Multiple condominium or PUD projects that do not have one of these characteristics, but are managed by the same management company, are considered unaffiliated.)
- Carrier: Must have general policyholder's rating of B+ or financial performance index of six or better in Best's Key Rating Guide, or an A or better in Demotech, Inc.
- Coverage: All perils covered by standard extended coverage endorsement including those covered by the standard "all risk" endorsement or "broad form" coverage (including wind and flood, if applicable).
- Amount: 100% of the insurable replacement cost of the project's improvements including the individual units, if applicable. If policy contains "Guaranteed Replacement Cost Endorsement:" or "Replacement Cost Endorsement "amount of coverage is acceptable.
  - If the policy has a coinsurance clause, inclusion of an Agreed Amount endorsement or selection of the Agreed Value Option (which waives the requirement for coinsurance) is considered acceptable evidence that the 100% insurable replacement cost requirement has been met. If an Agreed Amount/Agreed Value provision is used, the Agreed Amount must be no less than the estimated replacement cost.
  - If the policy includes a coinsurance clause, but the coinsurance provision is not waived, the policy is still eligible if evidence acceptable to the lender confirms that the amount of coverage is at least equal to 100% of the insurable replacement cost of the project improvements. This evidence (documentation) must be maintained by the lender.
- Deductibles: The deductible may not exceed 5% of the dwelling coverage for the master policy as well as the individual HO-6 policy.
- Named Insured: The project's master or blanket insurance policy must show the homeowner's association or the cooperative corporation as the named insured. The HO-6 policy will show the borrower as the insured, but FCM must also be listed as a loss payee.
- Property Address: The subject property address and unit number must be included on the proof of master insurance.
- Special Endorsements:
  - Any Insurance Trust Agreement is recognized.
  - The right of subrogation against unit owners is waived.
  - The insurance is not prejudiced by any acts or omissions of individual unit owners that are not under the control of the homeowners' association.
  - The policy must be primary, even if a unit owner has other insurance that covers the same loss.
  - Special Condominium Endorsement must be provided, including the following:
    - Inflation Guard if it can be obtained.
    - Building Ordinance or Law Endorsement, if the enforcement of any building, zoning, or land-use law will result in loss, damage, increased cost of repairs, etc. (The



endorsement must provide for contingent liability from the operation of building laws, demolition costs, and increased costs of reconstruction).

- Steam Boiler and Machinery if the project has central heating or cooling. This endorsement should provide for the insurer's minimum liability per accident to at least equal the lesser of \$2MM or the insurable value of the building(s) housing the boiler or machinery. In lieu of obtaining this as an endorsement to the commercial package policy, the project may purchase separate stand-alone boiler and machinery coverage.
- Condominium Projects
  - The lender must review the entire condo project insurance policy to ensure coverage requirements are met. The master or blanket policy must cover all of the general and limited common elements that are normally included in coverage, including fixtures, building service equipment, and common personal property and supplies belonging to the homeowners' association. The policy also must cover fixtures, equipment, and replacement of improvements and include betterment coverage to cover any improvements that the borrower may have made. If the master or blanket policy does not cover the unit's interior, then the borrower must obtain a "walls-in" policy, commonly known as an HO-6 policy. Note: Mortgages secured by a Condominium Unit in a Project with a master or blanket insurance policy that combines insurance coverage for multiple unaffiliated Condominium Projects are eligible for sale provided that each covered Condominium Project has a dedicated policy limit and a specific dedicated deductible that does not exceed the requirements below. Also, the policy must clearly state that each association is a named insured. The policy limit needs to cover the full replacement cost required for the Common Elements, and to the extent required, the units. The Seller/Service must obtain the insurance policy and endorsements to adequately evaluate the insurance coverage. Additionally, the insurance policy must meet all requirements of the Guide and other Purchase Documents applicable to master or blanket insurance policies covering affiliated Condominium Projects such as:
  - The insurance company underwriting the master or blanket policy must meet insurance ratings requirements reflected in Policy;
  - The protected perils must include those normally covered in policies for similar types of Condominium Projects; and
  - If applicable, the building ordinance or law endorsement and/or equipment breakdown endorsement. HO-6 Coverage for Condominiums: If the master or blanket insurance policy does not provide coverage of the interior improvements of the unit, the borrower will be required to obtain a "walls in" coverage policy (commonly known as HO-6 policy). If required, the HO-6 insurance policy must provide coverage in an amount as determined by the insurer that is sufficient to repair the condo unit to its condition prior to a loss claim event (i.e., replacement cost). Additionally, the HO-6 must be escrowed for unless waived per the requirements for Escrow Waivers. Note: Escrow waivers are not permitted for HPML loans.

## **Flood Insurance**

- Flood insurance compensates for physical property damages resulting from flooding. It is required in federally designated Special Flood Hazard Areas. Flood insurance may NEVER be waived.

Note: The requirements described in this section apply to the project itself. This is in addition to all standard insurance requirements for the individual unit



## **Liability Insurance**

- Liability insurance coverage offers protection against claims alleging that a property owner's negligence or inappropriate action resulted in bodily injury or property damage to another party.

Note: The requirements described in this section apply to the project itself. This is in addition to all standard insurance requirements for the individual unit.

- Type of Projects: Liability insurance is required for condominium projects.

Note: Liability insurance coverage is not required for condo projects reviewed under Limited or Streamline Project Review or projects that meet the Detached Condo Project requirements outlined in Project Review Types topic in Section 601.

- Policy Type: The condominium owners association or Cooperative Corporation must maintain a Commercial Liability General Policy for the entire project, including all common areas and elements, commercial spaces, public ways, and any other areas that are under its supervision, with premiums that are part of the common expense.
- Carrier: Commercial Liability.
- Coverage: The policy must provide coverage for bodily injury and property damage resulting from operation, maintenance, or use of the project's common areas and elements, commercial spaces, and public ways. The insurance must also cover commercial spaces, that are owned by the homeowners' association, even if they are leased to others.
  - The association must also maintain any additional coverage commonly required by private mortgage investors for developments similar in construction, location, and use, including the following where applicable and available:
    - Comprehensive automobile liability
    - Bailee's liability
    - Elevator collision liability. (Refer to section 609-Cooperative Projects/Liability Insurance for requirements for co-ops.)
    - Garage keeper's liability
    - Host liquor liability
    - Workers' compensation and employer's liability
    - Contractual liability
- Amount: A minimum of \$1,000,000 for personal injury, bodily injury or property damage for any single occurrence, and the coverage must provide for claim settlements on an occurrence basis. Higher amounts of coverage may be required if similar amounts are usually required by mortgage investors in other projects in the area.
- Deductibles: None.
- Special Endorsements: If the policy does not include a "severability of interest", a specific endorsement to preclude the insurer's denial of a unit owner's claim because of negligent acts of the homeowner's association, the fee simple landowner/lessor, or other unit owners.
- Notice of Cancellation/Modification: The policy should provide for at least ten days' written notice to the homeowners' association before the insurer can cancel or substantially modify it.





## **Fidelity Insurance**

- Fidelity insurance is a type of insurance that a homeowners association or Cooperative Corporation obtains to protect itself against economic loss from dishonest acts of anyone who either handles (or is responsible for) funds that the association or corporation holds or administers, whether or not that individual receives compensation for services.

Note: The requirements described in this section apply to the project itself. This is in addition to all standard insurance requirements for the individual unit.

- **Type of Project:** Fidelity insurance is required on all condominium and cooperative projects that have more than 20 units (including FHA approved projects), regardless of project approval type. It may not be waived for projects under the Expedited or FHA review. Note: Fidelity insurance coverage is not required for condo projects reviewed under Limited or Streamline Project Review or projects that meet the Detached Condo Project requirements outlined in the Project Review Types topic in Section 601.
- If the calculated amount of funds that triggers the requirement for fidelity or employee dishonesty insurance coverage is less than or equal to \$5,000 then fidelity insurance is not required.
- **Policy Type:** "Master" or "Blanket" policy with premiums that are part of the common expense paid by the association or corporation.
- **Carrier:** Master Insurance Carrier.
- **Coverage:** The homeowners' association or Co-op Corporation must have blanket fidelity insurance coverage for anyone who handles or is responsible for the homeowners' association funds that it holds or administers, whether or not that individual receives compensation for services. The insurance policy should name the homeowners' association or Co-op Corporation as the insured. A management agent that handles funds for the homeowners' association or Co-op Corporation should be covered by its own fidelity insurance policy, which must provide the same coverage required of the homeowners' association or Co-op Corporation.
- **Amount of Coverage:** The policy must cover the maximum funds that are in the custody of the homeowners' association or Co-op Corporation or its management agent at any time while the policy is in force. A lesser amount of coverage is acceptable if the project's legal documents require the homeowners' association and any management company to adhere to one or more of the following financial controls:
  - Separate bank accounts are maintained for the working account and the reserve account, each with appropriate access controls, and the bank in which funds are deposited sends copies of the monthly bank statements directly to the homeowners' association (or Co-op Corporation).
  - The management company maintains separate records and bank accounts for each homeowners' association (or Co-op Corporation) that uses its services, and the management company does not have the authority to draw checks on, or transfer funds from, the homeowners' association's reserve account.
  - Two members of the Board of Directors must sign any checks written on the reserve account.
  - Even then, the fidelity insurance coverage must equal at least the sum of three months of assessments on all units in the project.

Note: If the project is located in a state with statutory fidelity insurance requirements, compliance with those requirements is acceptable in lieu of the above.



- **Notice of Cancellation/Modification:** The policy should provide for at least ten days written notice to the HOA or insurance trustee before the insurer can cancel or substantially modify it. For condo projects, similar notice also must be given to each holder of a first mortgage on an individual unit in a project.

## Ineligible Projects-Condominium and PUD

Ineligible Project Characteristics	Condo Project Type
Non-warrantable condominiums	X
Hotel/Resort Projects: Projects operated as a hotel, resort or other type of hospitality entity, even though the units are owned. Refer to the Condo Hotel (Condotel) topic below. Any condo, PUD or cooperative project that includes features listed for Condotel is considered ineligible	X
Project is managed by a hotel or resort management company that also facilitates short term rentals for unit owners or projects with management companies that are licensed as a hotel, motel, resort or hospitality entity	X
Hotel or motel conversions (or conversions of other similar transient properties) unless the project is an established project that meets all requirements for gut rehabilitation projects	X
Houseboat projects	X
Timeshare; fragmented or segmented ownership projects	X
Projects subject to a recreational lease between the HOA and a third party for access to recreational facilities for a specified time period and payment	X
Unit owners must have sole ownership in AND the right to the use of the common elements. If both these requirements are not met, the project is ineligible	X
Manufactured Housing: Projects comprised of manufactured homes; the subject is manufactured housing or the project consists of any single-width manufactured homes	X
Multi-Dwelling Units: A project that permits an owner to hold title to more than one unit, with ownership evidenced by a single deed and mortgage	X
<p><b>Non-Incidental Business Operations:</b> Projects with nonincidental business operations owned or operated by the homeowners association such as, but not limited to, a restaurant, spa, health club.</p> <p>A project is ineligible if the HOA is receiving more than 10% of its budgeted income from non-incidental business arrangements related to the active ownership and/or operation of amenities or services available to unit owners and the general public. This includes, but is not limited to, businesses such as a restaurant or other food and beverage-related services, health clubs, and spa services.</p> <p>Non-incidental income from the following sources is permitted provided the income does not exceed 15% of the project's budgeted income:</p> <ul style="list-style-type: none"> <li>• Income from the use of recreational amenities or services owned by the HOA for the exclusive use by unit owners in the project or leased to another project</li> </ul>	X



<p>according to a shared amenities agreements such as, but not limited to, a fitness facility, pool, community room or laundry facility; or</p> <ul style="list-style-type: none"> <li>Income from the leasing of units in the project acquired by the HOA through foreclosure.</li> </ul>	
<p>Projects with more than 35% of the total space used for nonresidential purposes are not permitted. Commercial parking facilities can be excluded from the commercial space calculation. Rental apartments and hotels located within the project must be classified as commercial space even though these may be considered “residential” in nature. For eligible projects, the appraisal must support that the excess in non-residential usage is common and customary for the area and the appraiser must provide comparables that strongly support that projects with the higher commercial/non-residential concentrations are common and customary for the area.</p>	X
<p>Concentration Levels Exceeded: Concentration levels are exceeded</p>	X
<p>Litigation or Pre-Litigation: Any project that the homeowners association or cooperative corporation is named as a party to current litigation, arbitration, mediation or pre-litigation that is reasonably expected to proceed to formal litigation, or other dispute resolution process or, if the project has not been turned over to the homeowners association, the project sponsor or developer is named as a party to current litigation that relates to the project, unless the litigation involves minor matters that do not impact the safety, soundness, habitability, or functional use of the project, such as:</p> <ul style="list-style-type: none"> <li>The litigation amount is known, the insurance company has committed to providing defense, and the litigation amount is covered by the associations or the cooperative corporation’s insurance policy.</li> <li>The HOA or co-op corporation is the plaintiff in the litigation and upon investigation and analysis the lender has reasonably determined the matter is minor and will result in an insignificant impact to the financial stability of the project;</li> <li>The reasonably anticipated or known damages and legal expenses are not expected to exceed 10% of the project’s funded reserves. If the project’s reserves are used to pay for litigation, it must not violate the applicable jurisdiction’s laws and regulations;</li> <li>The litigation involves a non-monetary neighbor dispute regarding rights of quiet enjoyment;</li> <li>The HOA or co-op corporation is seeking recovery of funds for issues that have already been remediated, repaired, or replaced and there is no anticipated material adverse impact to the HOA or coop corporation if funds are not recovered;</li> <li>Litigation concerning localized damage to a unit in the project that does not impact the overall safety, structural soundness, habitability, or functional use of the project; or</li> <li>The HOA or cooperative corporation is named as the plaintiff in a foreclosure action or as the plaintiff in an action for past due HOA dues.</li> </ul> <p>All other litigation must be submitted to FCM’s Underwriting Team to determine eligibility</p>	X



Common-Interest Apartment Projects: or community apartment projects where individuals have an undivided interest in a residential apartment building and the land on which the building is located, and have the right of exclusive occupancy of a specific apartment, often owned by several owners as tenants-in common or by a homeowner's association	X
Excessive Contributions: Projects with excessive disclosed or undisclosed seller contributions offered by the builder, developer, or property seller that may affect the value of the subject; including rent-backs, leasebacks, payment of principal, interest, taxes and insurance or HOA fees for any period of time	X
Continuing Care Retirement Communities: or Life Care Facilities, where residents sign long-term contracts for housing, medical, assisted-living and other services. Continuing Care Retirement Community (CCRC) – a residential project designed to meet the health and housing needs of seniors as their needs change. Also known as Life-Care Facilities, they are distinguished from age-restricted facilities because the residents contract in advance for a lifetime commitment from the facility	X
If the project is located in a jurisdiction that has enacted the Uniform Condo Act (UCA), the Uniform Common Interest Ownership (UCIOA) or other similar statutes that provide for regular common expense assessments, as reflected by the project's operating budget, to have priority over first mortgage liens, the agencies allow up to six months of regular common expense assessments to have limited priority over the first mortgage lien. If the title commitment reflects that the condo or PUD project is located in a jurisdiction that allows for more than six months of regular common expense assessments to have priority, unless the assessments are subordinated to the first mortgage, the project is not acceptable	X
Projects located on land owned by community land trusts	X
Projects that were rejected by Fannie Mae	X
New or newly converted condominium projects in Florida that were not approved using Fannie Mae's PERS process	X
Projects with "Unavailable" status in Fannie's Condo Project Manager	X
Freddie Mac Florida Condominium Effort	X
Projects with upfront membership fees	X
Projects that don't meet live/work guidelines	X
Newly converted non-gut rehabs	X

**Ineligible Transactions**

- All Deed Restricted Properties, including Age Only
- Higher Priced Mortgage Loans
- Industrial, Commercial or Agricultural Zoned Properties
- Income sources listed in Section 1508.5-Employment and Income/Introduction/Ineligible Sources of Income topic



first community mortgage

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## Prime Jumbo Eligibility/Requirements

- Mixed Use Properties
- Non-Arm's Length Transactions
- Non-occupant Co-borrowers
- Non-resident Applicants
- Partial Release
- Technical Refinance
- Texas Cash-Out
- Texas Section 50(a)(6)
- Texas Section 50(f)(2)
- Work Completion Escrow



## **Underwriting**

- Loans are manually underwritten, AUS decisions are not permitted.

## **Comprehensive Risk Assessment**

- Under the comprehensive risk assessment approach certain key elements—called Primary Risk and Contributory Risk factors—are evaluated to form the overall level of default risk that is present in each mortgage application. By identifying the level of risk for each of these elements and examining how the elements relate, lenders can determine the comprehensive risk associated with a mortgage application and make an informed decision about the overall risk level for the mortgage.
- When a loan is manually underwritten, underwriters are expected to thoroughly assess the default risk of the mortgage loan.
- ALL Non-Agency transactions must use the comprehensive risk assessment guidelines outlined in this section.
- Underwriters are responsible for:
  - Evaluating the default risk of each loan;
  - Reviewing the credit report, as well as all credit information, to determine that the credit report meets Agency requirements and that the data evaluated was accurate;
  - Assessing the adequacy of the property as collateral for the mortgage requested; and
- The following three steps address the levels of a comprehensive risk and instructions for each one.
  - Assess Primary Risk: Two characteristics form the primary risk of any mortgage application—the combined equity investment and the credit history for all of the borrowers who are applying for the mortgage. These two characteristics are the most significant factors in determining the default risk for any mortgage and establish the foundation of the comprehensive risk of a mortgage.
    - Equity investment in a mortgage is measured by the loan-to-value ratio (or combined loan-to-value ratio, if subordinate financing exists). The underwriter must confirm that the borrower satisfies the minimum cash down payment requirement for the type of mortgage being requested, by using his/her own financial assets (or, if appropriate, other acceptable sources). This is especially important when a borrower is requesting a mortgage that has a higher loan-to-value ratio.
    - Credit history can be defined in several ways. Generally, credit scores are used to assist with the assessment of credit risk in a mortgage application because a credit score objectively evaluates all of the characteristics in a borrower's credit file and enables the underwriter to process mortgage applications more accurately, quickly, and with a greater degree of confidence. However, there may be instances in which the underwriter may not be able to rely on credit scores, and will need to perform a comprehensive review of each borrower's credit reports. The Underwriter must verify that the documentation in the mortgage file is consistent with the credit report. Note: If the credit history for all borrowers consists only of nontraditional credit sources, then the credit history must be defined as "high primary risk".
- When evaluating Primary Risk factors, the underwriter should assess the combined effect of the borrower's equity investment and credit history so that they can make a more accurate assessment of default risk than could be gained from a separate assessment of each of these factors. Default risk varies significantly among





mortgages that have the same combined loan-to-value ratio, depending on the strength of the borrowers' credit profiles.

- Assess Contributory Risk: Contributory Risk factors are those risk factors that are not of sufficient weight by themselves to use as the basis for reaching an underwriting decision. However, when combined with primary risk factors or other contributory risk factors, they either increase or decrease the overall risk of the mortgage application.
- The contributory risk factors that have the greatest influence on mortgage loan performance, are:
  - Property Type
  - Occupancy
  - Transaction Type (Purpose)
  - Previous mortgage payment history
  - Prior bankruptcy or foreclosure, and
  - Mortgage term
  - Total debt-to-income ratio
  - Liquid financial reserves
  - Product Type
  - Presence of co-borrowers
- Note: Certain contributory risk factors may have a greater influence on the mortgage loan performance than others. However, contributory risk factors only become meaningful when they are considered with other factors.
- Assess Comprehensive Risk of the Mortgage Loan as a Whole: The underwriter should base their comprehensive risk assessment for a loan on the cumulative effect of the Primary Risk factors and the Contributory Risk factors. The underwriter's comprehensive risk assessment must be expressed in terms of a low, moderate, or high likelihood of a mortgage default. A mortgage that has a high comprehensive risk has a high probability of default.
- The cumulative effect of the layering of risk factors in a mortgage application - without sufficient offsets to lower the risks - will increase the risk of mortgage loan default. In addition to reviewing the acceptability of the documentation in the file, the underwriter must assess the comprehensive risk of the mortgage loan before deciding whether to originate.
- Documenting the Comprehensive Risk Assessment
  - Upon conclusion of the assessment, the underwriter's must document that the loan has acceptable layering of risk. The loan file must at a minimum include:
  - Document the identified risk factors; and
  - Identify and document FICO score and credit related offsets for the risks indicated by the FICO reason codes; for example, if the reason codes indicate nonpayment of obligations, the underwriter may establish that the borrower was unable to meet credit obligations because s/he experienced financial difficulties attributable to the specified extenuating circumstance; and
  - Document the identified offsetting/compensating factors; and
  - Documentation of the offsetting/compensating factors; and
  - A written conclusion that the Mortgage does not exhibit excessive layering of risks

### **Determining When To Re-Underwrite**

- After a loan has been fully approved, if the lender becomes aware of any new undisclosed debt, a reduction in income, or a final rate that is higher than the rate the borrower was approved for, the loan must be re-



underwritten. For new debts, the lender must verify the unpaid balance, the terms of repayment and the payment history (if applicable) by obtaining documentation from the borrower or the creditor. For a reduction in income, the lender must obtain updated income documentation.

- The lender must recalculate the debt ratio based on changes that have occurred since the loan was approved, and perform a comprehensive risk assessment.
  - A comprehensive risk and eligibility assessment must be performed. As a guideline for manually underwritten loans, monthly debt-to-income ratios that exceed 36% should have strong compensating factors.
  - The final loan application signed by the borrower(s) must include all income and debts that were verified, disclosed or identified prior to closing.

### **Qualifying Rate**

- Fixed Rate
  - Primary Residence-Note Rate
  - Second Home-Note Rate
  - Investment Property-Note Rate
- SOFR ARM
  - 7yr/6m SOFR- - Higher of Note Rate or FIR\*
  - 10yr/6m SOFR- Higher of Note Rate or FIR\*

\*Fully Indexed Rate (FIR).

### **Buy Downs**

- Temporary buy downs not permitted

### **Power of Attorney**

- If the closing documents have been signed by a power of attorney or attorney-in-fact, presence of a copy of a uniform or specific power of attorney document that has been appropriately signed and notarized is required prior to purchase. A general power of attorney is not acceptable unless permitted by state law.

### **Title**

- All purchase and refinance transactions on existing properties will require a 12 month "chain of title" from the title insurer that does not evidence any previous flipping activity for the property (i.e., multiple property transfers).

### **Fee Simple**

- Fee Simple is the greatest possible interest a person can have in real estate and gives them the right to dispose of the property or pass it on to their heirs. FCM must be recorded as the principal on the mortgagor's estate, subject only to liens for taxes and special assessments that are not yet due and payable, and conditions, restrictions, and encumbrances that we do not consider as material.
  - We do not consider minor impediments to title as material problems if they do not affect the marketability of the property.



- Documentation must be obtained to show that the current installments of taxes and assessments (or future installments of special assessments that have been levied)—including prior liens that may no longer be in arrears—have been paid or sufficient deposits are being collected to pay them.
- Will consider lending on properties held in trust provided it would not compromise the ability to secure a lien on the property or prevent the ability to foreclose in the event of a default by the borrower.

### **Tenants in Common (TIC) with a Tenancy in Common Agreement**

- Tenants in Common with a Tenancy In Common Agreement are not permitted given the overall risk associated with this type of ownership

### **Subordinate Financing**

- Subordinate financing is any type of financing which creates a subordinate lien on the same property for which we are originating a first mortgage. Funds from subordinate financing may be used for a variety of reasons, including:
  - Supplementing the down payment
  - Payment of closing costs
  - Setting up a Permanent Buy Down
  - Repairing/improving the subject property
- If the loan is secured by the subject property, subordinate financing and LTV parameters for the first mortgage must be enforced. Any lien against the subject property other than the first mortgage must be acceptable to FCM clearly subordinated to the first mortgage lien, and properly recorded. The monthly payment on the subordinate lien should be included with the PITIA on the subject property, if applicable, when calculating the monthly housing ratio.
- Note: This also includes business loans, such as those provided by the Small Business Administration (SBA) unless the borrower can meet the Business Debt requirements in section 1508.3 Liabilities/Recurring Debt/Business Debt.
- If funds are from a subordinate lien that is secured by another property, we need not be concerned with the type of financing or combined LTV parameters, but we must include the monthly payment in the back-end qualifying ratio.

### **Documentation Requirements**

- For purchase transactions, and refinance transactions where subordinate financing is originated concurrently with the first mortgage (either new subordinate financing or refinance of an existing subordinate lien), all the following subordinate financing documentation must be included in the loan file as applicable for each loan:
  - Note or other evidence of subordinate lien terms; and
  - Closing Disclosure or other closing statement; and
  - For HELOCs, the HELOC agreement indicating all fees and costs paid by the borrower at closing, and the maximum permitted credit advance.
- For refinance transactions, if an existing subordinate lien is not paid off, it must be re-subordinated to the new first lien, and a copy of the recorded subordination agreement must be maintained in the loan file. The note or other evidence of subordinate lien terms must be included in the loan file, so terms can be appropriately disclosed as indicated below.



- Underwriter must review the terms of the note and the security instrument for the subordinate financing to make sure the terms are acceptable.
- The subordinate financing must provide for the following:
  - Regular payments of principal and interest, OR regular payments of interest only so that negative amortization does not occur.
  - If the repayment terms provide for a variable interest rate, the monthly payment must remain constant for each 12-month period over the term of the subordinate lien mortgage. Exception: For HELOCs, the monthly payment does not have to remain constant.
  - Interest rate should be at market rate.
  - If the subordinate lien contains a maturity date or balloon or call provision within the five-year period after the note date of the first lien, it must be fully amortizing under a level monthly payment. (May be less than 5 years if the subordinate debt is minimal in comparison to the borrower's financial assets and/or credit profile. E.g., borrower's financial situation supports ability to pay off or refinance within the balloon period.)
  - Be recorded and subordinate to the first mortgage lien.

### **Disclosure Requirements**

- Lender must disclose the existence of subordinate financing and the terms of repayment (including note rate, repayment terms, and the institution or individual providing the financing) to the appraiser, the mortgage insurer and the investor. Lender may not indicate to the appraiser a value or loan-to-value needed to support the transaction.

### **Maximum Combined Loan Amount**

- There are no restrictions on the combined loan amount. The first mortgage transaction must meet LTV/CLTV/HCLTV and loan amount guidelines for the program selected. Note: This includes business loans, such as those provided by the Small Business Administration (SBA).

### **Calculations**

- CLTV: Calculate the CLTV by adding the first mortgage loan amount plus the current balances of all subordinate financing, divided by the lower of the appraised value or purchase price.
- HCLTV: Calculate the HCLTV by adding the first mortgage loan amount, plus the total amount of all subordinate financing, including the entire available home equity line amount, divided by the lower of appraised value or purchase price. If the HELOC has been modified, a copy of the modification agreement must be obtained in order for the lower, modified total line amount to be used in the HCLTV calculation. The amount on the modification agreement and the subordination agreement should also match.
- Minimum Down Payment Requirements: The minimum down payment requirement for a transaction is based on the CLTV, not the HCLTV, so if the CLTV is 80%, a 10% down payment would be required, regardless of what the HCLTV is. Note: Borrowers must use their own funds to meet the minimum borrower down payment or contribution requirement for the loan transaction.

Note: Subordinate financing may be paid off or paid down by the title company at closing; the amount paid off/down must be shown on the HUD- 1/Closing Disclosure. Additional evidence of payoff/pay down is not required.

- Subordinate financing may not have the following:



- Negative amortization
- Have special Servicing requirements for FCM
- Terms that restrict prepayments or provide for a prepayment penalty, except as indicated above
- Does not fully amortize under a level monthly payment plan when the maturity or balloon payment date is less than five years after the note date of the new first mortgage.

### **Trade Equity**

- Trade equity is equity that results from a property purchaser giving his/her existing real property as all or part of the down payment for the property that is being purchased.
- Trade equity is not allowed.

### **Interested Party Contributions**

- Interested Party Contributions (IPCs) are funds provided by someone other than the borrower(s) to pay costs associated with obtaining a mortgage that are normally the responsibility of the property purchaser. They may be paid by the seller, lender, or by any other third party who has an interest in the property sale or purchase transaction.
- IPCs are defined as Financing Concessions or Sales Concessions, as discussed later in this section.

### **Interested Parties**

- An interested party is defined as anyone other than the borrower who has a financial interest in, or can influence the terms and sale or transfer of, the property including: the property seller, builder/ developer, real estate agent, or broker (or an affiliate who may benefit from the sale of the property and/or the sale of the property at the highest possible price). A relative, domestic partner, fiancé, fiancée, municipality, non-profit organization, or employer is not considered an interested party unless s/he is the property seller or is affiliated with the property seller.
- A lender is not considered an interested party unless it is the property seller, or is affiliated with the property seller or another interested party to the sales transaction. An affiliation exists if there is direct common ownership or control by the lender over the interested party or vice versa or if there is direct common ownership or control by a third party over both the lender and the interested party. A relationship between a builder and a lender that serves as its financial institution is not an affiliation.

### **Appraisal Requirements**

- Appraisers must be provided with information relating to all interested party contributions for the subject property granted by anyone associated with the transaction, including both financing and sales concessions that have been, or will be, granted. The appraiser must also be provided with information associated with a permanent interest rate buy down funded through a standby commitment provided by the lender or the builder.
- Positive adjustments for sales or financing concessions are not acceptable.

### **File Document Requirements**

- When there is an IPC in a transaction, all loan and sales contract documents, including the sales contract, Loan Estimate (LE), the loan application, appraisal report and Closing Disclosure must include or address all financing arrangements that have been negotiated between the buyers and sellers.



- **Items That Are Subject to IPC Limits**
  - Financing Concessions are IPCs that are payments or credits related to acquiring the property or paying for financing terms (including prepaids).
  - Financing concessions are items that are subject to IPC limits.
  - Origination fees, Discount points, Commitment fees
  - Cost for Interest Rate Shortfalls
  - Appraisal Costs
  - Transfer taxes
  - Stamps
  - Attorney fees
  - Survey charges
  - Title insurance premiums or charges
  - Real estate tax service fees
  - Real estate taxes covering any period after the settlement date.
  - Funds to subsidize a permanent interest rate buy down. Permanent buy down points may be charged up to the lesser of the maximum permitted under state law or FCM Initiatives, as applicable. If the buy down subsidy was included in a standby commitment taken out by the originating lender, the buy down subsidy and the discount points being charged for the bought down rate must be included in the IPC limit calculation.
  - Funds that flow from an interested party to a non-profit and then to the buyer for payment of closing costs. These plans may not be used for to fund down payment or reserves.
- **Prepaid items:**
  - Interim interest charges (limited to no more than 30 days of interest)
  - Escrow Fees (may not be paid by FCM)
  - Real estate taxes covering any period after the settlement date (if the taxes are being escrowed by the servicer for future payments)
  - Hazard\* insurance premiums (limited to no more than 14 months); and
  - Initial or renewal mortgage insurance premiums and any escrows required for renewal of borrower-purchased mortgage insurance coverage.
  - Homeowner association (HOA) dues covering any period after the closing date (limited to no more than 12 months); \*Includes flood insurance, where applicable.
- **Lender Paid Assistance programs where the lender is the property seller or is affiliated with the property seller or another interested party to the sales transaction.**
- **Fees for standby commitments that a builder obtains for blanket coverage before it enters into a contract with a borrower are contributions, but they are not subject to limitations because they are not attributable to the specific mortgage transaction.**
- **Items paid by the property seller that are the responsibility of the seller—such as real estate sales commissions, charges for pest inspections, deed release fees, or costs that the property seller is required to pay under state or local law—are not contributions. This includes pro-rated real estate tax credits provided by the seller at closing in those jurisdictions in which property taxes are paid in arrears. This credit represents property tax amounts assessed but not yet due and payable, for the period when the seller still owned the property, and it is not considered to be a contribution. Pro-rated real estate taxes cannot be considered when determining the funds required for the transaction. Although a pro-rated tax credit from the property seller can offset that portion of the charge for the establishment of the escrow account, the**





borrower must still verify sufficient funds for down payment, closing costs, prepaids and reserves, including the payment of pro-rated real estate taxes prior to closing. (Example: Borrowers closing costs and prepaids are \$5,000. The seller's portion of the pro-rated real estate tax credit to the borrower is \$2,000. This reduces the borrower's cash to close to \$3,000. The borrower must still verify the entire \$5,000 prior to closing). Pro-rated real estate tax credits cannot be used to meet the borrowers minimum required investment or down payment.

### Items Not Subject to IPC Limits

- Buyer-broker fees paid by the seller as part of the real estate sales commission, as long as the commission being paid is typical of the commission usually paid in that real estate market.
- Gift funds received from a donor that complies with gift policy.
- Gifts or grants from a non-profit that do not obtain funding from the seller or any other interested party to the transaction.
- Funds the lender provides for closing costs and borrower prepaid fees as long as the lender is not the property seller or affiliated with an interested party to the transaction. Refer to the Lender Paid Assistance topic below for further information.
- Sales Concessions

### IPC Contribution Limits

- IPC contribution limits are based on occupancy type. They are measured using the lesser of the sales price and appraised value. The contribution limits are as follows:
  - Loan Process & Products:

Occupancy	Maximum Contribution
Primary Residence & Second Home	6%
Investment Property	2%

- The total dollar amount of the Financing Concessions may not exceed the actual total dollar amount of the allowable closing costs.

### Items Not Permitted as IPCs

- Contributions may not be used to meet the borrower's down payment or minimum borrower contribution requirements, or to meet reserve requirements for the transaction.
- Payment Abatements. Monthly payment abatements to pay for or reimburse the borrower for payments of principal, interest, taxes, insurance, and more than 12 months of homeowner association fees for units in condominium, PUD or cooperative projects are not permitted, regardless of whether they are disclosed on the Closing Disclosure. This applies to transactions where the interested party is directly funding the abatement and/or if the funding for the abatement is flowing through another entity, such as a non-profit down payment assistance program (DAP). Note: The payment of HOA fees is not considered abatement unless the payment of the fee extends for more than 12 months. The payment of HOA fees for 12 months or less is considered an interested party contribution.



- Undisclosed IPCs, including "Silent" second mortgages held by the property seller. Seller contributions that are not disclosed on the Closing Disclosure are often given to homebuyers outside of loan closing. These undisclosed contributions tend to reduce the effective sales price of a property, and may compromise the loan-to-value ratio for a mortgage. Consequently, a mortgage with undisclosed seller contributions is not eligible for origination or purchase.

### **Sales Concessions**

- IPCs that exceed allowable Financing Concession limits are considered Sales Concessions. In addition to contributions that exceed those limits, additional inducements may come in the form of cash or personal property such as furniture, automobiles, securities, and/or other "giveaways" granted by any interested party to the transaction. Often they are used as an incentive to the buyer and may or may not be disclosed on the Closing Disclosure. Other inducements to purchase that are not disclosed on the Closing Disclosure are not permitted. The cost of items that are in the form of personal property (i.e., furniture, decorator items, automobiles, or other "giveaways") are also considered Sales Concessions.
- Sales Concessions are not subject to IPC contribution limits, but their value must always be deducted from the sales price of the property. For underwriting purposes, the sales price must be reduced to reflect the amount of all Sales Concessions. The LTV ratio should then be calculated based on the lesser of the reduced sales price or the appraised value.
- Sales Concessions include, but are not limited to:
  - Payment of various fees on the borrower's behalf that are not considered allowable Financing Concessions
  - Pre-foreclosure or short sale processing fees that are charged to the borrower (also referred to as short sale negotiation fees, buyer discount fees, short sale buyer fees, etc) must be treated as a sales concession if any portion is reimbursed by the seller or an interested party to the transaction.
  - Financing Concessions that exceed allowable IPC Financing Concession limits, or that exceed the dollar amount of actual costs
  - Cash
  - Furniture
  - Automobiles
  - Decorator allowances
  - Repair allowances\*
  - Moving expenses\* Money received for repairs will not be considered contributions provided the property is new construction, repairs are complete prior to close, or if funds have been escrowed for work to be completed. Note: Escrows for repairs on existing properties are not permitted.
- For underwriting purposes, the value of Sales Concessions must be deducted from the sales price. The LTV and CLTV ratios should then be calculated based on the lesser of the reduced sales price or the appraised value.

### **Lender Contributions**

- The lender may provide the borrower with a contribution to fund borrower paid closing costs and prepaid fees in the following cases:



- The lender credit is derived from premium pricing. Refer to Section 1508.4- Assets/Funds to Close/At-Closing Principal Curtailments for details.
- The funds are sourced directly from lender with no expectation for repayment or financial obligation apart from the subject mortgage. Funds passed to the lender from a third party for the purpose of providing a lender credit are not eligible as a lender contribution.
- The amount of the lender contribution cannot exceed the amount of the borrower-paid closing costs and prepaid fees and may not be used to fund any portion of the down payment or reserve requirements.

### **Lender Incentives for Borrowers**

- Cash or Cash-like Incentives for all Transactions Types: The Lender may provide the borrower with a cash or cash-like incentive (e.g., a gift card) that is not reflected on the Closing Disclosure provided that the amount of the incentive does not exceed \$500, and no repayment is required.
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- These types of lender incentives are not considered IPCs and, as a result, are not included in the IPC limit calculation. Furthermore, these incentives are not considered cash out to the borrower and do not have to be included in the cash back to borrower at closing calculation.

### **Land Equity**

- If the property is new construction with end loan permanent financing, the equity in the land can be credited towards the borrower's minimum down payment requirements. (Borrower must own the lot/land.)
- The loan-to-value ratio should be based on the lesser of documented acquisition cost or the appraised value of the property at the time the end-loan is closed. If the conversion is treated as a refinance transaction, the loan-to-value ratio will be based on the current appraised value of the property.
- To determine the amount of equity in the lot, use one of the following:
  - If the borrower acquired the lot more than 12 months before the date of the mortgage application—or if the borrower acquired the lot at any time as gift or inheritance—the value of the lot will be its current appraised value.
  - If the borrower acquired the lot 12 or fewer months before the date of the mortgage application, the value of the lot will be the lesser of its sales price or its current appraised value.
- A 2075 Inspection will not provide a land value so if the borrower needs land equity to meet down payment requirements a full appraisal is required.

### **Lease-to-Own / Rent with Option to Buy**

- If the borrower is currently renting the subject property under a lease option contract, the portion of the monthly rent payment that exceeds the market rent can be applied to the down payment if there is a valid rental/purchase agreement in effect. The borrowers minimum cash down payment does not have to come from the borrowers own funds in order to receive the credit.
- Example: If fair market rent is \$500 per month and the borrower is paying \$600 per month, \$100 for each month the borrower has rented can be credited towards the down payment.
  - A copy of the rental/purchase agreement, verifying monthly rent and the specific terms of the lease is required;



- The original term may not be less than 12 months and the total credit due to the borrower must not exceed the amount specified in the contract;
- The appraiser must develop the market rent; and
- Copies of canceled checks or money order receipts for the last 12 months are required to document rent payments.

### **Lender Paid Assistance**

- Lender-Paid Assistance (LPA), which is financial assistance in the form of a non-repayable credit provided by a lender that is to be applied toward the borrower's closing costs only, may not be used to make any part of the borrower's down payment, meet financial reserve requirements or meet minimum borrower contributions. Additionally, Lender-Paid Assistance is not subject to the Interested Party Contributions (IPC) limitations as long as the lender is not the property seller or affiliated with an interested party to the transaction.
- Lender-paid assistance may not be used as a source of funds.

### **Trust Accounts**

- Funds from a Trust may be used with a copy of the Trust Agreement or a letter from the Trustee confirming the following information:
  - Identify the trustee's name, address, and telephone number. The trustee must be an independent third party that would typically handle trust accounts.
  - Identify the borrower as the beneficiary.
  - Verify that the borrower has access to all or a specific amount of the funds.
  - Verify that the funds are available for disbursement to the borrower.
  - Proof that funds have been received is required if assets from the trust are being used for closing.



## **Compliance/General**

### **QM Designation**

- All loans must be General QM with Safe Harbor

### **Higher Priced Mortgage Loan (HPML)**

- Not permitted

### **Assignments-MERS System**

Loans NOT registered with MERS® will be billed a \$25.00 fee.

- On a refinance transaction, if the mortgage/deed of trust has wording for the Mortgage Electronic Registration System (MERS) along with the lender's name on the title, the MERS wording is irrelevant and the Right to Cancel form should be determined based on the name of the lender that is shown along with the MERS wording.

### **Title Insurance & MERS**

- If the mortgage is registered with the Mortgage Electronic Registration System (MERS), the title insurance policy may identify it as the security instrument given to MERS solely as the nominee for the lender, its successors and assigns, but in no event may MERS be designated as the beneficiary of the title policy. MERS-registered loans must meet all agency requirements in connection with the use of that system.