Carrington Prime Advantage Underwriting Guidelines

DOCUMENT OVERVIEW

Purpose

The following document describes the responsibilities and requirements of the Carrington Mortgage Services, LLC (CMS) Mortgage Lending Division Underwriter (Underwriter) when reviewing and underwriting mortgage loan applications. The purpose of credit and property underwriting is to ensure that each loan meets high quality standards that make the loans acceptable to CMS Mortgage LLC.

Table of Contents

Overview (continued)

Revision Summary	See the Revision Summary section.

INTRODUCTION

These guidelines serve to provide direction and consistency in loan, borrower, and property eligibility.

GENERAL PROGRAM INFORMATION

Programs

See the Carrington Prime Advantage Program Matrix for details

Documentation

Full Documentation or Bank Statement Documentation and 1-Year Alternative Income Documentation is required.

Products

See applicable Carrington Prime Advantage Program Matrix

Loan Amounts and Loan-to-Values

See applicable Carrington Prime Advantage Program Matrix

State Restrictions

See applicable Carrington Prime Advantage Program Matrix

New York Loans

NY CEMA Loans are permitted (NY CEMA not eligible for CMS Correspondent channel). NY subprime loans are not permitted.

Prepayment Penalties, Points, and Fees

Total points, fees, and APR may not exceed current state and federal high-cost thresholds.

Prepayment penalties are not permitted for Owner Occupied Primary Residence and Second Home loan transactions.

Prepayment penalties are permitted for Non Owner-Occupied Investment Property loan transactions and may only be charged when permissible by State law.

See applicable Carrington Prime Advantage Program Matrix for details.

Note: States may impose different definitions of points and fees, rate/APR, or prepayment penalties than apply under HOEPA. States may also use different triggers in each category for determining whether a loan will be a "high-cost mortgage" (or equivalent terms) under state law. As a matter of policy, CMS does not offer high-cost mortgages (or equivalent terms) under Federal or state law, regardless of the basis for the loan's treatment as such.

Exceptions

Exceptions to published guidelines may be considered on a case-by-case basis and must be approved by Carrington Capital Management (CCM). Exceptions will not be considered to the Carrington Prime Advantage guidelines when the loan request generally complies with the Carrington Flexible Advantage and Carrington Flexible Advantage Plus programs. Loans with exception requests must exhibit strong compensating factors and be submitted to the Underwriting Manager along with any supporting documentation according to CMS Exception policy.

General Program Information (continued)

Anti-Steering

CMS does not direct or “steer” a consumer to consummate a transaction based on the fact that CMS will receive greater compensation in that transaction than in other transactions CMS offered or could have offered to the consumer, unless the consummated transaction is in the consumer’s interest.

Alternative Loan Program Analysis

All loan applications are to be reviewed for possible approval under a traditional conventional conforming or FHA loan program offered by the CMS. The Underwriter to complete the *CMS Alternative Program Analysis Form* to ensure borrowers are proceeding under the appropriate loan program. Loans with reduced income documentation are exempt.

TRANSACTIONS

Occupancy

Primary Residence

A primary residence (or owner-occupied property) is a dwelling occupied by the borrower as his or her principle residence.

To qualify as a primary residence, the transaction must meet each of the following criteria:

- Property is located in the same general area as the borrower’s employment
- Borrower intends to occupy the subject property for the majority of the year
- Property possesses physical characteristics that accommodate the borrower’s family
- Borrower shall occupy the property as a principal residence within 60 days after closing and continue to occupy the property as a principal residence for at least one year after the date of occupancy

Second Home

A second home is a dwelling occupied by the borrower in addition to their primary residence (may also be referred to as a vacation home). Second homes are restricted to 1-unit dwellings.

Typical second homes should meet the following criteria:

- Be located a reasonable distance away from the borrower’s primary residence
- Must be occupied by the borrower for some portion of the year
- Suitable for year-round occupancy
- Borrower must have exclusive control over the property

Must not be subject to any timeshare arrangements, rental pools or other agreements which require the borrower to rent the subject property or otherwise give control of the subject property to a management firm.

Investment Property

An investment property (or non-owner occupied property) is an income-producing property that the borrower does not occupy.

Transactions (continued)

Purchase

A purchase transaction is one which allows a buyer to acquire a property from a seller. A copy of the fully executed purchase contract and all attachments or addenda is required. Assignment of the sales contract is not permitted.

The lesser of the purchase price or appraised value of the subject property is used to calculate the loan-to-value.

General Refinance Requirements

Rate/term refinance and cash-out refinance transactions are allowed.

Determining Loan-to-Value

If the subject property was purchased between 6 months and 12 months from the note date of the new mortgage, the current appraised value may be used to determine the loan amount when two full appraisals are obtained. The lower of the two values must be used.

If the property was purchased ≤ 6 months from the note date of the new mortgage, the lesser of the current appraisal value or previous purchase price plus documented improvements (if any) must be used. The purchase settlement statement and any invoices for materials/labor will be required.

Benefit to Borrower

In keeping with the commitment of responsible lending, all primary residence and second home refinance transactions must have a measurable benefit to the borrower.

When determining the benefit on a refinance transaction, one or more of the following must exist to support the benefit to the borrower:

- Balloon payoff
- Title transfer
- Property retention
- Rate reduction
- P&I reduction
- Debt reduction
- Uncontrolled cash-out

State-specific and/or federal benefit to borrower compliance requirements must be adhered to. Underwriters are to complete the *CMS Benefit for Borrower Worksheet* to ensure compliance with the CMS benefit to borrower policy. Files must contain documentation supporting the acceptable benefit.

Additional restrictions apply if the new loan refinances an existing loan considered to be a special mortgage.

Transactions (continued)

General Refinance Requirements (continued)

A special mortgage is originated, subsidized, or guaranteed by or through a state, tribal, or local government, or nonprofit organization that either bears a below-market interest rate at the time the loan was originated or has nonstandard payment terms beneficial to the borrower, such as payments that vary with income, are limited to a percentage of income, or where no payments are required under specified conditions.

If the borrower will lose one or more of the benefits of the special mortgage, then both of the following apply:

- Underwriter must check that the loan complies with all applicable state and local laws as well as laws associated with the subject special loan program for compliance; and
- Underwriter must take special care to ensure a net tangible benefit to the borrower

Payoff in Less Than 12 Months

CMS may refrain from making a loan if it obtains any information that indicates that the borrower may pay off the loan in fewer than 12 months, whether such payoff is anticipated by refinance, sale of the property or otherwise.

Properties Listed for Sale

To be eligible for either a rate/term or a cash-out refinance, the subject property must be taken off the market on or before the application/submission date. The borrower must also confirm in writing the reason for the prior MLS listing and statement of intent to retain the subject property for 12 months after closing.

For cash-out transactions, if the subject property was listed for sale in the 6 months prior to the application/submission date, a minimum 2-year prepayment penalty* or 10% LTV reduction from the maximum available for the specific transaction is required.

The lesser of the most recent list price or the current appraised value should be used to determine loan- to-value for both rate/term or cash-out transactions.

*Note - Prepayment penalties may only be applied to Investor Loans and may not be used in AK, DE, MD, NJ, NM, or VT. Prepayment restrictions may exist in other states. Please refer to the state-specific matrices for details.

Refinances of Short Payoffs

Refinances of Short Payoffs are ineligible.

Transactions (continued)

Rate/Term Refinance

A rate/term refinance is the refinancing of an existing mortgage for the purpose of changing the interest and/or term of a mortgage without advancing new money on the loan.

The mortgage amount for a rate/term refinance is limited to the sum of the following:

- Existing first mortgage payoff
- Closing costs and prepaid items (interest, taxes, insurance) on the new mortgage
- The amount of any subordinate mortgage liens used in their entirety to acquire the subject property (regardless of seasoning)
- The amount of a home equity line of credit in first or subordinate lien position that was used in its entirety to acquire the subject property (regardless of seasoning)
- Any subordinate financing that was not used to purchase the subject property provided:
    - For closed end seconds, the loan is at least one year seasoned as determined by the time between the note date of the subordinate lien and the application date of the new mortgage
    - For HELOCs and other open-ended lines of credit, the loan is at least one year seasoned and there have been less than $2,000 in total draws over the past 12 months

If the most recent first mortgage transaction on the property was a cash-out refinance within the last 6 months, the new mortgage is not eligible. Note date to note date is used to calculate the 6 months.

On rate/term transactions, the borrower may only receive cash back in an amount that is the lesser of 2% of the new mortgage balance or $2000.

Texas Conversion (Refinance) Transactions

The state of Texas permits conversion of Texas Home Equity cash-out transactions to rate/term refinance transactions under Tex. Const. Art. 16 §50(f)(2).

Refer to Refinancing an Existing Home Equity Loan - Texas Conversion Transactions for detailed requirements to convert (refinance) a Texas 50(a)(6) loan to a non-home equity rate/term loan.

Transactions (continued)

Cash-Out Refinance

A cash-out refinance is a refinance that does not meet the rate/term refinance definition. Cash-out would include a refinance where the borrower receives cash from the transaction or when an open-ended subordinate lien (that does not meet the rate/term seasoning requirements) is refinanced into the new transaction.

A mortgage taken out on a property previously owned free and clear is always considered a cash-out refinance.

The mortgage amount for a cash-out refinance transaction may include any of the following:

- Existing first mortgage payoff
- Closing costs and prepaid items (interest, taxes, insurance) on the new mortgage
- The amount of any subordinate mortgage liens being paid off that do not meet seasoning and draw history requirements as described in Rate/Term Refinance
- The amount of any non-mortgage related debt paid off through closing
- Additional cash in hand reflected on the settlement statement

Cash-Out Letter of Explanation Required

A signed letter from the borrower disclosing the purpose of the cash-out must be obtained on all cash-out transactions. Borrower(s) must write, sign, and date the letter themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content.

The Underwriter should ensure the purpose of the cash-out is also reflected on the loan application. The application alone is not sufficient to explain the purpose of the cash-out.

Seasoning

For all cash-out refinance transactions:

- At least one borrower must have been on title a minimum of six (6) months prior to the new note date, and
- A minimum of six (6) months must have elapsed since the most recent mortgage transaction (either the original purchase transaction or subsequent refinance) on the subject property. Note date to note date is used to calculate the six (6) months.

See also Determining Loan-to- Value for calculating LTV.

For cash-out refinance transactions where the property is currently vested in a Trust or LLC, the borrowers must have owned the property in the name of a Trust or LLC for at least six (6) months prior to closing.

Note: The six (6) months seasoning requirement may include a recent vesting change from a Trust or LLC to the borrower; however, loans may not close vested in the name of a Trust or LLC. Properties removed from a Trust/LLC are not required to meet the seasoning requirements if the property moves from the Trust to the owner of the Trust or the LLC to the owner of the LLC. Minimum fifty-percent (50%) ownership of the LLC is required.

Transactions (continued)

Cash-Out Refinance (continued)

There is no waiting period if the borrower was legally awarded the property through divorce, separation, or dissolution of a domestic partnership. See also Inherited Properties and Property Buyouts.

Delayed Financing

Cash-out on properties purchased by the borrower with cash and owned less than 6 months is allowed. The following requirements apply:

- Original transaction was an arm's-length transaction
- Settlement statement from purchase confirms no mortgage financing used to acquire subject
- Source of funds used for purchase documented (gift funds may not be included)
- New loan amount can be no more than the actual documented amount of the borrower's initial investment in purchasing the property plus the financing of closing costs, prepaid fees, and points on the new mortgage loan
- All other cash-out refinance eligibility requirements must be met

Cash-Out Limits

CASH-OUT LIMITS		
Program	**Occupancy**	**All LTVs**
Carrington Prime Advantage Program	Primary Residence, Second Homes and Investment Properties	Refer to program matrix.

Higher Priced Mortgage Loans (HPML)

A higher-priced mortgage loan (HPML) is a closed-end consumer credit transaction secured by the consumer's principal dwelling (owner-occupied, primary residence, 1- 4 units, 1^{st} or 2^{nd} lien purchase and refinance transactions).

Exemptions: These requirements do not apply to the following:

- Second homes
- Investment properties

The loan will be considered a HPML if the APR exceeds the average prime offer rate (APOR) for a comparable transaction as of the date the interest rate is set by:

- 1st Lien: 1.5% or more
- 1st Lien (Jumbo Loans): 2.5% or more
- 2nd Lien: 3.5% or more

Transactions (continued)

Higher Priced Mortgage Loan Requirements

CMS must comply with the following requirements on all HPML:

Escrow Accounts Required

CMS may not extend a higher-priced mortgage loan secured by a first lien on a consumer’s principal dwelling unless an escrow account is established before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor.

Insurance Premiums: Insurance premiums need not be included in escrow accounts for loans secured by dwellings in condominiums, planned unit developments, or other common interest communities in which dwelling ownership requires participation in a governing association, where the association has an obligation to the dwelling owners to maintain a master policy insuring all dwellings.

Appraisals Required

Generally, CMS is required to obtain an appraisal prior to extending a higher-priced mortgage loan to a consumer. CMS must provide to the consumer a copy of any written appraisal performed in connection with a higher-priced mortgage loan. Copies must be provided no later than three business days prior to consummation of the loan or in the case of a loan that is not consummated, no later than 30 days after CMS determines that the loan will not be consummated.

A second appraisal, at no cost to the consumer, must be obtained if:

- The seller acquired the property 90 or fewer days prior to the date of the consumer’s agreement to acquire the property and the price in the consumer’s agreement to acquire the property exceeds the seller’s acquisition price by more than 10%, or
- The seller acquired the property 91 to 180 days prior to the date of the consumer’s agreement to acquire the property and the price in the consumer’s agreement to acquire the property exceeds the seller’s acquisition price by more than 20%.

The second appraisal must be obtained by a different certified or licensed appraiser than the one who prepared the first appraisal.

Flip Transactions

A transaction will be considered a flip transactions when:

- The seller acquired the property 90 or fewer days prior to the sales contract date, and the new contract price exceeds the seller’s acquisition price by more than 10 percent; or
- The seller acquired the property 91 to 180 days prior to the sales contract date, and the new contract price exceeds the seller’s acquisition price by more than 20 percent.

The chain of title and appraisal report must be reviewed for prior sale and transfer history. Flip transactions are subject to the following requirements:

- All transactions must be arm’s length, with no identity of interest between the buyer and property seller or other parties participating in the sales transaction
- No assignments of the contract to another buyer
- A second full appraisal is required

Transactions (continued)

Non-Arm's Length Transactions

Non-arm's length transactions involve a direct relationship outside of the subject transaction between a borrower and a party to the loan. The appraiser must be informed of the relationship and address any impact on market value.

Examples of non-arm's length transactions include, but are not limited to, the following:

- Family member sales
- Renters purchasing from current landlord
- Buyer trading properties with the seller
- Property seller foreclosure bailouts
- Existing buyer relationship with loan officer, real estate agents, closing agent, appraiser, builder, or developer

Non-arm's length transactions are subject to all of the following requirements:

- Primary residence only
- Relationship must be fully disclosed
- An appraisal review product is required
- Borrower to provide a written letter of explanation stating relationship to the seller and reason for purchase. Borrower(s) must write, sign, and date the letter themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content.
- Borrower to provide a copy of the canceled earnest money check paid to the property seller
- Underwriters must be satisfied that the transaction makes sense and that the borrower will occupy the property
- All liens on title to be paid in full and reflected on the settlement statement
- Lesser of sales price or current appraised value to be used to calculate the LTV
- Borrowers cannot provide services on transaction (closing agent, title agent, appraiser, etc.)
- Borrower may not be an owner of a business entity selling the subject property

The following additional requirements apply only to family sales:

- Payment history for the seller's mortgage on the subject property must be obtained and show no pattern of delinquency within the past 12 months (if applicable)
- Verification that the borrower has not been in title to the property in the past 24 months
- Gift of equity is permitted

Transactions (continued)

Inherited Properties and Property Buyouts

Refinances of inherited properties and properties legally awarded to the borrower (divorce, separation, or dissolution of a domestic partnership) are allowed. If the subject property was acquired < 12 months prior to loan closing, the transaction is considered a cash-out.

These transactions are subject to the following:

- Written agreement signed by all parties stating the terms of the buyout and property transfer must be obtained
- Equity owners must be paid through settlement
- Subject property has cleared probate and property is vested in the borrower's name
- Current appraised value is used to determine loan-to-value

Cash-Out Refinance Transactions: For inherited properties, a minimum of six (6) months must have elapsed since the most recent title transfer or mortgage transaction (either the original purchase transaction or subsequent refinance) on the subject property. For title transfers the recording date to note date is used to calculate the six (6) months. For mortgage transactions the note date to note date is used to calculate the six (6) months.

Land Contract/ Contract for Deed

When the proceeds of a mortgage transaction are used to pay off the outstanding balance on a land contract that was executed more than 12 months prior to the date of the loan application, the transaction is considered rate/term refinance.

If the land contract was executed within 12 months of the date of the loan application, the transaction is considered a purchase.

The following requirements apply:

- Primary residence only
- Copy of fully executed land contract and payoff(s) to be obtained
- Copies of canceled checks for 12 months (or term of the lease if less) as evidence of timely payments
- If the land contract was executed less than 12 months ago, the borrower's previous housing payment history must also be verified to complete a completed 12-month history
- Liens on title to be paid in full and reflected on settlement statement at closing
- If the contract was executed less than 12 months ago, the lesser of the purchase price or the current appraised value must be used to determine LTV. The current appraised value may be used to determine LTV if the land contract was executed over 12 months ago.
- Cash-out and non-arm's length transactions not eligible

Transactions (continued)

Lease with Purchase Option

Lease with purchase option transactions are allowed for primary residences only. Borrowers may apply a portion of the rent paid to their down payment requirements. See Rent Credit for Lease with Purchase Option for detailed requirements.

For lease with purchase option transactions, the file must contain:

- Copy of fully executed rental/purchase agreement verifying monthly rent and the specific terms of the lease; and
- Copies of canceled checks for 12 months (or term of lease if less) as proof of rental payments

Permanent Financing for New Constructions

The conversion of construction-to-permanent financing involves the granting of a long-term mortgage to a borrower to replace interim construction financing obtained by the borrower to fund the construction of a new residence. The borrower must hold title to the lot, which may have been previously acquired or purchased as part of the transaction.

When a refinance transaction is used, the borrower must have held legal title to the lot before he/she applied for the construction financing and must be named as the borrower for the construction loan.

A construction-to-permanent transaction may be closed as a purchase, rate/term refinance or cash-out refinance. All construction work must be complete. See New Construction.

- For lots owned ≥12 months from application date for the subject transaction, LTV is based on the current appraised value.
- For lots owned < 12 months from application date for subject transaction, LTV is based on the lesser of the current appraised value of the property or the total acquisition costs (sum of construction costs and purchase price of lot).

TEXAS HOME EQUITY LOANS

Background

A Texas Section 50(a)(6) mortgage is a home equity loan originated under the provisions of Article XVI, Section 50(a)(6), of the Texas Constitution, which allow a borrower to take equity out of a homestead property under certain conditions.

All Texas Home Equity transactions must comply with the more restrictive of the Loan Purchase Eligibility Guidelines or this Texas Home Equity Loans Section.

Seller Certification

CMS certifies that with respect to all of the Texas Section 50(a)(6) mortgages the following:

- All Texas Section 50(a)(6) mortgages were (or will be) originated pursuant to written processes and procedures that comply with the provisions of the Texas Constitution applicable to mortgage loans authorized by Section 50(a)(6), Article XVI of the Texas Constitution, as amended from time to time.
- CMS has in place a specific process for the receipt, handling, and monitoring of notices from borrowers that CMS failed to comply with the provisions of the law applicable to Texas Section 50(a) (6) mortgages. Such process must be adequate to ensure that CMS will correct the failure to comply by one of the authorized means no later than the 60th day after the date CMS is notified of the failure to comply by the borrower.
- An attorney familiar with the provisions of Section 50(a)(6), Article XVI of the Texas Constitution was consulted (or will be consulted prior to origination of the Texas Section 50(a)(6) mortgages) in connection with the development and implementation of the processes and procedures used for the origination of the Texas Section 50(a)(6) mortgages.
- To ensure ongoing compliance with the law applicable to mortgage loans authorized by Section 50(a) (6), Article XVI of the Texas Constitution, the processes and procedures used for the origination of the Texas Section 50(a)(6) mortgages will be reviewed by CMS regularly and will be updated and revised, as appropriate pursuant to clarifications of the law, on a regular and continual basis.
- CMS certifies that it is lawfully authorized to make loans described by Section 50(a)(6), Article XVI, of the Texas Constitution.
- The matters certified herein are CMS representations and warranties given in connection with each Texas Section 50(a)(6) mortgage.

General Requirements

The following parameters apply to Texas Section 50(a)(6) mortgages:

- Fixed 30-year and Fixed 40-year products
- Full Documentation and Alternative Documentation of income allowed
- Maximum LTV = Maximum Cash Out LTV per Matrix (not to exceed 80% LTV)
- 1-unit properties only

Texas Home Equity Loans (continued)

Loan Parameters

The following are considered Texas Section 50(a)(6) loans:

- Loans using proceeds to pay off an existing 50(a)(6) loan (as identified in title work)
- Loans using proceeds to pay off federal tax debt liens
- Loans using proceeds to pay property tax liens on the property securing the new loan
- Loans using proceeds to pay off or pay down debts that are not secured by the homestead property
- Loans with any cash back to the borrower

The following are **NOT** considered Texas Section 50(a)(6) loans:

- Loans using proceeds to pay current taxes due on the property securing the loan
- Loans using proceeds to buy out equity pursuant to a court order or agreement of the parties (usually applies to a divorce settlement)
- Loan proceeds used to pay a prepayment penalty assessed on an existing non-50(a)(6) loan, and the prepayment is included in the payoff amount (new loan must have a new title policy issued without exception to the financing of the prepayment fee)
- Loans that include the payment of HOA dues, if title company requires them to be paid

Restrictions

The following restrictions apply to Texas Home Equity loans:

- Texas Home Equity loans may not be refinanced more than once a year (>12 months)
- There can be only one outstanding 50(a)(6) loan on a property at any given time
- If the borrower has an existing 50(a)(6) second lien and is getting cash-out from the first mortgage, that lien must be paid off
- The 50(a)(6) loan may not be used to acquire the property or to finance construction

Occupancy

Texas Home Equity loans are allowed on primary residences only. All borrowers on the loan must be in title and occupy the subject property as their primary residence.

Texas Home Equity Loans (continued)

Borrowers

The following borrowers are permitted on Texas Home Equity loans. All borrowers must maintain primary occupancy in the subject property:

- U.S. Citizens
- Permanent Resident Aliens
- Non-Permanent Resident Aliens

The following borrowers are not allowed:

- Co-signer(s)
- Non-occupant co-borrowers
- Borrowers not on title
- Foreign Nationals
- Corporations, partnerships, or LLCs
- Irrevocable trusts
- Inter Vivos Revocable Trusts

Non-Borrowing Spouse

A married borrower may not create a lien against the property unless his/her spouse consents to the lien by signing the following:

- Notice Concerning Extension of Credit
- Security Instrument (including any Riders)
- Federal Truth-in-Lending (TIL) Disclosure Statement
- Right of Rescission Notice
- Discount Point Disclosure
- Acknowledgment of Fair Market Value
- Premium Pricing Disclosure
- All owners must sign the application and the Notice Concerning Equity Loan Extension of Credit (English or Spanish). The signing of both of these documents starts the 12-day ‘cooling off’ period.
- Notice of Presentment of CD One Day Before Closing
- Texas Home Equity Affidavit and Agreement
- Owner’s Affidavit of Compliance
- Receipt of Copies of Documents
- Certificate of Non-Cancellation of Loan

An owner-in-title (whether a spouse or individual) must sign the application and Texas Home Equity Notice (English or Spanish) at the time of application, along with all appropriate documentation.

Texas Home Equity Loans (continued)

Refinancing an Existing Home Equity Loan

Effective for loans made on or after 1/1/18, existing home equity loans (as identified in title work) may be refinanced as non-home equity loans and secured with a lien against the home, provided the following conditions are met:

- the refinance occurs at least a year after the home equity loan was closed;
- the additional loan amount only covers the actual costs of the refinancing, and does not provide the consumer with additional funds;
- the value of the new loan combined with the total of the outstanding principal balances of all other valid indebtedness secured by the homestead does not exceed 80% of the fair market value of the homestead on the date the extension of credit is made; and
- the lender provides the homeowner the written notice (required by and promulgated under Section (f)(2)(D) and referenced below) on a separate document no later than the third business day after the date the owner submits the loan application and at least 12 days before the closing of the refinance.

The 'Notice Concerning Refinance of a Texas Home Equity Loan Pursuant to Subsection (f)(2) of Article XVI, Section 50 of the Texas Constitution', must be provided to the owner:

NOTICE CONCERNING REFINANCING A HOME EQUITY LOAN

YOUR EXISTING LOAN THAT YOU DESIRE TO REFINANCE IS A HOME EQUITY LOAN. YOU MAY HAVE THE OPTION TO REFINANCE YOUR HOME EQUITY LOAN AS EITHER A HOME EQUITY LOAN OR AS A NON-HOME EQUITY LOAN, IF OFFERED BY YOUR LENDER.

HOME EQUITY LOANS HAVE IMPORTANT CONSUMER PROTECTIONS. A LENDER MAY ONLY FORECLOSE A HOME EQUITY LOAN BASED ON A COURT ORDER. A HOME EQUITY LOAN MUST BE WITHOUT RECOURSE FOR PERSONAL LIABILITY AGAINST YOU AND YOUR SPOUSE.

IF YOU HAVE APPLIED TO REFINANCE YOUR EXISTING HOME EQUITY LOAN AS A NON-HOME EQUITY LOAN, YOU WILL LOSE CERTAIN CONSUMER PROTECTIONS. A NON-HOME EQUITY REFINANCED LOAN:

(1) WILL PERMIT THE LENDER TO FORECLOSE WITHOUT A COURT ORDER;
(2) WILL BE WITH RECOURSE FOR PERSONAL LIABILITY AGAINST YOU AND YOUR SPOUSE; AND
(3) MAY ALSO CONTAIN OTHER TERMS OR CONDITIONS THAT MAY NOT BE PERMITTED IN A TRADITIONAL HOME EQUITY LOAN.

BEFORE YOU REFINANCE YOUR EXISTING HOME EQUITY LOAN TO MAKE IT A NON-HOME EQUITY LOAN, YOU SHOULD MAKE SURE YOU UNDERSTAND THAT YOU ARE WAIVING IMPORTANT PROTECTIONS THAT HOME EQUITY LOANS PROVIDE UNDER THE LAW AND SHOULD CONSIDER CONSULTING WITH AN ATTORNEY OF YOUR CHOOSING REGARDING THESE PROTECTIONS.

YOU MAY WISH TO ASK YOUR LENDER TO REFINANCE YOUR LOAN AS A HOME EQUITY LOAN. HOWEVER, A HOME EQUITY LOAN MAY HAVE A HIGHER INTEREST RATE AND CLOSING COSTS THAN A NON-HOME EQUITY LOAN.

For loans refinancing an existing home equity loan, the loan file must include the Texas Constitution Section 50(f-1) Affidavit Acknowledging Requirements of Subsection (f)(2), which must be properly executed under Texas law by the owner/owner's spouse.

NOTE: All the above requirements must be met in order for the home equity loan to be refinanced as a non-home equity loan.

Texas Home Equity Loans (continued)

12-Day Cooling Off Period

The Notice Concerning Equity Loan Extension of Credit must be provided to the borrower in English and an additional copy of the notice translated into the written language in which the discussions were conducted. To ensure the disclosure is provided to the borrower in the correct language, the loan officer must add a comment to the Loan Submission form identifying the language spoken. The processor must properly identify the language spoken when ordering documents.

- Loan may not be closed until at least 12 calendar days after the borrower has dated and signed the initial application and Notice Concerning Equity Loan Extension of Credit.
- E-Consent signatures are acceptable
- The "cooling off" period in which the borrowers, owners-in-title, and/or spouse (including non-borrowing spouse) can change his/her mind about the Texas Home Equity first mortgage runs from the later of:
    - The date the initial loan application is signed, or
    - The date that the Notice Concerning Equity Loan Extension of Credit is signed and dated by the borrowers, owners-in-title, and/or spouse.

Payoff of Debt

CMS may require the payoff of the existing first lien as part of the loan approval when the following requirements are met:

- CMS may not require any other seller-owned debt be paid off as part of the transaction as a condition of loan approval.
- If the payoff of debts to other sellers/creditors is required in order to qualify the borrower, then those payoffs must be shown on the settlement statement and disbursed directly to the creditor by the title company. Personal debt being paid through the closing is required to reflect the name of the creditor as the payee.
- Debts that are elected to be for paid off by the borrower but are not required to be paid off in order to qualify the borrower, may be disbursed directly to the borrower.

Secondary Financing

New subordinate financing is not allowed, but existing subordinate financing may remain in place. See Secondary/Subordinate Financing. Existing subordinate financing is subject to the following:

- Second lien must be re-subordinated
- Maximum CLTV = Maximum LTV for the transaction (Institutional seconds only).
- Second lien may not be a HELOC or a reverse mortgage

Texas Home Equity Loans (continued)

Property Characteristics

All properties must be residential in nature. Tax certification and exemptions for the property are to be reviewed and must meet the following requirements:

- Property must be a principal residence constituting the borrower's homestead in state of Texas.
- The homestead property may not exceed the applicable acreage limit as determined by Texas law.
- All separate structures must be included in the homestead exemption.
- The homestead parcel, as identified on the county appraisal district records, must include ingress/egress to a properly identified public road.
- The new lien may only be secured by the homestead parcel and the market value for LTV calculation can only be assessed on that parcel.
- All property repairs must be completed prior to closing with no exceptions. Escrow holdbacks are not permitted.

Urban Homestead Definition

Acreage

Acreage securing the loan may not exceed 10 acres.

Property Location and Services

Property must be located:

- Within municipal boundaries, or
- Its extraterritorial jurisdiction, or
- A platted subdivision and be served by police protection, paid or volunteer fire protection, and at least three of the following services provided by a Municipality or under contract to a municipality:
  - Electric
  - Natural gas
  - Sewer
  - Storm sewer
  - Water

Properties determined to be ‘Urban’ cannot exceed 10 acres. The property should conform to and be acceptable in the market area. The appraisal must include the actual size of the site and not a portion of the site.

Texas Home Equity Loans - Closing Requirements

Attorney Review

All documents must be reviewed by one of the following law firms (other attorneys may be acceptable when approved in advance by CMS and the Investor):

- McGlinchey Stafford and Youngblood & Associates
- Polunsky Beitel Green, LLP
- Brown, Fowler, Alsup
- Beadle, Newman, & Lawler
- Gregg & Valby, LLC
- Black, Mann and Graham, LLP
- Robertson Anschutz Vetters, LLC

Closing Disclosure and Final Loan Application

The final Closing Disclosure (CD) and a copy of the final Uniform Residential Loan Application (URLA) must be delivered to/accepted by the borrower(s) during normal business hours. CMS is responsible for ensuring all timing requirements under Regulation Z and state law are complied with.

Borrower must sign the Acknowledgment of Itemization of Fees, Points, Interest, Costs and Charges for Texas Home Equity Loan or Line of Credit to evidence their receipt of the final Closing Disclosure and URLA.

Points and Fees

Borrower paid fees are limited to 2% of the principal balance (including the origination fee). The following are not included in the 2% limitation:

- Lender paid closing costs
- Per diem interest
- Bona fide discount points used to reduce the interest rate
- Escrow/impound funds
- Appraisal fee paid to third-party appraiser
- Surveys (completed by state registered or licensed surveyors)
- A state base premium for a mortgagee policy of title insurance with endorsements established in accordance with state law; or if a mortgagee title policy is not issued, a title examination report (if cost is less than the state base premium for a mortgagee title policy without endorsements)

If borrowers are paying discount points, the borrowers, owners-in-title and/or spouse must execute the TX Home Equity Discount Point Acknowledgment.

Only fees which are allowed by State Law and RESPA/ECOA regulatory guidelines can be charged to the borrower and MUST be accurate and reflected on the Loan Estimate (LE) and the Closing Disclosure (CD).

Please note: Texas Conversion loans are excluded from the 2.00% fee limitation.

Power of Attorney

Power of Attorney is not allowed on Texas Home Equity transactions.

Texas Home Equity Loans - Closing Requirements, continued

Survey

Surveys are required on all Texas Home Equity transactions to ensure the following:

- Confirm lot size
- Evidence homestead property and any adjacent land are separate
- Evidence homestead and property is a separately platted and subdivided lot for which full ingress and egress is available
- Properties must be served by municipal utilities, fire and police protection
- Homestead must be separate parcel within permissible acreage

Title

A title insurance policy written on Texas Land Title Association forms (standard or short) including T42 and T42.1 endorsements is required.

For self-employed borrowers operating a business from the homestead property, the title company must issue a T42.1 endorsement without exception or deletion.

Title may not include language that:

- excludes coverage for a title defect that arises because financed origination expenses are held not to be "reasonable costs necessary to refinance"; or
- defines the "reasonable costs necessary to refinance" requirement as a "consumer credit protection" law since the standard title policy excludes coverage when lien validity is questioned due to a failure to comply with consumer credit protection laws.

Loans must be closed in a Texas title company's office or attorney's office. No mobile notaries are permitted.

Texas Home Equity Documents

The following additional Texas Home Equity Specific documents must be included in the closing package:

- Notice Concerning Extension of Credit Defined by Section 50(a)(6) (signed by each owner of the property and each spouse of an owner)
- Acknowledgment of Fair Market Value of Homestead Property (borrower and seller must sign at closing with an appraisal attached to the Acknowledgment)
- Notice of Right to Cancel (signed by each owner of the property and each spouse of an owner)
- Texas Home Equity Security Instrument (Form 3044.1)
- Texas Home Equity Note (Form 3244.1)
- Texas Home Equity Affidavit and Agreement (Form 3185)
- Texas Home Equity Condo Rider (Form 3140.44), if applicable
- Texas Home Equity PUD Rider, (Form 3150.44), if applicable

Texas Home Equity Loans - Closing Requirements, continued

Texas Home Equity Documents, continued

- Texas Home Equity Certificate from Originating Lender's Regarding Compliance with Section 50(a)(6) Article XVI of the Texas Constitution signed by CMS's Attorney
- Texas Home Equity Discount Point Acknowledgment, if applicable
- Affidavit of Non-Homestead for all other dwellings, if borrower owns more than one
- Detailed closing instruction letter acknowledged by title company (Compliance Requirements for Texas Home Equity Loans)
- Note for any re-subordinating second (cannot be an (a)(6) Note, a new loan or a HELOC) with subordination agreement, if applicable

BORROWERS

A borrower is a credit applicant who will have ownership interest in the subject property, sign the security instrument, and sign the mortgage or deed of trust note. If two or more individuals own the property jointly, and are jointly and severally liable for the note, all are considered to be borrowers. CMS limits the maximum number of borrowers on one loan to eight (8).

Customer Identification Program (CIP)

The USA Patriot Act requires banks and financial institutions to verify the name, date of birth, address and identification number of all borrowers. Underwriters are to follow the published CMS procedures for each seller to ensure the true identity of all borrowers has been documented.

Fraud Report and Background Check

All loans must include a third-party fraud detection report for all borrowers, owners of the business entity and/or guarantors; however, a fraud report is not required for the business entity itself. Report findings must cover standard areas of quality control including, but not limited to: borrower validation, social security number verification, criminal records, and property information (subject property and other real estate owned). All high-level alerts on the report must be addressed by the Underwriter.

U.S. Citizen

U.S. Citizens are eligible for financing.

Borrowers (continued)

Permanent Resident Aliens

A permanent resident alien is a non-U.S. citizen authorized to live and work in the U.S. on a permanent basis. Permanent resident aliens are eligible for financing.

Acceptable evidence of lawful permanent residency must be documented and meet one of the following criteria:

- I-151 – Permanent Resident Card (Green Card) that does not have an expiration date
- I-551 – Permanent Resident Card (Green Card) issued for 10 years that has not expired
- I-551 – Conditional Permanent Resident Card (Green Card) issued for 2 years that has an expiration date, as long as it is accompanied by a copy of USCIS form I-751 requesting removal of the conditions
- Un-expired Foreign Passport with an un-expired stamp reading as follows: “Processed for I-551 Temporary Evidence of Lawful Admission for Permanent Residence. Valid until mm-dd-yy. Employment Authorized.”

Foreign Borrowers

Borrowers living overseas are eligible for second home and investment financing. The Foreign Borrower must:

- Have a social security number and meet residency requirements as a Citizen, Permanent Resident, or Non-Permanent Resident,
- Have sufficient domestic credit to generate FICO scores and meet minimum trade line requirements,
- Document his or her foreign housing expense,
- Provide tax returns and follow Foreign Income requirements if using Foreign Income for qualifying
- If bank statements are required, they will be reviewed for undisclosed debts, and
- Disclose all foreign debts on the URLA, and provide a foreign credit report if available to verify ratings.

Borrowers (continued)

Non-Permanent Resident Alien

A Non-Permanent Resident Alien is a non-U.S. citizen authorized to live and work in the U.S. on a temporary basis.

Verification of Residency Status

Non-Permanent Resident Aliens are not eligible for the Carrington Advantage Products if they do not have a green card or valid visa or if they only have an employment authorization document (EAD).

The following visa classifications are allowed as Non-Permanent Resident Aliens:

- A-1, A-2, A-3
- E-1, E-2, E-3
- G-1 through G-5
- H-1
- L-1
- NATO
- O-1
- R-1
- TN (NAFTA)

Copies of the borrower's passport and unexpired visa must be obtained. Acceptable alternative documentation to verify visa classification is an I-797 form (Notice of Action) with valid extension dates and an I-94 form (Arrival/Departure Record). Borrowers unable to provide evidence of lawful residency status in the U.S. are not eligible for financing.

A valid employment authorization document (EAD) must be obtained if the visa is not sponsored by the borrower's current employer. If the visa will expire within 6 months of loan application, it is acceptable to obtain a letter from the employer documenting the borrower's continued employment and continued visa renewal sponsorship (employer on the loan application must be the same as on the unexpired visa).

If a non-U.S. citizen is borrowing with a U.S. citizen, it does not eliminate visa or other residency requirements. Individuals in possession of spouse or family member visas are to qualify as co-borrowers only. A valid EAD must be provided to use income for qualification.

Borrowers who are residents of countries which participate in the State Department's Visa Waiver Program (VWP) will not be required to provide a valid visa. Participating countries can be verified through the U.S. Department of State website at http://travel.state.gov/content/visas/english/visit/visa-waiver-program.html.

Citizens of Venezuela are ineligible.

Borrowers (continued)

Non-Permanent Resident Alien (continued)

Credit Requirements

A U.S. credit report is required for each borrower on the loan using a valid Social Security number. The credit report should provide merged credit information from the 3 major national credit repositories. A 2- year housing history is required.

The Qualifying U.S. Credit designation refers to a non-U.S. citizen borrower who meets Standard Tradelines in Tradeline Requirements. A Qualifying U.S. Credit borrower is eligible for all products and programs available on the Carrington Prime Advantage Program Matrix.

Income/Employment Requirements

Standard guidelines apply for verifying income and employment of Non-Permanent Resident Aliens.

Assets

All funds required for down payment, closing costs, and reserves on Non-Permanent Resident Alien transactions must be seasoned for 60 days. See Asset Documentation. Foreign assets deposited into a U.S. institution within 60 days of application are acceptable if there is evidence that the funds were transferred from the country from which the borrower previously or currently resides. It must also be established that the funds belonged to the borrower before the date of transfer.

Assets required for closing (down payment and closing costs) must also be seasoned in a U.S. depository institution for 30 days prior to closing.

Borrowers with Qualifying U.S. Credit must have 6 months of PITIA reserves for the subject property. Qualifying Foreign Credit borrowers must have 12 months of PITIA reserves for the subject property.

Assets held in a foreign account can be used for reserves. The most recent 30-day account statement is required, and funds are to be converted to U.S. dollars using the current exchange rate. A letter of reference on company letterhead from a verifiable banking institution may also be obtained. Contact information must be provided by the person signing the letter, and the letter must state the type of relationship, length of the relationship, how accounts are held, and current balance. Any translation must be signed and dated by a certified translator.

Borrowers (continued)

Exclusionary List/OFAC/ Diplomatic Immunity

All parties involved on each transaction must be screened through any exclusionary list used by CMS. CMS should apply its exclusionary list policy to any loans originated under these guidelines.

Parties to the transaction must also be cleared through OFAC's SDN List (borrowers, property sellers, employers, banks, etc.). A search of the Specially Designated Nationals and Blocked Persons List may be completed via the U.S. Department of the Treasury website: https://sanctionssearch.ofac.treas.gov/

Borrowers from OFAC sanctioned countries are ineligible. Access the link below for a list of sanctioned countries: http://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx

Individuals with diplomatic immunity are not eligible due to the inability to compel payment or seek judgment. Verification the borrower does not have diplomatic immunity can be determined by reviewing the visa, passport, and/or the U.S. Department of State's Diplomatic List at http://www.state.gov/s/cpr/rls/.

Co-Borrowers

Co-borrower is often used to describe any borrower other than the first borrower whose name appears on the note. All borrowers are evaluated on their ability to meet credit requirements, and underwriting and eligibility standards. All co-borrowers must occupy and take title to the subject property. Co-borrowers may not be an interested party to the transaction. Possible examples include, but are not limited to, property seller, builder, realtor, appraiser (a buyer who also acts as their own buying agent is generally permitted.)

Co-Signers

Co-signer(s) are personally responsible for the mortgage debt, but have no vested interest on title.

Co-signer(s) are required to sign all closing documents except the security instrument and any related riders.

Non-Occupant Co-Borrowers/ Co-Signers

Allowed

Note: if a non-occupant co-borrower is the primary wage earner, their credit score will be used for qualifying purposes.

First Time Home Buyers

A First-Time Home Buyer is defined as a purchase transaction where any borrower has had no ownership interest in a residential property in the United States during the preceding 3-year period.

There are no additional First-Time Home Buyer requirements.

First Time Investor

A First-Time Investor is a borrower who has not owned at least one investment property for at least 12 months anytime during the most recent 36-month period. See the Carrington Prime Advantage Program Matrix for restrictions when all borrowers are First-Time Investors.

Borrowers (continued)

Individual Taxpayer Identification Number (ITIN) Borrowers

Individual Taxpayer Identification Number (ITIN) borrowers work and reside in the U.S. but do not possess U.S. citizenship or a Social Security Number (SSN).

Refer to the applicable program matrix for the FICO and LTV restrictions when any borrower is using an ITIN. The maximum Unpaid Principal Balance (UPB) is $2.0MM.

- All ITIN borrowers must provide:
  - Unexpired government ID with photo (foreign driver's license, passport, visa, etc.), and
  - Unexpired ITIN card or CP565 letter from the IRS assigning the ITIN to the borrower. The letter must be unexpired through the closing date. IRS form W7 is not an acceptable alternative to the ITIN card or CP565 letter.
    - ITINs are expired if the ITIN card or IRS CP565 letter is more than three years old at closing.
- If the ITIN is expired, one of the following must be provided: Transcripts showing tax returns filed within the last three years using the ITIN (does not apply to alt doc income types); E-file receipt or letter from a Tax Preparer confirming the borrower’s most recent return has been filed with the IRS; or fully executed IRS W7 renewing the ITIN including agent signature.
- A U.S. credit report must be obtained for each borrower using the valid ITIN number.
  - Limited tradelines are not permitted. The primary wage earner must meet the requirements for Standard Tradelines.
- Full Income Documentation and Alternative Income Documentation types are permitted.
  - When required, 4506-C must be executed and processed using the borrower's ITIN number. See IRS 4506-C section in Employment/Income Documentation for processing requirements.
- Non-occupant co-borrowers permitted on primary residence transactions. The non-occupant co-borrower must be a relative, defined as the borrower's spouse, fiancé, domestic partner, parent, grandparent, sibling, child or other dependent, who is related to the borrower by blood, marriage, adoption, or legal guardianship.
- The following are ineligible:
  - Limited tradelines
  - ITIN borrowers with income documentation referencing a SSN
- The above requirements apply when any borrower on the loan application is using an ITIN.

Borrowers (continued)

Limited Power of Attorney

A Limited Power of Attorney (POA) is acceptable when following requirements are met:

- POA is specific to the transaction
- Recorded with the Mortgage/Deed of Trust
- Contains an expiration date
- Used only to execute the final loan documents
- Borrower who executed the POA signed the initial URLA
- No interested party to the transaction (such as property seller, broker, loan officer, realtor, etc.) may act as Power of Attorney
- Not permitted on cash-out transactions

Ownership

Ownership must be fee simple.

Vesting

Borrower(s) approved on the transaction must have a vested interest to the subject property. CMS will permit co-signer(s) on refinance transactions. The borrower(s) names and marital status (where applicable) must match the URLA application.

Purchase transactions require a certified copy of a Transfer Deed from the title company or settlement agent transferring title from the seller(s) to the borrower(s) and non-borrowing spouse(s) (when applicable).

Refinance transactions requiring corrections to the borrower(s) and/or non-borrowing spouse(s) vested name and/or marital status to match the URLA require a Transfer Deed.

Acceptable forms of vesting are:

- Individuals
- Joint tenants
- Tenants in Common
- Business Entity (Investment Properties only – Refer to the Vesting in the Name of a Business Entity section below)

Note: Vesting in the name of a Trust is not permitted.

Vesting for Non-Borrowing / Non-Title Spouse

A non-borrowing spouse may have a vested interest to the subject property (purchase or refinance) so long as they sign the security instrument and any related closing documents. No other non-borrower party is permitted to have a vested interest to the subject property.

Borrowers (continued)

Vesting in the Name of a Business Entity

Vesting in the name of an LLC, partnership, corporation, or S-corporation is acceptable on investment property transactions. To vest a loan in an Entity, the following requirements must be met:

- Business purpose and activities are limited to ownership and management of real estate
- Business Entity is limited to a maximum of 4 'owners' (owners are members, partners, or shareholders, as the case may be)
- All Entity owners must be natural persons and provide a personal Guaranty for the loan
- Each Entity owner must complete a URLA. The loan application, credit report, property Debt Coverage Ratio (DCR) and assets for each owner will be used to determine qualification and pricing.
- Each Entity owner must receive notice of the loan and its terms prior to closing

The following Entity documentation must be provided:

- Entity Articles of Organization, Partnership, and Operating Agreements (if applicable)
- Tax Identification Number
- Certificate of Good Standing
- Certificate of Authorization for the person executing all documents on behalf of the Entity

No seller shall suggest or encourage the formation of an Entity for the purpose of obtaining a mortgage loan. Such structures shall be initiated and arranged by the owners of the Entity.

Documents must be completed and signed as follows:

Document Type	Requirement(s)
Business Purpose and Occupancy Affidavit (Initial)	The initial disclosure provided is for informational purposes only. No signatures required.
Uniform Residential Loan Application (URLA)	Completed and signed by each owner as an individual.
Disclosures (Notice of Intent to Proceed, Servicing Disclosure, etc.)	Completed and signed by each owner as an individual.

Borrowers (continued)

Vesting in the Name of a Business Entity (continued)

Document Type	Requirement(s)
Guaranty	Completed and signed by each owner as an individual (or 'Guarantor'). The owner's signature on the Note as an Individual may also serve as evidence of Personal Guaranty.
Closing Disclosure	Completed and signed by each owner as an individual and by the authorized owners(s) of the Entity that can legally sign and bind Entity.
Other Closing Documents (Closing Disclosure, Business Purpose and Occupancy Affidavit, etc.)	Completed and signed by each owner as an Individual and by the authorized owners(s) of the Entity that can legally sign and bind Entity.
Note, Deed of Trust / Mortgage, and all **Riders**	Completed by the authorized owner(s) of the Entity who can legally sign and bind Entity.

Seasoning (Cash-Out)

For Cash-Out Individual borrower(s) must be on title for at least six (6) months prior to application.

For example: For Cash-out, borrowers must have owned the property in the name of a trust for at least 6 months prior to closing. See Seasoning for full detail.

Multiple Financed Properties

There is no limit on the number of properties borrowers may currently have financed. When the transaction is for a second home or investment property, 2 months of additional reserves for each financed property is required. Additional reserves are not required when the subject property is a primary residence.

CMS Mortgage exposure may not exceed a maximum of five (5) loans for each individual borrower. Exceptions to this policy will be reviewed on a case-by-case basis.

Please Note: If the borrower is not personally liable (personally liable means the debt shows on their credit bureau) for the debt and is not listed on title personally as an owner, the Schedule of REO should not reflect the property as owned by the borrower. In this case, it is not necessary to count a commercial property as an additional financed property.

Borrowers (continued)

Ineligible Borrowers

The following borrowers are not eligible:

- Borrowers with diplomatic immunity or otherwise excluded from U.S. jurisdiction
- Residents of any country not permitted to transact business with US companies are ineligible (as determined by any U.S. government authority)
- Irrevocable Trusts or Land Trusts
- Borrowers less than 18 years old
- Loans to employees of CMS
- Inter Vivos Revocable Trust
- Limited and General Partnerships
- Corporations
- Foreign Nationals
- Deferred Action for Childhood Arrivals (DACA - EAD Category C33)

CREDIT ANALYSIS

Equal Credit Opportunity Act, Fair Housing Act and State Fair Lending Laws

The Federal Equal Credit Opportunity Act prohibits lenders from discriminating against credit borrowers on the basis of race, color, religion, national or ethnic origin, sex, marital or familial status, age (provided the borrower has the capacity to enter into a binding contract), disability, because all or part of the borrower's income is derived from a public assistance program or because the borrower has, in good faith, exercised any rights under the Consumer Credit Protection Act. State laws may also prohibit discrimination on certain additional basis such as sexual orientation.

Similarly, the Fair Housing Act prohibits lenders from discriminating against mortgage borrowers on the basis of race, color, religion, sex, familial status, national origin, or disability.

Credit Report

A credit report is required for every borrower, guarantor, and any majority member of a borrowing entity. The credit report should provide merged credit information from the 3 major national credit repositories. A valid Social Security number (SSN) is required for all borrowers on the loan.

Either a three-bureau merged report or a Residential Mortgage Credit Report (RMCR) is required. The credit report should include verification of all credit references provided on the loan application and must certify the results of public record searches for each city where the individual has resided in the last 2 years.

Age of Credit Report/Credit Documentation

All credit documentation, including the credit report, may not be more than 120 days old at the time of closing.

Fraud Alerts

The three national credit repositories have developed automated messaging to help identify possible fraudulent activity on a credit report. Examples of fraud alerts include:

- Initial 90-day Fraud Alert
- Extended Fraud Alert
- Active Duty Alert
- HAWK Alert

All Fraud Alerts must be properly addressed and resolved in accordance with CMS policy. The actions must be reasonable and compliant with applicable laws. An underwriting decision cannot be made without full resolution of the alert.

Credit Report Security Freeze

The credit report used to evaluate a loan may not reflect a security freeze and must be resolved prior to an underwriting decision. If a borrower unfreezes his or her credit after the date the original credit report was ordered, a new three-bureau merged report must be obtained to reflect current and updated information from all repositories.

Credit Analysis (continued)

Credit Report, continued

Inquiries

A signed letter of explanation from the borrower or creditor is required for all inquiries within the most recent 90 days to determine whether additional credit was granted as a result of the borrower's request. Borrower(s) must write, sign, and date the letter themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content.

Updated Payment Histories

Payment histories may be requested directly from a creditor when the credit report indicates delinquencies have been removed or when the majority of credit is from a non-institutional lender.

Soft Pull Credit Report

A soft pull credit report is required within 14 days of closing.

Credit Score Requirements

The primary wage-earner score is used as the Representative Credit Score for each loan. The primary wage-earner may be an occupying or non-occupying co-borrower. The primary wage-earner must have a valid score from at least two (2) of the following three (3) agencies: Experian (FICO), Trans Union (Empirica), and Equifax (Beacon). Only scores from these agencies are acceptable. Additional borrowers on the loan must have at least one (1) valid score of 660 or greater.

To determine the Representative Credit Score for the primary wage-earner, select the middle score when three (3) agency scores are provided and the lower score when only two (2) agency scores are provided.

Note: if co-borrowers earn the exact same amount (for example, both own 50% of a company) the borrower with the higher credit score should be listed as the primary wage-earner and must have a valid score from at least two (2) of the three (3) agencies listed above.

Rapid Rescore

Rapid rescore is a method by which borrowers can raise their credit score quickly by submitting proof of positive account changes (for example, paying down a revolving debt) to the three major credit bureaus.

CMS will use the most recent credit score, including a rapid rescore report, for the primary wage-earner who qualified for the loan program at the current credit score and will adjust the loan pricing based on the most recent credit score.

Credit Analysis (continued)

Tradeline Requirements

Minimum Tradelines			
	Occupancy	**Tradeline History**	**Minimum Standards**
Standard Tradelines	Primary Residence, Second Homes and Investment Properties	3 tradelines reporting for 12+ months or 2 tradelines reporting for 24+ months	0X60 for most recent 12 months

To qualify as a valid tradeline, the following requirements apply:

- The credit line must be reflected on the borrower's credit report
- The account may be open or closed
- Tradelines used to qualify may not exceed 0x60 in the most recent 12 months of reporting
- An acceptable 12- or 24-month housing history not reporting on credit may also be used as a tradeline
- Manually rated utility bills with at least 12 or 24 payments made may be used to meet Minimum Tradelines if they are added to the credit report or credit supplement. Utilities include mobile and landline phone, internet, cable and satellite, gas, electricity, water, solar, and trash. Video streaming services are not permitted.

Only the primary wage-earner must meet the minimum tradeline requirements listed above.

Credit lines on which the borrower is not obligated to make payments are not acceptable for establishing a minimum history. Examples of unacceptable tradelines include loans in a deferment period, collection or charged- off accounts, accounts discharged through bankruptcy, and authorized user accounts. Student loans can be counted as tradelines as long as they are in repayment and are not deferred.

Standard Tradelines

Borrowers qualifying with Standard Tradelines are eligible for all occupancy types and programs.

Insufficient Tradelines/Non-Traditional Credit

Insufficient Tradelines and Non-traditional credit are not allowed. Each borrower must have a valid and usable score as defined in Credit Score Requirements.

Credit Analysis (continued)

Disputed Tradelines

Borrowers are not required to remove disputed tradelines from their credit report regardless of the number of accounts or the amounts.

A disputed account is not a waiver of the debt from consideration in underwriting. Disputed accounts must meet the guideline requirements for collections and/or charge off status unless there is documentation provided of a bonafide dispute such as a police report due to fraud or theft.

Mortgage and Rental Payment Verification

Mortgage payments not reflected on the original credit report must be documented via an institutional Verification of Mortgage (VOM). VOMs from servicers and LLCs are considered institutional. Rental payments must be documented via a Verification of Rent (VOR). A combined total of all late mortgage and rental payments in the past 12 months must be used to determine the housing history for all borrowers.

Twelve (12) months of cancelled checks or bank statements must be obtained when:

- the borrower is making rental payments to an interested party, or
- the borrower is making mortgage payments to an individual or an interested party.

A VOR/VOM is not required but may be requested for clarification.

All mortgages and rental payments should be current at time of closing. If the credit report or VOR/VOM reflects a past-due status, updated documentation is required to verify account is current.

Mortgages and rental payments may not exceed 1x30 in the past 12 months.

No Housing History or Less than 12 Months Verified

Borrowers who do not have a complete 12-month housing history are subject to the following restrictions:

- VOR/VOM must be obtained for all months available reflecting paid as agreed
- Obtain verification from the property owner where the borrower is residing that the borrower has been living rent-free and the amount of time the borrower has been living rent free to cover a full 12-mth history

Mortgage Modification

A mortgage modification resulting in any of the attributes listed below is subject to Housing Event seasoning guidelines under Housing Events:

- Forgiveness of a portion of principal and/or interest on either the first or second mortgage
- Application of a principal curtailment by or on behalf of the investor to simulate principal forgiveness
- Conversion of any portion of the original mortgage debt to a “soft” subordinate mortgage
- Conversion of any portion of the original mortgage debt from secured to unsecured

Credit Analysis (continued)

Rolling Late Payments

Rolling late payments are not considered a single event. Each occurrence of a contractual delinquency is considered individually for loan eligibility.

Past Due Accounts

Past due consumer debts must be brought current prior to closing.

For mortgage debt requirements refer to Mortgage and Rental Payment Verification.

Delinquent Credit Belonging to Ex-Spouse

Delinquent credit belonging to an ex-spouse can be excluded from the credit evaluation when all of the following apply:

- Borrower provides a copy of the divorce decree or separation agreement which shows the derogatory accounts belong solely to the ex-spouse

  Note: CMS will follow State specific divorce laws for acceptable documentation.

- Late payments occurred after the date of the divorce or separation
- Evidence of title transfer prior to any delinquent debt must be provided if debt is a mortgage, and evidence of buyout as part of court proceedings

Collection accounts assigned to an ex-spouse may be excluded from aggregate collection totals with a divorce decree or separation agreement assigning the account solely to the ex-spouse.

See also Contingent Liabilities.

Lawsuit/Pending Litigation

If the application, title, or credit documents reveal that the borrower is presently involved in a lawsuit or pending litigation, a statement from the borrower's attorney is required. The statement must explain the circumstances of the lawsuit or litigation and discuss the borrower's liability and insurance coverage. A copy of the complaint and answer may also be needed. The title company closing the loan must be informed of the lawsuit or litigation and provide affirmative coverage of our first lien position.

Consumer Credit Counseling Service (CCCS)

Borrower enrollment in CCCS is allowed when a minimum of 12 months have elapsed on the plan and evidence of timely payments for the most recent 12 months is provided. The CCCS administrator must also provide a letter allowing the borrower to seek financing on a new home while enrolled in the plan.

If accounts included in CCCS plan reflect as charge-off or collection accounts on the credit report, the Underwriter can exclude these balances from the charge-off and collection limits in Collections and Charge-offs. The monthly CCCS plan payment must be included in the DTI calculation.

If a completion date is not shown on the credit report, the borrower is required to submit verification from the counseling agency establishing the date of completion.

Credit Analysis (continued)

Collections and Charge-Offs

The following accounts may remain open:

- Collections and unsecured charge-offs < 24 months old with a maximum cumulative balance of $2,000
- Collections ≥ 24 months old with a maximum of $2,500 per occurrence
- Unsecured charge-offs ≥ 24 months old
- Collections and charge-offs that have passed beyond the statute of limitation for that state (supporting documentation required)
- All medical collections

Collection and charge-off balances exceeding the amounts listed above must be paid in full under Carrington Prime Advantage. Charge offs secured by real estate must be paid in full.

Collections and Charge-Offs Paid through Closing Transaction

If collection or charge-off accounts are being paid off through our closing transaction, a payoff demand or credit report or supplement will be required. The credit report or supplement must list the same information as a payoff demand (e.g. per diem amount, balance, rate, mailing address.)

The amount reflected on the credit report or supplement can be used UNLESS:

- The account is listed on the Title report
- The reporting date on the credit report is older than 90 days
- Underwriter discretion for layered risk

Example: The account is not recently rated, large balance owed and the borrower is short to close.

Judgments and Tax Liens

Judgments tax liens must be paid off prior to or at closing, unless the requirements listed below are met. Adverse credit that will impact title must be paid in full as title must insure our lien position without exception.

Court-ordered judgments may remain open when all of the following requirements are met:

- A copy of the repayment agreement is obtained;
- A minimum of 3 months has elapsed on the plan and evidence of timely payments for the most recent 3 months is provided; and
- The maximum payment required under the plan is included in the debt-to-income ratio.

Outstanding tax liens may remain open on purchase transactions only (additional LTV reductions may be required based on the size of the lien). All of the following requirements must be met:

- A copy of the repayment agreement is obtained;
- A minimum of 3 months has elapsed on the plan and evidence of timely payments for the most recent 3 months is provided;
- The maximum payment required under the plan is included in the debt-to-income ratio; and
- The title company must provide written confirmation confirming (a) the title company is aware of the outstanding tax lien, and (b) there is no impact to first lien position.

Credit Analysis (continued)

IRS Taxes Owed (No Lien)

For IRS taxes owed and there is no lien present, all of the following requirements must be met:

- A copy of the repayment agreement is obtained;
- A minimum of 3 months has elapsed on the plan and evidence of timely payments for the most recent 3 months is provided;
- The maximum payment required under the plan is included in the debt-to-income ratio

Bankruptcy

All bankruptcies must be discharged or dismissed for a minimum of 48 months from closing date.

Housing Events

A Housing Event is any one of the following events listed below:

- Foreclosure
- Deed-in-Lieu
- Short Sale
- Modification
- 1x120 mortgage history

Seasoning of a foreclosure is measured from the date of the Sheriff's sale or foreclosure auction. Seasoning of a deed-in-lieu or short sale is measured from the date of final property transfer.

For a 120-day mortgage late, seasoning is from the date the mortgage was brought current. Seasoning for a modification is from the date the modification was executed. See also Mortgage Modification.

If the property was surrendered in a Chapter 7 bankruptcy, the bankruptcy discharge date is used for seasoning. Bankruptcy papers may be required to show the property was surrendered. The foreclosure action is not required to be fully complete.

Housing Events must be seasoned for a minimum of 48 months from loan closing.

LIABILITIES

Installment Debt

Installment debt is a monthly obligation with fixed payments and terms. Payments on installment loans must be included in the borrower's debt-to-income ratio.

Payments can be excluded if there are 10 or fewer monthly payments remaining to pay the debt in full. The installment debt may be paid down to meet the 10 payment requirement. If the payment is substantial and exceeds 5% of the borrower's qualifying income, the Underwriter should review the overall transaction to ensure the remaining payments will not impact the borrower's ability to handle the new mortgage payment.

Installment debt paid in full prior to closing can be excluded from the debt-to-income ratio. Supporting documentation, such as a credit supplement or direct verification from the creditor, must be obtained as evidence the debt has been paid in full.

Revolving Debt

Revolving debt is open-ended debt in which the principal balance may vary from month to month. The minimum required payment as stated on the credit report or current account statement should be used to calculate the debt-to-income ratio. If no payment is stated on the credit report, the greater of $10 or 5% of the current balance should be included in the debt-to-income ratio calculation.

Revolving accounts are allowed to be paid off prior to or at closing in order to exclude the payment from the debt ratio. Supporting documentation, such as a credit supplement or direct verification from the creditor, must be obtained as evidence the debt has been paid in full. See Asset Documentation for sourcing and seasoning requirements.

Authorized User Account

Authorized user account should not be considered in the borrower's debt-to-income ratio.

Business Debt

A business debt is a financial obligation of a business and can be the sole responsibility of the business or be personally secured by the business owner, making 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 ratio.

Debts paid by the borrower's business can be excluded from the debt-to-income ratio with any of the following supporting documentation:

- Most recent 6 months canceled checks drawn against the business account; or
- Tax returns reflect the business expense deduction; or
- Business bank account statement showing assets remain after funds to close and reserve requirements are with a balance greater than or equal to the balance of the debt.

If the debt is less than 6 months old, the payment must be included in the debt-to-income ratio.

Liabilities (continued)

Child Support, Alimony or Maintenance Obligations

Monthly alimony, child support or separate maintenance fees should be current at time of application and must be included in the borrower's debt-to-income ratio. File should contain supporting documentation as evidence of the obligation, such as a final divorce decree, property settlement agreement, signed legal separation agreement, or court order. If payments are past due, the arrearages must be brought current prior to loan closing or must be repaid through an active repayment plan and included in the DTI calculation.

If 10 or fewer payments remain, see Installment Debt to determine if the obligation may be excluded from the DTI calculation.

Contingent Liabilities

An individual has a contingent liability when an outstanding debt has been assigned to another party and the creditor does not release the borrower from liability. Contingent liabilities can be excluded from the debt-to- income ratio under any of the following scenarios:

- Property resulting from buyout of former co-owner (i.e. divorce): file must include the court order and evidence of transfer of ownership
- Mortgage assumption by third party: file must include the formal assumption agreement and evidence of transfer of ownership
- Court ordered assignment of debts: file must include a copy of the court order assigning the debt to another party

The Underwriter is not required to evaluate the payment history for the assigned debt after the effective date of the assignment.

Debts Paid By Others

If the Underwriter obtains documentation that a non-mortgage debt has been satisfactorily paid by another party for the past 12 months, then the debt can be excluded from the debt-to-income ratio. This policy applies regardless of whether the other party is obligated on the debt. The other party may not be an interested party to the transaction.

Housing Payments

The monthly mortgage payment (PITIA) used for qualification consists of the following:

- Principal and Interest
- Hazard and flood and insurance premiums
- Real Estate Taxes
- Special Assessments
- Association Dues
- Any subordinate financing payments on mortgages secured by the subject property

Lease Obligations

Lease obligations must be included in the debt-to-income ratio calculation, regardless of time remaining on the lease.

Liabilities (continued)

Material Recurring Non-Debt Obligations	Underwriters are not permitted to make inquiries or verifications prohibited by Regulation B. A recurring non-debt obligation is defined as medical expenses for the borrower or a dependent of the borrower that are expected to continue for greater than one year. If the borrower informs the Underwriter of a recurring non-debt obligation, the loan file must be noted. If the Underwriter believes it could be material to the borrower's ability to repay the loan, escalation is required. Documentation of material recurring non-debt obligations should be done consistent with CMS ability to repay policies.
Open 30-Day Charge Accounts	For open 30-day charge accounts that do not reflect a monthly payment on the credit report, or 30-day accounts that reflect a monthly payment that is identical to the account balance, 5% of the outstanding balance will be considered to be the required monthly payment. Open-end accounts do not have to be included in the monthly debt payment if the borrower has sufficient funds to pay off the outstanding account balance. The funds must be verified in addition to any funds required for closing and reserves. If the borrower paid off the account balance prior to closing, the Underwriter may provide proof of payoff in lieu of verifying funds to cover the account balance.
Retirement, Saving Plan Loans	Repayment for loans against a financial asset (retirement/savings plan, insurance policy) can be excluded from the total debt-to-income ratio provided the debt can be repaid by liquidating the asset. Value of the asset must be reduced by the amount of the debt when calculating funds to close and reserves.
Student Loans	Student loan obligations must be included in the debt-to-income ratio calculation, whether they are deferred or in repayment. If no payment is shown on the credit report, then the payment should be provided by the student loan lender. If a payment is unable to be determined, 1% of the current loan balance may be used. **Income Based Repayment (IBR)** If the borrower has an income-based repayment plan, CMS must use 1% of the current balance to determine the monthly payment to be included in the DTI.
Timeshares	For credit review purposes, timeshare obligations will be considered installment loans.

Liabilities (continued)

Undisclosed Debts

If asset statements provided reflect payments made on obligations not listed on the credit report or URLA, additional information must be obtained to determine if the liability should be included in the borrower's debt- to-income ratio.

If the obligation does not belong to the borrower, supporting documentation is required. If there is a non- borrower also on the account, a signed letter of explanation from the borrower is sufficient. Borrower(s) must write, sign, and date the letter themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content.

If the borrower is the obligor on the debt, an account statement and pay history should be obtained to review the account for acceptability. The payment must be included in the debt ratio. Proof the debt is no more than 30 days past due is required at closing.

Forbearance due to Presidentially Declared Disasters, including COVID-19

Generally, borrowers who have missed mortgage payments on any mortgage while in forbearance related to a presidentially declared disaster will not be penalized, however any such disaster forbearance must be documented as follows:

- Borrower has continued to make all payments within the month due: No additional action is necessary, the borrower is eligible for any Carrington non-agency loan program. The borrower is not required to remove the disaster forbearance status on mortgages that are paid timely.
- Borrower has missed payments after establishing a disaster forbearance: If any mortgage payment was not paid within the month due after the disaster forbearance was established, the forbearance may be resolved through one of the following two options:
  1. Remove the disaster forbearance status and reinstate the mortgage by making a lump-sum payment to bring the mortgage current. The impact of any lump sum payment must be considered in the asset analysis. Funds may not be borrowed for the purpose of a full reinstatement after the date of the loan application. Or
  2. Complete three (3) regular monthly payments after an approved loss mitigation option with the current servicer, such as a repayment plan, payment deferral, or trial payments for a loan modification. Any remaining balance due after three timely payments are made pursuant to a loss mitigation option may be included in a rate and term or cash out refinance.

Borrowers who have missed payments pursuant to a disaster forbearance must provide documentation of acceptable resolution of any hardship. Missed mortgage payments during the period of a disaster forbearance will not be deemed as "late" payments for the purpose of establishing eligibility or credit grade, provided the forbearance is documented per the requirements above. Missed mortgage payments after termination of the forbearance plan or during an approved loss mitigation option will be considered late for the purposes of establishing eligibility and graded accordingly. A borrower who experiences a Housing Event, including foreclosure, short sale, or deed-in-lieu of foreclosure after a forbearance must continue to meet all program guidelines related to Housing Events, including seasoning and credit grading.

DOCUMENTATION

Age of Loan Documentation	The title report, and closing protection letter (CPL) must be dated within 90 days of closing. All other loan documentation, including credit, income, and asset documentation, must be dated within 120 days of closing.
CPA General Requirements	CPA letters must include the name of the borrower(s) and business.
Document Images	CMS permits the use of any available technology to produce copies of the documents in the mortgage loan file, such as a photocopier, facsimile machine, document scanner, or camera. Copies of documents provided by the borrower may be photos or scanned versions of the original documents and can be delivered to CMS in hardcopy or via email or other electronic means. Document images must be typical of what the actual document would look like and must have good image quality, be legible, and not have borders showing phone/mobile background content.
Employment/ Income Documentation	Documentation of income is required using Full Documentation, Bank Statement Documentation, and 1-Year Alternative Income Documentation. **IRS 4506-C** IRS Form 4506-C must be completed and signed by all borrowers at closing. 4506-C transcripts are not required to be signed or processed for business tax returns or loans utilizing Bank Statement Documentation for income. Documentation received from executing the 4506-C must be reviewed and compared to the qualifying income to confirm consistency. Results from processing the 4506-C should generally be equal to or greater than the income used to qualify the loan. Any inconsistencies between the 4506-C results and qualifying income should be addressed by the Underwriter. **Note:** If there are no transcript records available, CMS will accept a copy of the tax return, stamped or otherwise, and proof of receipt of the refund or a cancelled check/bank draft documenting the taxes were paid. The refund or check/bank draft must match the tax return exactly. **Pay Stubs and W-2s** Pay stubs and W-2s should be typed or computer generated. They should provide the borrower's full name, address, employer name, year-to-date earnings, and rate of pay. CMS will consider handwritten pay stubs as long as the borrower can provide the most recent two years of tax returns along with the W-2s and tax transcripts. If pay stubs reflects garnishments (child support, IRS, etc.) or any loan deductions, additional information will be required to determine if a monthly payment should be included in the debt-to-income ratio calculation. W-2s should reflect a nine-digit Employer ID Number (EIN). Also, Social Security and Medicare withholding should be calculated at the appropriate rates on the W-2s and pay stubs. W-2 transcripts may be used in lieu of paper W-2s.

Documentation (continued)

Employment/ Income Documentation (continued)

Federal Income Tax Returns

For some types of income, federal income tax returns (personal and/or business) are required. See Self-Employed Income for detailed requirements.

1040 transcripts may be used in lieu of paper 1040s when the breakdown of the individual schedules is not required for qualifying purposes.

Written Verification of Employment (WVOE)

Income and employment for wage-earners or salaried borrowers may be obtained via direct written verification from the borrower's employer (FNMA Form 1005). The verification should be signed by a member of the company's human resource department or one of the business owners or officers. At a minimum, the verification must include the borrower's name, position, dates of employment, and base salary.

Verbal Verification of Employment (VVOE)

Verbal Verifications of Employment must be obtained for each borrower using employment income to qualify. VVOEs must meet all of the following criteria:

- Completed within 10 business days of closing
- Confirm that the borrower is employed at time of verification
- Include the name and phone number of person processing the VVOE
- Include the name, position and phone number of the person providing the verification (employer)
- Telephone number for the borrower's employer must be verified independently via any of the following: telephone book, the internet, directory assistance, or by contacting the applicable licensing bureau
- For self-employed borrowers, the existence of the business must be independently verified by two (2) years of business licenses or a CPA letter through a disinterested third party within 10 business days of closing. The loan file should reflect the documentation secured from these sources. Sources may include: CPA, regulatory agency, or applicable licensing bureau.

Self-Employed Confirmation of Employment Requirements

Verification of the existence of a self-employed borrower's business for a minimum of 2 years from a third party, such as a CPA, regulatory agency, or the applicable licensing bureau is required. A CPA letter must include the name of the business, the owner(s) of the business, and how long the business has been in existence.

In addition to the requirement above, the underwriter must document verification of the self-employed borrower's business within 60 days of the note date as follows:

- Self-employed borrowers with qualifying income from LLCs, Partnerships, S Corporations and Corporations must have a valid Secretary of State internet printout from the state the business was incorporated in showing the business is active and in good standing.

Documentation (continued)

Employment / Income Documentation (continued)

- Businesses, including sole proprietorships that require licensing must have a valid internet printout from the licensing authority confirming the license is active and in good standing. Examples of common business licenses include, but are not limited to, state or local tax licenses, city business licenses, professional licenses for borrowers in the fields of real estate, construction, law, medicine, etc.
- In jurisdictions where the Secretary of State and/or state or local licensing authority does not offer an internet verification of the corporation, business, and/or professional license, the underwriter must obtain a TLO report on the business. In the event that a TLO report is unavailable, the underwriter may rely on a CPA letter but must document their attempts to obtain an independent verification of the business in the loan level conversation log.

Asset Documentation

Assets to be used for down payment, closing costs, debt payoff, and reserves must be seasoned for 60 days or sourced. Asset statements must be dated within ~~90~~ 120 days of closing and verified with one of the following:

- Most recent two (2) months' account statements, or most recent quarterly account statement, indicating opening and closing balances, and reflecting a consecutive 60 days of asset verification
  - Supporting documentation should be obtained for single, unexplained deposits that exceed 50% of the borrower's gross monthly qualifying income for the loan.
  - Documentation of large deposits is not required on refinance transactions
- If account summary page provides the required information, additional pages are not required.
- Written Verification of Deposit (VOD), completed by the financial institution
  - Must include the current and average balances for the most recent two (2) months
  - Large disparities between the current balance and the opening balances will require additional verification or supporting documentation
- Account statements must provide all of the following information:
  - Borrower as the account holder
  - Account number
  - Statement date and time period covered
  - Current balance in US dollars

EMPLOYMENT/INCOME ANALYSIS

Full Documentation

Wage Earners

Income derived from a consistent hourly, weekly or monthly wage, must be verified by all of the following:

- W-2s for the most recent two (2) years; and
- Pay stub(s) covering the most recent 30-day period providing year-to-date earnings at approval date. (E.g. paid weekly = 4 paystubs, Bi-weekly/semi-monthly = 2 paystubs); and
- Signed and executed 4506-C (W-2 transcripts only); and
- Verbal Verification of Employment (VVOE) completed within 10 days of closing.

Self-Employed Borrowers

See Self-Employed Income for detailed documentation requirements.

1-Year Alternative Income Documentation

In lieu of the standard 2-year documentation requirement for wage-earners and self-employed borrowers, the following will be accepted:

- Wage-Earners: the transcript(s) for most recent year W-2(s) **and** pay stub(s) covering the most recent 30-day period providing year-to-date earnings at closing
- Self-Employed Alternative Doc: the most recent year filed federal income tax returns (personal and business; extensions are not allowed) **and** year-to-date P&L if end of applicable tax year is > 120 days from closing
- Self-Employed Bank Statements: 12 months complete personal or business bank statements from the same account
- Self-Employed 1099: 1 Year IRS Form 1099 Statements
- Self Employed P&L: 12 or 24 months P&L income documentation

Bonus, overtime, and/or commission income for wage-earners may also be documented for 1 year. A full Written VOE must be obtained and must state that the bonus, overtime, and/or commission income is likely to continue.

Supplemental income is not eligible for 1-Year Alternative Income Documentation (i.e. rental income, dividend/interest income, capital gains, alimony, child support, pension or retirement).

All other requirements for Full Documentation apply. See the following sections for complete documentation requirements:

- Wage-Earners
- Self-Employed Income
- Personal Bank Statements
- Business Bank Statements
- 1099 Income Documentation
- Profit & Loss Income Documentation

Employment/Income Analysis (continued)

Bank Statement Documentation

Self-employed borrowers are eligible for either Personal Bank Statement Documentation or Business Bank Statement Documentation. The following restrictions apply to both documentation types:

- Deposits into all bank accounts must be considered as acceptable business deposits in order to be considered as effective income. Deposits should be consistent to the Borrower's deposit pattern within the 12-24 month history in the loan file. Any unusual or large deposits must be sourced by the business through invoices, receipts, etc. Any deposits from gifts, loans or any other non-income sources may not be considered as income.
- Borrowers must be self-employed for at least two (2) years verified by two (2) years of business licenses or a CPA letter.
- Borrower may not be an employee of any other borrower
- Business must be in existence for at least two (2) years.
- Standard Trade lines are required.
- Foreign Nationals are ineligible. Exceptions are not permitted.
- Foreign sources of income are ineligible.
- Statements must be consecutive and reflect the most recent months available as of the application date.
- Statements must support stable and generally predictable deposits. Unusual deposits must be documented.
- Evidence of a decline in earnings may result in disqualification.
- More than 3 NSFs or overdrafts within the most recent 12 months require explanation, supporting documentation, and underwriter analysis for acceptability. **Note:** Overdraft Protection Transfers from a linked bank account or line of credit are not considered an NSF. Refer to NSF Checks and Overdrafts below for additional guidance.
- If bank statements provided reflect payments being made on obligations not listed on the credit report, see Undisclosed Debts for additional guidance.
- Money transfer service business account statements, including PayPal, Venmo, Zelle, etc. are not eligible. Money transfer service earnings must be deposited into a business or personal bank account for consideration.
- W-2 Wages: Additional income deposited into the bank statements but derived from a source other than the self-employed business may not be included in the bank statement average. W-2 earnings must be documented as per the requirements in Wage-Earners along with a processed 4506-C verifying the W-2 earnings only.
- Rental Income: Borrowers who receive rental income as a secondary income source may utilize Bank Statement Documentation for calculating business income and the most recent lease agreement(s) for rental properties for calculating rental income. Obtain proof of receipt at the current lease rate using a cancelled check or bank statement. Calculate the qualifying rents by using 75% of the current lease minus the full PITIA.

Employment/Income Analysis (continued)

Bank Statement Documentation (continued)

Borrowers whose primary source of income is derived solely from the ownership of rental properties as declared on personal or business tax returns must be calculated using Full Documentation of Income. See Rental Income.

Personal Bank Statements

Personal Bank Statement Documentation is allowed. See the applicable Carrington Prime Advantage Matrix for credit score and LTV restrictions.

The Carrington Prime Advantage Program allow for either 12 or 24 months of bank statements.

The following documentation is required:

- 12 or 24 months complete personal bank statements. Bank statements should be from the same account. Account changes during the review period are acceptable for circumstances such as account closure when the borrower is a victim of fraud or the borrower changes banking institutions, provided there is a clear account transfer date and no deposits are duplicated. Transaction history printouts are not acceptable.
- 2 months complete business bank statements to evidence
  - the borrower's business maintains a separate business account for business deposits and expenses, and
  - the borrower's personal account reflects deposits transferred from the business account (i.e., the personal account receives net income from the business)

  If the borrower does not maintain a separate business account, or business expenses are comingled in the borrower's personal account, the guidelines for Business Bank Statements must be followed.
- Initial signed URLA with monthly income disclosed
- Verification business has been in existence for 2 years
- Verification of business existence required within 10 business days of closing

The following requirements apply when analyzing the personal bank statements:

- All parties listed on each bank account must be included as borrowers on the loan.
- Multiple bank accounts may be used, but a combination of business and personal is prohibited
- 100% of deposits used for income and averaged over 12 or 24 months
- Transfers between personal accounts should be excluded
- Transfers from a business account into a personal account are acceptable

Employment/Income Analysis (continued)

Bank Statement Documentation (continued)

Calculating Qualifying Income

Qualifying income using Personal Bank Statement Documentation is calculated as follows:

- Personal Bank Statement Average (total deposits [minus any disallowed deposits] / *24 months)

**12 months should be used for the calculation when the 12-month bank statement option is chosen.*

Business Bank Statements

Business Bank Statement Documentation is allowed under all programs. See the applicable CMS Matrix for credit score and LTV restrictions.

The following documentation is required (see also 1-Year Alternative Income Documentation):

- 12 or 24 months complete business bank statements. Bank statements should be from the same account. Multiple bank accounts may be used, but a combination of business and personal is prohibited. Account changes during the review period are acceptable for circumstances such as account closure when the borrower is a victim of fraud or the borrower changes banking institutions, provided there is a clear account transfer date and no deposits are duplicated. Transaction history printouts are not acceptable.

  Note: If borrower elects 12 months, additional LLPA's apply.
- Initial signed URLA with monthly income disclosed
- Required Expense Statement Documentation applicable to Calculation Option chosen (see Calculating Qualifying Income for requirements)
- Verification borrower is 100% owner of business and business has been in existence for two (2) years

Documenting Business Bank Account Ownership

- Verification business has been in existence for two (2) years
- Document Business Bank Account Ownership
  - Verification borrower is 100% owner of business, or
  - If the borrower is not 100% owner of the business, or multiple parties appear on a business bank account but are not borrowers on the loan, business records must be provided to prove the borrower's percentage of ownership and entitlement to profits. Qualifying income must be multiplied by the percentage of profits that the borrower is entitled to. Examples of acceptable documentation include:
    - Articles of Incorporation with stock ownership breakdown
    - the business's Operating Agreement,
    - a Corporate Resolution, or
    - letter from the company's tax preparer.
- Verification of business existence required within 10 business days of closing

Employment/Income Analysis (continued)

Bank Statement Documentation (continued)

The following requirements apply when analyzing the business bank statements:

- Business bank accounts, personal bank accounts addressed to a DBA, or personal accounts with evidence of business expenses can be used for qualification
- Wire transfers and transfers from other accounts must be documented or excluded
- Statements should show a trend of ending balances that are stable or increasing over time
- Decreasing or negative ending balances must be explained
- Business expenses must be reasonable for the type of business (examples of businesses with higher expense ratios may include construction companies, builders, restaurants and retail firms)
- The business owner must provide a signed letter of explanation describing the business in order to differentiate as a "Service Business" or "Product Business". The letter must include the number of years the business has been in operation.
- Underwriters have discretion to request a CPA letter if the business bank statements reflect expenses that appear higher than the factors set forth in these guidelines.

Calculating Qualifying Income

To calculate qualifying income using Business Bank Statement Documentation, choose one of the documentation options below applicable to the Expense Statement method chosen:

OPTION 1: DEFAULT EXPENSE FACTOR

Add up the deposits over the 12 or 24 months of statements provided to determine a gross deposit number as follows:

Multiply Gross deposits by the result of [100% (minus) Expense Factor%] to determine a net deposit number. Divide the net deposit number by 12 or 24 months as determined by the number of months of bank statements utilized to support monthly income. Qualifying income must be multiplied by the percentage of ownership the borrower is entitled to.

Default Expense Factors will be applied as follows:

- Service Business = 50% Expense Factor (examples include Consulting, Accounting, Legal, Counseling, Therapy, Financial Services, Insurance, IT)
- Product Business = 60% Expense Factor (examples include Retail, Food Services, Restaurant, Manufacturing, Contracting, Construction)

If the borrower's business expense factor is lower than 50% an Expense Statement prepared and signed by a third-party (i.e. CPA or licensed tax preparer) (See OPTION 2 below) may be used to determine monthly income.

Employment/Income Analysis (continued)

Bank Statement Documentation (continued)

OPTION 2: THIRD-PARTY PREPARED EXPENSE STATEMENT

Net income using the Expense Statement

If the borrower's business operates more efficiently, or typically has a materially different expense factor than the default expense factors above, then a reduced expense factor is acceptable subject to the following requirements:

- Expense Statements must be prepared and signed by a third-party licensed or registered tax preparer. Tax preparers must be a Certified Public Accounts (CPA), Enrolled Agent (EA), hold a state license for tax preparation, or belong to a professional trade organization within their state, such as the California Tax Education Council (CTEC).
- Expense Statements must specify business expenses as a percentage of the gross annual sales/revenue of the business.
- Expense Statements must not include unacceptable disclaimers or exculpatory language regarding its preparation.
- Expense Factors may never be lower than:
  - Service Business = 20% Expense Factor Floor
  - Product Business = 35% Expense Factor Floor

Net income from the Expense Statement is calculated by determining total deposits per bank statements (minus any disallowed deposits) multiplied by the expense percentage provided by CPA or tax preparer.

$$\text{Net Income} = \frac{\text{Total Deposits * (1 – Expense Statement Percentage)}}{\text{24 months}}$$

Qualifying income must be multiplied by the percentage of ownership the borrower is entitled to.

NSF Checks and Overdrafts

NSF (non-sufficient funds) is a term used to indicate that a demand for payment can't be honored due to insufficient funds available in the account. Overdraft protection transfers are not considered an NSF.

Excessive NSFs will be highly scrutinized and may cause the loan to be deemed ineligible.

The Underwriter is responsible for evaluating the borrower's most recent 12 months bank statements for NSF patterns. When a borrower has more than 3 NSFs within the past 12 months, the Underwriter must justify their approval thought process on the 1008 to differentiate between financial mismanagement and an extenuating circumstance or one-off event. The borrower is required to provide a letter of explanation (LOE) and additional documentation if needed to support the LOE. Borrower(s) must write, sign, and date the letter themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content.

Employment/Income Analysis (continued)

Bank Statement Documentation (continued)

Recent NSFs within the most recent 90 days must be scrutinized more in depth to support the borrower's income stream is not negatively affected as a result of the NSFs.

Acceptable examples include, but are not limited to:

- Multiple NSFs within the 1 month period or rolling to the next month may be treated as an isolated event (i.e. 1 NSF) as long as they are the direct result of an extenuating circumstance or one-time event. The one–time event must be outside of the borrower's control and be documented.
- No NSFs in most recent 9 months (with prior NSF history in months 10-12) with LOE from borrower explaining how they were able to resolve their financial situation going forward.

Examples that may be unacceptable include, but are not limited to:

- Most recent 6 months bank statements reflect a trend of several NSFs without documentation supporting extenuating circumstances or a one-time event.

Most recent 12 months with scattered multiple NSFs

Employment/Income Analysis (continued)

1099 Income Documentation

Self-employed borrowers with earnings on IRS Form 1099, such as independent contractors and gig workers, may submit 1 or 2 years 1099 forms, subject to the following requirements:

- Borrowers must be self-employed for at least two (2) years verified by two (2) years of business licenses or a CPA letter.
- Business must be in existence for at least two (2) years.
- Standard Trade Lines are required.
- Foreign Nationals are ineligible. Exceptions are not permitted.
- IRS form 4506-C must be processed for 1 or 2 years 1099 forms
- Multiple 1099 forms from the same line of work may be added together, for example a borrower with earnings from Lyft and Uber will be qualified based on combined earnings. Multiple 1099 forms from different industries will be reviewed independently as separate businesses, for example a borrower with earnings from Uber and IT Consulting must have a two-year history in each line of work to consider earnings from both sources.
- Evidence of a decline in earnings may result in disqualification
- Year-to-Date earnings must support the qualifying income calculated per instructions below. YTD earnings must be documented with one of the following, utilizing the most recent documentation available as of the loan application date:
  - YTD Profit & Loss statement prepared by a licensed or registered CPA or tax preparer. Net monthly earnings on the P&L must not be more than 10% less than qualifying net income of the previous 1 or 2 years.
  - Earnings Statement with YTD income or Pay Stub with YTD income from the Payer listed on the 1099 forms. Gross earnings on the YTD Earnings Statements must not be more than 10% less than gross monthly 1099 earnings.
  - Most recent two (2) months bank statements, earnings statements without YTD income, or pay stubs without YTD income. Earnings statements or pay stubs must come from the Payer listed on the 1099 forms. Gross deposits or earnings on bank statements, earnings statements, or pay stubs must not be more than 10% less than gross monthly 1099 earnings.
- Rental Income: Borrowers who receive rental income as a secondary income source may utilize 1099 Income Documentation for calculating self-employment income and the most recent lease agreement(s) for rental properties for calculating rental income. Obtain proof of receipt at the current lease rate using a cancelled check or bank statement. Calculate the qualifying rents by using 75% of the current lease minus the full PITIA.

Employment / Income Analysis (continued)

1099 Income Documentation (continued)

Borrowers whose primary source of income is derived solely from the ownership of rental properties, including short-term rentals, as declared on personal or business tax returns must be calculated using Full Documentation of Income. See Rental Income.

Calculating Qualifying Income

To calculate qualifying income using 1099 Income Documentation, choose one of the options below to account for business expenses:

Option 1: Default Expense Factor

Default Expense Factors will be applied as follows:

- Service Business = 50% Expense Factor (examples include Consulting, Accounting, Legal, Counseling, Therapy, Financial Services, Insurance, IT, Rideshare, Freelance Workers, Writers)
- Product Business = 60% Expense Factor (examples include Retail, Food Services, Restaurant, Manufacturing, Contracting, Construction)

Multiply gross 1099 earnings by the default expense factor to determine estimated business expenses. Subtract the expense estimate from gross earnings and divide the result by 12 months for 1 year 1099 form or by 24 months for 2 years 1099 forms.

Option 2: Third-Party Prepared Expense Statement

If the borrower's business operates more efficiently, or typically has a materially different expense factor than the default expense factors above, then a reduced expense factor is acceptable subject to the following requirements:

- Expense Statements must be prepared and signed by a third-party licensed or registered tax preparer. Tax preparers must be a Certified Public Accounts (CPA), Enrolled Agent (EA), hold a state license for tax preparation, or belong to a professional trade organization within their state, such as the California Tax Education Council (CTEC).
- When a YTD Profit and Loss statement is provided from a licensed or registered CPA or tax preparer per the YTD Income option above, the expense factor will be calculated from the expenses listed on the YTD P&L.
- Expense Statements must specify business expenses as a percentage of the gross annual self-employment earnings.
- Expense Statements must not include unacceptable disclaimers or exculpatory language regarding its preparation.
- Expense Factors may never be lower than:
    - Service Business = 20% Expense Factor Floor
    - Product Business = 35% Expense Factor Floor

Net expenses from the Expense Statement is calculated by multiplying gross 1099 earnings by the expense percentage provided by the CPA or tax preparer.

$$\text{Net Income} = \frac{\text{Total Deposits} * (1 - \text{Expense Statement Percentage})}{\text{12 or 24 months}}$$

Employment / Income Analysis (continued)

Profit & Loss Income Documentation

Self-employed borrowers may submit Profit and Loss (P&L) statements covering 12 or 24 months, subject to the following requirements.

Documenting Business Ownership

- Borrowers must be self-employed for at least two (2) years verified by two (2) years of business licenses or a CPA letter.
- Business must be in existence for at least two (2) years.
- Foreign Nationals are ineligible. Exceptions are not permitted.
- Documentation must be provided to show the borrower's percentage of business ownership. Qualifying income will be multiplied by the percentage of profits that the borrower is entitled to. Examples of acceptable documentation include:
  - Articles of Incorporation with stock ownership breakdown
  - Business's Operating Agreement,
  - Corporate Resolution, or
  - Letter from the tax preparer.

Requirements for P&L Documentation

- Standard Trade Lines are required.
- IRS form 4506-C is not required for income documented with profit and loss statements.
- The borrower or tax preparer must provide a signed letter of explanation describing the nature of the business, how income is generated, and how long the business has been in existence.
- Profit and Loss statements must be provided for the most recent 12 or 24 months, and:
  - P&L statements must be prepared and signed by a third-party licensed or registered tax preparer. Tax preparers must be a Certified Public Account (CPA), Enrolled Agent (EA), hold a state license for tax preparation, or belong to a professional trade organization within their state, such as the California Tax Education Council (CTEC). Evidence of licensing or professional organization membership must be documented.
  - The borrower must sign all P&L statements.
  - P&L statements must not include unacceptable disclaimers or exculpatory language regarding their preparation.
  - P&L statements may be provided for the 12- or 24-month period immediately predating the loan application, or for the prior 12- or 24-month calendar or fiscal year period. If more than 120 days have passed since the end of the most recent calendar or fiscal year, a Year-to-Date P&L statement must be provided. The YTD P&L must be prepared by the same licensed party that prepared the 12- or 24-month P&L.

Employment / Income Analysis (continued)

Profit & Loss Income Documentation (continued)

Requirements for P&L Documentation (continued)

- Business expenses must be fully itemized and must be reasonable and reflect all expenses expected for the type of business. Underwriting may request additional documentation if necessary.

- Multiple businesses are permitted, P&L statements must be supplied for each business and each business must have been in existence for at least two (2) years.
- Evidence of a decline in earnings will require additional evaluation by the underwriter and may result in disqualification
- Rental Income: Borrowers who receive rental income as a secondary income source may utilize Profit and Loss Income Documentation for calculating self-employment income and the most recent lease agreement(s) for rental properties for calculating rental income. Obtain proof of receipt at the current lease rate using a cancelled check or bank statement. Calculate the qualifying rents by using 75% of the current lease minus the full PITIA.
  Borrowers whose primary source of income is derived solely from the ownership of rental properties, including short-term rentals, as declared on personal or business tax returns must be calculated using Full Documentation of Income. See Rental Income.

Calculating Qualifying Income

To calculate qualifying income using Profit and Loss Income Documentation:

- If necessary, adjust net income on the P&L to account for the following minimum expense thresholds. Total business expenses as a proportion of total business earnings may never be lower than:
  - Service Business = 20% Expense Floor (examples include Consulting, Accounting, Legal, Counseling, Therapy, Financial Services, Insurance, IT, Rideshare, Freelance Workers, Writers)
  - Product Business = 35% Expense Floor (examples include Retail, Food Services, Restaurant, Manufacturing, Contracting, Construction)
- Divide the P&L net income by 12 or 24 months, as applicable, to determine qualifying income.
- When a YTD P&L is provided, compare monthly YTD earnings to confirm qualifying income is supported within a 10% tolerance.

Employment / Income Analysis (continued)

Written Verification of Employment Alternative Income Documentation

A Written Verification of Employment may be used to calculate income for borrowers qualifying with wages from base pay/salary, overtime, bonus, tips, and commissions, subject to the following requirements:

- Borrower must be employed by the same employer for a minimum of two years.
- The Written VOE must be obtained directly by CMS from an automated or third-party service, such as Equifax The Work Number, CoreLogic AutomatIQ, Veri-Tax, etc., and include income data.

  Note: CMS may issue an initial decision using a hand-written or TPO-provided Written VOE, but must obtain an automated or third-party Written VOE directly from the service provider for the final income calculation.
- Income labeled as "Other" or similar on the Written VOE will require a year-to-date and year-end itemization from the employer or pay stubs in order to use for qualifying.
- W-2s and pay stubs are otherwise not required.
- Tax returns, transcripts, and 4506-C are not required unless the borrower is qualifying with additional forms of income like interest, dividends, capital gains, etc.
- Self-employment, employment by a family member, and foreign income are not eligible.
- Borrowers who receive rental income as a secondary income source may utilize Written VOE Documentation for calculating employment-related income and the most recent lease agreement(s) for rental properties for calculating rental income. Obtain proof of receipt at the current lease rate using a cancelled check or bank statement. Calculate the qualifying rents by using 75% of the current lease minus the full PITIA.

Employment History

Employment must be stable with at least a 2-year history in the same job or jobs in the same field. Income from self-employment is considered stable if the borrower has been self-employed for 2 or more years.

Frequent Job Changes

Frequent job changes to advance within the same line of work may be considered favorable. Job changes without advancement or in different fields of work should be carefully reviewed to ensure consistent or increasing income levels and the likelihood of continued stable employment.

Employment / Income Analysis (continued)

Employment History (continued)

Gaps in Employment

Borrowers re-entering the workforce following a gap in employment of 6 months or more are allowed provided borrower has been in his/her current position more than 6 months and evidence of 2 years previous employment is documented.

Borrowers should provide a signed, written letter of explanation for any employment gaps that exceed 30 days in the most recent 12-month period, or that exceed 60 days in months 13-24. Borrower(s) must write, sign, and date the letter themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content.

Recent graduates with evidence of post-secondary education from a college, university, community college, Junior college, Career school, technical school, or vocational/trade school are allowed.

SOURCES OF INCOME

Overview

For all income sources, borrowers are qualified based on calculated stable monthly income over the most recent 2-year period. Income may be obtained from a variety of sources such as salary, bonus, commission, self-employment, etc., and should be reasonably expected to continue for the next 3 years.

See Full Documentation for detailed income documentation requirements.

Annuity Income

Annuity income can be used for qualification when the following requirements are met:

- 12-month history must be verified using 1099s, tax returns, and/or bank statements
- Letter from issuer of annuity to be obtained stating that it has been set up on periodic withdrawal, amount of withdrawal, duration and balance
- Account asset balance must support the continuance of the monthly payments for at least 3 years after the close of escrow

Annuities less than 12 months old must be in a non-revocable trust with a minimum term of 40 months in order to use the income to qualify.

For annuity distributions from a 401(k) or pension, see Pension/Retirement.

Sources of Income, continued

Asset Conversion

Permitted on Purchase, Rate and Term and Cash Out. All occupancy types are permitted. See the Carrington Prime Advantage Program Matrix for credit score and LTV restrictions.

Borrowers must have the lesser of (a) 1.5 times the loan balance or (b) $1mm in qualified assets, both of which must be net of down payment, loan costs and required reserves to qualify.

Qualified Assets can be comprised of stocks, bonds, mutual funds, vested amount of retirement accounts and bank accounts. If a portion of the qualified assets are being used for down payment, closing costs, or reserves, those amounts must be excluded from the balance before analyzing a portfolio for income determination. **Please note:** Restricted stock and margined accounts are not considered qualified assets and are not eligible.

The following assets are considered Qualified Assets and can be utilized to calculate income:

- 100% of checking, savings, and money market accounts
- 100% of the remaining value of stocks & bonds
- 70% of retirement assets
- 100% Cash Value of Life Insurance
- 3-months seasoning of assets required

The following assets are not permitted:

- Funds in Foreign Banks

Asset Conversion is an Alternative Income Documentation type and may be used as standalone income or with other income types. Bank Statement Documentation used to calculate self-employment income may not be included in the Asset Conversion calculation.

The income calculation is as follows:

Monthly Income = Net Qualified Assets / 60 Months

Automobile Allowance

Automobile allowances can be used to qualify the borrower, subject to additional requirements. Allowances may not be used to offset a car payment, and automobile payments must be included in the debt-to-income ratio calculation.

Payments must have been received a minimum of 2 years, and the allowance must be documented on the borrower’s pay stub. Qualifying income is the allowance received from the employer minus the expenses the borrower has deducted on IRS Form 2106. If the allowance is less than the expenses, the loss must be deducted from qualifying income.

Bonus and Overtime

Bonus and overtime can be used to qualify if the borrower has received the income for the past 2 years and it is likely to continue. The Underwriter should use an average of bonus or overtime income.

A written Verification of Employment (FNMA Form 1005) should be obtained to provide a breakdown of bonus or overtime earnings for the most recent 2 years. If the employment verification states the income is unlikely to continue, it may not be used in qualifying.

Sources of Income, continued

Capital Gains

When income from capital gains is used to qualify the borrower, tax returns for the most recent 2 years are required to determine if the income is recurring and may be considered in qualifying. If a capital gain appears to be a onetime occurrence, it should not be considered when calculating income available.

For the income to be considered stable and likely to continue, the Underwriter must document sufficient assets to show the borrower will continue receiving the capital gains for a minimum of 3 years from note date. If the income is declining and/or there will be no asset base to generate the capital gains, it cannot be used for qualification purposes.

In addition, if assets that generated capital gains are being sold as part of the mortgage transaction, the income from capital gains must be reduced by a percentage equal to the percentage reduction in the value of the assets that generated the income.

Child Support, Alimony or Maintenance Income

In order for child support, alimony or separate maintenance to be considered stable income, it must continue for at least 3 years from note date as specified by the court order. The following requirements apply:

- A copy of the divorce decree or legal separation agreement must be obtained
- Documentation must be received to evidence receipt of the most recent 6 months of payments through copies of deposit slips, canceled checks, and/or bank statements

Full and timely payments must have been received for 6 months or longer. Income received for less than 6 months is considered unstable and may not be used to qualify the borrower. Also, if full or partial payments are made on an inconsistent or sporadic basis, the income is not acceptable for qualifying the borrower.

Commission Income

A commissioned borrower is one who receives more than 25% of his or her annual income from commissions. Commission earnings should be averaged over the most recent 2 years and require the following documentation:

- Copies of federal income tax returns for most recent 2 years
- Most recent year-to-date pay stub reflecting the commission earnings

A borrower on his current job for less than 2 years with a minimum 2-year history of receiving commission in the same line of work may also qualify to use commission earnings.

If there are large fluctuations, the borrower must provide a signed, written letter of explanation to support the increase or decrease in income. Borrower(s) must write, sign, and date the letter themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content. Additional supporting documentation is required to use commission income for qualification when documentation shows a decline in earnings from one year to the next.

With borrowers that receive a draw against the commission earnings, the draw income is not to be considered in addition to the commission income. Draws are only to be considered income paid in advance of receiving commissions, where the amount is then subtracted once the commissions are earned.

See also Unreimbursed Business Expenses.

Sources of Income, continued

Declining Income

Declining income sources should be closely reviewed to determine if the income may be used for qualifying purposes. Income showing a consistent decline over the prior years should not be considered as stable or usable income for qualification purposes.

A signed, written letter of explanation for the decline should be obtained from the borrower and/or employer. Borrower(s) must write, sign, and date the letter themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content. In instances where there is sufficient information to support the use of the income, the most recent lower income over the prior 2-year period must be used and may not be averaged.

Disability Income

Long-term and short-term disability income can be used for qualification. The following documentation should be obtained for both long-term and short-term disability:

- Documentation from either the insurance company or employer providing the payment amount, conditions for termination of payment, and the likelihood of it continuing for at least 3 years
- Copy of most recent check or bank statement is required if the award letter does not reflect the current payment being received

Short-term disability also requires the following documentation:

- Signed letter from borrower stating intent to return to work, once the disability no longer exists
- Verification from employer stating that the borrower will be allowed to return to work once the disability no longer exists. The letter must identify the borrower's position and rate of pay upon return. If the future employment income will be less than the disability income, the lower income amount must be used to qualify for the loan.

In documenting disability income, CMS employees must not make inappropriate and/or unlawful inquiries regarding the nature or severity of the borrower's disability.

Dividend / Interest Income

Dividend and interest income derived from investments can be used as qualifying income when the following requirements are met:

- 2 most recent years federal income tax returns received supporting a 2-year history of receipt; and
- Verification of stock asset values no older than 30 days at closing.

Sufficient assets should remain after closing to continue to generate an acceptable level of earnings. If assets that generated dividend/interest income are being sold as part of the mortgage transaction, the qualifying income must be reduced by a percentage equal to the percentage reduction in the value of the assets that generated the income.

Earnings should generally be averaged over the time period verified when current earnings are consistent with historical dividend and interest earnings.

Sources of Income, continued

Employment by a Relative

Income for borrowers who are employed by a relative must be verified with all of the following:

- Federal income tax returns for the most recent 2 years;
- W-2s for the most recent 2 years; and
- Pay stub(s) covering the most recent 30-day period.

Income should be averaged over the 2-year period. Clarification of potential ownership by the borrowers of family-owned businesses may also be required. A borrower may be an officer of a family operated business but not an owner. Verification of their status should be provided by written confirmation obtained from a CPA or legal counsel.

Foreign Income

Foreign income is income earned by a borrower who is self-employed, employed by a foreign corporation or a foreign government and is paid in foreign currency. Borrowers may use foreign income to qualify if the following requirements are met:

- Two years U.S. federal income tax returns reflecting the foreign income
- Income is translated to U.S. dollars
- Standard income stability and continuance requirements are met
- Standard documentation requirements apply based on the type of income
- Income from sanctioned countries administered by OFAC is not allowed

Foster Care Income

Income derived from foster care payments may be considered if there is a 2-year history of receipt and it is expected to continue for the next 3 years.

The income can be verified by letters from the organizations and copies of borrower's deposit slips or bank statements showing regular deposit of the payments, or by providing federal income tax returns for the most recent 2 years. The documentation received must clearly show the number of foster children involved, their ages, and length of care.

Income must be averaged over the 2-year period, and may not be considered for children who will reach the age of 19 within 3 years.

Hourly Wages

Borrowers paid on an hourly basis, or who may not work a regular 40-hour work week throughout the year, will generally have their income averaged over the minimum employment history required. If there is an indication of declining income, the current income is used instead of the average.

Lump Sum Distributions

Proceeds from the sale of investments held in a 401(k) or IRA account are not eligible as an income source. See Dividend/Interest Income for related allowable income sources.

Sources of Income, continued

Minister / Clergy Income	Ministers are individuals duly ordained, commissioned or licensed by a church or church denomination. Ministers and members of the clergy are generally considered self-employed unless exempted by IRS from self-employment taxes. If exempt, an exception from the IRS must be provided. Rental or housing allowance received can be considered income for qualifying the borrower. Written documentation, such as a WVOE provided by the church, must be obtained showing receipt of the income. The borrower's pay stub should also reflect receipt of the housing allowance. If the borrower is newly employed, obtain a copy of the church budget (in lieu of a check) showing funds have been allocated for housing allowance. Housing allowance for ministers is non-taxable income and can be grossed up for qualifying. The church may budget for educational, medical insurance, life insurance, retirement, etc. to be paid on behalf of borrower; however, these items will not be considered as qualifying income, unless exempted by the IRS. The housing allowance, although not subject to federal income taxes, is subject to self-employment taxes. Gross income on Schedule SE of the borrower's 1040 should include housing allowance paid.
Non-Taxable Income	Non-taxable income can be grossed up by 25%. Examples of non-taxable income may include military allowances for clothing, quarters, and subsistence, child support, worker's compensation, disability retirement, social security income, clergy housing allowance, foster care income, food stamps, income from municipal bonds, and certain types of insurance benefits. Some income types may contain both taxable and non-taxable income. Federal income tax returns may be required to accurately determine the non-taxable portion. Income may not be grossed-up for calculating Residual Income.
Notes Receivable Income	Income from notes receivables can 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 12 months and can verify that the income will continue for at least 3 years from note on the new mortgage. Evidence of receipt for the last 12 months must be verified with either canceled checks, bank deposit slips, of federal income tax returns. A copy of the note verifying payment amount and remaining term of at least 3 years must also be obtained.

Sources of Income, continued

Part Time / Second Job Income

Income from part-time employment or a second job can be considered stable income if it has been received for the previous 2 years and is likely to continue. Earnings must be documented with current pay stubs and W-2s for the most recent 2-year period.

Pension / Retirement

Pension and retirement income must be verified with any of the following:

- Letters from the organization providing the income
- Copy of retirement award letters
- Tax returns for the most recent 2 years
- W-2 forms or 1099 forms for the most recent 2 years
- Bank statements reflecting regular deposits for the most recent 2 months

Proof of Continuance

If the borrower is of retirement age, proof of continuance does not have to be documented when the income is received from corporate, government or military retirement/pension.

If retirement income is in the form of monthly annuity distributions, such as 401(k) or IRA, proof of continuance for 3 years is required. If the borrower intends to use the retirement account to also satisfy asset requirements, the value of the asset must be reduced by the funds being withdrawn prior to determining a 3-year continuance of income. Assets available beyond the deduction for continuance of income may be used as reserves. See also Retirement Accounts.

Forthcoming Retirement

Any borrower presently employed but anticipating retirement within 3 years from note date must be evaluated upon the verified anticipated retirement income. Effective income for borrowers planning to retire (or end employment for other reasons) during the period must include the amount of documented retirement or other benefits to be received, Social Security payments, or other payments expected to be received in retirement. A combination of present earnings and future retirement income does not represent a supportable level of earnings.

Public Assistance

Income from government assistance programs, such as food stamps, Aid to Dependent Children, or welfare, can be used as qualifying income provided such income has a reasonable likelihood of continuing for at least 3 years.

The applicant must provide a copy of a benefits awards letter as evidence of eligibility. This documentation must verify the amount of assistance, duration of payment and what portion if any is non-taxable. Verification of receipt of benefits for the previous 2 years can be documented with copies of checks, copies of bank statements, copies of award letter or copies of grant statements.

In documenting and evaluating public assistance income, CMS expects employees to comply fully with the requirements of the federal Equal Credit Opportunity Act and applicable state anti-discrimination laws.

Sources of Income, continued

Rental Income

Rental income may be used for qualifying. The following requirements apply:

- Rental income must be disclosed on the loan application
- Rental income from a 1-unit primary residence or second home may not be used
- Boarder income may not be used
- Required forms:
    - Single Family Comparable Rent Schedule (FNMA Form 1007)
    - 1-4 Family Rider Assignment of Rents for all 2-4 unit properties (FNMA Form 3170)

Note: if rental income from the subject property is not being used to qualify, the gross monthly rent must still be documented with appraisal form 1007 or 1025 for lender reporting purposes.

Income or Loss

The treatment of the monthly qualifying rental income or loss in the total debt-to-income ratio (as calculated in Calculating Rental Income from the Subject Property and Rental Income from Other Real Estate Owned) varies based on occupancy of the property.

If the property is a primary residence, the following applies:

- The monthly qualifying rental income must be added to the borrower's total monthly income (income is not netted against the PITIA); and
- The full PITIA must be included in the borrower's total monthly obligations when calculating the DTI.

If the rental income or loss relates to a property other than the borrower's primary residence, the following calculations apply:

- If the monthly qualifying rental income minus the full PITIA is positive, it must be added to the borrower's total monthly income
- If the monthly qualifying rental income minus PITIA is negative, the monthly net rental loss must be added to the borrower's total monthly obligations

The full PITIA for the rental property is factored into the amount of the net rental income or loss; therefore, it should not be counted as a monthly obligation.

Sources of Income, continued

Rental Income (continued)

Calculating Rental Income from the Subject Property

Rental income from the subject property owned prior to loan application should be calculated using the borrower's federal income tax returns for the most recent 12-month period (Cash Flow Analysis of Schedule E). Income should be averaged. Net rental losses should be included in ratios as a liability.

Rental income should be calculated using the lesser of:

- 75% of the current lease minus the full PITIA; or
- Cash flow analysis of the Schedule E from the most recent year's federal income tax return (if applicable)

The underwriter may determine circumstances warrant utilizing 75% of the current lease agreement despite the rental appearing on Schedule E. In such cases, the underwriter must provide an explanation and justification in the loan file.

Rental income from a new property being acquired through a purchase transaction can be used to qualify, using the lesser of:

- 75% of the current lease minus the full PITIA (evidence of deposit must be obtained); or
- 75% of the appraiser's opinion of rent on appraisal form 1007 minus the full PITIA

If no lease exists and rental income is calculated using only the appraiser's opinion of rent, an additional 3 months PITIA reserves is required.

Rental Income from Other Real Estate Owned

To calculate rental income from a departure residence when converting a current residence into a rental: 75% of a lease minus the full PITIA may be used.

Rental income from another property owned prior to loan application should be calculated using the borrower's federal income tax returns for the most recent 12-month period (Cash Flow Analysis of Schedule E). Income should be averaged. Net rental losses should be included in ratios as a liability.

Rental income should be calculated using the lesser of:

- 75% of the current lease minus the full PITIA; or
- Cash flow analysis of the Schedule E from the most recent year's federal income tax return (if applicable)

The underwriter may determine circumstances warrant utilizing 75% of the current lease agreement despite the rental appearing on Schedule E. In such cases, the underwriter must provide an explanation and justification in the loan file.

Sources of Income, continued

Rental Income (continued)

Cash Flow Analysis of Schedule E

Cash Flow Analysis of Schedule E should be completed as follows:

Gross Rents and Royalties Received

- Total Expenses

+ Depreciation

+ Insurance

+ Mortgage Interest

+ Taxes

+ HOA fees (if included on Schedule E)

Subtotal

Subtotal / 12 = Monthly Total

Monthly Total

<u>- Proposed or Existing Monthly PITIA</u>

MONTHLY NET RENTAL INCOME/LOSS

Rental Income from an ADU

Rental income from an ADU may be considered when permitted by local zoning laws and/or regulations. Any rental income received from the accessory unit and used for qualifying must be documented as follows:

- The loan file must contain documentation to support that the ADU may be legally rented per local codes or regulations.
- Purchase transactions involving a property with an ADU:
  - For ADUs that are currently leased, obtain a copy of the current lease.
  - Obtain the appraiser’s estimate of market rent on FNMA Form 1007, Comparable Rent Schedule or FNMA Form 1025, Small Residential Income Property Appraisal Report.
  - The lesser of the actual or market rents less a 25% vacancy and maintenance factor may be used for qualifying.
- Refinance transactions involving a property with an ADU:
  - For full doc loans, obtain the most recent tax return. For alt doc loans using bank statements, P&Ls, or 1099s for qualifying, or properties acquired since the most recent tax filing, obtain the current lease and proof of receipt at the current lease rate using a cancelled check or bank statement.
  - Obtain the appraiser’s estimate of market rent on FNMA Form 1007, Comparable Rent Schedule or FNMA Form 1025, Small Residential Income Property Appraisal Report.

Sources of Income, continued

Rental Income from an ADU (continued)

- For full doc loans, the lesser of the Sch E net rents or market rents less a 25% vacancy and maintenance factor may be used for qualifying. For alt doc loans and properties acquired since the most recent tax filing, the lesser of the actual or market rents less a 25% vacancy and maintenance factor may be used for qualifying.
- Rental income may not be considered for ADUs that do not have a history of being leased.

- Transactions where other Real Estate Owned has an ADU that may be legally rented:
  - For full doc loans, obtain the most recent tax return. Sch E net rents may be used for qualifying.
  - For alt doc loans using bank statements, P&Ls, or 1099s for qualifying, or properties acquired since the most recent tax filing, obtain the current lease and proof of receipt at the current lease rate using a cancelled check or bank statement. The actual rents less a 25% vacancy and maintenance factor may be used for qualifying.
  - Rental income may not be considered for ADUs that do not have a history of being leased.

Royalty Payment Income

Obtain copies of the royalty contract, agreement, or statement confirming amount, frequency, and duration of the income; and borrower’s most recent signed federal income tax return, including the related IRS Form 1040, Schedule E.

Income from royalty payments may be considered with confirmation that the borrower has received royalty payments for at least 12 months and that the payments will continue for a minimum of three years after the date of the mortgage application.

Seasonal Income

Income from seasonal employment may be considered if the applicant has worked the same job during the season for the past 2 years and expects to be rehired for the next season.

A written Verification of Employment (WVOE) and W-2s for the most recent 2 years are required. The WVOE must reference the likelihood of the borrower’s rehire. Seasonal income should be averaged over a 2-year period.

Temporary/Contract Income

Borrower must have 2 years in the same line of work. Underwriter must verify working with temp agency is common for the borrower’s line of work. The contract must show continuance and/or the temp agency must verify they guarantee employment at the end of contract expiration date.

A written Verification of Employment (WVOE) and W-2s for the most recent 2 years are required. The WVOE must reference the likelihood of the borrower’s continuance. Temporary/Contract income should be averaged over a 2-year period.

Sources of Income, continued

Self-Employed Income

A borrower is considered self-employed with 25% or more ownership interest in a business. The business may be a sole proprietorship, general partnership, limited partnership, corporation, or S-corporation. A Liquidity Test is not required to qualify the borrower.

Sole Proprietorship

A sole proprietorship is a business structure in which an individual and his or her company are considered a single entity for tax and liability purposes. Income and losses are reported on the owner's schedule C of the individual federal income tax return.

Documents required for determining income from a sole proprietorship are**:**

- Federal income tax returns (IRS Form 1040) for the most recent 2 years, including all schedules; and
- Year-to-date profit and loss statement (if the loan application is > 120 days after the year-end reflected on the most recent business tax returns provided); and
- Signed and processed IRS form 4506-C (full 1040 transcripts capturing all schedules); and
- Verification of the existence of the business within 10 business days of closing.

Partnerships

A partnership is a business organization in which 2 or more individuals manage and operate the business. The partners share profits and losses and control of the business.

Documents required for determining partnership income are**:**

- Federal income tax returns (IRS Form 1040) for the most recent 2 years, including all schedules; and
- W-2s for the most recent 2 years (if applicable); and
- Partnership tax returns (IRS Form 1065) for the most recent 2 years, including all schedules and K-1s (**Note:** if borrower is a limited partner with less than 50% ownership, partnership tax returns are not required); and
- Year-to-date profit and loss statement (if the loan application is > 120 days after the year-end reflected on the most recent business tax returns provided); and
- Signed and processed IRS form 4506-C (full 1040 transcripts capturing all schedules); and
- Verification of the existence of the business within 10 business days of closing.

Sources of Income, continued

Self-Employed Income, continued

Corporations

A corporation is a legal entity that is separate and distinct from its owners. If a borrower has more than 25% ownership in a corporation, they are considered to be self-employed. A borrower that is self-employed as a corporate officer will receive a pay stub and W-2, and will report income on his or her personal tax returns. Corporate income or losses are reported on the corporate tax returns (IRS Form 1120).

Documents required for determining income from a corporation:

- Federal income tax returns (IRS Form 1040) for the most recent 2 years, including all schedules; and
- W-2s for the most recent 2 years; and
- Corporate tax returns (IRS Form 1120) for the most recent 2 years, including all schedules; and
- Year-to-date profit and loss statement (if the loan application is > 120 days after the year-end reflected on the most recent business tax returns provided); and
- Signed and processed IRS form 4506-C (full 1040 transcripts capturing all schedules); and
- Verification of the existence of the business within 10 business days of closing.

S Corporations (Subchapter S Corporations)

S Corporation (S-Corp) is a type of corporation which enables the company to have the benefits of a corporation but be taxed as if it were a partnership. S-Corps are generally small corporations. The profit of the corporation is given to each owner according to his or her share of ownership. The adjusted profit is then divided by the borrower's share of ownership and combined with W-2 income used for qualifying. Income is reported with both a W-2 and K-1 (reporting on the Schedule E) or only with a K-1.

Documents required for determining income from an S-corporation:

- Federal income tax returns (IRS Form 1040) for the most recent 2 years, including all schedules; and
- W-2s for the most recent 2 years; and
- Corporate tax returns (IRS Form 1120-S) for the most recent 2 years, including all schedules and K-1s; and
- Year-to-date profit and loss statement if the loan application is dated more than 120 days after the end of the business's tax year; and
- Signed and processed IRS form 4506-C (full 1040 transcripts capturing all schedules); and
- Verification of the existence of the business within 10 business days of closing.

Sources of Income, continued

Self-Employed Income, continued

1099 Miscellaneous Income

Payments to sole proprietors or contract individuals will also be reported on IRS Form 1099 form and included in the borrower's Schedule C. Borrowers who receive self-employed 1099 earnings may be qualified under the Sole Proprietorship guidelines by providing IRS Form 1040 tax returns for the most recent 1 or 2 years, or under the 1099 Income Documentation guidelines by providing IRS Form 1099 for the most recent 1 or 2 years.

When a borrower is qualified solely on W-2 wages and secondary 1099 income is discovered during the underwriting process, tax returns are not required unless the borrower requests the secondary business income to be considered.

1099 forms covering a full 2-year period are not required when a borrower changes from being paid W-2s to 1099s while working for the same employer in the same position. Documentation from the employer should be obtained to verify the borrower is not responsible for additional expenses.

Reduced Documentation for a Secondary Business

Business tax returns, associated schedules, and profit and loss statements may be waived when all of the following requirements are met:

- Income/loss referenced on personal tax returns is generated from a secondary business that is not the borrower's primary income source; and
- Income/loss from each separate business is ≤ 10% of qualifying income for the transaction; and
- All losses are subtracted from the borrower's qualifying income.

If income from a business is used to qualify the borrower, or if business expenses are added back to income or a loss, then business tax returns, associated schedules, and profit and loss statements must be obtained. Underwriters may also use discretion to obtain all documentation for self-employed earnings when the secondary business may have a significant impact on the loan.

Cash Flow Analysis

The Underwriter must prepare a written evaluation of the analysis of a self-employed borrower's personal income, including the business income or loss, reported on the borrower's federal income tax returns. A copy of the Underwriter's written analysis must be included in the loan file.

Adjustments to the net profit or loss of the business may be required to arrive at the borrower's cash flow. For example, tax returns (IRS Forms 1040 Schedule C, 1065, 1120S, 1120) may reveal income that was not obtained from the profits of the borrower's business; if such income is not recurring, the borrower's cash flow is adjusted by deducting the nonrecurring income.

Items that may be added back to the business cash flow include depreciation, depletion, amortization, business use of a home, casualty losses, net operating losses, and other special deductions that are not consistent and recurring.

Sources of Income, continued

Self-Employed Income, continued

The following items must be subtracted from the business cash flow:

- travel and meals exclusion,
- other reported income that is not consistent and recurring,
- tax liability and amount of any dividends for Corporations (IRS Form 1120), and
- the total amount of obligations on mortgages, notes, or bonds that are payable in less than one year. These adjustments are not required if there is evidence that these obligations roll over regularly and/or the business has sufficient liquid assets to cover them.

Social Security Income

When a borrower is drawing Social Security benefits from their own account/work record in the form of Retirement or Disability, one of the following items is required:

- Social Security Administrator's (SSA) Award letter, or
- Proof of current receipt

When a borrower is drawing benefits from their own account/work record in the form of Supplemental Security Income (SSI), both the award letter AND proof of current receipt must be obtained.

When a borrower is drawing Social Security benefits from another person's account/work record, all of the following items are required:

- SSA Award letter
- Proof of current receipt; and
- Proof benefit will continue for at least 3 years (e.g., verification of beneficiary's age)

See also Non-Taxable Income.

Teacher Income

Teachers are paid on a 9-month, 10-month or 12-month basis. The Underwriter should determine how the pay is structured before calculating the monthly income. If uncertainty exists, the borrower may provide a copy of their contract or the Underwriter may verbally confirm with the school district's personnel office.

Tips and Gratuities

Tips and gratuity income can be considered if receipt of such income is typical for borrower's occupation (i.e., waitperson, taxi driver, etc.). Income should be received for at least 2 years and documented through the most recent pay stub, 2 years W-2s and written verification of employment (VOE). Income should be averaged over the time period verified. If the tip income is not reported on the pay stubs or tax returns, then it may not be included in qualifying income.

Sources of Income, continued

Trailing Spouse or Co-Borrower Income / Relocation

Trailing spouse income or co-borrower income to be received when the borrower is being relocated is not allowed to be used as qualifying income.

Trust Income

Trust income can be used for qualification when all of the following requirements are met:

- Copy of the trust agreement or the trustee's statement must be obtained to confirm the amount, frequency, and duration of payments;
- Trust income to continue for at least 3 years from date of the mortgage application; and
- History of receiving the trust income must be documented for a minimum of 3 months.

Lump-sum distributions from the trust made prior to loan closing can be used for down payment or closing costs if the withdrawal does not affect the qualifying amount of continuing distributions to the borrower. The funds must be verified by a copy of the check or the trustee's letter that shows the distribution amount. See also Trust Accounts.

Unreimbursed Business Expenses

Unreimbursed business expenses reported on IRS Form 2106 should be evaluated when commission earnings represent 25% or more of the borrower's total income.

Unreimbursed expenses should be averaged over the most recent 2-year period and deducted from the borrower's cash flow. If the borrower's employment situation has changed (new job or position, retirement, etc.) the expense deduction should be adjusted accordingly to reflect the borrower's present earnings situation.

When the borrower uses "Actual Expenses" for a leased automobile rather than the "Standard Mileage Rate," the "Actual Expenses" section of the IRS Form 2106 must be analyzed to determine the amount of the lease payments. The lease expense should only be counted once in the borrower's cash flow analysis, either as an expense on Form 2106 or as a monthly obligation.

If automobile depreciation is referenced on IRS Form 2106, the borrower's cash flow needs to be adjusted based on the depreciation method selected by the borrower:

- Standard Mileage Deduction: multiply business miles driven by the depreciation factor for the appropriate year and add the calculated amount to the borrower's cash flow
- Actual Depreciation Expense Deduction: add the amount the borrower claimed to the borrower's cash flow

Sources of Income, continued

Unacceptable Income

- Gambling winnings (except lottery continuing for 5 years)
- Educational benefits
- Stock options
- Refunds of federal, state, or local taxes
- Expense account reimbursement
- Illegal income
- Income from medical marijuana dispensaries
- Any business or activity related to recreational marijuana use, growing, selling or supplying of marijuana, even if legally permitted under state or local law.

Unemployment Compensation

Income derived from unemployment compensation is generally not allowed due to the limited duration of its receipt. Seasonal unemployment, however, can be considered if the borrower is employed in a field where weather affects the ability to work and where unemployment compensation is often received (i.e., construction). The income can be used to qualify on with a 2-year employment history in the same field of work and a 2-year history of receipt of unemployment compensation with 2 years tax returns or 2 years 1099 forms. Income should be averaged over the time period verified.

VA Survivor's Benefits / Dependent Care

VA benefits must be documented with a copy of the award letter or distribution forms and must continue for at least 3 years.

RATIOS AND QUALIFYING

Ratios

The debt-to-income ratio (DTI) is calculated by adding the borrower's total PITIA and the borrower's total monthly obligations and dividing by the borrower's total monthly qualifying income.

Standard Ratio	
Debt Ratio	**43%**

<table>
<tr><th colspan="2">Expanded Ratio</th></tr>
<tr><td rowspan="2">Debt Ratio</td><td>50%</td></tr>
<tr><td><u>ALL </u>of the following requirements apply:
• Primary Residence and Second Homes
• 80% Max LTV
• Credit Score ≥ 680</td></tr>
</table>

Residual Income

Residual income is required for primary residence and second home transactions using the following calculation:

Residual Income = Gross Monthly Income - Total Monthly Obligations

Residual Income of $2,500 is required. An additional $150 per dependent must also be included for all programs. The initial URLA should reflect the number of dependents for all borrowers on the transaction.

Residual income is not required for investment properties.

Adjustable Rate Qualifying

For all ARM loans, the greater of the note rate or the fully indexed rate rounded up to the nearest eighth percentage is used to determine the qualifying PITIA. The fully indexed rate is calculated by adding the margin to the index. Floor is the margin.

See the Carrington Prime Advantage Program Matrix for the margin, index, and other restrictions.

Interest Only Payment Qualifying

All Interest-only loans qualify using the fully amortized payment calculated over the fully amortizing period, based on the greater of the note rate or the fully indexed rate rounded up to the nearest eighth percentage to determine the qualifying PITIA. For example, a 30-year loan with a 10-year interest-only period would have a 20-year fully amortizing period.

See the Carrington Prime Advantage Program Matrix for the margin, index, and other restrictions.

ASSET ANALYSIS

Overview	Loan files must evidence sufficient funds from acceptable sources for down payment, closing costs, prepaid items, debt payoff, and applicable reserves. A borrower's ability to accumulate assets provides insight into the individual's ability to successfully manage personal finances. See Asset Documentation for sourcing and seasoning requirements.
Down Payment	See the Carrington Prime Advantage Program Matrix for specific LTV and down payment requirements.
Reserves	Reserves are measured by the number of months of housing expense a borrower could pay using his or her financial assets. See the Carrington Prime Advantage Program Matrix. The highest reserve requirement, rather than a cumulative total, should be used when a transaction has multiple required reserves. Cash-out proceeds are permitted for reserves. Excess gift funds verified in the borrower's bank account prior to closing are permitted for reserves. Gift funds provided at closing may not be considered toward reserves. Additional reserves are also required when the following situations are present: • Multiple Financed Properties: 2 months for each additional property when the subject is a second home or investment property • Use of Rental Income Without a Lease: 3 months in addition to standard requirement
Qualifying Reserves on ARM Loans	Reserves on ARM loans must be determined based on the Fully Indexed Rate. Reserves are measured by the number of months of the qualifying payment amount for the subject mortgage (based on PITIA) that a borrower could pay using his or her financial assets.

VERIFICATION OF ASSETS

Borrowed Funds Secured by an Asset

Borrowed funds that are secured by an asset can be used as a source of funds for down payment, closing costs, and reserves. Assets that may be used to secure funds include automobiles, artwork, collectibles, real estate, stocks and/or bonds, and 401(k) accounts.

The terms of the secured loan and transfer of funds to the borrower should be documented. The individual providing the secured loan cannot be a party to the transaction.

The monthly payments for the loan secured by non-financial assets must be counted in the debt-to-income ratio. However, when the loan is secured by the borrower's financial assets and there are sufficient assets to pay off the loan currently verified, the monthly payment for the loan does not have to be considered as a long-term debt when qualifying the borrower (as in the case of a 401(k) loan). After a 401(k) loan is distributed, if the account balance including the 401(k) loan balance is sufficient to cover the payoff of the loan, the monthly payment does not need to be included in the debt-to-income ratio

If the same financial asset is also used as part of the borrower's financial reserves, adequacy of the borrower's reserves must be determined after taking into consideration the net value of the asset after it has been reduced by the proceeds from the secured loan (and any related fees). If any 401(k) assets are to be used as reserves, the net value after the loan proceeds are deducted must be used when calculating the amount of reserves. See also Retirement Accounts.

Business Assets

For self-employed borrowers, business assets are an acceptable source of funds for down payment, closing costs, and reserves. The borrowers on the loan must have 50% ownership of the business and must be the owners of the account or demonstrate ability to access the account. Business assets must be multiplied by the borrower's ownership percentage of the business. For bank accounts solely in the name of a business, access must be demonstrated using a cancelled check signed by the borrower, signature card or other documentation from the bank, CPA letter, or corporate documents such as a corporate resolution, operating agreement or similar.

A letter from a CPA or borrower must be obtained verifying that the withdrawal of funds for the transaction will not have a negative impact on the business. If a CPA letter is not provided, a cash flow analysis of the tax returns, business bank statements, and P&L (when applicable) must be completed by the Underwriter to determine if the withdrawal of funds from the business is acceptable.

Note: The requested information shall not be interpreted as an assurance of solvency.

Verification of Assets (continued)

Concessions and Contributions

Interested Parties

Interested parties to a transaction include, but are not limited to, the property seller, the builder/developer, the 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 price possible. A lender or employer is not considered an interested party to a sales transaction unless it is the property seller or is affiliated with the property seller or another interested party to the transaction.

Financing Concessions/Seller Contributions

For primary residence and second home transactions with LTVs of 75% or less, the property seller and/or interested parties may contribute up to 9% of the lesser of the property's sales price or appraised value toward the buyer's closing costs, prepaid expenses, discount points, and other financing concessions.

For LTVs from 75.01% and greater, interested parties may contribute up to 6%.

For investment property transactions, the property seller and/or interested parties may contribute up to 4%.

Sales Concessions

Sales concessions include:

- Financing concessions in excess of the max financing concession limitations; or
- Contributions such as cash, furniture, automobiles, decorator allowances, moving costs, and other giveaways granted by any interested party to the transaction (contributions with a combined value under $1,000 should be excluded)

The value of sales concessions must be deducted from the sales price when calculating LTV for underwriting and eligibility purposes. The LTV is then calculated using the lower of the reduced purchase price or the appraised value.

Verification of Assets (continued)

Depository Accounts

Funds held in a checking, savings, money market, certificate of deposit, or other depository accounts can be used for down payment, closing costs, and reserves.

The Underwriter must investigate any indications of borrowed funds, including recently opened accounts, recent large deposits, or account balances that are considerably greater than the average balance over the previous few months. A signed, written letter of explanation of the source of funds should be obtained from the borrower and the source of funds verified. Borrower(s) must write, sign, and date the letter themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content. Unverified funds are not acceptable. See also Asset Documentation.

If the borrower does not hold the deposit account solely, all non-borrower parties on the account (excluding a non-borrowing spouse) must provide a written statement that the borrower has full access and use of the funds. See also Spousal Accounts.

If bank statements provided reflect payments being made on obligations not listed on the credit report, see Undisclosed Debts for additional guidance.

NOTE: Payable on death (POD) depository accounts are regular accounts which pass to a designated individual or individuals upon death of the primary owner. POD bank accounts are permitted for the primary account owner only. The surviving owner(s) must have a death certificate for the deceased owner to claim ownership.

Earnest Money / Cash Deposit on Sales Contract

If earnest money is needed to meet the borrower's minimum contribution requirement, the Underwriter must verify that the funds are from an acceptable source. Satisfactory documentation includes any of the following:

- Copy of the borrower's canceled check
- Certification from the deposit holder acknowledging receipt of funds
- VOD or bank statement showing that the average balance was sufficient to cover the amount of the earnest money at the time of the deposit

If the earnest money check has cleared the bank, bank statements should cover the period up to and including the date the check cleared the account. A copy of the check that has not cleared may also be obtained along with a processor's certification verifying with the bank the date the check cleared, the dollar amount of the check, and the individual providing the information.

Verification of Assets (continued)

Gift Funds

Gift funds are allowed after the borrower has made the minimum required borrower contribution towards the down payment.

Gift funds can be used for down payment and closing costs. See also Reserves.

Gift funds must be from a relative: defined as the borrower's spouse, child, or other dependent; or by any other individual who is related to the borrower by blood, marriage, adoption, or legal guardianship; or a fiancé, fiancée, or domestic partner.

A signed gift letter is required to provide all of the following information:

- Donor's name, address, phone, and relationship to borrower (donor must be a relative); and
- Dollar amount of gift; and
- Date funds were transferred; and
- Donor's statement that no repayment is expected.

Underwriters must verify that sufficient funds to cover the gift are either in the donor's account or have been transferred to the borrower's account. Acceptable documentation includes any of the following:

- Copy of the donor's check and the borrower's deposit slip
- Copy of the donor's withdrawal slip and the borrower's deposit slip
- Copy of the donor's check to the closing agent
- Evidence of wire transfer from donor to borrower
- Settlement statement showing receipt of the donor's check

When the funds are not transferred prior to closing, the Underwriter must document that the donor gave the closing agent the gift funds in the form of a certified check, a cashier's check, money order, or wire transfer. See also Spousal Accounts.

Gifts of Equity

Gifts of equity on non-arm's length transactions are allowed. Primary residence transactions with gifts of equity are subject to the maximum LTVs available for cash-out transactions, and no minimum borrower contribution is required. Investment property transactions with gifts of equity are allowed after meeting borrower's minimum contribution requirement.

The following requirements apply:

- Gift of equity is from a relative
- Six months of reserves required of borrower's own funds
- Non-arm's length criteria is met
- Signed gift letter is provided
- Gift of equity is listed on the settlement statement
- For ITIN borrowers using a gift of equity, a 5% LTV reduction is required in lieu of using cash out LTVs

Verification of Assets (continued)

Foreign Assets

For U.S. citizen and permanent resident alien borrowers, all funds required for down payment, closing costs, and reserves must be seasoned for 60 days. See Asset Documentation. Foreign assets deposited into a U.S. institution within 60 days of application are acceptable if there is evidence that the funds were transferred from the country from which the borrower previously or currently resides. It must also be established that the funds belonged to the borrower before the date of transfer.

Funds required for closing (down payment and closing costs) must be seasoned in a U.S. depository institution for 30 days prior to closing.

Assets held in a foreign account can be used for reserves. The most recent 30-day account statement is required, and funds are to be converted to U.S. dollars using the current exchange rate. A letter of reference on company letterhead from a verifiable banking institution may also be obtained. Contact information must be provided by the person signing the letter, and the letter must state the type of relationship, length of the relationship, how accounts are held, and current balance. Any translation must be signed and dated by a certified translator.

Life Insurance

Net proceeds from the surrender of a life insurance policy or from a loan against the cash value are acceptable for down payment, closing costs, and reserves.

If the funds are needed for the down payment or closing costs, CMS must document the borrower's receipt of the funds from the insurance company by obtaining either a copy of the check from the insurer or a copy of the payout statement issued by the insurer. If the cash value of the life insurance is being used for reserves, the cash value must be documented but does not need to be liquidated and received by the borrower.

The Underwriter must assess any repayment obligations to determine any impact on borrower qualification or reserves. If penalties for failure to repay the loan are limited to the surrender of the policy, payments on a loan secured by the cash value of a borrower's life insurance policy do not have to be considered in the total debt-to-income ratio. If additional obligations are indicated, the amount must be factored into the total debt-to-income ratio or subtracted from the borrower's reserves.

Net Proceeds from Sale of Real Estate

If part of the down payment is expected to be paid from the sale of the borrower's current home, a final settlement statement verifying sufficient net proceeds must be obtained.

Like-Kind Exchanges

Assets for the down payment from a "like-kind exchange," also known as a 1031 exchange, are eligible if properly documented and in compliance with Internal Revenue Code Section 1031.

Verification of Assets (continued)

Rent Credit for Lease with Purchase Option

Borrowers may apply a portion of the rent paid to their down payment requirements. Credit for the down payment is determined by calculating the difference between the market rent and the actual rent paid for the last 12 months. The market rent is determined by the appraiser in the appraisal for the subject property. See Lease with Purchase Option for full requirements.

The Underwriter must obtain the following documentation:

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

Relocation and Employer Assistance

Forms of Employer Assistance

The employer assistance may be in the form of:

- a grant,
- a direct, fully repayable second mortgage or unsecured loan,
- a forgivable second mortgage or unsecured loan, or
- a deferred-payment second mortgage or unsecured loan.

A borrower of a mortgage loan secured by a principal residence may use funds provided by an employer to fund all or part of the down payment or closing costs subject to the minimum borrower contribution requirements below. Employer assistance can also be used for financial reserves for all types of assistance with the exception of unsecured loans (which may only be used for the down payment and closing costs). Funds must come directly from the employer, including through an employer-affiliated credit union. Employer assistance funds are not permitted on second homes or investment properties.

Minimum Borrower Contribution Requirements

See the Carrington Prime Advantage Program Matrix for the minimum borrower contribution requirements.

Documentation Requirements

CMS must document:

- that the program is an established company program, not just an accommodation developed for an individual employee.
- the dollar amount of the employer's assistance.
- an unsecured loan from an employer with an award letter or legal agreement from the note holder and must disclose the terms and conditions of the loan.
- the terms of any other employee assistance being offered to the borrower (such as relocation benefits or gifts).
- that the borrower received the employer assistance funds directly from the employer (or through the employer-affiliated credit union).

Verification of Assets (continued)

Retirement Accounts

Vested funds from individual retirement accounts (IRA/SEP/Keogh accounts) and tax-favored retirement savings accounts (401(k) accounts) are acceptable sources of funds for the down payment, closing costs, and reserves. The lender must verify the ownership of the account and confirm that the account is vested and allows withdrawals regardless of current employment status.

If the retirement assets are in the form of stocks, bonds, or mutual funds, the account must meet the requirements of Stocks, Bonds, and Mutual Funds for determining value and whether documentation of the borrower's actual receipt of funds is required when used for the down payment and closing costs. When funds from retirement accounts are used for reserves, the funds do not have to be withdrawn from the account.

Retirement accounts must qualify at 60% of the retirement assets (70% for borrowers of retirement age that do not have a 10% withdrawal penalty), see also Proof of Continuance.

Sale of Personal Assets

Proceeds from the sale of personal assets are an acceptable source of funds for down payment, closing costs, and reserves, provided the individual purchasing the asset is not a party to the property sale or mortgage financing transaction.

The Underwriter must document the following:

- Borrower's ownership of the asset
- Value of the asset, as determined by an independent and reputable source
- Transfer of ownership of the asset, as documented by either a bill of sale or a statement from the purchaser
- Borrower's receipt of the sale proceeds from documents such as deposit slips, bank statements, or copies of the purchaser's canceled check

Secondary / Subordinate Financing

Secondary or subordinate financing is allowed with a maximum CLTV equal to the maximum LTV for the transaction. Secondary financing is not permitted for second home or investor-occupied properties.

If the subordinate financing has a simultaneous closing, the following is required:

- A copy of the loan approval and repayment terms for the new financing; and
- A copy of the executed note at closing.

If the subordinate financing is being subordinated, the following is required:

- The repayment terms of the existing second lien;
- An unsigned copy of the subordination agreement prior to closing; and
- A copy of the executed subordination agreement at closing.

Verification of Assets (continued)

Secondary / Subordinate Financing, continued

The following requirements apply to all subordinate liens:

- Seller-held subordinate liens are not permitted. Institutional seconds only.
- Subordinate financing must be recorded and clearly subordinate to the new mortgage
- Payment on the subordinate financing must be included the borrower's DTI. If a payment is unable to be determined, 1.5% of the original loan balance can be used.
- If the debt is an equity line of credit, the CLTV ratio is calculated by adding the total HELOC credit line limit (rather than the amount of the HELOC in use) to the first mortgage amount, plus any other subordinate financing, and dividing that sum by the value of the property
- Negative amortization is not allowed and the scheduled payments must be sufficient to cover at least the interest due
- Subordinate financing from the borrower's employer may not include a provision requiring payment upon termination

Subordinate liens can be paid off through closing. See Rate/Term Refinance and Cash-out Refinance for more information.

Refer to Texas Home Equity Loans - Secondary Financing section for additional Texas subordination restrictions.

PACE, HERO and other Energy Efficiency Loans

Liens for Property Assessed Clean Energy (PACE) or Home Energy Renovation Opportunity (HERO) and other energy efficiency loans may not remain on title.

Loans used to finance energy improvements such as PACE or HERO loans may be paid off and included in the new mortgage as follows: loans with seasoning of 12 months or longer may be refinanced as a Rate/Term transaction. Loans with seasoning of less than 12 months must be refinanced as a cash-out transaction. Seasoning is measured from the recording date of the energy improvement loan to the Note date of the new refinance loan transaction.

Spousal Accounts

Accounts held solely in the name of a non-borrowing spouse may be used for down payment and closing costs only and are subject to the seasoning requirements outlined in Asset Documentation.

Accounts held solely in the name of a non-borrowing spouse may not be used to meet reserve requirements.

Stock Options

Vested stock options are an acceptable source of funds for down payment and closing costs when immediately available to the borrower. Stock options may not be used to meet reserve requirements. The value of vested stock options can be documented by:

- Referencing a statement listing the number of options and the option price; and
- Determining the gain that would be realized from exercise of an option and the sale of the optioned stock using the current stock price

Verification of Assets (continued)

Stocks, Bonds, and Mutual Funds

Vested assets in the form of stocks, government bonds, and mutual funds are acceptable sources of funds for the down payment, closing costs, and reserves provided their value can be verified. The lender must verify the borrower's ownership of the account or asset.

When used for the down payment or closing costs, if the value of the asset is at least 20% more than the amount of funds needed for the down payment and closing costs, no documentation of the borrower's actual receipt of funds realized from the sale or liquidation is required. Otherwise, evidence of the borrower's actual receipt of funds realized from the sale or liquidation must be documented.

When used for reserves, 100% of the value of the assets (as determined above) may be considered, and liquidation is not required.

Trust Accounts

Funds disbursed from a borrower's trust account are an acceptable source for down payment, closing costs, and reserves provided the borrower has immediate access to the funds.

To document trust account funds, the Underwriter must:

- Obtain written documentation of the value of the trust account from either the trust manager or the trustee; and
- Document the conditions under which the borrower has access to the funds and the effect, if any, that the withdrawal of funds will have on trust income used in qualifying the borrower for the mortgage.

See Trust Income if trust is also being used as a source of income to qualify the borrower.

Ineligible Sources of Assets

- Cash-on-hand
- Sweat equity
- Gift or grant funds which must be repaid
- Down payment assistance programs
- Bridge loans
- Unsecured loans or cash advances
- Section 8 Voucher Assistance
- Cryptocurrency (digital assets such as bitcoins)
- Private Savings Club accounts

PROPERTY

General Property Requirements

A completed appraisal report is required on all loan transactions to assess the adequacy of the property as collateral for the mortgage requested. The Underwriter is responsible for all of the following:

- The accuracy and completeness of the appraisal and its assessment of the marketability of the property
- Underwriting the completed appraisal report to determine whether the subject property presents adequate collateral for the mortgage
- Continually evaluating the quality of the appraiser's work through normal underwriting review of all appraisal reports and spot-check field review of appraisals as part of its quality control program
- Ensuring that the appraiser uses sound reasoning and provides evidence to support the methodology used for developing the value opinion
- Ensuring that the appraiser provides an accurate opinion, an adequately supported value, and an accurate description of the property
- Ensuring that the appraiser provides his or her license or certification on the appraisal report
- Complying with the Appraiser Independence Requirements (AIR) published by Fannie Mae/Freddie Mac and the requirements of the Federal Truth in Lending Act and Regulation Z with respect to valuation independence
- Disclosing to the appraiser any information about the subject property of which it is aware of that could impact the marketability of the property
- Providing the appraiser with the ratified sales contract and other financing or sales concessions that are associated with the transaction
- Ordering and receiving the appraisal report for each mortgage transaction
- Ensuring the appraiser does not use unsupported assumptions or use race, color, religion, sex, handicap, familial status, national origin for any party in the transaction, or impermissible demographics of the community in which the property is located, as the basis for market value

Uniform Residential Appraisal Report (URAR)

Appraisers are required to use current appraisal report forms that are acceptable to Fannie Mae and/or Freddie Mac. The following appraisal report forms should be used:

- Uniform Residential Appraisal Form (FNMA Form 1004)
- Small Residential Income Property Appraisal Report (FNMA Form 1025)
- Individual Condominium Unit Appraisal Report (FNMA Form 1073)
- Appraisal Update and/or Completion Report (FNMA Form 1004D)
- 1-4 Family Rider (Assignment of Rents) for all 2-4 unit properties (FNMA Form 3170)

Property (continued)

Uniform Residential Appraisal Report (URAR) (continued)

Appraisal Report Requirements

The following items must be contained in the appraisal report:

- Street map showing the location of the subject property and all comparables used.
- Exterior building sketch of the improvements indicating dimensions. A floor plan sketch is required along with calculations demonstrating how the estimate for gross living area is determined. For a unit in a condo project, the sketch of the unit must indicate interior perimeter unit dimensions rather than exterior building dimensions.
- Original color photographs or digital color images of the front, street, and rear views of the subject property. Original digital black and white photographs/pictures are permitted if the appraisal clearly indicates the subject property meets our standards.
- Interior photos of the subject are required to include the kitchen, all bathrooms, the main living area, any areas with physical deterioration, and any renovations/ improvements.
- Any other data as an attachment or addendum to the appraisal report form necessary to provide an adequately supported estimate of market value.
- Appraisal report must contain analysis of all agreements of sale, options or listings for the subject property current as of the effective date of the appraisal, and analysis of all sales of the subject property that occurred within the 3 years prior to the effective date of the appraisal.
- Appraisal report must include a completed Sales Comparison Approach section of FNMA Form 1004 where there are comparables used with more than one sale or transfer in the 12 months prior to the effective date of the appraisal.
- Appraiser comments on any unfavorable conditions, such as adverse environmental or economic factors, and how those conditions impact the market value of the property. In those cases, the appraiser's analysis must reflect and include comparable sales that are similarly affected.
- Certification and Statement of Limiting Conditions signed by the appraiser.

Appraiser Qualifications

See CMS Appraisal Management Policy.

Property (continued)

Uniform Residential Appraisal Report (URAR) (continued)

Electronic Submission of Appraisal Report

Appraisal reports which have been transmitted electronically using internet, wireless transmissions, or other types of electronic transmissions are acceptable, provided the following are met:

- The appraisal report accurately identifies the appraiser and is signed by the appraiser. Digitized signatures are acceptable.
- The appraisal report was created by the appraiser whose name appears on the appraisal report and that the appraisal is complete, unaltered, and submitted by the identified appraiser.

Transferred Appraisals

Transferred appraisals are permitted with underwriting approval and proof the transferred appraisal complies with Appraiser Independence Requirements (AIR).

Refer to CMS Appraisal Management Policies and Procedures.

Appraisal Re-Use

Re-use of an appraisal inspection report is not permitted. Appraisal inspections must be specific to the CMS loan transaction.

Age of Appraisal and Appraisal Updates

Properties must be appraised within the 240 days that precede the date of the note and mortgage.

When an appraisal report will be more than 120 days old on the date of the note and mortgage, regardless of whether the property was appraised as proposed or existing construction, the appraiser must inspect the exterior of the property and review current market data to determine whether the property has declined in value since the date of the original appraisal. This inspection and results of the analysis must be reported on the Appraisal Update and/or Completion Report (Form 1004D), with exterior photos.

If the appraiser indicates on the Form 1004D that the property value has declined, then the Underwriter must obtain a new appraisal for the property.

If the appraiser indicates on the Form 1004D that the property value has not declined, then the Underwriter may proceed with the loan in process without requiring any additional fieldwork.

Note: The appraisal update must occur within the 120 days that precede the date of the note and mortgage.

The original appraiser should complete the appraisal update; however, Underwriters may use substitute appraisers. When updates are completed by substitute appraisers, the substitute appraiser must review the original appraisal and express an opinion about whether the original appraiser's opinion of market value was reasonable on the date of the original appraisal report. The Underwriter must note in the file why the original appraiser was not used.

Property (continued)

Minimum Property Standards

All properties must:

- Be improved real property
- Be designed and available for year around residential use
- Contain a kitchen and a bathroom
- Contain a minimum of 600 square feet of gross living area
- Be heated by a continuously fueled heat source which is permanently affixed to the real estate. Alternative heat sources are acceptable when marketability has been demonstrated.
- Average or better than average condition
- Represent the “highest and best” use of the subject
- Be free of all health and safety violations
- Not exhibit items that adversely affect the ownership, habitability, or marketability of the subject property
- Must have a remaining economic life of 30 years (40-year terms require a remaining economic life of at least 40 years)

Property Location

See the Carrington Prime Advantage Program Matrix. Subject property must be subject to the laws of the state in which the loan is made.

Eligible Property Types

- Single-Family Residence
- Planned Unit Development Type E (existing)
- Planned Unit Development Type F (new)
- Townhomes
- 1-4 unit Multi-Family Properties
- Modular Homes
- Condominium (low-rise and high-rise)*
- Site Condominium*

**See the* Carrington Prime Advantage Program Matrix *for LTV restrictions.*

Property (continued)

Ineligible Property Types

- Manufactured/Mobile Homes
- Co-operative Units
- Condotels or Condo Hotels
- Non-Warrantable Condominiums
- Leaseholds
- Rural Properties
- Log Homes
- Farms or Hobby/Working Farms
- Unique Properties (Earth Homes, Berm Homes, Dome Homes, etc.)
- Barn conversions or Barndominiums
- Properties with oil, gas, or mineral rights
- Hawaiian properties in lava zones 1 and 2
- Properties with active oil, gas, or mineral drilling, excavation, etc
- Builder Model Leaseback
- Non-Conforming zoning regulations that prohibit rebuilding
- Illegally zoned properties
- State-approved medical marijuana producing properties

Market Analysis

Neighborhood Review

The neighborhood section should contain an accurate description of the subject's neighborhood and any factors about the neighborhood that may influence value. Specific neighborhood characteristics include the following:

- Degree of development
- Demand and supply
- Present land use
- Owner-occupancy
- Price range and predominant value
- Age of subject property
- Appeal to market and marketing time

Compatibility of Subject Property and Neighborhood

The age and price of the subject property should generally be within the age and price ranges of properties in the subject neighborhood as reported on the URAR. Neighborhood factors indicating compatibility of the subject, such as present land use, predominant occupancy, and anticipated change in present land use are considered. Residential properties in areas that are zoned as either agricultural or commercial may be considered acceptable risks so long as their location does not impact marketability.

Property (continued)

Market Analysis (continued)

Proximity of Comparable to Subject Property

Whenever possible, comparable sales in the same neighborhood as the subject property should be used. Sales prices of comparable properties in the neighborhood should reflect the same positive and negative location characteristics.

For properties in established subdivisions, condo projects 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. Use of comparable properties located outside of the established subject neighborhood must be explained in the appraisal analysis.

For properties in new subdivisions, condo projects or PUDs, the subject property must be compared to other properties in its general market area as well as to properties within the subject subdivision or project. The appraiser must select one comparable sale from the subject subdivision or project and one comparable sale from outside the subject subdivision or project. The third comparable sale can be from inside or outside of the subject subdivision or project, provided it is a good indicator of value for the subject property.

Age of Comparables

Generally, appraisals should contain comparables sales dated within 6 months from the report date. Comparables from 6 to 12 months are permitted on a limited basis with an explanation from the appraiser. Older comparable sales that are the best indicator of value for the subject property may be used if appropriate. Underwriters to ensure value is supported and market acceptance has been demonstrated when older comparables are utilized.

Property Values within Market Area

The value of subject property should be in line with the home prices in the subject's market area. The appraiser must report the primary indicators of market condition for properties in the subject neighborhood as of the effective date of the appraisal by noting the following:

- the trend of property values
- the supply of properties in the subject neighborhood
- marketing time for properties

The appraiser must provide their conclusions for the reasons a market is experiencing declining property values, an over-supply of properties, or marketing times over 6 months.

Property (continued)

Market Analysis (continued)

Redlining Prohibition

Prohibited bases such as race, ethnicity, gender, minority geography or any other prohibited basis category should not be included as an appraisal factor or considered when reviewing an appraisal. As a matter of policy, appraisal reports which make reference to a prohibited basis category (e.g. race or minority geography) are not acceptable. The use of code phrases as proxies for race which are not necessarily descriptive of value or risk is unacceptable. The information in the appraisal report must support in an objective manner any statement or conclusion contained in the report.

Over Improvements

An over-improvement is an improvement that costs more than its contributory value within the marketplace. The appraiser must comment on over-improvements and indicate their contributory value in the “sales comparison analysis” adjustment grid. Improvements can represent an over-improvement for the neighborhood, but still be within the neighborhood price range—such as a property with an in-ground swimming pool, a large addition, or an oversized garage in a market that does not demand these kinds of improvements. Underwriters must review appraisals on properties with over-improvements that may not be acceptable to the typical purchaser to ensure that only the contributory value of the over-improvement is reflected in the appraisal analysis.

Property (continued)

Valuation Analysis

Sales Comparison Approach

Each appraisal must contain an estimate of market value. Market value is defined as the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition are the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- Buyer and seller of property are typically motivated
- Both parties are well informed or well advised, acting in what they consider their best interest
- A reasonable time is allowed for exposure in the open market
- Payment is made in terms of cash in US dollars or in terms of comparable financial arrangements comparable
- The price represents the normal consideration for the subject property sold unaffected by special financing or sales concessions granted by anyone associated with the sale

A minimum of 3 closed comparables must be reported in the sales comparison approach. Additional comparable sales may be reported to support the opinion of market value provided by the appraiser. The subject property can be used as a fourth comparable sale or as supporting data if it was previously closed. Contract offerings and current listings can be used as supporting data, if appropriate.

Comparable sales utilized in the market approach should:

- Be within one mile of the subject property
- Have been closed within the last 6 months
- Indicate properties that are similar to the subject property with respect to age, size, features, amenities, etc.
- Result in an overall net adjustment not exceeding 15% of the sales price of that comparable and a gross adjustment not exceeding 25% of the sales price of that comparable
- Reflect adjustments for individual line items not exceeding 10%
- Have a sales price that is within the general range of value as the subject
- Have at least 3 of the comparables should be recently closed sales

In instances where comparables conforming to the criteria stated above cannot be used, the appraiser must clearly justify reasons for alternate comparables.

Property (continued)

Valuation Analysis (continued)

Cost Approach

When completed, the cost approach must clearly segregate value attributed to land, outbuildings, etc. If the ratio of land value to total value exceeds 35%, an explanation from the appraiser may be required to demonstrate conformance with neighboring properties. See also Land Value. Appraisals that rely solely on the cost approach as an indicator of market value are not acceptable.

Income Approach

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

Valuation Analysis and Final Reconciliation

In the final reconciliation, appraisers must reconcile the reasonableness and reliability of each applicable approach to value along with validity of the indicated values. The appraiser must select and report the approaches that were given the most weight. An averaging technique cannot be used.

Appraisal Review Process

The Appraisal Review Process requires a secondary due diligence product to support the appraised value for the transaction. Acceptable products, subject to the restrictions below include:

- Fannie Mae Collateral Underwriter (CU) score of 2.5 or lower
- Desk Review (must contain a value and comparative sales data to support the valuation result)
- Field Review
- Second Full Appraisal (appraisals must be completed by different, independent appraisers and the lower of the two appraised values used to determine value)
- Review by Carrington Capital Management (CCM)

Due diligence product restrictions:

- To utilize the Fannie Mae Collateral Underwriter (CU) score, all of the following must be met:
  - Loan amount ≤ $1,500,000, and
  - CU Score ≤ 2.5
- The following requires a Desk Review (ineligible for CU):
  - Any loan where the LTV > 80%, or
  - CU Score > 2.5

Property (continued)

Appraisal Review Process, continued

- The following require a Second Full Appraisal:
  - Loan amount > $1,500,000
  - Flip Transactions
  - HPML* New Construction Properties with any title transfer within 180 days prior to the sales contract date, or any title transfer after the sales contract date, including land-only and zero value title transfers, require a Second Full Appraisal.

    Please note: title transfers from a builder to a wholly owned subsidiary of the builder are considered a "change of ownership" and require a Second Full Appraisal.

    *Refer to HPML Requirements. Only Principal Dwellings are subject to HPML regulations, and the borrower may not pay for the second appraisal when ordered solely due to HPML flipping rules.
- The following requires a CCM Review:
  - Appraised value ≥ $1,500,000. When two appraisals are present the lowest value is used.
- Desk Reviews, Field Reviews, and Second Full Appraisals, when required, must be ordered from a CMS-approved AMC. A Second Full Appraisal must be completed by a different, independent appraiser than the first appraisal. CMS reserves the right to request additional appraisal products at our discretion based on review of the appraisal and loan file.

Appraisal Review Tolerance

A 10% tolerance is permitted for secondary review products. If the review product value is more than 10% below the appraisal value, the lower of the two values may be used, or an additional review product of a higher-level review may be ordered. The following review options may be utilized:

- Desk review
  - If the desk review value is not more than 10% below the appraised value, then use the appraised value.
  - If the desk review value is more than 10% below the appraised value, then
    - Use lower of the two values, or
    - Order a field review, or
    - Order a second full appraisal.
- Field review
  - If the field review value is not more than 10% below the appraised value, then use the appraised value.
  - If the field review value is more than 10% below the appraised value, then
    - Use lower of the two values, or
    - Order a second full appraisal.
- Second full appraisal
  - Use the lower of the two appraised values.

PROPERTY CONSIDERATIONS

Accessory Units

Properties with accessory units, also known as Granny units, mother-in-law suites, etc., are acceptable if all of the following are met:

- Property is typical, readily-acceptable, and common in the subject's market area
- Property must conform to all zoning laws and/or regulations. Illegal Accessory Units are not permitted.
- For an ADU that is legal non-conforming, the appraisal contains 2 comparables with similar additional accessory units
- Accessory unit is substantially smaller than the primary dwelling
- Legal non-conforming use is acceptable provided its current use does not adversely affect value and marketability
- Any rental income received from the accessory unit must comply with Rental Income from an ADU.
- Existence of the unit must not jeopardize any future hazard insurance claim that may need to be filed for the property

See also Rental Income from an ADU.

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. If the appraiser does not give value to the unpermitted additions, the appraiser must provide an explanation.

Dampness

If the appraisal report notes evidence of dampness, the appraiser must clearly define the effect on value and marketability of the subject property, as well as comment regarding the probable cause of the dampness problem. Generally, a structural engineer's report is required prior to making a loan decision. The cause of the dampness must be corrected prior to closing should the dampness problem indicate a structural deficiency and/or significant negative impact on value or marketability.

Deed Restrictions

Deed restrictions impact the future transferability of a property. The following deed restrictions are allowed:

- Age Restricted Communities

Deed restrictions must be reviewed to ensure all of the following requirements are met:

- Appraisal supports property is common and typical for the market area
- Deed restriction must not impair or restrict the first mortgage holder's legal rights in the event of a default (or cure), foreclosure, or any other default measure
- Declarations must not contain any provisions that would require the first mortgage holder to send a notice of default or foreclosure to any third party
- Deed restriction must not require the lender to provide notification to the governing authority of any delinquency or default

Property Considerations (continued)

Deferred Maintenance

Property must be in average or better condition. Properties in C5 or C6 condition are not acceptable. Deferred maintenance is allowed subject to the requirements below.

CMS permits appraisals to be based on the “as is” condition of the property provided existing conditions are minor and do not affect the safety, soundness, or structural integrity of the property, and the appraiser’s opinion of value reflects the existence of these conditions.

Deferred maintenance is typically due to normal wear and tear from the aging process and the occupancy of the property. While such conditions generally do not rise to the level of a required repair, they must be reported. Examples of minor conditions and deferred maintenance include worn floor finishes or carpet, minor plumbing leaks, holes in window screens, or cracked window glass.

Disaster Areas

CMS is responsible for identifying areas impacted by disasters and taking the appropriate steps to ensure the subject property has not been adversely affected. Examples of disasters include, but are not limited to, hurricanes, earthquakes, floods, landslides, tornadoes, wildfires, volcanic eruptions, civil unrest, and terrorist attacks.

Adverse events that receive a formal disaster declaration issued by local, state or federal departments of emergency management must follow the procedures listed below. A list of all federally declared disaster areas may be found on the FEMA website at http://www.fema.gov/disasters.

In addition, when there is knowledge of an adverse event occurring in and around the subject property’s geographic region and a formal declaration has not yet been made, additional due diligence is required to determine whether the disaster area guidelines must be followed.

Time Period

Guidelines for disaster areas should be followed for 90 days from the incident period ending date or the date the adverse event occurred, whichever is later.

Appraisal Not Completed or Appraised Prior to Disaster Incident

When the appraisal was completed prior to the disaster incident, or the appraisal has not been completed, an interior and exterior inspection of the subject property is required.

- Inspection must be completed by licensed third-party professional to certify the condition of the subject property and to identify any impact to habitability or marketability
- Inspection report must include photographs of front, rear and street view of the property
- Any damage must be repaired and re-inspected prior to purchase
- File must contain a copy of the inspection report and evidence of inspector licensing

Property Considerations (continued)

Disaster Areas, continued

An appraisal update or final inspection from the appraiser must also be obtained.

- Appraiser must comment on the adverse event and certify there has been no decline in value
- Existing damage must meet requirements in Deferred Maintenance

Appraised After Disaster Incident

When the inspection date of the appraisal is after the disaster incident, the following requirements must be met:

- Appraiser must comment on the adverse event and any effect on marketability or value
- Existing damage must meet requirements in Deferred Maintenance

Disaster Incident Occurs After Closing, Prior to Funding or Purchase

Loan is ineligible for purchase or funding until an appraisal update or final inspection from the appraiser is obtained.

- Appraiser must comment on the adverse event and certify there has been no decline in value
- Existing damage must meet requirements in Deferred Maintenance

Verbal Verification of Employment Re-Verification

If a disaster event occurs after the Verbal Verification of Employment (VVOE) has been completed, CMS must obtain an update to ensure the borrower is still employed and that they are continuing to receive the same amount of income.

Electrical Systems

An electrical certification from a licensed electrician is required if the appraisal notes a fair or poor rating concerning the adequacy or condition of the system. Any electrical inadequacies must be corrected prior to closing.

Environmental Hazards

The appraisal report should note the existence of known environmental hazards and its effect on value and marketability of the subject property. Environmental hazards may include but are not limited to:

- Evidence of radon above EPA safety levels which is left untreated
- Properties built on or near toxic waste dumps, cleanup sites, etc.
- Presence of urea formaldehyde foam insulation (UFFI)

A property inspection completed by a licensed inspector is required in order to make final determination of the acceptability of the property. The mortgagor's acknowledgment of condition is required.

Property Considerations (continued)

Escrows for Work Completion	Not Allowed.
Flood Zone	The appraisal should indicate if the property is located in a flood zone. Refer to Flood Insurance for additional information on flood certifications and flood insurance.
Foundation Settlement	If the appraisal report notes evidence of excessive settlement, the appraiser must clearly define the effect on value and marketability of the subject property. Settlement problems which denote structural deficiencies and/or significant negative impact on value and marketability must be corrected prior to closing. Generally, a structural engineer's report is required prior to making a loan decision. Properties with evidence of sinkhole activity are ineligible for financing.
Hawaiian Lava Zones	Only mortgage loans secured by properties that are located within lava zones 3 through 9 on the island of Hawaii are eligible. Properties in lava zones 1 and 2 are not eligible due to the increased risk of property destruction from lava flows within these areas. Hawaiian lava flow maps and other information are available online at the U.S. Geological Survey Hawaiian Volcano Observatory website.
Heating Systems	A central heat source with ductwork or baseboard in all rooms is required on all properties. If subject does not have central heat, the appraiser must provide similar comparable properties and an addendum indicating: • the heat source is typical for the area • the heat source is permanently attached • the heat source is adequate for the dwelling • the heat source is externally vented
Land Value and Acreage	Acreage and land value must be typical and common for the subject's market. Maximum acreage permitted is 10 acres. Investment property transactions are limited to 2 acres. Special consideration should be taken for properties with land values that exceed 35% of the total property value to ensure the value is justified and the property has marketability. The appraisal report must provide data which indicates like-size properties with similar land values are typical and common in the subject's market area.

Property Considerations (continued)

Log Homes

Log homes are ineligible.

Mixed Use Properties

Properties that have a business use in addition to their residential use, such as a property with space set aside for a day care facility, a beauty or barber shop, or a doctor's office are eligible when the following special eligibility criteria are met:

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

The appraisal requirements for mixed-use properties must:

- provide a detailed description of the mixed-use characteristics of the subject property;
- indicate that the mixed use of the property is a legal, permissible use of the property under the local zoning requirements;
- report any adverse impact on marketability and market resistance to the commercial use of the property; and
- report the market value of the property based on the residential characteristics, rather than of the business use or any special business-use modifications that were made.
- report that no modifications have been made that would adversely affect marketability

Modular Homes

Modular, prefabricated, panelized, or sectional housing homes are eligible for financing at a maximum LTV of 80%. Modular homes must meet all of the following requirements:

- Must assume the characteristics of site-built housing; and
- Must be legally classified as real property; and
- Must conform to all local building codes in the jurisdiction in which they are permanently located.

Property Considerations (continued)

Multiple Parcels

When a property consists of more than one parcel of real estate, the following requirements must be met:

- Each parcel must be conveyed in its entirety.
- Parcels must be adjoined to the other, unless they comply with the following exception. Parcels that otherwise would be adjoined, but are divided by a road, are acceptable if the parcel without a residence is a non-buildable lot (for example, waterfront properties where the parcel without the residence provides access to the water). Evidence that the lot is non-buildable must be included in the loan file.
- Each parcel must have the same basic zoning (for example, residential, agricultural).
- The entire property must contain only one dwelling unit. Limited additional nonresidential improvements, such as a garage, are acceptable. For example, the adjoining parcel must not have an additional dwelling unit. An improvement that has been built across lot lines is acceptable. For example, a home built across both parcels where the lot line runs under the home is acceptable.
- The mortgage must be a valid first lien that covers each parcel.

New Construction

The following are required for all new construction properties:

- Appraisal Update and/or Completion Report (FNMA Form 1004D) with complete interior and exterior photos reflecting completion, if applicable. Proposed improvements are not allowed.
- To calculate property taxes for new construction, use the estimated taxes from the builder or escrow/closing agent or the following Prequalification Tax Rate Table can be used when other resources do not exist to provide tax information for the subject property county. This table contains recommended percentages; however, actual values should be used whenever possible.

Refer to the Property Tax Policy for calculation of monthly taxes for qualification.

Property Considerations (continued)

New Construction (continued)

State	Prequalification Rate*	State	Prequalification Rate*
AK	1.50%	MT	1.00%
AL	0.50%	NC	1.00%
AR	0.75%	ND	1.75%
AZ	0.85%	NE	1.75%
CA	1.25%	NH	2.00%
CO	0.60%	NJ	2.00%
CT	1.25%	NM	0.75%
DC	0.75%	NV	1.00%
DE	0.50%	NY	1.50%
FL	1.50%	OH	1.40%
GA	1.00%	OK	1.00%
HI	0.30%	OR	1.00%
IA	1.50%	PA	1.50%
ID	0.80%	RI	1.50%
IL	1.50%	SC	0.70%
IN	1.00%	SD	1.50%
KS	1.30%	TN	1.00%
KY	1.00%	TX	2.25%
LA	0.60%	UT	0.75%
MA	1.25%	VA	1.25%
MD	0.80%	VT	1.50%
ME	1.25%	WA	1.00%
MI	1.50%	WI	1.75%
MN	1.25%	WV	0.60%
MO	1.00%	WY	0.60%
MS	0.70%		

Another source for a specific county may be utilized if this table is not reflective of that specific county. Additionally, if the actual tax information for the property is available then that is the information that should be used for all the calculations.

<u>*When the title report reflects additional tax assessments such as Mello Roos Community Facilities District (CFD), then a copy of the tax bill listing the additional tax assessment(s) must be obtained to determine the amount of property taxes above the Prequalification Tax Rate Table.</u>

Property Considerations (continued)

Pest Infestation

If the appraisal report or sales contract notes evidence of termites or other insect infestation, a pest inspection report certifying treatment of the infestation prior to closing is required. Any significant structural damage due to pest infestation must be corrected prior to closing.

Plumbing

A plumbing certification from a licensed plumber is required whenever the appraisal states a fair or poor rating concerning the adequacy or condition of the system. Any inadequacies must be corrected prior to closing.

Private Roads

Properties on private roads are acceptable subject to the following:

- The title company must insure access to the subject property from a public street; and
- A legally enforceable agreement or covenant for maintenance of the street is required.
    - The agreement should include provisions for the responsibility for payment of repairs, including each party's representative share, default remedies in the event a party to the agreement or covenant fails to comply with his or her obligations, and the effective term of the agreement which in most cases should be perpetual and binding on any future owners.
    - If the property is located within a state that has statutory provisions that define the responsibilities of property owners for the maintenance and repair of a private street, no separate agreement or covenant is required. Any maintenance costs are to be included in the borrower's housing ratio.

Note: Maintenance agreements are not required for private roads in Homeowners Associations (HOAs).

PUD (Planned Unit Development)

A Planned Unit Development (PUD) is a project or subdivision that consists of common property and improvements that are owned and maintained by an owners' association for the benefit and use of the individual PUD units. In order for a project to qualify as a PUD, each unit owner's membership in the owners' association must be automatic and non-severable and the payment of assessments related to the unit must be mandatory. Zoning is not a basis for classifying a project or subdivision as a PUD. The PUD project must be analyzed to ensure that an individual unit in the project will be acceptable security for the mortgage.

There are two distinct classifications for PUD projects: Type E (established) and Type F (new).

Detached PUDs

If the subject property is a detached unit, no analysis is required.

Property Considerations (continued)

PUD (Planned Unit Development) (continued)

Attached PUDs

Attached Type E PUD: the developer must have turned over voting control of the HOA to the unit purchasers. This is the sole criteria to qualify a Type E Project.

Attached Type F PUD: the developer has not turned over voting control of the HOA to the unit purchasers. The project must meet the following eligibility criteria:

- The project cannot have been created by the conversion of existing buildings into a PUD
- The project must not include any multi-dwelling units that represent the security for a single mortgage
- The project must not be composed of manufactured homes
- A sufficient number of the total units in the project (or legal phase) must have been conveyed or be under contract to be sold to the purchasers in order to determine whether the presales will support the responsibilities of the owners' association for at least 2 years
- The units must be owned in fee simple and the unit purchasers must the sole ownership interest in, and right to the use or, the projects' facilities once control of the owners' association has been turned over to them

Repairs and Escrow Holdbacks

The appraisal must identify all items that require repair. It should also include and describe physical deficiencies that could affect a property's soundness, structural integrity, livability or improvements that are incomplete. Any immediate or necessary repairs must be completed and re-inspected by the appraiser prior to closing. See also Deferred Maintenance.

Escrow Holdbacks are permitted only for delayed installation of landscaping on new construction properties, subject to the following requirements:

- The builder must provide the contract, invoice, or bid from their landscape contractor. If the cost of landscaping has not be prepaid by the builder, the closing agent must withhold 150% of the bid amount from the builder's sales proceeds.
- An Escrow Holdback Agreement must be executed at closing.
- The default holdback period is 30 days. Extensions up to 6 months may be approved by CMS for weather delayed repairs.
- Once complete, a final inspection on FNMA form 1004D must be obtained. The closing agent must withhold the cost of the inspection at closing.
- Any excess builder funds may be disbursed back to the builder upon approval by CMS.

Property Considerations (continued)

Rural Properties

Rural properties are not permitted. Properties are considered rural if the appraiser identifies the subject's Location as Rural in the Neighborhood section of the appraisal report.

An exception may be considered, review and approval by CCM is required.

Septic System / Sewage Disposal System

Sewage disposal systems require certification if the appraiser or purchase contract indicates the necessity. The report should be provided by a city, county, state (or governing body) official or qualified entity stating:

- Sewage disposal system complies with applicable local and/or state health standards, is in proper working order, and can be expected to function satisfactorily; or
- Local and/or state health standards do not apply for the sewage disposal system; however, it is found to be in proper working order and adequate for the subject property.

For systems one-year-old or less, the certification must be no more than one-year-old on the date of closing. For systems more than one-year old, the certification should be no more than 120 days old on the date of closing.

Property Considerations (continued)

Solar Panels

Properties with solar panels are eligible for financing. If the property owner is the owner of the solar panels, standard eligibility requirements apply (for example, appraisal, insurance, and title). If the solar panels are leased from or owned by a third party under a power purchase agreement or other similar arrangement, the following requirements apply (whether to the original agreement or as subsequently amended):

- The solar panels must not be included in the appraised value of the property.
- The property must maintain access to an alternate source of electric power that meets community standards.
- The monthly lease payment must be included in the debt-to-income (DTI) ratio calculation unless the lease is structured to:
    - provide delivery of a specific amount of energy at a fixed payment during a given period, and
    - have a production guarantee that compensates the borrower on a prorated basis in the event the solar panels fail to meet the energy output required for in the lease for that period.
- Payments under power purchase agreements where the payment is calculated solely based on the energy produced may be excluded from the DTI ratio.
- The lease or power purchase agreement must indicate that:
    - any damage that occurs as a result of installation, malfunction, manufacturing defect, or the removal of the solar panels is the responsibility of the owner of the equipment and the owner must be obligated to repair the damage and return the improvements to their original or prior condition (for example, sound and watertight conditions that are architecturally consistent with the home);
    - the owner of the solar panels agrees not to be named loss payee (or named insured) on the property owner’s property insurance policy covering the residential structure on which the panels are attached. As an alternative to this requirement, the lender may verify that the owner of the solar panels is not a named loss payee (or named insured) on the property owner’s property insurance policy; and
    - in the event of foreclosure, the lender or assignee has the discretion to:
        - terminate the agreement and require third-party owner to remove the equipment;
        - become, without payment of any transfer or similar fee, the beneficiary of the borrower’s lease/agreement with the third party; or
        - enter into a new lease/agreement with the third party, under terms no less favorable than the prior owner.

Property Considerations (continued)

Unconventional Floor Plans

Properties with unusual floor plans or functional obsolescence are allowed if the appraisal demonstrates acceptability in the market place and includes appropriate adjustments. A floor plan sketch is required for all appraisals.

Unpermitted Additions

See Additions without Permits

Water Supply

Water certification must be obtained if required by the appraiser or purchase contract. The report should be provided by a city, county, state (or governing body) official or a qualified entity stating:

- The water supply system is in proper working order and pumping an adequate supply of water for the subject property; and
- The water supply is potable and complies with local and/or state health authority standards (in the absence of a local health authority, a reputable chemical testing agency must certify that the water is fit for human consumption). The water certification(s) for existing properties can be no more than 120 days old on the date of closing. If new construction, the report may be one-year old as of the date of closing.

Zoning and Land-Use Regulations

Property improvements must constitute a legally permissible use of the land based on the zoning ordinance. If the improvements represent a legal, non-conforming use of land, a letter from the local building authority or appraiser must be obtained to certify the subject property can be rebuilt "as is" in the event of partial or total destruction.

The appraiser must compare the existing and potential use of the subject property to the zoning regulations. In addition, the appraiser should note any adverse effect that a non-conforming use has on the value and marketability of the subject property.

Special consideration must be given to properties that are subject to other types of land use regulations, such as coastal tideland or wetland laws, as setback lines or other provisions may prevent reconstruction or maintenance of the property improvements in the event of damage or destruction. The intent of some land-use regulations is to remove existing land uses and to stop land development (including the maintenance, or new construction, or seawalls) within specific setback lines. Except as stated above, properties with land-use restrictions which prohibit the reconstruction to maintenance the dwelling are ineligible.

CONDOMINIUMS

Definitions

A condominium is a form of ownership in which the interior space is individually owned and the balance of the property (including land and building) is owned collectively with the other unit owners.

Definitions of Established and New Condominiums

Specific eligibility criteria are dependent upon whether the condo project reviewed classified as established or new.

Established condominium projects meet the following criteria:

- At least 90% of the total units in the project have been conveyed to the unit purchasers
- Project is 100% complete, including all units and common elements
- Project is not subject to additional phasing or annexation
- Control of the HOA has been turned over to the unit owners

New condominium projects meet the following criteria:

- Fewer than 90% of the total units in the project have been conveyed to the unit purchasers
- 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
- The project is newly converted
- The project is subject to additional phasing or annexation

General Condominium Requirements

All condominium projects must meet the following requirements:

- All common areas and amenities within the project or subject phase must be complete.
- Subject unit must have at least 600 square feet of living space.
- The sustainability, marketability and financial stability of the project must be supported.
- Project must be located in an area where acceptability of condominium ownership is demonstrated.
- The project must be in compliance with all applicable state or local laws. The homeowners' association must be incorporated in the state where the project is located.
- Condo projects must have acceptable insurance coverage.
- An environmental hazard assessment is required for condo projects if an environmental problem is identified by CMS through performance underwriting or due diligence.

Condominiums (continued)

General Condominium Requirements (continued)

- Projects with pending or threatened litigation are typically ineligible. Litigation may be acceptable if it is determined to be minor and immaterial.
- The project must be located on one contiguous parcel of land. The project may be divided by a public street.
- The structures within the project must be within a reasonable distance from each other. Common elements and facilities, such as recreational facilities and parking, must be consistent with the nature of the project and competitive in the marketplace.
- All programs are limited to a maximum number of units within one project of 20% or 20 loans, whichever is less.
- The maximum loan concentration by an individual borrower in a single condo development is 10%.

Condominium Project Review

A valid project review is required for all condominium transactions, along with a completed *CMS Mortgage Homeowners' Association Certification*. The HOA certification may not be greater than 120 days old at the time of closing.

The project review methods below should be utilized to determine the acceptability of a condominium project:

- **PERS (Project Eligibility Review Service)**

  PERS project approvals: https://www.fanniemae.com/singlefamily/project-eligibility

  Projects with Fannie Mae PERS approvals are acceptable and can be found on the Fannie Mae website. Projects must also meet the General Condominium Requirements and may not be an Ineligible Project. A PERS approval is valid for 18 months from the date of issue and must be valid as of the note date.

  New projects are acceptable only with a PERS approval.

- **FHA Approved Condominiums**

  FHA condo approvals: https://entp.hud.gov/idapp/html/condlook.cfm

- Projects with FHA condo approvals are acceptable and can be verified on the HUD website. Projects must also meet the General Condominium Requirements and may not be an Ineligible Project. An FHA condo approval must be valid as of the date of the note.

Condominiums (continued)

HOA Certification Review

For all established condominium projects without valid PERS or FHA approvals, or for projects that do not meet all the requirements of the various project review methods, an HOA Certification Review is required. CMS must review the completed CMS Mortgage Homeowners' Association Certification to ensure compliance with the following requirements:

- Project must meet the definition of an established condo.
- At least 50% of the total units in the project must be conveyed to purchasers as primary or second homes.
- No more than 15% of the total units in a project may be 60 days or more past due on their HOA dues.
- No single entity, the same individual, investor group, partnership, or corporation may own more than 10% of the total units in the project. For projects with 1-4 total units, single entity ownership may not exceed 1 unit. For 5-20 unit projects, single entity ownership may not exceed 2 units.
- No more than 25% of the total square footage of the project may be used for commercial purposes.
- Mortgagee may not be responsible for more than the greater of 6 months or the maximum amount permitted under applicable state law of delinquent HOA dues. For condos in Florida, the first mortgagee's liability for dues assessed prior to its acquisition of title is limited to the lesser of 12 months' assessments or 1% of the original mortgage debt.
- All facilities related to the project must be owned by the unit owners or the HOA cannot be subject to a lease between the unit owners or HOA and another party.
- HOA certification reflects the funding of replacement reserves for capital expenditures and deferred maintenance that is at least 10% of the budget.

Condominiums (continued)

Condominium Conversions

A condominium conversion is the conversion of an existing building to a condominium project. Project conversions legally created in the past 3 years are not allowed.

Site Condominiums

Projects consisting of single-family detached dwellings (also known as site condominiums) are acceptable provided the appraisal supports market acceptance of site condominiums in the subject's market area. A Homeowners' Association Certification is not required

Appraisals for site condos are to be documented on FNMA Forms 1004 Uniform Residential Appraisal Report or 1073 Individual Condominium Unit Appraisal Report. The appraiser should include an adequate description of the project, information about the homeowners' association fees, and note the quality of the project maintenance.

Ineligible Projects

- Projects comprised of manufactured homes
- Projects with units used for 'live-work"
- Projects managed and operated as a hotel or motel
- Projects containing the word hotel or motel in the name
- Projects that restrict the owner's ability to occupy the unit
- Projects with mandatory rental pooling agreements that require unit owners to either rent their units or give a management firm control over unit occupancy
- Projects with non-incidental business operations owned or operated by the homeowners' association (such as a restaurant, spa, health club, etc.)
- Common interest apartments
- Timeshare or segmented ownership projects
- Continuing Care Retirement Communities or Life Care Facilities
- Multi-unit dwelling condos that permit an owner to hold title to more than one dwelling unit, with ownership of all of his or her owned units evidenced by a single deed and financed by a single mortgage

PROPERTY INSURANCE

Hazard Insurance

Minimum Hazard Insurance Coverage Amount

Hazard insurance must protect against loss or damage from fire and other hazards covered by the standard extended coverage endorsement. The coverage must provide for claims to be settled on a replacement cost basis. Extended coverage must include, at a minimum, wind, civil commotion (including riots), smoke, hail, and damages caused by aircraft, vehicle, or explosion.

Hazard insurance policies that limit or exclude from coverage (in whole or in part) windstorm, hurricane, hail damages, or any other perils that normally are included under an extended coverage endorsement are not acceptable.

Borrowers may not obtain hazard insurance policies that include such limitations or exclusions, unless they are able to obtain a separate policy or endorsement from another commercial insurer that provides adequate coverage for the limited or excluded peril or from an insurance pool that the state has established to cover the limitations or exclusions.

The minimum requirements for the Hazard Insurance is outlined in the CMS Insurance Binder/Policy, which must be provided covering the subject property to include the following:

Coverage must be in an amount at least equal to the lessor of the replacement cost from the property appraisal or the base loan amount, or the policy must include “Guaranteed Replacement Cost” (if the policy includes “Extended Replacement Cost” the additional amount may be applied towards the dwelling amount).

Dwelling Coverage determined by totaling the following:

Dwelling Amount +
Dwelling Amount (other structures)*
Extended Replacement Cost %

Example: $100,000 (Dwelling) + $10,000 (Other Structures) = $110,000
50% (Extended Replacement Cost) = $165,000 (Total Dwelling Coverage)

- A Cost Estimator from the insurance agent may only be used to determine the replacement cost of the subject property in absence of an appraisal with a completed replacement cost.

Property Insurance (continued)

Hazard Insurance (continued)

Deductible Amount

The maximum allowable deductible for insurance covering a property securing a first mortgage loan is 5% of the face amount of the policy. When a policy provides for a separate wind-loss deductible (either in the policy itself or in a separate endorsement), that deductible must be no greater than 5% of the face amount of the policy.

Evidence of Hazard Insurance

Policy must be effective for at least 30 days after the date of funding (does not apply to condominium project insurance policies). Evidence of Insurance may be provided in one of the following forms:

- Policy
- Certificate of Insurance (COI)
- Insurance Binder

Evidence of Insurance must provide the following information:

- Names of borrowers reflect the same as the names on the note
- Property address agrees with the note/security instrument
- Mailing address is the same as property address
- Policy Number
- Loan Number
- Name of insurance company
- Insurance Agent information
- Effective and expiration dates of coverage
- Premium Amount
- Coverage amount and deductible
- Loss payee clause as applicable
- Signed and dated by agent

Optional Coverage

Hazard insurance policies may include optional coverage(s) which are acceptable, but are not required. For example, a “homeowners” or “package” policy is acceptable as long as any part of the coverage that exceeds the required coverage is not obligated for renewal.

Property Insurance (continued)

Hazard Insurance (continued)

Rating Requirements

The hazard insurance policy must be written by a carrier that meets at least one of the following requirements:

- Carriers rated by A.M. Best Company, Inc. must have:
  - a “B” or better Financial Strength Rating in Best’s Insurance Reports, or an “A” or better Financial Strength Rating and a Financial Size Category of “VIII” or
  - greater in Best’s Insurance Reports Non-US Edition
- Carriers rated by Demotech, Inc. must have an “A” or better rating in Demotech’s Hazard Insurance Financial Stability Ratings
- Carriers rated by Standard and Poor’s must have a “BBB” or better Insurer Financial Strength Rating in the Standard and Poor’s Ratings Direct Insurance Service

Policies underwritten by a state’s Fair Access to Insurance Requirements (FAIR) plan or other state insurance plan are also acceptable, if it is the only coverage that can be obtained.

An insurance policy that includes either of the following endorsements will assure full insurable value replacement cost coverage:

- A Guaranteed Replacement Cost Endorsement (under which the insurer agrees to replace the insurable property regardless of the cost) and, if the policy includes a coinsurance clause, an Agreed Amount Endorsement (which waives the requirement for coinsurance).
- A Replacement Cost Endorsement (under which the insurer agrees to pay up to 100% of the subject property’s insurable replacement cost, but no more) and, if the policy includes a coinsurance clause, an Agreed Amount Endorsement (which waives the requirement for coinsurance).

Unless a higher maximum amount is required by state law, the maximum deductible amount for policies covering the common elements in a PUD project is the lesser of $10,000 or 5% of the policy face amount. However, for losses related to individual PUD units that are covered by the blanket policy for the project, the maximum deductible related to the individual unit may not exceed 5% of the face amount of the insurance policy. Funds to cover these deductible amounts should be included in the operating reserve account that is maintained by the homeowners’ association.

Property Insurance (continued)

Condominium and PUD Project Insurance Requirements

Minimum Hazard Insurance Coverage

Insurance should cover 100% of the insurable replacement cost of the project improvements and common elements, including the individual units in the project.

If the subject property is an attached PUD or a condominium, the respective associations may acquire a blanket policy to cover the project. The entire project insurance policy should be reviewed to ensure the homeowners' association maintains a master or blanket type of insurance policy, with premiums being paid as a common expense. The policy must show the HOA as the named insured.

For PUD projects, individual insurance policies are also required for each unit. If the project's legal documents allow for blanket insurance policies to cover both the individual units and the common elements, blanket policies are acceptable in satisfaction of its insurance requirements for the units.

The policy must require the insurer to notify in writing the HOA (or insurance trustee) and each first mortgage loan holder named in the mortgagee clause at least 10 days before it cancels or substantially changes a condo project's coverage.

HO-6 Insurance Coverage for Condominiums

If the unit interior improvements are not included under the terms of the condominium policy, the borrower is required to have an HO-6 hazard policy ("wall-in coverage"), which is sufficient to repair the condo unit to its condition prior to a loss claim event.

Deducible Amount

For policies covering the common elements in a PUD project and for policies covering condo projects, the maximum deductible amount must be no greater than 5% of the face amount of the policy.

For losses related to individual PUD units that are covered by the blanket policy for the project, the maximum deductible amount related to the individual unit should be no greater than 5% of the replacement cost of the unit. If, however, the policy provides for a wind-loss deductible (either in the policy itself or in a separate endorsement), that deductible must be no greater than 5% of the face amount of the policy.

For blanket insurance policies that cover both the individual units and the common elements, the maximum deductible amount related to the individual unit should be no greater than 5% of the replacement cost of the unit.

Property Insurance (continued)

Condominium and PUD Project Insurance Requirements (continued)

General Liability Coverage

Project liability insurance requirements are as follows:

- The homeowners' association must maintain a commercial general liability insurance policy for condo projects or Type F PUD projects, including all common areas and elements, public ways, and any other areas that are under its supervision.
- The insurance should cover commercial spaces that are owned by the homeowners' association, even if they are leased to others. The commercial general liability insurance policy should provide coverage for bodily injury and property damage that result from the operation, maintenance, or use of the project's common areas and elements.
- The amount of liability coverage should be at least $1,000,000 for bodily injury and property damage for any single occurrence.
- The policy should provide for at least ten days' written notice to the owners' association before the insurer can cancel or substantially modify it. For condominium projects, similar notice must also be given to each holder of a first mortgage or share loan on an individual unit in the project.

An insurance policy that includes either of the following endorsements will assure full insurable value replacement cost coverage:

- A Guaranteed Replacement Cost Endorsement (under which the insurer agrees to replace the insurable property regardless of the cost) and, if the policy includes a coinsurance clause, an Agreed Amount Endorsement (which waives the requirement for coinsurance); or
- A Replacement Cost Endorsement (under which the insurer agrees to pay up to 100% of the subject property's insurable replacement cost, but no more) and, if the policy includes a coinsurance clause, an Agreed Amount Endorsement (which waives the requirement for coinsurance).

Fidelity Bond Coverage

Fidelity bond coverage is required for condominium projects over 20 units (or per state requirements). The insurance coverage must be at least equal to the greater of 3 months HOA dues or reserves or minimum required by state law. Coverage is not required when the calculated amount is $5,000 or less.

Property Insurance (continued)

Flood Insurance

Flood insurance is required for any property located within any area designated by the Federal Emergency Management Agency (FEMA) as a Special Flood Hazard Area (SFHA). SFHAs are labeled as Zone A, Zone AO, Zone AH, Zones A1-A30, Zone AE, Zone A99, Zone AR, Zone AR/AE, Zone AR/AO, Zone AR/A1-A30, Zone AR/A, Zone V, Zone VE, and Zones V1-V30. Properties in Flood Zone A or V must be located in a community which participates in the FEMA program to be eligible for financing.

Flood Certificate

Determination whether a subject property is in a flood zone must be established by a Flood Certificate provided by the Federal Emergency Management Agency (FEMA). The appraisal report should also accurately reflect the flood zone.

The flood insurance requirement can be waived if:

- Subject property improvements are not in the area of Special Flood Hazard, even though part of the land is in Flood Zone A or V; or
- Borrower obtains a letter from FEMA stating that its maps have been amended so that the subject property is no longer in an area of Special Flood Hazard

Minimum Flood Insurance Coverage

The minimum amount of flood insurance required for most first mortgages secured by 1-unit properties and individual PUD units is the lower of:

- 100% of the replacement cost of the insurable value of the improvements;
- the maximum insurance available from the National Flood Insurance Program (NFIP), which is currently $250,000 per dwelling; or
- the unpaid principal balance of the mortgage

Project Flood Insurance Requirements

The flood policy for a PUD or condominium project must cover any common element buildings and any other common property located in a SFHA. The amount of flood insurance coverage for a PUD or condo project should be at least equal the lesser of 100% of the insurable value of the facilities or the maximum coverage available under the appropriate National Flood Insurance Program (NFIP).

Deductible Amount

The maximum allowable deductible is the maximum available from the NFIP, which is currently $10,000. The maximum allowed deductible for a PUD or condo project is $25,000.

Property Insurance (continued)

Flood Insurance (continued)

Evidence of Flood Insurance

Flood insurance must be maintained throughout the duration of the loan. If final evidence of flood insurance is not available at closing, the following may be used:

- Completed and executed NFIP application with a copy of the borrower's premium check, the insurance agent's paid receipt.
- Completed and executed NFIP General Change Endorsement Form showing the assignment of the current flood insurance policy by the property seller to the borrower
- Agent-executed NFIP Certification of Proof of Purchase of Flood Insurance

Evidence of Insurance must provide the following information:

- Names of borrowers reflect the same as the note
- Property address agrees with the note/security instrument
- Mailing address is the same as property address
- Policy Number
- Loan Number
- Name of insurance company
- Insurance Agent information
- Effective and expiration dates of coverage
- Premium Amount and deductible
- Coverage amount
- Loss payee clause as applicable
- Signed and dated by agent

TITLE INSURANCE

Title Policy Requirements

Loans must be covered by a title insurance policy that has been paid in full and is valid, binding, and remains in full force and effect.

Preliminary title must indicate that the final title policy will be issued after funding.

The title insurer must be qualified to do business in the state where the subject property is located. The title insurer and policy must conform to Fannie Mae/Freddie Mac requirements.

Borrower Information

All borrower names must be indicated on the title commitment. If the borrower's marital status appears to be different than on the URLA, the discrepancy must be addressed. The property seller's name must be cross referenced to the purchase agreement and valuation chain of title.

Coverage Amount

The amount of title insurance coverage must at least equal the original principal amount of the mortgage.

Insured Name

Title policy must insure that CMS's name appears in the security instrument. It must also include the language "its successors and assigns as their interest may appear."

Age of Report

The preliminary title report/title commitment should be dated no later than 90 days prior to closing. Any requirements by title, such as Statements of Information or copies of trust agreements, must be cleared prior to closing.

Vesting

Final title policy vesting should reflect the name(s) of the individual borrower(s) or Business Entity (for LLC). See Vesting and Ownership.

Gap Coverage

The preliminary title report/title commitment must be updated after closing in writing to ensure the mortgage is in first lien position and documented through one of the following:

- Final title policy
- Title bring-down search representing the period of time from the original search through the time the mortgage is recorded
- Gap coverage from the time of the original search until the mortgage is recorded, when the mortgage is not recorded at the time of diligence

Title Insurance (continued)

Title Policy Requirements (continued)

Title Policy Forms

The final title policy must be written on one of the following forms:

- 2006 American Land Title Association (ALTA) standard form
- ALTA short form
- ALTA form with amendments required by state law in states in which standard ALTA forms of coverage are not used or in which the 2006 ALTA forms have not yet been adopted, provided those amendments are acceptable to Fannie Mae/Freddie Mac

Title Policy Underwriter

A nationally recognized insurer or reinsurer which has received one of the following ratings must have underwritten the title insurance policy:

- BBB or better rating from Duff and Phelps Credit Rating Company
- C or better rating from LACE Financial Corporation
- Baa or better rating from Moody's Investors Service
- BBB or better rating from Standard and Poor's, Inc.
- A Financial Stability Rating of S (Substantial) or better, or a Statutory Accounting Rating of C (Average) or better from Demotech, Inc.

Title Commitment Review

Chain of Title

All files are to contain a 24-month title history from an acceptable source. Transfer date, price, and buyer and seller names on any title transfers that occurred within the previous 24 months should be provided. The vesting history should be reviewed for inconsistencies or any indication of flipping activity.

Title Exceptions

The following items are allowable title exceptions:

- Customary public utility subsurface easements; the location of which are fixed and can be verified. The exercise of rights of easement will not interfere with use and enjoyment of any improvement of the subject property or proposed improvements upon which the appraisal or loan is based.
- Above-surface public utility easements that extend along one or more property lines for distribution purposes, or along the rear property line for drainage, provided they do not extend more than 12 feet from the subject property lines and do not interfere with any of the buildings or improvements, or with the use of the subject property; and public utility restrictions, provided their violation will not result in the forfeiture or reversion of title or a lien of any kind for damages, or have an adverse effect on the fair market value of the subject property.
- Mutual easement agreements that establish joint driveways or party walls constructed on the subject property and on an adjoining property, provided all future owners have unlimited and unrestricted use of them.

Title Insurance (continued)

Title Commitment Review (continued)

- Encroachments on one foot or less on adjoining property by eaves or other overhanging projections or by driveways provided there is at least a 10-foot clearance between the buildings on the subject property and the property line affected by the encroachments.
- Encroachments on the subject property by improvements on adjoining property provided these encroachments extend one foot or less over the property line of the subject property, have a total area of 50 square feet or less, do not touch any buildings, and do not interfere with the use of any improvements on the subject property or the use of the subject property not occupied by improvements.
- Encroachments on adjoining properties by hedges or removable fences.
- Liens for real estate or ad valor taxes and assessments not yet due and payable.
- Outstanding oil, water, or mineral rights as long as they do not materially alter the contour of the property or impair its value or usefulness for its intended purposes.

Survey Requirements

If the title company requires a survey or plat map due to an exception noted on the title policy, a copy must be submitted in the loan file. Surveys must be certified, dated, and signed by the licensed civil engineer or registered surveyor performing the survey. Unimproved land surveys are not acceptable.

Surveys should be reviewed for easements, encroachments, flood zone impacts, and possible boundary violations, taking into account the location of the dwelling on the property.

Servicing

Borrowers are required to establish initial and monthly escrow for annual taxes, hazard insurance, flood insurance (if applicable), and HO-6 insurance coverage (if applicable), unless otherwise specified by applicable state law. One twelfth (1/12) of the annual premiums are to be paid with the principal and interest payments.

End of Document

REVISION SUMMARY

Date	Version	Description of Change
04/16/25	5.4	• Revised **Vesting** to add Limited Liability Company (LLC). • Added **Vesting in the Name of a Business Entity** requirements. • Revised **Ineligible Borrowers** to remove Limited Liability Company (LLC). • Revised **Age of Credit Report/Credit Documentation** to 120 days (was 90). • Revised **Age of Loan Documentation** requirements to clarify documents and seasoning. • Revised **Asset Documentation** to 120 days (was 90). • Add **Written Verification of Employment Alternative Income Documentation** requirements. • Revised **Gifts of Equity** to add For ITIN borrowers using a gift of equity, a 5% LTV reduction is required in lieu of using cash out LTVs. • Revised **Uniform Residential Appraisal Report (URAR)** to remove FNMA Form 1004MC. • Revised **Property Values** within Market Area to remove FNMA Form 1004MC. • Revised **Vesting** to add Business Entity (for LLC).
01/22/25	5.3	Revised **Individual Taxpayer Identification Number (ITIN) Borrowers** requirements for foreign driver's license.
09/04/24	5.2	• Revised **First Time Investor** to 36-month period (was 12 months). • Revised **Mortgage and Rental Payment Verification** to reflect Mortgages and rental payments may not exceed 1x30 in the past 12 months (was 0x30). • Added **CPA General Requirements**. • Revised **Asset Conversion** to remove funds in business accounts as not permitted and updated Income documentation type requirements. • Revised **Concessions and Contributions** to reflect investment property transactions, the property seller and/or interested parties may contribute up to 4% (was 2%). • Revised **Gift Funds** to remove gift funds as ineligible for investment property transactions. • Revised **Gifts of Equity** to add requirements for primary residence and investment property transactions.
07/25/24	5.1	• Revised **Cash-Out Limits** to refer to program matrix. • Revised **Bank Statement Documentation** to align with CFA/CFA+ Underwriting Guidelines (added “Borrower may not be an employee of any other borrower” and updated “Statements must be consecutive and reflect the most recent months available as of the application date”).
05/28/24	5.0	• Removed **Exhibit A – Tier 3 Markets by Zip Code Table** • Revised **Gift Funds** to refer to Reserves section. • Revised **Rural Properties** to remove Tier 3 Markets requirements.
04/11/24	4.9	Revised **Borrowers** to add Individual Taxpayer Identification Number (ITIN) Borrower requirements.
03/21/24	4.8	• Revised **General Refinance Requirements** to reflect subject property was purchased (formerly acquired) for seasoning purposes. • Revised **Texas Section 50(a)(6) General Requirements** to add Alternative Documentation of income is allowed (formerly stated Bank Statement Documentation) • Revised **Expanded Ratio** to require Credit Score ≥ 680 (was 700).
02/07/24	4.7	• Revised **Personal Bank Statements** to reflect verification completed within 10 business days (was calendar days). • Revised **Sole Proprietorship, Partnerships, Corporations and S Corporations** to reflect verification completed within 10 business days (was calendar days). • Revised **Ineligible Property Types** to add Barn conversions or Barndominiums. • Revised **Accessory Units** requirements for rental income.

Revision Summary (continued)

Date	Version	Description of Change
09/15/23	4.6	• Revised **Collections and Charge-Offs** requirements. • Revised **Bank Statement Documentation** to remove non-permanent residents as ineligible. • Revised **1099 Income Documentation** to remove non-permanent residents as ineligible. • Revised **Profit & Loss Income Documentation** to remove non-permanent residents as ineligible.
08/07/23	4.5	• Revised **Mortgage and Rental Payment Verification** to clarify VOM and VOR requirements. • Revised **Reserves** to clarify gift fund requirements. • Renamed **Repairs** to **Repairs and Escrow Holdbacks** and revised to add requirements for escrow holdbacks on delayed landscaping on new construction properties.
06/01/23 (06/16/23)	4.4	• Revised **Properties Listed for Sale** to add minimum 2 year prepayment requirements. • Revised **Tradeline Requirements** to remove requirement for activity within the past 12 months and add requirements for manually rated trade lines. • Updated **OPTION 1: DEFAULT EXPENSE FACTOR** calculation. • Revised **Rural Properties** to add requirements for exceptions. • Updated document with 40-Year Fixed program (06/16/23).
04/27/23	4.3	• Revised **General Refinance Requirements** seasoning to “property was acquired ≤ 6 months from the note date of the new mortgage (was application date). • Revised **Fraud Report and Background Check** to clarify that a fraud report is not required for the business entity itself. • Revised **Reserves** to remove 620 FICO score requirement.
03/22/23	4.2	• Revised **General Refinance Requirements** for determining LTV. • Revised **Higher Priced Mortgage Loan Requirements** to remove requirement for second appraisal from a different AMC. • Revised **Flip Transactions** to simplify requirements and clarify a second full appraisal is required. • Revised **Business Bank Statements** documentation requirements to add multiple bank accounts may be used, but a combination of business and personal is prohibited. • Added **Rental Income** from an ADU requirements. • Revised **Reserves** to lower FICO requirement to 620 (was 700). • Revised **Eligible Property Types** to update Multi-Family Properties for primary residence to 1-4 units (was 1-2 units). • Revised **Accessory Units** requirements to add Illegal Accessory Units are not permitted and For an ADU that is legal non-conforming, the appraisal contains 2 comparables (was 3) with similar additional accessory units • Revised **Site Condominiums** to update FNMA form requirements to 1004 Uniform Residential Appraisal Report or 1073 Individual Condominium Unit Appraisal Report.

Revision Summary (continued)

Date	Version	Description of Change
02/15/23	4.1	• Revised **Power of Attorney** to clarify a Power of Attorney is not allowed on Texas Home Equity transactions. • Revised **Business Bank Statements** to state 12 or 24 months complete business bank statements are required (formerly incorrectly listed personal bank statements).
01/04/23	4.0	• Revised **Bank Statement Documentation** to clarify effective income requirements.
11/01/22 (11/08/22)	3.9	• Revised **Prepayment Penalties, Points, and Fees** to remove requirement to obtain the Business Purpose Affidavit. • Rebranded document with new logo (11/08/22).
04/28/22	3.8	• Revised **Asset Documentation** to add "Asset statements must be dated within 90 days of closing".
04/18/22	3.7	• Revised **1-Year Alternative Income Documentation** to add Self-Employed 1099: 1 Year IRS Form 1099 Statements and 12 and 24 months Profit & Loss Statements. • Added **1099 Income Documentation** and **P&L Income Documentation** requirements (Permitted under the Carrington Flexible Advantage Plus (CFA+) program.) • Revised **Self-Employed Income** to add **"**Borrowers who receive self-employed 1099 earnings may be qualified under the Sole Proprietorship guidelines by providing IRS Form 1040 tax returns for the most recent 1 or 2 years, or under the 1099 Income Documentation guidelines by providing IRS Form 1099 for the most recent 1 or 2 years."
02/02/22	3.6	Revised Exceptions to remove rural properties and align with UW Exception Policy.
12/13/21	3.5	Revised **Business Assets** requirements to require 50% and add business assets must be multiplied by the borrower's ownership percentage of the business.
10/12/21	3.4	Revised **Business Assets** to add "**Note:** The requested information shall not be interpreted as an assurance of solvency."
09/02/21	3.3	• Updated **Asset Depletion** requirements.
08/11/21	3.2	• Revised **Exceptions** requirements. • Revised **First Time Investor** requirements. • Revised **Soft Pull Credit Report** requirement to 14 days. • Revised **Asset Depletion** requirements. • Revised **Ineligible Property Types** to add illegally zoned properties. • Revised **Appraisal Review** Process. • Revised **Rural Properties** requirements.

Revision Summary (continued)

Date	Version	Description of Change
06/23/21	3.1	• Revised **Higher Priced Mortgage Loan Requirements** to add second appraisal must be "from a different AMC." • Updated references to Letters of Explanation to clarify "Borrower(s) must write, sign, and date all Letters of Explanation themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content." • Updated **Flood Insurance** with SFHA zones.
06/10/21	3.0	• Added **Appraisal Re-Use** requirements.
05/24/21	2.9	• Revised **General Refinance Requirements > Determining Loan-to-Value** to 6 months seasoning. • Revised **Forbearance due to Presidentially Declared Disasters, including COVID-19** payment requirements. • Revised **Age of Loan Documentation** seasoning requirements. • Revised **Personal Bank Statements** / **Business Bank Statements** documentation requirements. • Revised **50% Expanded Debt Ratio** requirements.
04/19/21	2.8	• Revised **Prepayment Penalties, Points, and Fees** to add Investment Property requirements. • Revised **Occupancy** to add Second Home and Investment Property requirements. • Revised **General Refinance Requirements** > **Benefit to Borrower to add** primary residence and second home requirements. • Revised **Cash-Out Limits** to add Second Homes, and Investment. • Revised **Higher Priced Mortgage Loans (HPML)** to add exemptions for Second Homes and Investment properties. • Updated **Foreign Borrowers** requirements. • Revised **Multiple Financed Properties** to add requirements for Second Homes and Investment properties. • Revised **Tradeline Requirements** to update occupancy with Second Home, and Investment. • Revised **Rental Income** requirements. • Revised **Ratios and Residual Income** requirements. • Revised **Reserves** to add Multiple Financed Properties requirements. • Revised **Financing Concessions/Seller Contributions** requirements. • Revised **Gift Funds** requirements to add .Gift funds are not permitted for investment property transactions. • Revised **Relocation and Employer Assistance** to add Employer assistance funds are not permitted on second homes or investment properties.

Revision Summary (continued)

Date	Version	Description of Change
04/19/21 continued	2.8	• Revised **Secondary / Subordinate Financing** to add Secondary financing is not permitted for second homes. • Added **First Time Investor** requirements. • Revised **Eligible Property Types** requirements for primary and Investment properties. • Revised **Ineligible Property Types** to remove 3-4 unit properties. • Revised **Land Value and Acreage** to add Investment property transactions are limited to 2 acres.
03/23/21	2.7	• Revised **Reserves** to add Cash-out proceeds are permitted for reserves with a FICO score greater than or equal to 700.
02/17/21	2.6	• Updated references to Uniform Residential Loan Application (URLA) and 4506-T to 4506-C throughout guidelines.
1/19/21	2.5	• Revised **Seasoning** to update Trust and LLC requirements. • Revised **Points and Fees** to add Texas Conversion loans are excluded from the 2.00% fee limitation. • Revised **Bank Statement Documentation** to clarify requirements for money transfer service business account statements. • Revised **Rural Properties** to remove exceptions are not permitted.
11/06/20	2.4	• Added **Self-Employed Confirmation of Employment Requirements.** • Updated **Documenting Business Bank Account Ownership.**
11/02/20	2.3	• Updated **Texas Home Equity > General Requirements** to add Maximum LTV = Maximum Cash Out LTV per Matrix (not to exceed 80% LTV). • Updated **Secondary Financing** to add Maximum CLTV = Maximum LTV for the transaction. • Updated **Secondary / Subordinate Financing** to clarify the maximum CLTV is equal to the maximum LTV for the transaction (Institutional seconds only).
09/25/20	2.2	Updated **Rural Properties** requirements.
09/23/20	2.1	Updated **Forbearance Due to a Disaster** requirements.

Revision Summary (continued)

Date	Version	Description of Change
09/10/20	2.0	• Updated **New York Loans** to remove restriction that “Loans require a minimum loan size of “Conforming Balance plus $1”.” Added NY subprime loans are not permitted. • Revised **Prepayment Penalties, Points, and Fees** requirements. • Updated **Occupancy > Second Home** requirements to not permitted. • Updated **Benefit to Borrower** requirements. • Revised **Cash-Out Limits** Occupancy and LTV requirements. • Revised **Higher Priced Mortgage Loans (HPML)** to remove exemptions. • Revised **Texas Home Equity Loans > General Requirements** for LTV. • Revised Foreign Borrowers requirements to state “Borrowers living primarily overseas are not eligible.” • Revised **First Time Home Buyers** requirements. • Revised **Multiple Financed Properties** requirements. • Revised **Age of Credit Report/Credit Documentation** seasoning to 60 days (was 120 days). • Revised **Tradeline Requirements** to remove Second Homes. • Updated **Age of Loan Documentation** seasoning requirements. • Revised **Employment History > Gaps in Employment** to clarify recent graduates with evidence of post-secondary education from a college, university, community college, Junior college, Career school, technical school, or vocational/trade school are allowed. • Revised **Asset Depletion** to not permitted and removed requirements. • Revised **Rental Income** requirements. • Revised **Ratios and Qualifying** for expanded 50% ratio. • Revised **Residual Income** to remove Second Homes. • Revised Asset **Analysis > Reserves** to clarify reserve requirements. • Revised **Financing Concessions/Seller Contributions** occupancy and LTV requirements. • Revised **Relocation and Employer Assistance** requirements. • Revised **Secondary / Subordinate Financing** CLTV requirement and Seller-held requirement. • Revised **Eligible Property Types** to remove Rural Properties. • Revised **Ineligible Property Types** to add Non-Warrantable Condominiums and Rural Properties. • Revised **Rural Properties** requirements.
12/05/19	1.0	New document.

This Page is Intentionally Blank