CMS Second Lien Loan Underwriting Guidelines

DOCUMENT OVERVIEW

Purpose

This document describes the responsibilities and requirements of the Carrington Mortgage Services, LLC (CMS) Mortgage Lending Division Underwriter (Underwriter) when reviewing and underwriting second lien 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.

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Revision Summary

Please see the Revision Summary section.

ELIGIBILITY

FICO/LTV	Refer to the CMS Second Lien Loans Matrix for FICO and LTV requirements.
Loan Terms	Fixed Rate terms of 5, 10, 15, 20, 25 and 30 years available. Purchase seasoning of 6 months prior to closing is required, limited only by an assumption of the related 1st lien as provided below. • If the prior settlement statement is available: Calculate from settlement date to new note date • If the prior settlement statement is not available: Calculate from deed recording date to new note date
Interest Only	Interest-Only (IO) can be offered for a period of 36 months with loan terms of 10 years or more. Full amortization is required after the IO period. Minimum FICO: 720 and Maximum CLTV of 85% is required. Qualifying payment is calculated using the fully amortizing payment after the initial Interest Only Period.
Debt to Income	Maximum 50% Debt to Income (DTI)
Assumption of Existing 1st Lien	In the event of an assumption of an existing 1st lien mortgage loan, the assuming party can be offered a closed-end second lien up to a maximum of 80% CLTV. Must have a qualifying FICO ≥ 680.
Ineligible States	Refer to CMS Second Lien Program Matrix.
Broker Licensing Requirements	Refer to CMS Second Lien Program Matrix.
Mortgage Loan Application	The Mortgage Loan Application must be complete, including a full two-year history of employment and residency and all personal information for each Borrower (social security number, date of birth, address, and education.) All applications must be signed and dated by the Borrower(s). The final application for closing must adhere to the requirements above, including the Borrower's complete and accurate financial information relied upon by the underwriter, and be signed and dated by all Borrowers. All debt incurred during the application process and through loan closing must be disclosed on the final application. All transactions are reviewed for reasonability as part of the underwriting process. The feasibility of occupancy claims and the overall financial picture of the Borrowers must be reasonable. Where conflicting information exists between or within documents, an adequate explanation must be provided, documented and included in the Mortgage Loan File. **Borrower MUST have owned the property for at least 6 months to qualify.** ***In the event of an assumption of an existing 1st lien mortgage loan, the assuming party can be offered a closed-end second lien up to a maximum of 80% CLTV. Must have a qualifying FICO ≥ 680.***

Eligibility (continued)

Existing First-Lien Restrictions

The current first-lien loan may not have negative amortization, a balloon payment or an active prepayment penalty. The Underwriter must review the original first-lien note to confirm that none of these terms apply to the current first lien loan. In cases where the prepayment penalty term has expired (or will expire by the settlement date), then the loan file may proceed.

Other Subordinate Financing

Re-subordination of debt is not permitted. Existing subordinate liens, including Partial Claims, must be satisfied through closing. A Close letter is required for existing HELOCs.

Identity Verification

The identity must be confirmed for each Borrower whose credit is used for loan qualification. The closing agent, notary public or signing attorney, as appropriate, must provide evidence that the identification document has been confirmed for each Borrower. Acceptable forms of identification include:

- Valid state driver's license with photo;
- Work ID with photo;
- Military photo ID;
- Permanent Resident card with photo;
- Medicare card;
- Valid state non-driver's license with photo;
- Student photo ID;
- Military dependents photo ID;
- Department of Public Welfare photo ID;
- US passport with photo; or
- Notary-signed Patriot Act Consumer Identification Form

Social Security Number Validation

Evidence of a valid social security number is required for all Borrowers. Acceptable documentation for a social security number includes, but is not limited to, a valid Social Security card, a current paystub, W-2, or tax transcripts. Any social security number discrepancies that are identified must be resolved.

Borrower Types

Any person signing an application for a Mortgage Loan is a Borrower. All Borrowers must sign the Mortgage Note.

A Borrower must be an individual. Title must be in Borrower's name at time of application for refinance transactions and at time of closing for all transactions. Non-individual legal entities such as corporations, general partnerships, limited partnerships, real estate syndications, or trusts are not eligible. Title must be in the borrower's name at the time of closing.

Note: Transferring title from a trust to the borrower as a natural person requires 6 months title seasoning.

Eligibility (continued)

U.S. Citizens

The Borrower must have a valid social security number and be a citizen of the United States or a United States Possession or Territory.

Non-U.S. Citizens

Permanent Residents

A permanent resident is a non-U.S. citizen who is legally eligible to maintain permanent residency in the U.S. and holds a Permanent Resident card (form I-551). Document legal residency with one of the following:

- A valid and current Permanent Resident card;
- A passport stamped “processed for I-551”;
- A copy of the expired Permanent Resident card and a copy of form I-797 confirming receipt of the application to replace expired card

Non-Permanent Residents

A non-permanent resident is a non-U.S. citizen who lawfully enters the United States for specific time-periods under the terms of a visa. A non-permanent resident status may or may not permit employment.

- Verification that the Borrower has one of the following is required:
- Unexpired Employment Authorization Document (“EAD”) issued by the United States Citizenship and Immigration Services (“USCIS”).
- One of the following visas: H series, L, E-1, G series or TN Visa. For further information see http://www.uscis.gov/
- Expiring visas: If the authorization for temporary residency status will expire within one year and a prior history of residency status renewals exist, continuation may be assumed. If there are no prior renewals, the likelihood of renewal must be determined, based on information from USCIS.
- A valid passport, letter from employer/sponsor and an I-94 proving work authorization.
- All Borrowers signing the Mortgage Note must have a valid social security number.
- Individuals classified under Diplomatic Immunity, Temporary Protected Status (EAD classes A12 or C19), Deferred Enforced Departure (EAD class A11), or Humanitarian Parole (EAD card states “Serves as I-512 Advance Parole”) are not eligible.

Eligibility (continued)

Non-Occupant Co-Borrower, Guarantor, and Co-Signer

Non-Occupant Co-Borrowers are an Ineligible Borrower type

A non-occupant Co-Borrower is a credit applicant who:

- Has an ownership interest in the property as indicated on the title;
- Signs the Mortgage;
- Signs the Mortgage Note and thus has joint liability for the Mortgage Note with the occupant Borrower; and/or
- Does not occupy the Mortgaged Property.

Guarantors or Co-Signers are an Ineligible Borrower type

A guarantor or co-signer is a credit applicant who:

- Does not have ownership interest in the property as indicated on the title;
- Signs the Mortgage;
- Signs the Mortgage Note and thus has joint liability for the Mortgage Note with the occupant Borrower; and/or
- Does not have an interest in the property sales transaction.

All individuals who hold title to the Mortgaged Property are required to sign the Security Instrument, but are not required to sign the Mortgage Loan Application or the Mortgage Note unless their income is used for qualifying purposes.

MULTIPLE PROPERTIES FINANCED/OWNED

Limit

Each borrower is limited to no more than five (5) financed properties.

Ownership Defined

- Partial or joint ownership is considered the same as total ownership in the property
- Ownership applies to financed properties owned by the Borrower, including any properties the Borrower owns outside of the United States
- A Borrower who is obligated on a Mortgage, regardless of whether they hold title to the Mortgaged Property is included in this limitation
- These limitations apply to the total number of all financed properties, not to the number of mortgages on the property

TITLE/VESTING

Owner and Encumbrance Report

For loan amounts less than or equal to $150k, must utilize an Owner & Encumbrance report with an attached Error & Omission (E&O) policy or attain an Attorney Opinion Letter (AOL), where applicable, validating title findings. The Error & Omission insurance attached is transferrable to all investors and provides coverage for 360 months. **Effective Date**: The Owner & Encumbrance report must not exceed 90 days at the time of funding. The E&O Insurance Policy must be unexpired at the time of funding.

The purpose of the Owner & Encumbrance Report is to provide the following information:

- Current grantee and grantor
- Last deed of record information
- Recordable legal description
- Status of real estate taxes
- Open mortgages and voluntary encumbrances
- Judgments, liens and involuntary encumbrances

Title must be in Borrower's name and at time of application for all transactions and at time of closing for all transactions.

For Loan amounts greater than or equal to $150k, must attain a full ALTA title report.

Eligible Ownership Interests

- Fee Simple
- Leasehold Estate (subject to meeting Fannie Mae requirements)

Ineligible Ownership Interests

- Life Estates
- See also Borrower Types above

Eligible Transaction Types

Borrower must have owned the subject property for a minimum of 6 months. *In the event of an assumption of an existing 1st lien mortgage loan, the assuming party can be offered a closed-end second lien up to a maximum of 80% CLTV. Must have a qualifying FICO ≥ 680.*

Stand-alone second lien fixed rate home equity loans. Funds received from transaction are not limited to a specific purpose.

Ineligible Transaction Types

- Purchase transactions
- Second mortgages with a simultaneous 1st lien transaction. *In the event of an assumption of an existing 1st lien mortgage loan, the assuming party can be offered a closed-end second lien up to a maximum of 80% CLTV. Must have a qualifying FICO ≥ 680.*
- Employee loans

Title/Vesting (continued)

Acceptable Senior Lien Terms	Ineligible terms include, but are not limited to: • Tax and judgment liens • Mortgages with balloon terms • Subordinate mortgages that allow negative amortization (this does not include language in the Mortgage Note warning Borrowers that the lack of payment may result in negative equity and negative amortization is not a feature of the product) • **Interest only features can be offered for a maximum of 36 months, with a minimum FICO of 720 and a CLTV of 85%** • Senior Lien loans with ARM adjustments must be underwritten to fully amortized rate for determining ATR

DOCUMENTATION AGE AND REQUIREMENTS

Documentation Age	The credit report must be dated not more than 120 days prior to the Mortgage Note date. When the credit report will be more than 60 days old as of the Mortgage Note date, a credit soft pull must be obtained within 14 calendar days of the Mortgage Note date. • Any increase in the total monthly payments of trade lines not being paid at closing must be updated for qualifying purposes. • Any increase in the balances of individual trade lines must be updated for debts to be paid at closing. • A new credit report is required if the credit soft pull reveals new derogatory credit, defined as new collection, charge-off, repossession, or judgment accounts, or non-mortgage trade lines that have fallen 30 days or more past due.
Documentation Standards	All accounts, revolving and installment, reported by the Borrower on the application must be verified on the credit report or directly by a credit reference. The current balance, current status, rating, monthly payment amount, and payment history for the most recent 12 months must be provided.

CREDIT REPORT REQUIREMENTS

Credit Report Requirements

The Mortgage Loan File must contain a three repository, merged in-file report including Credit Scores.

The credit report used to evaluate a Mortgage Loan may not have Frozen Credit. If a Borrower unfreezes his or her credit after the date that the original credit report was ordered, credit report must be obtained to reflect current updated information from all applicable repositories. Nontraditional credit is not acceptable as a replacement for Frozen Credit.

All credit reports must include FACT Act messages and at least one repository fraud alert product.

When the credit report shows a victim statement under the FACT Act, CMS must document in writing the steps taken to validate the Mortgage Loan Application is not the result of identity theft. The actions must be reasonable and compliant with applicable laws.

Credit report alerts must be reasonably resolved with supporting documentation included in the Mortgage Loan File. Although due diligence is required, it does not release CMS from its representations and warranties regarding misrepresentation.

Credit Report Red Flags

When underwriting a credit report, the Borrower's credit use and limits must be reviewed to ensure consistency with the reported income, assets, and application information. The Borrower's address history must be examined for consistency with other file documentation. Discrepancies must be adequately explained and questionable explanations researched.

Non-Traditional Credit Report

Non-traditional credit reports are not acceptable.

Non-U.S. Citizens

Foreign credit reports are not acceptable.

Selection and Validation of Credit Score

The Credit Score will be used as a component in evaluating the credit quality of the Mortgage Loan.

- When Credit Scores are obtained from two different repositories, choose the lower score.
- When Credit Score are obtained from three different repositories, choose the middle score. (If two of the three scores are the same, choose the middle of the three scores. For example: 700, 680, 680 = 680; 700, 700, 680 = 700)
- If more than one Credit Score is supplied from the same repository on the same credit report, the lowest score will be used for that repository.
- When more than one credit report is obtained for the same borrower, the Credit Scores from the most recent credit report are to be used.

Credit Report Requirements (continued)

Loan Qualification Score	Use the lowest selected Credit Score among all Borrowers. All Borrowers must meet the minimum Credit Score and all other credit evaluation requirements.
Authorized User Accounts	When a credit account owner permits another person to have access to and use an account, the user is referred to as an authorized user of the account. This practice is intended to assist related individuals in legitimately establishing a credit history and Credit Score based on the account and payment history of the account owner, even though the authorized user is not the account owner. Authorized user accounts cannot be considered in the underwriting decision.
Tradeline Requirements	All Mortgage Loans require a Credit Score based a minimum credit history and trade line requirements. All borrowers must meet ONE of the following: • Minimum of three trade lines. At least one trade line must be open and active for the past 12 months; **OR** • A current mortgage paid as agreed for the past 36 months Authorized user accounts may not be used to satisfy the trade line requirements. Active trade lines are defined by the date of the last activity on the account within six months from the current date.
Credit History Evaluation	The Borrower's credit profile must be traditionally evaluated for manually underwritten Mortgage Loans. The evaluation of the Borrower's credit profile must be based on the entire credit history documented in the Mortgage Loan File. The manner in which the Borrower has managed previous credit is a strong indicator of future performance. In a subjective evaluation of credit, many factors are considered when evaluating a Borrower's credit history. These include: • Credit utilization; • Inquiries and undisclosed liabilities; • Number and age of accounts; and • Payment history. The following factors may not be used as offsets for weaknesses in the Borrower’s credit reputation because they have already been considered in creating the Credit Score: • The absence of, or age of, derogatory information; • The number/proportion of accounts paid as agreed versus delinquent; • The types of accounts paid as agreed versus the type of accounts that are delinquent; • Recent paydown or consolidation of account balances by the Borrower; • The length of the Borrower's credit history; and • Any combinations of the above factors.

Credit Report Requirements (continued)

Credit Utilization

Review the credit report to evaluate the Borrower's use of revolving credit by comparing the current balance on each account to the amount of credit that is available to determine whether the Borrower has a pattern of using revolving accounts up to (or approaching) the credit limit. Patterns of revolving credit spending are credit risk indicative.

Credit histories that include revolving accounts with a low balances-to-limits ratio generally represent a lower credit risk, while those that include accounts with a high balances-to-limits ratio represent a higher credit risk.

A credit history that includes recently opened accounts that are at or near their limits may indicate that the Borrower is overextended or overly reliant on the use of revolving credit, and, when combined with a delinquent payment history, is generally an indication that the Borrower has not managed his or her credit successfully.

Inquiries and Undisclosed Liabilities

All debt incurred during the application process and through loan closing of the Mortgage must be disclosed on the final application and included in the Mortgage Loan qualification. When the credit report reveals a significant debt not listed on the application, a written explanation from the Borrower addressing the omission may be required. The absence of a written explanation from the Borrower may render the Mortgage Loan ineligible.

Review the section of the Borrower's credit report that indicates the presence of creditor inquiries. Recent inquiries may indicate that the Borrower has been actively seeking new credit accounts. The presence of a large number of unrelated inquiries represents higher risk (whether or not the Borrower obtained credit as a result of the inquiry). The presence of many recent inquiries in combination with a significant number of recently opened accounts or delinquent accounts represents a high credit risk.

When the credit report indicates recent inquiries, confirm that the Borrower has not applied for and/or been approved for or obtained any additional credit that is not reflected in the credit report or the Mortgage Loan Application. If additional credit was applied for and/or approved or obtained, a verification of that debt must be provided and the Borrower must be qualified with the monthly payment.

Validation must be made with any of the following methods, with the applicable documentation provided in the Mortgage Loan File:

- Retrieving a refreshed credit report and reviewing it for additional credit lines. If a new inquiry is identified on the refreshed credit report, a detailed letter of explanation from the Borrower is required;
- Direct verification with a creditor that is listed on the credit report under recent inquires to determine whether a prospective Borrower did in fact enter into a financial arrangement with a creditor, which may not be listed on the Mortgage Loan application;
- Third party vendor debt monitoring service; or
- A detailed letter of explanation from the Borrower is acceptable if the Mortgage Loan closes within 30 calendar days of the date of the initial credit report

As a result of the Borrower's explanation letter, additional research and documentation may be needed.

Credit Report Requirements (continued)

Inquiries and Undisclosed Liabilities (continued)	In addition, running a Mortgage Electronic Registration System (MERS) report to determine if the Borrower has undisclosed liens or another mortgage being established simultaneously may also be used to reduce the risk of undisclosed obligations. If additional debt has been incurred, the Mortgage Loan must be re-underwritten with the new debt to ensure the debt-to-income ratio is still within Program Guidelines.
Number and Age of Accounts	Review the age of the Borrower's credit history to determine whether the Borrower has an older established credit history or a newly established credit history, and whether there are a significant number of recently opened accounts or a mix of new account and older accounts. Credit histories that include older, established accounts generally represent lower credit risk. However, an older, established credit history that includes a significant number of recently opened accounts may indicate that the Borrower is overextended, and may represent a higher credit risk. A newly established credit history does not automatically represent a higher credit risk, since making payments as agreed on newly opened accounts represents less of a risk than not making payments as agreed on older, established accounts. A change in the Borrowers pattern of credit use, which includes several newly opened revolving accounts, several inquiries and high utilization of revolving trade lines, indicates significant layering of risk to the Borrower's credit profile.
Payment History	Review the credit report to determine the current status of each credit account, including mortgages, the timeliness of payments, and the frequency, recency, and severity of any delinquent payments. • Credit histories that include no late payments, collection or charged-off accounts, foreclosures, deeds-in-lieu, bankruptcies, or other public records information represent a lower credit risk. • Credit histories that include recent late payments represent a higher credit risk than those with late payments that occurred more than 24 months ago. When there are payments that were 30, 60, or 90+ days past due, determine whether the late payments represent isolated incidences or frequent occurrences. Delinquent payments must be evaluated in the context of the Borrower's overall credit history, including the number and age of accounts, credit utilization, and recent attempts to obtain new credit. • Credit histories that include foreclosures, deed-in-lieu, and public records information (such as bankruptcies, judgments, and liens) represent a higher credit risk. The greater the number of such incidences and the more recently they occurred, the higher the credit risk.

Credit Report Requirements (continued)

Payment History (continued)

- Credit histories that include forbearance represent a higher credit risk. Borrowers who pursued forbearance but remained current are eligible. Borrowers who pursued forbearance and did not pay current, will need 24 months of post-forbearance payment history. A forbearance resulting in a loan modification will require a 4-year waiting period from the modification date. Minimum of 12 months seasoning on a CARES ACT modification post forbearance for borrowers who remained current through the forbearance period. Minimum of 24 months seasoning on CARES ACT modification or standalone partial claim post forbearance for borrowers who were delinquent for any period during forbearance.

HOUSING PAYMENT HISTORY

Requirements

A mortgage payment is considered current if it is paid within the month due along with any late charges assessed for payments made beyond the 15-day grace period. A letter of explanation and supporting documentation is required when payments are made beyond the month due.

Payment history on any property, regardless of occupancy, is considered mortgage credit. Payment histories on all mortgage trade lines, including first and second mortgage liens, HELOCs, Mobile Homes, and Manufactured Homes are considered mortgage credit, even if reported as an installment loan.

Mortgage

Maximum of 0x30x24 mortgage payment history is required inclusive of all REO for all borrowers on the transaction.

Minimum of 12 months seasoning on a CARES ACT modification post forbearance for borrowers who remained current through the forbearance period.

Minimum of 24 months seasoning on CARES ACT modification or standalone partial claim post forbearance for borrowers who were delinquent for any period during forbearance.

Landlord

A 12-month satisfactory landlord reference is required using one of the following:

- Cancelled checks for the most recent 12-month period and a copy of the lease verifying the due date; or
- Credit report reference for the most recent 12-month period.
- Verification of Rent (VOR) from verifiable company

Housing Payment History (continued)

Significant Derogatory Credit

The presence of significant derogatory credit dramatically increases the likelihood of a future default and represents a significantly higher level of default risk. Examples of significant derogatory credit include bankruptcies, deeds-in-lieu, foreclosures, and short sales.

Determine the cause and significance of the derogatory information, verify that sufficient time has elapsed since the date of the last derogatory information and confirm that the Borrower has reestablished an acceptable credit history.

For cases where a Significant derogatory event is present, the following time periods must have elapsed prior to loan being eligible:

Event	Timeframe
Foreclosure	7 Years
Charge-Off of a Mortgage Account, Deed-in Lieu, Pre-foreclosure Sale or Short Sale	7 Years
Modified, Restructured or Short Payoff of a mortgage secured by a property other than subject	4 years See above for CARES Act exception
Chapter 7, 11, or 13 Bankruptcy	4 years from discharge or 4 years from dismissal
Multiple Events are not permitted	

Derogatory credit information is not significant when it consists only of isolated late payments, even if several accounts show sporadic late payments, provided all of the following exist:

- The late payments were not recent;
- The late payments did not extend beyond one month;
- The number and size of delinquent accounts is not large in relation to the overall credit;
- The credit history does not show multiple revolving accounts with high balances-to-limits or high overall utilization of revolving credit; and
- All other credit has been paid as agreed.

However the derogatory information is significant if any of the following exist:

- There are several accounts showing recent late payments;
- There are multiple 60- or 90-day late payments;
- The number and size of the delinquent accounts are large in relation to the overall credit;
- There are multiple episodes of late payments extending over a period of time;

Housing Payment History (continued)

Significant Derogatory Credit (continued)

- The credit history shows derogatory credit information within the two most recent years combined with multiple revolving accounts with high balances-to-limits;
- The public record information reveals several occurrences of derogatory credit information, including judgments, tax liens and/or collection accounts;
- There is a bankruptcy, foreclosure, deed-in-lieu of foreclosure or short sale within the last seven years that is disclosed on a credit report; or disclosed by the Borrower on the uniform residential loan application or is evidenced by other documentation contained in the Mortgage Loan file.

Consumer Credit Counseling

Borrowers must provide a satisfactory explanation for participating in Consumer Credit Counseling. A Borrower is eligible when they participated in Consumer Credit Counseling provided all of the following criteria are met:

- Credit Score requirements are met;
- Counseling completed 24 months prior to application; and
- All accounts must be current

Major Adverse Credit

Major adverse credit are collection accounts, charge-off accounts, judgments, liens, delinquent property taxes, repossessions, garnishments, and non-mortgage accounts currently 90 days or more delinquent.

ASSETS

Overview

Regardless of underwriting method, additional information may be requested at the discretion of the underwriter.

Documentation Age

Asset documentation must be dated within 60 days from the Mortgage note date.

Cash to Close

Evidence must be provided to determine that the Borrower has sufficient funds to pay the prepaid items, and closing. The Borrower is not required to meet a minimum reserve requirement but rather used as an additional compensating factor.

All funds for cash to close must be documented and verified. Electronic verifications are acceptable.

Foreign Assets

Foreign assets being used for closing costs and reserves must be held in a U.S. account prior to closing. If the assets are derived from a sale of a foreign asset or from assets held in a foreign bank account, the assets must be converted into United States currency by an independent third party and placed in a United States banking institution. The sale of the foreign asset and conversion of foreign currency must be fully documented and verified.

Assets (continued)

Asset Sources

Acceptable sources of assets are listed below:

- Bank Accounts
    - Bank Statements
    - Verification of Deposits
    - Review of Bank Account Statements
- Review of Settlement Statements
- Retirement Accounts
- Stocks/Bonds
    - Stock – Privately Held Corporation
- Systematic Savings
- Trust Funds

Bank Accounts

Bank accounts include funds on deposit in savings accounts, checking accounts, certificate of deposits, and money market accounts. These funds may be used for closing costs and reserves.

- Individual Accounts - Funds in the Borrower's individual bank account are acceptable
- Joint Accounts - Funds held in a joint checking or joint savings account are acceptable since the Borrower has access to all funds in the account at all times
- Trust Accounts - Funds disbursed from a trust account where the Borrower is the beneficiary are acceptable if the Borrower has immediate access to them. The trust manager or trustee must verify the value of the trust account and confirm the conditions under which the Borrower has access to the funds.

Accounts that do not allow the Borrower to have immediate access to the funds for the above stated purposes may not be used as acceptable assets, including funds in accounts where the Borrower is not the beneficiary, such as custodial accounts.

Bank Statements

Two consecutive monthly bank statements may be obtained to document the Borrower's assets. Bank statements must be dated within 30 days of application. Quarterly and annual bank statements dated greater than 30 days and less than 90 days are acceptable with verification that the funds are still available.

Bank statements must clearly identify:

- Name and address of the depository or investment institution;
- The Borrower as the account holder;
- Account number;
- Time period covered by the statement;
- All deposits and withdrawal transactions for depository account or all purchase and sale transactions for a financial portfolio account; and
- Ending account balance.

Assets (continued)

Bank Statements (continued)

If a supplemental statement is necessary, any bank-generated form (such as deposit or withdrawal slips) that shows a machine-printed account number, balance and date is acceptable. Supplemental information must be on a bank form indicating the name of the bank or on bank letterhead signed by a bank representative.

Bank statements may be online account or portfolio statements obtained by the Borrower, provided such are printed and the internet uniform resource locator address is included identifying the source of information as well as all of the other information listed above for standard bank statements or protected bank statements retrieved online.

Verification of Deposit

A Verification of Deposit as a standalone document is not acceptable. Full account statements must be provided. A Verification of Deposit issued by the depository institution may be obtained. Each Verification of Deposit must clearly identify:

- The name and address of the depository or investment institution;
- The Borrower as the account holder;
- Account number;
- Type of account;
- The open date;
- The account balance as of the date of the VOD;
- The average balance for the previous two months
- In cases where average balances are not available, the most recent two months bank statements must be provided.

The VOD must be remitted directly to the depository. A VOD should never be mailed to a post office box or to an individual's attention. If the Borrower indicates this is necessary, the file must contain verification that the depository was independently contacted and verified this requirement. The return address on the verification must be the originator's address. The hand carrying of verifications is strictly prohibited.

Review of Bank Account Statements

Any indications of borrowed funds must be investigated. Indications of borrowed funds include:

- A recently opened account;
- A recently received large deposit; or
- An account balance that is considerably greater than the average balance over the previous few months.

When there is a recently opened account with a substantial balance, a discrepancy between the average and current balances or a large increase in an existing account, the source of funds must be explained by the Borrower and verified. If a large deposit is from another account that is verified in the Mortgage Loan File, that account must be verified after the withdrawal to ensure that the assets are not counted twice.

Unverified funds are not acceptable sources for the closing costs and/or reserves. Examine asset documentation for signs of fabrication or alteration. Analyzing the documentation to calculate interest, and reviewing deposits against income levels and sources are necessary to validate the documents.

Assets (continued)

Retirement Accounts

Vested funds from individual retirement accounts (IRA, SEP-IRS, and KEOGH) and tax-favored retirement savings accounts (e.g. 401(k), 403(b)) may be used as the source of funds for closing costs or cash reserves. The most recent retirement account statement must be provided and must identify the Borrower's vested amount and the terms.

Closing Costs

When funds from these sources are used for the closing costs, the funds must be withdrawn and proof of withdrawal must be provided.

Cash Reserves

When funds from these sources are used to support cash reserves as a compensating factor, it is not required to withdraw the funds from the account but the percentages must be used to determine the "net" amount eligible for withdrawal and therefore reserves. Use caution when considering retirement accounts as reserves as these accounts often feature significant penalties for early withdrawals, allow limited access, or have vesting requirements. Retirement accounts that do not allow for any type of withdrawal may not be used for reserves. In addition, retirement accounts that only allow for withdrawal in connection with the Borrower's employment termination, retirement or death, the vested funds must not be considered for reserves.

Savings Bonds

United States savings bonds may be used as a source of funds for closing costs or cash reserves. When savings bonds are being used for cash reserves, verification must include a statement from a representative at a financial institution confirming that they have seen the bonds, listing the serial numbers of the bonds, maturity date, type and amount of bond, and stating that the Borrower is the owner. There must be proof of the bond value.

If the assets are required for closing, proof of redemption and receipt is required.

Stocks/Bonds

The value of stocks, bonds or mutual funds must be documented by:

- Current statement; and
- Photocopy of the stock certificate accompanied by a current, dated newspaper or internet stock list.

When using stocks or bonds for reserves, only 70 percent of the value may be used.

Government bonds should be valued at the purchase price unless redemption value can be determined and verified.

Stock options and non-vested restricted stocks are not an eligible asset source for reserves.

Verification of liquidation and receipt is required when the funds from the sale of stocks/bonds are used for closing costs, or other costs.

Assets (continued)

Stock – Privately Held Corporation/ Unlisted Corporation

When the stock of a privately held (not publicly traded) corporation will be used as funds for losing costs and/ or reserves, the price per share must be validated by a CPA for the corporation. A copy of the buy/sell agreement is also required. Verification of receipt of the funds from the sale of the stock is required. When using the funds for reserves, only 70 percent of the value may be used.

In the situation where the privately held corporation is a source of the Borrower's income, the above documentation will be required together with verification from the accountant that sale of the stock will not have an adverse effect on the business or reduce the Borrower's current income level.

Systematic Savings

Borrowers should have the funds needed to close the transaction at the time of underwriting. However, a loan to a Borrower who does not have sufficient assets to close may be underwritten subject to the following parameters:

- 80 percent of the required assets must be documented
- The ability of the Borrower to save based on his/her income and debts must be documented; and
- The required assets must be documented and verified in the Borrower's account prior to closing.

Trust Funds

Funds disbursed from a trust are acceptable assets with a typed copy of the trust agreement or signed statement on letterhead from the trustee that details the following information:

- Identifies the trustee, including name, address, telephone number and individual contact. The trustee must be an independent party that typically handles trust accounts, such as a trust company, financial institution, CPA, or lawyer.
- Identifies the Borrower as the beneficiary.
- Shows that the Borrower has access to all or certain specific amount of the funds.
- Evidences that the trust has the assets to disburse funds to the Borrower.
- If the assets are required for closing, proof of receipt is required.

Assets (continued)

Unacceptable Sources of Assets

Sources of funds considered ineligible include, but is not limited to the following:

- Business Funds
- Bridge Loans
- Cash advance on a revolving charge account or unsecured line of credit
- Cash for which the source cannot be verified (e.g., garage sales)
- Contribution limitations
- Credit card financing
- Donated funds in any form, such as cash or bonds donated by the seller, builder or selling agent outside of approved financing contributions in the seller concession
- Funds from a community second mortgage/down payment assistance program
- Funds in a custodial or in trust for account
- Gift funds Individual development accounts
- Labor performed by the Borrower, also referred to as sweat equity
- Materials furnished by the Borrower that are not part of a pre-closing agreement with a builder
- Pooled funds
- Real estate commission
- Salary advance

LIABILITIES & DEBT RATIOS

The Liabilities & Debt Ratios standards apply to all Mortgage Loan Programs.

Overview

Ratios are used to compare the Borrower's anticipated monthly housing expense and total monthly obligations to stable monthly gross income. These ratios indicate limitations on the Borrower's ability to meet expenses involved in home ownership.

Loan ratio requirements are discussed under the following topics:

- Monthly Housing Expenses
- Qualifying Housing Payment
- Monthly Debt Obligations
- Total Qualifying Debt-to-Income Ratios (DTI)
- Possible Exclusions to DTI
- Debt Payoff

Liabilities & Debt Ratios (continued)

Monthly Housing Expenses

Monthly housing expenses are required to calculate the anticipated total monthly housing expense- to- income ratio. Housing expense-to-income ratios compare monthly housing expenses to stable gross monthly income. Monthly housing expenses include the following:

- Principal and Interest payments on the first mortgage loan;
- Interest payments for interest only loans;
- Subordinate financing payments on mortgages secured by the subject property;
- Hazard Insurance premiums;
- Flood Insurance premiums;
- Mortgage Insurance Premiums;
- Real estate taxes;
- Homeowners' Association dues;
- Leasehold payments;
- Ground rent; and
- Special assessments.

Qualifying Housing Payment

Generally, the Principal and Interest (P&I) payment, based on the actual interest rate, is used to determine the Borrower's monthly housing expense.

When the subject property has a Senior Lien loan with ARM adjustments, the housing payment must be qualified at the fully amortized rate for determining ATR.

When the subject lien contains an Interest Only Period, the qualifying payment is calculated using the fully amortizing payment after the initial Interest Only Period.

Total Qualifying Debt-to-Income Ratios

Debt-to-income ratios compare all monthly obligations and debt payments to monthly stable income. In evaluating the total debt-to-income ratio, be aware of the degree and frequency of credit usage and its impact on Borrower's ability to repay the loan.

MONTHLY DEBT OBLIGATIONS

Overview

The Borrower's ability to repay mortgage debt is critical in evaluating the overall quality of the Mortgage Loan. Assess the Borrower's liabilities relating to the number of active accounts, usage and repayment history. Evaluation of the Borrower's capacity includes an assessment of the Borrower's financial obligations in relation to income.

The total monthly debt obligations considered is the sum of all housing expenses plus any other monthly expenses incurred by the Borrower. Any additional debt obtained as a result of a recent inquiry on the credit report must be included in the monthly debt obligation.

Monthly Debt Obligations (continued)

Monthly Debt Obligation

Monthly expenses include:

- Alimony, Child Support and Maintenance Payments
- Bridge Loans
- Business Debt in Borrower's Name
- Co-Signed Loans
- Court-ordered Assignment of Debt
- Deferred Installment Debt
- Home Equity Lines of Credit
- Installment Debt
- Lease Payments
- Loans Secured by Financial Assets
- Mortgage Assumptions
- Open 30-day Charge Accounts
- Other Real Estate Owned
- Property Settlement Buy-out
- Revolving Charges/Lines of Credit
- Student Loans
- Voluntary Recurring Debt

Alimony, Child Support and Maintenance Payments

When the Borrower is required to pay alimony, child support, or maintenance payments under a divorce decree, separation agreement, or any other written legal agreement, and those payments will continue for more than 10 months, the payments must be considered in the debt-to-income ratio (and may not be deducted from income). The alimony, child support and maintenance payments may not be deducted from income. Voluntary payments do not need to be taken into consideration.

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

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

Bridge Loans

A bridge loan is a form of mortgage secured by the Borrower's present home, which is for sale. By using funds from this loan, the Borrower can close on a new home before selling the present home. Bridge loans must be included in the Borrower's debt-to-income ratio.

Monthly Debt Obligations (continued)

Business Debt in Borrower's Name

When a self-employed Borrower indicates that certain liabilities are paid by his or her business, it must be confirmed that the obligation was paid from company funds and meets all of the following requirements:

- There is no history of delinquency;
- A minimum of 12 months evidence documenting that the debt is paid by the business account; and
- The cash flow analysis of the business took the payment obligation into consideration.

The payment must be included in the Borrower's individual recurring monthly debt obligations if any of the following situations exist:

- The business does not provide sufficient evidence that the obligation was paid out of company funds.
- The business provides acceptable evidence of its payment of the obligation, but the cash flow analysis of the business does not reflect any business expense related to the obligation (such as an interest expense - and taxes and insurance, if applicable - equal to or greater than the amount of interest that one would reasonably expect to see given the amount of financing shown on the credit report and the age of the loan).
- It is reasonable to assume that the obligation has not been accounted for in the cash flow analysis.
- If the account in question has a history of delinquency

To ensure that the obligation is counted only once, adjust the net income of the business by the amount of interest, taxes, or insurance expense, if any that relates to the account in question.

Co-Signed Loans

When a Borrower co-signs for a loan to enable another party (the primary obligor) to obtain credit, but is not actually repaying the debt, the Borrower has a contingent liability.

The contingent liability must be included in the debt-to-income ratio, unless there is documentation to evidence the primary debtor has been making satisfactory payments for a minimum of 12 consecutive months and the account is current.

Evidence such as cancelled checks or automated savings withdrawals will be accepted.

Court-Ordered Assignment of Debt

When the Borrower has an outstanding debt that was assigned to another party by a court order (e.g., divorce decree or separation agreement), and the creditor does not release the Borrower from liability, it may be excluded from the debt-to-income ratio if all of the following can be documented:

- Copy of the court order assigning the debt; and
- Proof of transfer of ownership.

The payment history of the debt need not be taken into consideration after the transfer date occurred.

Monthly Debt Obligations (continued)

Deferred Installment Debt

Loans deferred or in forbearance are always included in the loan qualification. If the credit report does not indicate the monthly amount that will be payable at the end of the deferment period, copies of the Borrower's payment letters or forbearance must be obtained to determine the monthly payment used for loan qualification.

Installment Debt

Installment debt that is not secured by a financial asset, including student loans, automobile loans, timeshares, and home equity loans, must be included in the Borrower's monthly debt obligations, if there are more than 6 months remaining. On a case-by-case basis, an installment debt with fewer than 6 monthly payments remaining should be considered as a recurring monthly debt obligation if it significantly affects the Borrower's ability to meet his or her monthly obligations.

Lease Payments

Lease payments must be included in the Borrower's recurring monthly debt obligations, regardless of the number of months remaining on the lease.

Loans Secured by Financial Assets

The Borrower may use his or her financial assets (life insurance policies, 401k accounts, individual retirement accounts, certificates of deposit, stocks, bonds, etc.) as security for a loan. The payment on this type of loan is not required to be included in the debt-to-income ratio provided the applicable loan instrument shows the Borrower's financial asset as collateral for the loan.

Mortgage Assumptions

When the Borrower sells a property and the property purchaser assumes the outstanding mortgage debt without a release or liability, the Borrower has a contingent liability.

The contingent liability (PITIA) does not need to be included in the debt-to-income ratio if verification that property purchaser has at least a 12-month history of making regular and timely payments for the mortgage is provided. The following documentation must be provided:

- Evidence of transfer of ownership;
- Copy of the formal, executed assumption agreement; and
- Credit report indicating that the consistent and timely payments were made for the assumed mortgage.

If timely payments for the most recent 12-month period cannot be documented, the mortgage payment must be included in the Borrower's recurring monthly debt obligations.

Monthly Debt Obligations (continued)

Open 30-day Charge Accounts	Open 30-day charge accounts with account balances are required to be paid off.
Other Real Estate Owned	Mortgage payments and related expenses on any non-income producing real estate must be included in the Borrower's recurring debt obligations. This includes mortgage payments and related expenses on any property which is currently pending sale (not closing prior to subject transaction), or a property retained as a second home or investment property. Consider the following: • Aggregate net negative rental income from all rental properties; and • Current rental payment (when Borrower is currently renting and purchasing a second home or investment). When the Mortgage Loan Application reflects the Borrower owns other real estate free and clear of mortgage liens or encumbrances, evidence is typically not required. However, under certain circumstances the underwriter may require documentation confirming the real estate is unencumbered. The Borrower must qualify with the applicable taxes, hazard insurance, Homeowners' Association dues/fees (if applicable), and any other related expenses, which must be documented.
Property Settlement Buy-Out	When the Borrower's interest in a property is bought-out by another co-owner of the property, the mortgage lender may not release the Borrower from liability under the mortgage, thus creating a contingent liability for the Borrower. This contingent liability does not need to be included in the debt- to-income ratio provided there is documentation to evidence the transfer of title of the property.
Revolving Charge / Lines of Credit	Revolving charge accounts and unsecured lines of credit are open-ended and should be treated as long- term debts and must be considered part of the Borrower's recurring monthly debt obligations. These tradelines include credit cards, department store charge cards, and personal lines of credit. If the credit report does not show a required minimum payment amount and there is no supplemental documentation to support a payment of less than five percent, use five percent of the outstanding balance as the recurring monthly debt obligation.

Monthly Debt Obligations (continued)

Student Loans

For all student loans, whether deferred, in forbearance, or in repayment (not deferred), the greater of the following to determine the monthly payment may be used as the borrower's recurring monthly debt obligation:

- 1% of the outstanding balance; or
- The actual documented payment (documented in the credit report, in documentation obtained from the student loan lender, or in documentation supplied by the borrower).

If the payment currently being made cannot be documented or verified, 1% of the outstanding balance must be used.

Exception: If the actual documented payment is less than 1% of the outstanding balance and it will fully amortize the loan with no payment adjustments, the lower, fully amortizing monthly payment may be used to qualify the borrower.

Voluntary Recurring Debts

Voluntary recurring debts should generally not be considered in the underwriting analysis or subtracted from gross income (401k contributions, 401k loans, union dues, commuting expenses, open accounts with zero balances, federal, state, and local taxes, or other voluntary deductions). Specific circumstances in an individual file must always be analyzed.

DEBT PAY OFF/PAY DOWN

Overview

Pay off or pay down of debt solely to qualify must be carefully evaluated and considered in the overall loan analysis. The Borrower's history of credit use should be a factor in determining whether the appropriate approach is to include or exclude debt for qualification.

- **Pay Off of Revolving Debt for Loan Qualification**
  Permitted if the revolving account is paid off as reflected on the final settlement statement. If the revolving account is not paid off, the debt must be included in the debt-to-income ratio.
- **Pay Off of Installment Debt for Loan Qualification**
  Permitted.
- **Pay Down of Revolving Debt for Loan Qualification**
  Not Permitted.
- **Pay Down of Installment Debt for Loan Qualification**
  Not Permitted.

If debts are being paid off or paid down, the source of funds must be documented and verified. If an installment debt is paid off at closing, the creditor must provide a payoff statement which same balance must be reflected as the payoff amount on the settlement statement. If the payoff or pay down of will impact the Borrower's ability to pay the mortgage during the months immediately after closing the payment must be included in the qualifying debt to income ratio.

EMPLOYMENT AND INCOME

Stability and Continuance of Employment and Income

Income may not be used if it comes from any source that cannot be verified, is not stable, or will not continue.

When analyzing a Borrower's employment record, the following must be examined:

- The Borrower's past employment record;
- Previous training and education; and
- The employer's confirmation of continued employment.

A minimum of two years employment history and continuance of income for three years is generally required for all Borrowers whose income is being used to qualify. Unless there is evidence that the income will no longer be received, conclude that the income will continue for three years.

If a Borrower's employment history includes unemployment, the application must reflect at least two years of employment, therefore covering a longer period of time. If the Borrower has less than a two- year history of receiving income, a written analysis justifying the determination that the income being used for qualification is stable must be provided.

Consider both the length of the Borrower's employment with any one employer and the stable and reliable flow of income. When evaluating a Borrower who has frequent job changes or unemployment, focus on whether the changes have affected the Borrower's ability to repay their obligations. If the Borrower provides documentation of a consistent level and type of income and the ability to pay his or her obligations despite changes in the source of that income, it can be presumed that the Borrower's income level is stable.

Known economic conditions, such as plant closings or company bankruptcies that may affect the Borrower's income, must be taken into consideration.

The amount of income claimed by the Borrower must be reasonable for the Borrower's position/job title, education, age, assets, and geographic location.

Special attention should be paid to the income feasibility by reviewing the credit report, credit profile and examining the bank statements for income/deposit patterns.

A level or upward trend in earnings must be established. Any decreases or significant increases could affect the stability of the Borrower's income and would require further analysis and a satisfactory explanation. If a satisfactory explanation cannot be provided, the income will be considered questionable and should not be used to qualify the Borrower.

Borrowers who change jobs for advancement and maintain a stable earning capacity and good credit history, as well as Borrowers with demonstrated job stability, will be eligible. Education or training to enhance job opportunities and income will receive favorable consideration. If a Borrower does not meet the employment history requirement for the two full years prior to the date of the Mortgage Loan Application, and was previously in school or the military, obtain copies of the Borrower's diploma/transcripts or discharge papers.

Employment and Income (continued)

Employment Gaps	The stability of employment and income and its likelihood of continuance should be factored into the underwriting decision when there are gaps of employment. Written letters of explanation for employment gaps over 30 days in the last two years must be provided. In addition, Borrowers who are reentering the work force after an extended absence may have stable employment if the following are met: • The Borrower has been employed in his or her current job for six months or more; and • A two-year work history prior to the absence from the workforce is documented.
Furloughed Borrowers	Borrowers in a state with an active furlough policy are not eligible.
Borrowers Planning to Retire During the First Three Years of New Loan	If any Borrower on the transaction discloses they will retire during the first three-year period the following must be considered in determining the Borrower's debt-to-income ratio: • Documented retirement benefits; • Social security payments; and • Other payments expected to be received in retirement.
Documentation Age	All employment and income documents must be dated no more than 120 days prior to the Mortgage Note date.
Documentation Standards	• Tax Information Authorization IRS Form 4506-C/Tax Transcripts • Paystubs • W-2s • Written Verification of Employment • Verbal Verification of Employment • Personal Tax Returns • Income Calculation Worksheet
Tax Information Authorization IRS Form 4506-C/ Tax Transcripts	All Borrowers whose income is used to qualify must sign and date a completed and unexpired IRS Form 4506-C at application, authorizing the originator or its assigns to obtain income information, with the exception of self-employed borrowers using only bank statement income documentation for qualifying. The form must not expire before a reasonable time to allow originator to process, if needed. In addition, the Borrowers must sign a new IRS Form 4506-C at closing to allow for possible post funding quality control processing, with the exception of self-employed borrowers using only bank statement income documentation for qualifying. Borrowers qualifying with bank statement income documentation and a secondary source of income such as second job wages or retirement income must provide an initial and final signed IRS Form 4506-C, which will be processed to validate secondary W2 and/or 1099 income.

Employment and Income (continued)

Tax Information Authorization IRS Form 4506-C/ Tax Transcripts (continued)

The IRS Form 4506-C must be processed and tax transcripts obtained to validate the Borrower's personal tax returns and/or W-2s for the most recent two years. Income derived from wages may be validated using W2 or 1040 transcripts. For self-employed borrowers, in the event that tax transcripts are not available or useful, using 12 months of bank statements would be acceptable. Evaluate the information provided by the IRS during the underwriting process. Significant differences must be reviewed, resolved and detailed comments provided regarding the resolution documented on the transmittal summary.

If a Borrower is not required to file last year's tax return and the source of income cannot be validated through the IRS Form 4506-C process, documentation supporting the lack of filing tax returns must be provided.

Paystubs

The paystubs must clearly identify the following:

- Borrower as the employee;
- Gross earnings for the current pay period and year-to-date earnings;
- Year-to date-earnings must cover the most recent 30-day period;
- Reflect pay period; and
- Employer name

If the Borrower is paid hourly, the number of hours must be noted on the paystubs. Paystubs must be dated no earlier than 30 days prior to the Mortgage Loan Application.

Paystubs must be computer generated or typed. If the employer does not provide acceptable computer generated or typed paystubs, the most recent year’s income tax return and W-2 is required.

Paystubs must not have any alterations.

Paystubs that are issued electronically, via e-mail or downloaded from the internet are acceptable and must income the following:

- Date and time printed
- Verbal verification of employment
- The documentation must also contain information identifying the place of origin and/or the author of the documentation, all of which must be confirmed on the verbal verification
- Documents downloaded directly from the internet to a Microsoft Word document or Microsoft Excel spreadsheets are not acceptable

Employment and Income (continued)

IRS Form W-2

- The W-2 must clearly identify the Borrower as the employee and the employer name
- Should be the employee copy provided by the employer
- W-2s must be computer-generated or typed
- W-2s must not have any alterations

Written Verification of Employment

Written verification of employment must contain the following information:

- Dates of employment
- Position
- Prospect of continued employment, when available
- Base pay amount and frequency, for employees paid on an hourly basis, the verification must state the hourly wages, including the number of hours worked each week
- Additional salary information, which itemizes bonus, overtime, tip, gratuity, or commission income, if applicable
- Written verifications of employment are not acceptable as standalone documentation to substantiate the Borrower’s current employment/income

If a verification of employment is used, mail directly to the employer to the attention of the personnel department. Verifications of employment should never be mailed to a post office box or to an individual's attention. If the Borrower indicates this is necessary, the file must contain verification that the employer was independently contacted and verified this requirement. The return address on the verification must be the lender's address. The hand carrying of verifications is strictly prohibited.

- Written verification of employment as a standalone documentation is not acceptable.

Employment and Income (continued)

Verbal Verification of Confirmation of Employment

A verbal verification to confirm the Borrower's current employment status is required for all Borrowers within 10 business days from the Mortgage Note date (or Funding Date for escrow states) for wage income and verification of the existence of the Borrower's business through a third-party source within 30 calendar days for self-employment income.

If the Borrower is in the military, a military leave and earnings statement dated within 30 calendar days of closing is acceptable in lieu of a verbal verification.

If using a third party service to verify employment (e.g. LexisNexis) the following policy applies:

- Request to third party must be within 10 Business Days of the Mortgage Note date (or Funding Date for escrow states).
- Employment verification between employer and third party must be within 45 calendar days of the Mortgage Note date.

To comply with a verbal verification of employment (or telephone confirmation) requirement, independently obtain the phone number and address for the Borrower's employer.

Verbal Verification of Employment Requirements

A verbal verification of employment must contain the following information:

- Date of contact;
- Borrower's date of employment;
- Borrower's employment status and job title;
- Name, phone number, and title of individual contacted at entity;
- Name of the entity contacted;
- Name and title of associate contacting employer; and
- Method and source used to obtain the phone number

Self-Employed Confirmation of Employment Requirements

Verification of the existence of a self-employed Borrower's business must meet one of the following:

- Verification of the existence of the Borrower's business from a third party, such as a CPA, regulatory agency, or the applicable licensing bureau.
- Verification of the listing and address for the Borrower's business using a telephone book, the internet, or directory assistance.
- If contact is made verbally with a third party, document the source of the information obtained and the name and title of associate.

Employment and Income (continued)

Tax Returns

The following standards apply when using personal tax returns to verify income:

Personal Tax Returns must be:

Complete with all schedules and W-2s, 1099s, K-1 schedules, etc signed and dated Borrower's copy filed with the IRS

Business Tax Returns must be:

Complete with all schedules Signed and dated Borrower's copy filed with the IRS

Tax Returns Filed Prior to the Mortgage Loan Application Date

Tax returns filed prior to application are acceptable for underwriting purposes. Both the original filed return and the amended return are required. If the file was amended 60 days or less prior to the application, evidence of payment must also be provided.

Tax Returns Filed After the Mortgage Loan Application Date

Tax returns filed after the Mortgage Loan Application date may be acceptable when accompanied by the following:

- A letter of explanation regarding the reason for the re-file;
- Evidence of filing;
- Payment and the ability to pay the tax if the check has not been cancelled; and
- Confirmation that Borrower does not require use of amended income for qualification

Closely examine the original tax return and the amended tax return for consistency with previous filings to determine whether the use of the amended return is warranted. If the Borrower requires the amended income for qualification, an exception must be submitted and approved for the use of the amended income. A copy of the original and amended tax returns must be submitted with the exception. When using an amended return after application, the underwriter must provide justification and commentary on the transmittal summary regarding its use.

Income Analysis Forms

The following income analysis forms are acceptable

- Cash Flow Analysis (Fannie Mae Form 1084)
- Income Analysis (Freddie Mac Form 91)
- MGIC SAM

Note income calculation comments on the transmittal summary (Fannie Mae Form 1008/Freddie Mac Form 1077) or similar form.

Employment and Income (continued)

INCOME TYPES

Overview

- Wage Earners
- Bonus or Overtime
- Commission
- Self-Employed Income
- Rental Income

Wage Earner

Wage earners receive a consistent wage or salary from an employer in return for a service rendered and have less than 25 percent ownership interest in the business. Compensation may be based on an hourly, weekly, biweekly, monthly, or semimonthly basis.

If the Borrower's earnings are regular, use the monthly gross income to qualify. If a Borrower's hours fluctuate, average the past two years plus year-to-date earnings.

All of the following income documentation is required

- Most recent paystub(s);
- Most recent two years W-2s;
- Verbal verification of employment; and
- W-2 Tax transcripts for the most recent two years

Second Job or Multiple Job Employment

A Borrower must have at least two years, uninterrupted history on all second or multiple jobs in order to include the income for qualification purposes. If this income is received for less than two years, it may be considered as a Compensating Factor only.

Income will be averaged over the past 24 months. All of the following documentation is required:

- Most recent paystub(s);
- Most recent two years W-2s;
- Verbal verification of employment; and
- W-2 Tax transcripts for the most recent two years

Income Types (continued)

Bonus or Overtime

Bonus or overtime income is compensation in addition to an employee's straight salary or hourly wage. Bonus or overtime will be accepted if it has been received for at least two consecutive years.

All of the following income documentation is required:

- Most recent paystub(s);
- Most recent two years W-2s;
- Verbal verification of employment; and
- W-2 Tax transcripts for the most recent two years

This amount must be averaged unless declining, and then the most recent 12 months will be averaged.

Commission

Commission income is defined as a fee or percentage paid to an employee for performing a service and may be accepted as stable income if the income has been received for at least two consecutive years.

Originator must document that the income has been received for the past two years and validate from the employer that the commission income is likely to continue. If the income is unlikely to continue it may not be used in qualifying.

If commission income represents 25 percent or more of the Borrower's total annual income, document with all the following:

- Most recent paystub(s);
- Most recent two years W-2s;
- Verbal verification of employment; and
- W-2 transcripts for the most recent two years

This amount must be averaged over the most recent two years unless declining, and then the most recent 12 months will be averaged.

SELF-EMPLOYED INCOME

Self-Employed Income Analysis

A self-employed Borrower is an individual who has 25 percent or greater ownership interest in a business or receives 1099s to document income. Some examples of self-employed individuals include contract workers, real estate agents, or individuals relying on investments as their primary source of income.

Evidence that the Borrower has at least two consecutive years of self-employment operating the same business in the same location is required to demonstrate income stability.

Self-employed Borrowers relocating to a different geographic area must document and explain the reasoning that their income will continue at the same level at the new location. Consider the acceptance of the company's service or products in the marketplace before considering the income for qualifying purposes. Document and explain how the Borrower's income will continue at the same level in the new location.

When a Borrower uses funds for closing costs or reserves (as applicable) from their self-employed business, the impact must be considered in the analysis of the business. See Assets chapter for more information.

A level or upward trend in earnings must be established. Significant increases could affect the stability of the Borrower's income and would require a satisfactory explanation and documentation that the increase is stable and likely to continue at the level. Significant decreases in income cannot be included in the average using a previous higher income level unless there is following documentation:

- A one-time occurrence prevented the Borrower from working or earning full income for a period of time
- Proof that the Borrower is back to the income amount that they previously earned

Self-Employed Income (continued)

Documentation Requirements

All of the following income documentation is required:

- Most recent two years personal tax returns with all schedules;
- Most recent two years business income tax returns (with exception to sole proprietorships); and
- For corporations, "S" corporation, or partnership a year to date profit and loss statement and balance sheet required
- 1040 Tax transcripts for the most recent two years

This amount must be averaged based on the number of years tax returns required unless declining, and then the most recent 12 months will be averaged.

For self-employed borrowers, the underwriter may utilize the prior 12 months of bank statements to qualify income.

The underwriter may request additional information such as business license, profit and loss statement and/or balance sheet if it is necessary to further support the determination of the stability of the Borrower's income.

If any of the Borrowers on the loan transaction are self-employed and the self-employment income is not used to qualify, the first page of the most recent personal tax return must be obtained to determine whether there is a meaningful business loss. Additional documentation may be requested in order to fully evaluate the impact of the business loss on the income used for qualifying.

Bank Statement Documentation

Self-employed borrowers are eligible for either Personal Bank Statement Documentation or Business Bank Statement Documentation. Multiple bank accounts may be used, but a combination of business and personal is prohibited. The following restrictions apply to both documentation types:

- 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.
- Non-Permanent Resident Aliens and 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.
- 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.

Self-Employed Income (continued)

Bank Statement Documentation (continued)

- 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.

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

The following documentation is required:

- 12 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)

Self-Employed Income (continued)

Bank Statement Documentation (continued)

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 calendar 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 months
- Transfers between personal accounts should be excluded
- Transfers from a business account into a personal account are acceptable

Calculating Qualifying Income

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

- Personal Bank Statement Average (total deposits [minus any disallowed deposits] / 12 months)

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:

- 12 months complete business 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.
- 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

Self-Employed Income (continued)

Bank Statement Documentation (continued)

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

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.

Self-Employed Income (continued)

Bank Statement Documentation (continued)

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 months of statements provided to determine a gross deposit number as follows:

Multiply Gross deposits by the default expense factor to determine a net deposit number. Divide the net deposit number by 12 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.

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.

Self-Employed Income (continued)

Bank Statement Documentation (continued)

- 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.

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

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.

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

RENTAL INCOME

Overview

Rental income for qualification purposes may be derived from one of the following sources:

- Owner occupied property (two-to-four unit);
- Investment property (one-to-four-unit);
- Other than subject property; or
- Proposed rental income

When multiple sources of documentation are provided to verify rental income, the lowest calculated rental income will be used for qualification.

Short-term rental income from single-family residences in known vacation locations is acceptable income for investment properties. The Operating Income Statement is required. A short-term lease agreement is not acceptable documentation. Short-term/seasonal rental income from second homes cannot be used to qualify.

When rental income is not being used to qualify the Borrower, the fair market rent of each unit must still be obtained. Provide one of the following to evidence the fair market rent:

- Operating Income Statement;
- Comparable Rent Schedule;
- Fair market rent letter from a realtor;
- Current fully executed lease agreement; or
- Verbal confirmation from Borrower noted on Mortgage Loan Application or transmittal summary

Rental Income (continued)

Treatment of Income	Any monthly net rental income must be added to the Borrower's total monthly income. Any net rental loss must be added to the Borrower's total monthly obligations If total debt (PITIA) for the subject property is used in the Borrower's debt-to-income ratio (and not using rental income to qualify), rental income must still be reported on the Mortgage Loan application.
Rental Income Calculation and Documentation	For existing investment properties and 2-4 unit primary residences owned prior to the most recent tax filing, the most recent tax return is required to document rental income. Any depreciation, interest, taxes, and insurance must be added back in the cash flow analysis before subtracting the PITIA payment, to avoid double-counting the expenses. 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. If using the lease agreement, net rental income is 75 percent of the gross rent from the lease agreements, with the remaining 25 percent being absorbed by vacancy losses and ongoing maintenance expenses.
Reporting Rental Income	The monthly rental income and number of bedroom data must be provided for primary residences (two-to- four units) and investment properties (one-to-four units). These figures are commonly found on the Operating Income Statement. If the Operating Income Statement is not required, ask the Borrower what the current rent or approximate projected rent is for each unit, the number of bedrooms in each unit, and note it on the uniform residential loan application or the comment section of the transmittal summary.

OTHER INCOME SOURCES

Overview

Other sources of income are described in detail below. If used to qualify the Borrower, document a history of regular receipt and the probability of continuance for at least three years.

- Alimony, Child Support and Maintenance Payments
- Auto Allowances and Expense Account Payments
- Capital Gains and Losses
- Employment by a Relative, Property Seller, or Real Estate Broker
- Foster Care Income
- Housing or Parsonage Allowance
- Interest and Dividend Income
- Military Income
- Non-taxable Income
- Note Income
- Permanent Disability
- Public Assistance
- Retirement, Pension, Annuity, and IRA Distributions
- Royalty Payments
- Seasonal Income
- Social Security Income
- Teachers
- Temporary Leave
- Tip and Gratuity Income
- Trust Income
- Unemployment Benefits Income
- Union Members
- VA Benefits

Alimony, Child Support and Maintenance Payments

Alimony, child support and maintenance income will be considered when based on a divorce decree, court ordered separation agreement, court decree, or another legal agreement provided the payment terms confirm that the income will continue for at least three years. If the age of the child is not clearly defined, additional confirmation must be obtained to document the age of the child and income continuance.

When determining the acceptability of this income, the Borrower's regular receipt of the full payment due and any limitations on the continuance of the alimony (duration over which the alimony is required to be paid) must be taken into consideration. If a Borrower who is separated does not have a court order that specifies alimony, proposed or voluntary payments should not be considered as stable income.

Other Income Sources (continued)

Alimony, Child Support and Maintenance Payments (continued)

Income may be considered stable with documentation evidencing that the Borrower has been receiving full, regular, and timely payments for the past twelve months. If the Borrower has been receiving full, regular, and timely payments for six to twelve months, the income may be used for qualification, as long as it does not represent more than 30 percent of the total gross income.

Income may not be considered stable when a Borrower has been receiving full, regular, and timely payments for less than six months or has been receiving full or partial payments on an inconsistent or sporadic basis. This income may be used as a Compensating Factor only.

One of the following types of income documentation is required:

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

In addition, one of the following is required to document regular receipt of the full payment based the number of months of the income is being used to qualify as described above:

- Court records;
- Most recent personal tax returns with all schedules;
- Bank statements or deposits slips showing regular deposit of funds; or
- Cancelled checks

Auto Allowances and Expense Account Payments

Automobile allowances will be considered stable income for a Borrower who has been receiving the income for the past two years, provided all associated business expenditures are included in the calculation of the Borrower's total debt-to-income ratio.

Either an actual cash flow approach or an income and debt approach may be used to calculate the income.

Actual Cash Flow Approach

When the Borrower files an IRS Form 2106, the actual cash flow approach should be used. Any funds in excess of the Borrower's monthly expenses are added to the Borrower's monthly income.

When the Borrower uses IRS Form 2106 and recognized actual expenses instead of the standard mileage rate, look at the actual expenses section to identify the Borrower’s actual lease payments, and then make the appropriate adjustments.

If a Borrower elected to use a standard mileage deduction instead of taking the actual cash expenditure for auto expenses when he or she completed their personal tax return, an add-back can be used for qualification purposes.

Other Income Sources (continued)

Income and Debt Approach

When the Borrower does not report the allowance on IRS Form 2106, the income and debt approach should be used. The full amount of the allowance is added to the Borrower's monthly income. The full amount of the lease or financing expenditure for the automobile must be added to the Borrower's total monthly obligations.

Capital Gains & Losses

A capital gain or loss is generally a one-time transaction; and, therefore, should not be considered as either a gain or loss in determining income. However, if the Borrower has a constant turnover of assets that produces regular gains and losses, the capital gain or loss may be considered (e.g., a person who buys old automobiles, restores them, and sells them for profit). If the Borrower has operated in this manner over a sustained period, an average of gains or losses may be developed, as long as the Borrower provides evidence that he or she owns additional property or assets that can be sold if extra income is needed to make future mortgage payments.

Personal tax returns must be reviewed to get an accurate picture of the average earnings from this source. For example, an asset sold during the year might be an income-generating asset, resulting in a reduction in future income after the sale.

All of the following income documentation is required:

- A minimum of the most recent two years personal tax returns with all schedules. In some cases, additional year’s tax returns may be required
- Evidence of ownership of additional property or assets

Employment by a Relative, Property Seller or Real Estate Broker

A Borrower employed by a family member or employed by a family-held business, property seller or real estate broker is eligible. If employed by a relative, the business accountant must verify that the Borrower is not self-employed by indicating his or her percentage of interest in the business. The accountant must be a disinterested third party.

All of the following income documentation is required:

- Most recent paystub(s);
- Most recent two years W-2s;
- Most recent two years personal tax returns; and
- Letter from disinterested CPA to validate ownership percentage

Foster Care Income

One of the following types of income documentation is required:

- Letter from organization providing the income; or
- Copies of deposit slips or bank statements confirming regular payments

Foster care income may be considered stable with documentation evidencing that the Borrower has been receiving the income for less than two years but at least 12 months and the income does not represent more than 30 percent of the total gross income.

Other Income Sources (continued)

Housing or Parsonage Allowance

A non-military housing or parsonage allowance may be considered qualifying income, if the income has been received for the most recent 12 months. The housing allowance may not be used to offset the monthly housing payment.

All of the following income documentation is required:

- Written verification of employment, letter from employer, or paystubs reflecting the amount of the housing or parsonage allowance;
- Terms under which the housing or parsonage allowance is paid; and
- Proof of receipt of housing allowance for most recent 12 months

Interest & Dividend Income

A two-year average of interest and dividend income may be used to qualify if supported by sufficient assets after closing to support continuance of the interest or dividend income for at least three years. The asset providing the interest and dividend income may not be liquidated for cash to close unless that portion used is deducted and the interest and/or dividend amount is recalculated based on the unused portion of the asset.

Evidence of sufficient assets after closing to support continuance of the interest and/or dividend and one of the following types of income documentation is required:

- Most recent two years personal tax returns with all schedules;
- Most recent 2 months personal bank statements; and
- Most recent two years 1099s

This amount must be averaged unless declining, and then the most recent 12 months will be averaged.

Military Income

Military personnel may be entitled to different types of pay in addition to their base pay. Hazard or flight pay, rations, clothing allowance, quarters allowance and proficiency pay may be counted as income if they are verified as regular and continuous.

Reserves or National Guard

Not Called to Active Duty

Military reservists who have not been called to Active Duty may use their military reserve income to qualify, as long as they can provide a two-year history of receiving that income.

Called to Active Duty

If (i) one of the Borrowers is on Active Duty or has been called to Active Duty after the Mortgage Loan Application has been made, (ii) the Mortgage Loan is in process, and (iii) such Borrower wants to refinance his or her primary residence, which the family does not currently occupy, the Borrower must comply with the following:

- The Borrower must certify that the subject property is his or her primary residence;

Other Income Sources (continued)

Reserves or National Guard (continued)

- The subject property must be vacant, will remain vacant and will again be the Borrower's primary residence when the temporary assignment is completed;
- The Borrower must certify that he or she will return to the subject property as his or her primary residence upon completion of the temporary assignment; and
- The Borrower must provide documentation regarding the temporary assignment (orders supporting the assignment including duration)

Non-Taxable Income

Generally, income is taxable unless it is specifically exempted by law. Non-taxable income may be shown on the Borrower's tax return but is not taxed. Verify and document that the particular source of income is non-taxable. Documentation that can be used for this verification includes award letters, policy agreements, account statements, or any other documents that address the non-taxable status of the income.

If the income is verified as non-taxable, and the income and its tax-exempt status are likely to continue, develop an adjusted gross income for the Borrower by adding an amount equivalent to 25 percent of the non-taxable income to the Borrower’s income.

Filing requirements for most taxpayers can be found on the IRS website.

Note Income

Ongoing revenue received from Mortgage Note income may be eligible for loan qualification. Verification that the income can be expected to continue for a minimum of three years is required. Obtain a copy of the Mortgage Note documenting the amount, frequency and duration of payments. One of the following types of income documentation must be provided for the most recent two years:

- Most recent personal tax returns with all schedules; or
- Bank statements showing regular deposits of funds

Other Income Sources (continued)

Permanent Disability

Disability benefit payments (Social Security disability insurance benefits, maternity/parental benefits or Veterans disability compensation benefits, etc.) may be treated as acceptable, stable income, unless the terms of the disability policy specifically limit the stability or continuity of the benefit payments. A review date on a Social Security award letter for disability is not considered a defined expiration date. Confirm the Borrower's current eligibility for the disability benefits by obtaining a statement from the benefit's payer (insurance company, employer, or other qualified and disinterested party).

In cases where the income does not have a defined expiration date, the income may be considered stable, predictable, and likely to continue. The Borrower will not be required to provide additional documentation evidencing continuance of the income.

Public Assistance Program

Public Assistance (e.g., Temporary Assistance for Needy Families (TANF)) may be considered as acceptable income provided the income has been received for the last two years and is expected to continue for the next three years. See the Seasonal Unemployment section for details regarding the use of unemployment income.

All of the following income documentation is required:

- Letters or exhibits from the paying agency establishing the amount, frequency and duration of these payments; and
- Documentation of a two-year history of receipt of income

Retirement, Pension, Annuity Income and IRA Distributions

Retirement and pension income may be used to qualify provided evidence of three years continuance of monthly annuity payment, 401(k), or IRA monthly distribution is documented. Evidence of continuance of corporate, government, or military retirement/pension need not be documented.

The following types of income documentation is required:

- Letters from the organizations providing the income;
- Copy of award letter;
- Most recent personal income tax returns with all schedules;
- Most recent 1099; or
- Bank statements for the most recent two months showing deposit of funds

Royalty Payments

Ongoing income received from royalty payments, such as income from a work paid to its author or composer may be eligible for loan qualification. Verification that the income can be expected to continue for a minimum of three years is required. Due to fluctuating payments, income will be averaged over two years, based on the following income documentation is required:

- Most recent two years personal tax returns with all schedules, including the related Supplemental Income and Loss Schedule (Schedule E); and
- Evidence of receipt of at least 12 months must be documented

Other Income Sources (continued)

Seasonal Income

Seasonal part-time or seasonal second job employment may be acceptable if the Borrower has worked the job for two years. Due to these fluctuations, income will be averaged over the past two years based on all of the following income documentation:

- Most recent paystub(s), if available;
- Most recent two years W-2s or personal tax returns with all schedules; and
- Written confirmation from the Borrower's employer that there is a reasonable expectation that the Borrower will be rehired for the next season

If income received cannot meet these requirements, it should only be considered a Compensating Factor.

Social Security Income

Social Security income may be used to qualify with documented evidence of three years continuance of survivor and supplemental payments. If the benefits have a defined expiration date, confirm that the remaining term is at least three years from the application date and that the income will not diminish for any reason.

Evidence of continuance of Social Security retirement income need not be documented. One of the following types of income documentation is required:

- Copy of the Social Security Administration award letter;
- Most recent personal tax returns with all schedules;
- Most recent 1099s; or
- Most recent 2 months bank statements

Teachers

When a Borrower is employed as a teacher, the annual salary must be verified. If monthly or weekly base pay is provided, the employer must verify the number of pay periods per year if the payout is not clear or average the income based on the most recent W-2 over 12 months. Stipends or supplemental income must be documented as regular and continuous.

For teacher income paid over a 10-month period and obtaining financing during the summer months when income is not being received, the following documentation is required:

- Final year-end paystub from the school
- Verbal verification of employment; and
- Copy of fully executed, guaranteed contract, with no contingencies, indicating that the Borrower is paid over a 10-month period

Qualify the Borrower based on the income received on the final year-end paystub.

Other Income Sources (continued)

Temporary Leave	Benefits that have a defined expiration date must have a remaining term of at least three years from the date of the mortgage application in order to be used for loan qualification. Leave ceases being temporary when the Borrower does not intend to return to their current employer or does not have a commitment from the current employer to return to employment. If a Borrower is currently receiving short-term disability benefits that will decrease to a lesser amount within the next three years because they are being converted to long-term benefits, the long-term benefits must be used as qualifying income. During a temporary leave, a Borrower's income may be reduced and/or completely interrupted. It must be determined that during and after temporary leave, the Borrower has the capacity to repay the mortgage and all other monthly obligations.
Return to Work Prior to First Mortgage Payment	Use regular employment income that will be received prior to leave to qualify.
Return to Work after First Mortgage Payment	Use the lesser of the leave income or regular employment income. If the leave income is less than regular employment income: • Supplement with available liquid reserves; • Total qualifying income may not exceed the gross monthly income received upon return to work; and • Assets required to support the payment may not be counted towards available reserves The following documentation is required: • Verification of pre-leave regular income and employment history; • No evidence or information from employer indicating Borrower does not have the right to return to work after leave period; • Written confirmation of intent to return to work and agreed upon date of return are both evidenced by documentation by the employer (or third party service); • Verbal verification of employment; the Borrower is considered employed if the employer confirms the Borrower is currently on temporary leave; • Amount and duration of Borrower’s temporary leave income; • Amount of regular employment income the Borrower received prior to leave; and • All available liquid assets used to supplement the reduced income for the duration of leave must be verifiable

Other Income Sources (continued)

Tip and Gratuity Income

Tip or gratuity income is considered compensation in addition to an employee's regular wages. An average of the tip income may be used to qualify if the Borrower has received it for the last two years and it is likely to continue.

All of the following income documentation is required:

- Current paystub(s);
- Most recent two years W-2s; and
- Employer indication that the tip income is likely to continue

Trust Income

Confirm trust income and its continuance for at least three years by obtaining a copy of the trust agreement or trustee statement to document the following:

- Total amount of designated trust funds;
- Terms of payment;
- Duration of trust; and
- What portion, if any, of income to Borrower is not taxable

If the trust agreement or trustee's statement does not provide the historical level of distributions, one of the following must be provided:

- Most recent personal tax returns with all schedules;
- K-1 schedule; or
- 1041 fiduciary tax returns

A Borrower's trust income may be taxed at a lower rate or it may be part of a partnership that writes off losses, which may result in no tax liability. Trust income is reported on the 1041 fiduciary income tax return, which includes a K-1 schedule. All beneficiaries of trust income receive IRS Form K-1 from the trust.

Unemployment Benefits

Unemployment benefits, such as those received by seasonal workers, must have been received for the past two years and is predictable and likely to continue. Due to fluctuations in income, this amount will be averaged over the past two years based on all of the following income documentation:

- Most recent two years personal tax returns with all schedules; or
- Income must be clearly associated with seasonal layoffs and expected to recur

Other Income Sources (continued)

Union Members

Union members may hold several jobs during a year. Verification of income for a union member requires all of the following documentation:

- Verbal verification of employment from union confirming:
  - Borrower is in good standing with union; and
  - Borrower is employed by same employer issuing paystub and income used for qualification. If the union cannot provide confirmation, a verbal verification of employment with present employer is required
- Current paystub(s) from present employer. If there has been more than one employer in the current year, the last paystub from each employer will be required to adequately reflect year-to- date earnings
- Most recent two years personal tax returns with all schedules and all W-2s.

Due to fluctuations in income, income will be averaged over the past 24 months, unless the income has declined and then the most recent 12 months will be averaged.

VA Benefits

VA Benefits income may be used to qualify provided evidence of regular receipt and continuance. A letter or distribution form from the Veteran's Administration is required to document VA benefits income.

APPRAISAL TYPES

Appraisal Type	Regardless of type, each appraisal will provide the detail to evaluate the following: • Adequate support for the value of the Mortgaged Property; • Present and future marketability of the Mortgaged Property • Completeness and correctness of the appraisal forms and exhibits; • Applicability and timeliness of data used to determine marketability; and • Consistency, logic and accuracy of the appraisal
Retail Appraisal Type	For loans ≤ $150k: • A desktop appraisal with exterior inspection*, • A 2055 Drive-By appraisal, or • A prior appraisal report dated within 12 months of the settlement date plus Voxtur RACR (Retrospective Appraisal Credibility Report) desktop review or Consolidated Analytics CCA (Consolidated Collateral Analysis) desktop review. For loans > $150k: A full appraisal report with an interior inspection is required. HPML loans require an interior inspection, unless the Loan Amount is ≤ $74,599 <u>and</u> the loan is QM exempt (APR < APOR + 6.5%) *Acceptable products for desktop appraisal with exterior inspection are: • Single-family: Voxtur HVR or Consolidated Analytics CAPI (Consolidated Appraisal with Property Inspection) • 2-4 Units: Voxtur MVP Multifamily Exterior Report
Wholesale / Correspondent Appraisal Type	A full appraisal report with an interior inspection is required.
Age of Appraisal	Properties must be appraised within the 120 days that precede the date of the note and mortgage.
Eligible Property Types	• One-Unit Single Family Residences (SFRs - Attached and Detached) • 2-4 Unit properties • Townhomes • PUDs (Attached and Detached) • Condominiums (Fannie Mae Warrantable - Low and High Rise, established projects only)

Appraisal Types (continued)

Ineligible Property Types

- Investment Condominiums
- Co-ops
- Condotels
- Non-Warrantable Condominiums
- Manufactured Homes
- Mobile Homes
- Unique Properties
- Log Homes
- Working or income producing Farms
- Properties with active oil, gas, or mineral drilling, excavation, etc.
- Non-Conforming zoning regulations that prohibit rebuilding
- Hawaiian properties in lava zones 1 and 2
- State-approved medical marijuana producing properties.

Appraisal Review

The appraisal information must provide a logical basis for evaluation. The appraiser must present a concise picture of the neighborhood, site, and improvements to support an indicated value. Value must be supported by three comparable sales of a similar nature. The sales comparison approach must adequately support the estimate of market value. Originator must determine that the appraiser has adequately supported his or her opinion of the Mortgaged Property's value.

When reviewing the appraisal; the underwriter completes an analysis including, but not limited to:

- The appraisal report to ensure that the report is of professional quality and is prepared in a way that is consistent with industry appraisal standards.
- The Mortgaged Property based on the appraisal.
- The Mortgaged Property's acceptability as security for the Mortgage requested in view of its value and marketability.
- The current offering or listing for sale, if applicable.
- The current ownership for the Mortgaged Property
- The sale or transfer history of the Mortgaged Property, and comparable sales
- The sales of the Mortgaged Property and the sales price trend in relation to the appraiser's opinion of value to confirm that they are reasonable and representative of the market

TRANSFERRED APPRAISALS

Transferred Appraisals

Transferred appraisals are permitted with proof the transferred appraisal complies with Appraiser Independence Requirements (AIR) and CMS obtains a copy of the Voxtur RACR (Retrospective Appraisal Credibility Report) desktop review or Consolidated Analytics CCA (Consolidated Collateral Analysis) desktop review.

End of Policy

REVISION SUMMARY

Date	Version	Description of Change
04/09/24	3.1	• Updated **Retail Appraisal Type** to add Consolidated Analytics requirements • Added **Wholesale/Correspondent Appraisal Type** - A full appraisal report with an interior inspection is required. • Revised **Transferred Appraisals** to add Consolidated Analytics CCA (Consolidated Collateral Analysis) desktop review allowed.
03/15/24	3.0	Revised **Existing First-Lien Restrictions** to remove CMS-originated Non-Agency First Liens are ineligible.
03/04/24	2.9	• Revised **Existing First-Lien Restrictions** to remove senior lien must be currently of previously serviced by CMS, senior liens never serviced by CMS are ineligible. • Revised **Debt Pay Off/ Pay Down** to remove the requirement to close the account if paid off for qualifying.
01/29/24	2.8	• Revised **Ineligible States** to add New Jersey. • Added **Transferred Appraisals** requirements.
01/10/24	2.7	• Revised **Tax Information Authorization IRS Form 4506-C/Tax Transcripts** to remove requirements when transcripts are unavailable or not returned due to IRS IVES processing delays. • Revised **Eligible Property Types** to add Townhomes.
08/09/23	2.6	• Revised **Borrower Types** to add clarification that transferring title from a trust to the borrower as a natural person requires 6 months title seasoning. • Revised **Bank Statement Documentation** to clarify Multiple bank accounts may be used, but a combination of business and personal is prohibited.
04/17/23	2.5	Revised **Commission** to remove the references to tax returns which are no longer required for commission income.
03/17/23	2.4	Revised **Credit Report Requirements** to remove requirements for old credit reports.
02/21/23	2.3	Revised **Ineligible States** to add Massachusetts, New York, and North Dakota.
01/11/23	2.2	• Revised **Business Bank Statements** to correctly list “business” bank statements (formerly incorrectly listed as personal bank statements) • Revised **Appraisal Type** to update HPML loan threshold to $74,599 for 2023.
11/29/22	2.1	• Revised **Loan Terms** to add assumption requirements. • Added new **Assumption of Existing 1st Lien** requirements. • Revised **Mortgage Loan Application** to add assumption requirements. • Revised **Existing First-Lien Restrictions** to add “Senior lien must be currently or previously serviced by CMS, senior liens never serviced by CMS are ineligible.” • Revised **Owner and Encumbrance Report** to add “**Effective Date**: The Owner & Encumbrance report must not exceed 90 days at the time of funding. The E&O Insurance Policy must be unexpired at the time of funding.” • Revised **Eligible Transaction Types** to add assumption requirements. • Revised **Ineligible Transaction Types** to add assumption requirements.
10/11/22	2.0	• Revised **Payment History** to update seasoning requirements on modifications post forbearance. • Revised **Housing Payment History** to update mortgage payment history requirements. • Revised **Significant Derogatory Credit** table to refer to CARES Act exceptions listed in Housing Payment History.

Revision Summary (continued)

Date	Version	Description of Change
10/04/22	1.9	• Revised **Documentation Age** requirements • Revised **Selection and Validation of Credit Score** requirements. • Revised **Tax Information Authorization IRS Form 4506-C/ Tax Transcripts** requirements. • Revised **Employment and Income > Documentation Age** to 120 days. • Revised **Commission** documentation requirements.
09/07/22	1.8	Added **Ineligible States** – Texas. • Revised **Rental Income Calculation and Documentation** requirements.
08/31/22	1.7	• Added requirements for **Age of Appraisal** (Properties must be appraised within the 120 days that precede the date of the note and mortgage).
07/29/22	1.6	• Revised **Tax Information Authorization IRS Form 4506-C/ Tax Transcripts** to add VOI requirements when transcripts are unavailable or not returned due to IRS IVES processing delays. • Revised **Appraisal Type** to update interior inspection requirements for HPML loans.
07/28/22	1.5	• Revised **Consumer Credit Counseling** to add “participated” in counseling. • Revised **Tax Information Authorization IRS Form 4506-C/ Tax Transcripts** to use 12 months of bank statements (was 24 months) if transcripts are not available. • Revised **Personal Bank Statements** to remove the Prime Advantage FICO/LTV restrictions and references to 24 months bank statements. • Revised **Appraisal Type** to add for 2-4 Units. Voxtur MVP Multifamily Exterior Report is an acceptable product for desktop appraisal with exterior inspection.
07/08/22	1.4	• Revised **Selection and Validation of Credit Score**. • Revised **Pay Off of Revolving Debt for Loan Qualification** requirements. • Deleted **Non-Reimbursed Business Expenses** requirements. • Revised **Commission** requirements. • Revised requirements for **Appraisal Type** for loans less than or equal to $150k.
06/28/22	1.3	• Revised **Existing First-Lien Restrictions** to add CMS-originated Non-Agency First Liens are ineligible. • Added **Other Subordinate Financing** requirements. • Removed **Simultaneous Transactions** due to conflicts with Ineligible Transaction Types.
06/15/22	1.2	• Revised **Debt to Income** to 50% (was 45%). • Revised **Housing Payment History** seasoning to add "Minimum of 12 months seasoning on a CARES ACT modification post forbearance" and "Verification of Rent (VOR) from verifiable company" • Removed **Home Equity Lines of Credit** requirements. • Revised **Self-Employed Income** to add "For self-employed borrowers, the underwriter may utilize the prior 12 months of bank statements to qualify income." • Revised **Other Income Sources** to remove Borrower Qualification requirements.
06/06/22	1.1	Added requirements for **Existing First-Lien Restrictions**.
06/06/22	1.0	New document.