UNDERWRITING GUIDELINES

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UNDERWRITING GUIDELINES

OVERVIEW

Each file must be underwritten in compliance with the applicable underwriting guidelines in this Guide and all applicable governing statutes and regulations as amended including, but not limited to the following:

- **Equal Credit Opportunity (Reg B)**
- **Consumer Credit Protection Act**
- **Fair Credit Reporting Act**
- **Truth in Lending (Reg Z)**
- **Real Estate Settlement and Procedures Act (RESPA – Reg X)**
- **Home Mortgage Disclosure Act (Reg C)**
- **Home Ownership and Equity Protection Act**
- **PATRIOT Act**

You may not discriminate against applicants on the basis of race, religion, national origin, sex, marital status, age (provided the applicant has the ability to enter into a binding contract) or because all or part of the applicant's income is derived from any public assistance.

The Correspondent is responsible for originating conventional mortgage loans in compliance with current Freddie Mac/Fannie Mae guidelines. MSHA, FHA-insured, RD, and VA-guaranteed mortgage loans must conform to corresponding underwriting guidelines.

DOCUMENTATION OVERVIEW

The Automated Underwriting System (AUS) indicates the minimum level of documentation acceptable for a conventional secondary market loan. The loan file must contain the level of documentation required. If any information changes during the processing of a loan application that requires resubmission to AUS, it must comply with the updated requirements from the resubmission.

AGE OF DOCUMENTS

Date requirements for employment, income, source of funds and payment history (other than credit reports)

Verifications of employment, income, source of funds and payment history must be made within 120 days before the Note Date. Any verification not meeting this requirement must be re-verified through updated, written documentation. Verifications made after the Note Date are not acceptable.

Date requirements for credit reports

All credit reports used in conjunction with the Automated Underwriting Systems must be dated no more than 120 days before the Note Date.

UNDERWRITING GUIDELINES

BORROWER CREDITWORTHINESS

Borrower creditworthiness consists of:

- **Borrower credit reputation, and**
- **Borrower capacity to repay the Mortgage**

To document the credit reputation for Mortgages, use the following:

The Uniform Residential Loan Application (Form 1003)
The credit reports
The AUS Feedback Certificate for Conforming Loans
Additional documentation as required

For all Conforming Accept or Approve/Eligible Mortgages, the Automated Underwriting System (AUS) has determined that the Borrower(s) is creditworthy provided the amount of stable monthly income, and assets used by AUS are correct and meet the requirements for stable monthly income, and asset documentation as verified under the applicable verification requirements.

CUSO Home Lending limits the number of Borrowers on the Mortgage to four. When multiple Borrowers are involved, the overall credit worthiness of each Borrower and all Borrowers collectively must be evaluated.

It must be determined that all Borrowers collectively have acceptable credit reputations. The acceptable credit reputation of one Borrower cannot be used to offset the unacceptable credit reputation of another.

Frozen Credit Requirements:

If the borrower's credit information is frozen at one of the credit repositories for borrowers who have traditional credit, the credit report is still acceptable as long as

- **credit data is available from two repositories,**
- **a credit score is obtained from both of those two repositories, and**
- **the lender requested a three in-file merged report.**

Loans for borrowers with credit data frozen at two or more of the credit repositories will not be eligible.

LAYERING OF RISK

For all Accept or Approve/Eligible Mortgages AUS has determined that the layering of risk is acceptable.

The following factors cannot be used as a basis for concluding that excessive layering of risk is not present because the AUS has already considered them:

- **Total loan-to-value (TLTV) or loan-to-value (LTV) ratio below the maximum allowable financing.**
- **Qualifying monthly housing expense-to-income ratio, debt-to-housing gap ratio or monthly debt payment-to-income ratio below Freddie Mac/Fannie Mae's guidelines.**
- **The level of reserves**
- **The type of Mortgage product**
- **The type of property securing the Mortgage**
- **Fair, Isaac and Co. (FICO) score**

Or

- **Any combination of these factors**

The following chart gives examples of loan characteristics that increase risk in a mortgage

Credit Reputation	Capacity	Collateral
Adverse or derogatory credit information	A housing payment-to-income ratio in excess of guidelines	Low equity/down-payment
High balances-to-limits	A debt payment-to-income ratio in excess of guidelines	Maximum financing
High overall utilization of revolving credit	Debt-to-housing gap ratio in excess of guidelines	Investment Property
Credit history of short duration	Cash-out refinance	2-4-unit property
A significant change in the Borrower's credit history	No reserves	Manufactured Home
Several inquiries	Adjustable-rate Mortgage	Condominium Unit

DETERMINING CAPACITY

Another part of determining the Borrower's creditworthiness is evaluating the Borrower's capacity to repay their mortgage and other monthly obligations. The following characteristics specific to the Mortgage request may introduce an additional layer of risk that must be considered in evaluating capacity:

- **The payoff of a junior lien from the proceeds of a refinance Mortgage**
- **A cash out refinance**
- **A borrower with little or no reserves**

For Accept or Approve/Eligible mortgages the AUS makes the determination that Borrower capacity is acceptable so long as the amount of stable monthly income and debts submitted to AUS is correct and meets the requirements under Stable Monthly Income, as verified under the applicable verification requirements.

INCOME

Stable monthly income is the Borrower's verified gross monthly income from all acceptable and verifiable sources that can reasonably be expected to continue for at least the next three years. For each income source used to qualify the Borrower, you must determine that both the source and the amount of the income are stable. A Borrower who has had different types of employment in the past may be considered to have stable income if the income amount has remained at a consistent level. When evaluating a Borrower who has changed jobs frequently, you must focus on whether the changes have affected the Borrower's ability to pay the Borrower's obligations. In most instances, a two-year history of receiving income is required in order for the income to be considered stable and used for qualifying.

Determination that the income can reasonably be expected to continue must be based on the documentation required in this section, and should focus on the Borrower's occupation, tenure, past employment history and probability of consistent receipt. You may not consider income for qualifying if the you have knowledge or the documentation indicates that the income will terminate within the next three years. Regardless of the underwriting path, the income used to qualify the Borrower and the documentation in the Mortgage file must meet the requirements of this section. Only income that meets the requirements of this section may be used as qualifying income for the Mortgage.

Significant increases or decreases in income level

When the Borrower has experienced a decrease in income, you cannot average the Borrower's income using a previous higher level unless there is documentation of a one-time occurrence (i.e., injury) that prevented the Borrower from working or earning full income for a period of time and proof that the Borrower is back to the income amount that they previously earned. The Lender must focus their analysis on the most recent earnings and the income that is most likely to be received at the level used for qualifying.

When the Borrower has experienced a significant increase in income, and you qualify the Borrower using the higher amount, sufficient documentation must be obtained to determine that the increase is stable and likely to continue at the level used for qualifying (e.g. that the income is not a one-time incentive payment).

Many income sources, such as commission, bonus, overtime, tips and income from a second job, require two years of receipt of income and two years of income documentation. Notwithstanding the requirements below, in some extraordinary instances less than two years of income receipt may be acceptable with a documented, thorough analysis of the Borrower's income and a determination that the income is stable and likely to continue for the next three years at the level used to qualify.

Employed Income

Stable monthly income may be income from primary and secondary employment, including base earnings plus consistent and documented secondary income, such as bonuses, commissions, overtime, additional part-time employment or seasonal employment. You must analyze all income documentation from the income sources below and determine that the Borrower's income is stable and likely to continue at the level used to qualify.

Newly employed: **For a Borrower that has less than a two-year employment and income history, the Borrower's income may be qualifying income if the Mortgage file contains documentation to support**

that the Borrower was either attending school or in a training program in their field of employment immediately prior to their current employment history.

Re-entering the workforce: **For Borrower's that are re-entering the workforce and have less than a two-year employment and income history, the Borrower's income may be qualifying income if the Borrower has been at the current employer for a minimum of six months and there is evidence of a previous employment history in the same field that can be adequately documented. Income that has to be averaged over a 12-24 month period may not be used to qualify until the Borrower has been at their current employer for the applicable amount of time.**

Income from primary employment: base earnings: **In connection with a Borrower's primary employment, you must determine that the amount of income used to qualify the Borrower is stable. The following table is a guide for how to calculate monthly income that is paid on an hourly, weekly, every two weeks, semi-monthly or monthly basis. These income calculations may not apply in all situations or to income levels that fluctuate.**

<table>
<tr><th colspan="3">Calculation of Monthly Income: Hourly or Salaried Borrowers</th></tr>
<tr><th>Frequency</th><th>Calculation</th><th>Validation</th></tr>
<tr><td>Hourly</td><td>Multiply the hourly pay rate by the average number of hours worked per week then multiply by 52 weeks and divide by 12 months.</td><td rowspan="6">The monthly income documented in the Mortgage file must support the income calculation or documentation requirements). If the documentation does not support the calculation, further analysis is required and additional documentation may be necessary to support the stability of the income and the amount of income used to qualify.</td></tr>
<tr><td>Weekly</td><td>Multiply the weekly income by 52 weeks and divide by 12 months.</td></tr>
<tr><td>Every two weeks</td><td>Multiply the two weeks income by 26 pay periods and divide by 12 months.</td></tr>
<tr><td>Twice per month</td><td>Multiply the semi-monthly income by 24 pay periods and divide by 12 months.</td></tr>
<tr><td>Monthly</td><td>Use the monthly income from the paystub.</td></tr>
<tr><td>Borrowers who may be paid less than 12 months per year</td><td>Some Borrowers' annual salaries may be received over a time period of less than 12 months. It is important to determine how the Borrower is paid in order to accurately calculate income. Lenders should determine how often and for how long the Borrower is paid and then determine monthly income based on the calculations above. For example, if a Borrower is paid 10 months of the year, multiply their monthly salary by 10 months and divide by 12.</td></tr>
</table>

Income from Primary Employment: Additional Income: **A Borrower may receive additional income from primary employment such as commission, bonuses, and overtime pay. If you include additional earnings to qualify the Borrower, you must determine that the amount of additional income used to qualify the Borrower is stable and complies with the requirements below for each income type.**

- ***Commission income:*** **The Borrower must have a two-year consecutive history of receiving commission income with the same employer and the commission income must be likely to continue for the next three years in order to consider the income for qualifying. Commission income that has been received for 12 to 24 months may be considered as acceptable income, as long as there are positive factors to reasonably offset the shorter income history. Borrowers who receive commission income must provide federal tax returns for the previous two-year period that reflect at least six months of commission income.**

- ***Bonus income:*** **The Borrower should have a two-year consecutive history of receiving bonus income and the bonus income must be likely to continue for the next three years in order to consider the income for qualifying. Income that has been received for 12-24 months may be considered as acceptable income, as long as the borrower's employment profile demonstrates that there are positive factors to reasonably offset the shorter income history.**

  The following table is a guide for how to calculate monthly bonus and commission income. These income calculations may not apply in all situations or to income levels that fluctuate.

Commission and Bonus Income Calculation Examples		
Frequency	**Calculation**	**Validation**
Annual, quarterly or monthly	**If the amount of the bonus and/or commission income is consistent or has increased divide the total of the most recent two years bonus or commission income (minus business expenses, if applicable) by 24 months.** **If the amount of the bonus and/or commission income has decreased, divide the most recent annual payment (minus business expenses, if applicable) by 12 months (or if paid quarterly or monthly, by the number of months that the amount includes). If the bonus and/or commission income has decreased, you must determine that the income is stable and provide an explanation for the decrease.**	**The monthly income documented in the Mortgage file must support the income calculation. If the documentation does not support the calculation, further analysis is required and additional documentation may be necessary to support the stability of the income and the amount of income used to qualify. A written analysis of the income used to qualify the Borrower must be retained in the Mortgage file (Form 91, Income Analysis Form, or comparable form may be used for calculating commission income).**

- ***Overtime:*** **The Borrower should have a two-year consecutive history of receiving overtime income and the overtime income must be likely to continue for the next three years in order to consider the income for qualifying. Income that has been received for 12-24 months may be considered as acceptable income, as long as the borrower's employment profile demonstrates that there are positive factors to reasonably offset the shorter income history. You must consider the income trend by considering the hourly rate, the number of hours worked, and use the amount that is most likely to continue for**

the next three years. (Declining earnings cannot be averaged.)

- ***Mortgage differential:*** **A payment from the Borrower's employer for all or part of the interest differential between the Borrower's present and proposed mortgage payment may be considered qualifying income if the documentation shows that the payments are pursuant to an established, ongoing and documented employer program. The employer must not be an interested party to the transaction and the payment must be likely to continue for the next three years. A history of receipt is not required for the income to be considered stable.**

- ***Military income, entitlements and reserve duty income:*** **A Borrower who is a member of the United States Armed Forces may receive pay entitlements such as flight or hazard duty, rations, clothing allowance or quarters allowance in addition to base pay. You may consider entitlements qualifying income if documented and likely to continue for the next three years. If the Borrower is a member of a reserve component of the United States Armed Forces, you may consider the reserve duty income for qualifying. A history of receipt is not required for the income to be considered stable.**

- ***Tip income:*** **The Borrower must have a two-year consecutive history of receiving income from tips in order to consider the income for qualifying. For tip income that fluctuates, the Lender must evaluate the income trend and use the amount that is most likely to continue for the next three years. (Declining earnings cannot be averaged.)**

Income from Secondary or Part-time Employment:

- ***<u>Income from a second, part-time, or additional job</u>:*** **The Borrower must have a two-year consecutive history of receiving income from a second, part-time, or additional job and this income must be likely to continue for the next three years in order to consider the income for qualifying. However, income that has been received for a shorter period of time (no less than 12 months) may be considered as acceptable income, as long as there are positive factors to reasonably offset the shorter income history. You must evaluate the income trend and use the amount that is most likely to continue for the next three years.**
- ***<u>Seasonal employment and unemployment compensation</u>:*** **The Borrower must have a two-year consecutive history of receiving income from seasonal employment and the seasonal employment income must be likely to continue for the next three years in order to consider the income for qualifying. Unemployment compensation associated with seasonal employment may be considered qualifying income if the Borrower has a two-year history of receipt and the unemployment compensation is likely to continue for the next three years. You must not use seasonal employment income or unemployment compensation to qualify the Borrower unless the income is reported on the Borrower's individual federal income tax returns for the most recent two-year period.**

<u>Determining the Need for Federal Income Tax Returns</u>

The lender must obtain copies of the borrower's signed federal income tax returns filed with the IRS for the past one or two years (depending on the income type) for the following sources of income or employment if the borrower:

- **is employed by interested parties to the property sale or purchase (two years' returns);**

• is employed by family members (two years' returns);
• is employed by the Clergy
• receives rental income from an investment property;
• receives income from temporary or periodic employment (or unemployment) or employment that is subject to time limits, such as a contract employee or a tradesman;
• receives income from capital gains, royalties, or other miscellaneous non-employment earnings reported on IRS Form 1099;
• receives income that cannot otherwise be verified by an independent and knowledgeable source (two years' returns);
• uses foreign income to qualify;
• uses interest and dividend income to qualify;
• uses tip income reported on IRS Form 4137 that was not reported by the employer on the W-2 to qualify; or
• receives income from sole proprietorships, limited liability companies, partnerships, or corporations, or any other type of business structure in which the borrower has a 25% or greater ownership interest. Borrowers with a 25% or greater ownership interest are considered self-employed. The lender must document and underwrite the loan application using the requirements for self-employed borrowers.

Self Employed Income

A Borrower who has an ownership interest of 25% or more in a business is considered to be self-employed. The business may be a sole proprietorship, a partnership (general or limited) or a corporation. The various types of business structures are described below:

Sole Proprietorships

A sole proprietorship is an unincorporated business that is individually owned and managed. The individual owner has unlimited personal liability for all debts of the business. If the business fails, the borrower not only will have to replace his or her lost income, but also will be expected to satisfy the outstanding obligations of the business. Since no distinction is made between the owner's personal assets and the assets used in the business, creditors may take either (or both) to satisfy the borrower's business obligations.

The financial success or failure of this type of business depends solely on the owner's ability to obtain capital and to manage the various aspects of the business. Poor management skills or an inability to secure capital to keep the business running will compromise the continuance of the borrower's business (and income). The owner's death terminates the business and may cause the assets to be placed into probate, thus delaying the disposition of the assets to creditors and heirs.

Partnerships

A partnership is an arrangement between two or more individuals who have pooled their assets and skills to form a business and who will share profits and losses according to predetermined proportions that are set out in the partnership agreement.

A partnership may be either a general partnership or a limited partnership:

• General Partnership — Under a general partnership, each partner has responsibility for running the business, is personally liable for the debts of the entire business, and is responsible for the actions of every other partner (unless otherwise specified in the partnership agreement). A general partnership is dissolved immediately on the death, withdrawal, or insolvency of any of the partners, although the personal liability to partnership creditors exists even after the partnership is dissolved. However, the partnership's assets will first be applied to the creditors of the business and the partners' individual assets will be first be applied to their personal creditors, with any surplus in a partner's personal assets then being applied to the remaining business creditors.

• Limited Partnership — Under a limited partnership, a limited partner has limited liability based on the amount he or she invested in the partnership, does not typically participate in the management and operation of the business, and has limited decision-making ability. A limited partnership will have at least one general partner who manages the business and is personally liable for the debts of the entire business. A limited partner's death, withdrawal, or insolvency does not dissolve the partnership. Because limited partnerships often are formed as tax shelters, it is more likely that IRS Form 1065, Schedule K-1, will reflect a loss instead of income. In such cases, the borrower's ability to deduct the loss will be limited by the "at risk" amount of his or her limited partnership interest (and will probably be subject to passive loss limitations).

The partnership must report its profit or loss on IRS Form 1065 and each partner's share of the profit or loss on IRS Form 1065, Schedule K-1; however, the partnership pays no tax on the partnership income.

Each partner uses the information from IRS Form 1065, Schedule K-1, to report his or her share of the partnership's net profit or loss (and special deductions and credits) on his or her IRS Form 1040—whether or not the partner receives a cash distribution from the partnership. Individual partners pay taxes on their proportionate share of the net partnership income at their individual tax rates.

Limited Liability Companies

A limited liability company (LLC) is a hybrid business structure that is designed to offer its member-owners the tax efficiencies of a partnership and the limited liability advantages of a corporation. The member-owners of the LLC (or their assigned managers) can sign contracts, sell assets, and make other important business decisions. The LLC operating agreement may set out specific divisions of power among the member-owners (or managers). Although the member-owners generally have limited liability, there may be some instances in which they are required to personally guarantee some of the loans that the LLC obtains. Profits from the operation of the LLC may be distributed beyond the pool of member-owners, such as by offering profit distributions to managers.

The LLC may report its profit or loss on IRS Form 1065 or IRS Form 1120S with each member-owner's share of the profit or loss on Schedule K-1, IRS Form 1065 or IRS Form 1120S; however, the LLC pays no tax on its income. Each member-owner uses the information from Schedule K-1 to report his or her share of the LLC's net profit or loss

(and special deductions and credits) on his or her individual IRS Form 1040, whether or not the member-owner receives a cash distribution from the LLC. Individual member-owners pay taxes on their proportionate share of the LLC's net income at their individual tax rates.

S Corporations

An S corporation is a legal entity that has a limited number of stockholders and elects not to be taxed as a regular corporation. Business gains and losses are passed on to the stockholders. An S corporation has many of the characteristics of a partnership. Stockholders are taxed at their individual tax rates for their proportionate share of ordinary income, capital gains, and other taxable items.

The ordinary income for an S corporation is reported on IRS Form 1120S, with each shareholder's share of the income reported on IRS Form 1120S, Schedule K-1.

Because this income from the distribution of corporate earnings may or may not be distributed to the individual shareholders, the lender must determine if the borrower received a cash distribution from the S corporation.

Corporations

A corporation is a state-chartered legal entity that exists separately and distinctly from its owners (who are called stockholders or shareholders). It is the most flexible form of business organization for purposes of obtaining capital. A corporation can sue; be sued; hold, convey, or receive property; enter into contracts under its own name; and does not dissolve when its ownership changes. There are two types of corporations—publicly owned (widely held) corporations and privately owned (closely held) corporations. Because more than 50% of the outstanding stock of a privately owned corporation is owned directly or indirectly by no more than five people, the corporation has little or no access to public funds and must raise capital through institutional financing.

Although legal control of the corporation rests with its stockholders, they typically are not responsible for the day-to-day operations of the business since they elect a board of directors to manage the corporation and delegate responsibility for the day-to-day operations to the directors and officers of the company. The distribution of profits earned by the business is determined by the corporation's board of directors or other entities that have a significant financial interest in the business. However, the profits usually are filtered down to the owners in the form of dividends. Since a stockholder is not personally liable for the debts of the corporation, losses are limited to his or her individual investment in the corporation's stock.

Corporations must report income and losses on IRS Form 1120 and pay taxes on the net income. The corporation distributes profits to its shareholders in the form of dividends, which it reports on IRS Form 1099-DIV. The shareholders must then report the dividends as income on their individual IRS Form 1040.

A self-employed Borrower introduces an additional layer of risk to a Mortgage request due to the uncertain nature of future income. The AUS will take this additional risk into consideration in the overall risk evaluation. The Lender must indicate to the AUS that a Borrower is self-employed when the Borrower meets Freddie Mac/Fannie Mae's definition of self-employed as

stated above. This is required in all cases whether or not the Lender is using the self-employment income to qualify the Borrower.

A two-year history of self-employment is required in most instances to ensure that income is stable. When the Borrower has been self-employed for less than two years, you must document that the Borrower has a two-year history of receipt of income at the same or greater level in the same or similar occupation in order to consider the income for qualifying. In addition, you must consider the Borrower's experience in the business before considering the income for qualifying purposes. The Borrower's individual federal tax returns must reflect at least one year of self-employment income. If the Borrower has been self-employed for less than two years or is relocating to a different geographic area, you must consider the acceptance of the company's service or products in the marketplace before considering the income for qualifying purposes. You must document and explain how they determined that the Borrower's income will continue at the same level in the new location.

Calculation of a self-employed Borrower's average monthly income must be based on a review of the Borrower's complete individual federal tax returns (Form 1040) including W-2's and K-1's (if applicable) as well as the Borrower's complete business tax returns (Forms 1120, 1120S and 1065), when applicable. You must analyze the tax returns and provide a written analysis of the Borrower's self-employed income on Form 91 or a comparable form. Non-cash items such as depreciation, depletion and amortization may be added back to adjusted gross income for the purpose of determining qualifying income. Documented nonrecurring losses, such as casualty losses, can also be added back to the adjusted gross income, as well as loss carry-overs from previous tax years.

As part of the analysis, you must consider whether the Borrower's self-employed income has increased or decreased over the previous two years. If the analysis reflects that the Borrower's income has significantly increased or decreased, sufficient documentation must be provided and justification to support their determination that the income used to qualify the Borrower is stable and likely to continue for the next three years. It may be necessary to obtain additional years' tax returns when the Borrower's self-employment income fluctuates in order to determine the stability of the income. If the Borrower is self-employed and the self-employment income is not used to qualify, you must obtain the Borrower's individual federal tax returns to determine if there is a business loss that may have an impact on the stable monthly income used for qualifying. If a business loss is reported on the Borrower's individual federal tax returns, additional documentation may need to be obtained in order to fully evaluate the impact of a business loss on the income used for qualifying.

Caution must be used when including additional income that the Borrower draws from the Borrower's corporation, partnership or S-corporation as qualifying income. You must verify that the Borrower has a legal right to the additional income by obtaining a corporate resolution or other comparable document that establishes that right. You must also verify the Borrower's percentage of ownership of the business entity from a review of the business tax returns, letter from the accountant for the business or similar documents. Earnings from a corporation (IRS Form 1120) may not be used unless the borrower owns 100% of the business. The analysis of the business must support that the business is clearly capable of providing the Borrower with the additional income used to qualify.

The Loan Processor must verify the existence of the Borrower's business from a third-party source no more than 30 days prior to the Note Date. Acceptable third-party sources include, but are not limited to, a regulatory agency, the phone directory, the Internet, directory assistance or the applicable licensing bureau. When a verbal verification of the existence of the business is obtained, it must include the name and address of the business, provide the date the

information is verified, the entity contacted and the name and title of the person who obtained the verification.

When business assets are used for down payment and Closing Costs, Financing Costs, Prepaids/Escrows and reserves, the assets must be verified in accordance with the documentation requirements and must be related to the business that the Borrower owns that is documented in the mortgage file. The lender must perform a business cash flow analysis to confirm that the withdrawal of funds for this transaction will not have a negative impact on the business or the mortgage file must contain a letter from an accountant stating that the Borrower has access to the funds and that withdrawal of the funds for the down payment and Closing Costs will not have a detrimental effect on the business. The accountant must not be an interested party to the transaction and must not be related to the Borrower.

Other income (non-employed/not self-employed)

If a Borrower chooses to disclose income from alimony, child support or separate maintenance payments, public assistance payments, Social Security or retirement benefits, trust, investment, etc., the Lender should consider them as stable income to the extent that they are likely to be consistently made by the payor and can reasonably be expected to continue for at least the next three years based on required documentation.

Factors that must be considered in determining the likelihood of consistent payments for the income below include, but are not limited to, the following:

1. **Whether the payments are received pursuant to a written agreement, court decree or law**
2. **The length of time the payments have been received**
3. **The regularity of receipt**
4. **The availability of procedures to compel payment**
5. **Whether full or partial payments have been made**
6. **The age of each child for which child support payments are made (if applicable)**
7. **Eligibility criteria governing the continued receipt of the income, such as age of dependents or accumulation of assets**

- ***Notes Receivable income:*** **Income from Notes Receivable may be considered qualifying income if the Mortgage file contains a copy of the note and evidence that the Borrower has received payments on a regular monthly basis for the most recent 12 months. Notes Receivable income must be likely to continue for the next three years.**

- ***Dividend and interest income:*** **Dividend and interest income may be considered qualifying income if the Mortgage file contains evidence that the income has been received for the most recent two years. The Mortgage file must contain documentation of sufficient assets remaining after closing to support continuance of the dividend and interest income at the level used for qualifying for at least the next three years.**

- ***Trust income:*** **Trust income may be considered qualifying income if the Mortgage file contains evidence of the amount, frequency and duration of payments. A history of**

receipt is not required for the income to be considered stable; however, the trust income must be likely to continue for the next three years.

- ***Capital gains:*** **Capital gains may be considered qualifying income if the Borrower's most recent two years' individual federal tax returns (including Capital Gains and Losses, Schedule D), show that the Borrower has realized capital gains. You must include documentation of sufficient assets remaining after closing to support continuance of the capital gain income, at the level used for qualifying, for at least the next three years.**

- ***Royalty payments income:*** **Income received from royalty payments may be considered qualifying income if the Mortgage file contains evidence that the Borrower has received payments on a regular basis for the most recent 12 months and the royalty payments are likely to continue for the next three years. You must provide a copy of the most recent individual federal tax returns including Supplemental Income and Loss, Schedule E.**

- ***Public assistance income:*** **-Provide documentation from the applicable agency that indicates the amount, frequency and the length of time the benefit payments will be received. Public assistance income must be likely to continue at the income level used to qualify for the next three years.**

- ***Section 8 homeownership assistance payments:*** **Section 8 homeownership assistance payments that are paid directly to the Borrower may be considered qualifying income if the payments are likely to continue for the next three years. The payments may be considered qualifying income and may not be used to offset the monthly housing payment amount used for qualification. You must provide documentation that shows the amount and terms of the monthly payment received from the public agency that issued the voucher.**

- ***Foster-care income:*** **Foster-care income may be considered qualifying income if the income is received from a state- or county-sponsored organization, the Borrower has a two-year history of providing foster-care services (for the most recent two-years, income must be averaged), and the Borrower is likely to continue to receive the income at the level used to qualify for at least the next three years.**

- ***Alimony, child support or separate maintenance payments:*** **Document that alimony or child support will continue to be paid for at least three years after the date of the mortgage application, as verified by one of the following:**

  • A copy of a divorce decree or separation agreement where both parties are represented by counsel (if the divorce is not final) that indicates payment of alimony or child support and states the amount of the award and the period of time over which it will be received.

  Note: If a borrower who is separated does not have an adequate separation agreement that specifies alimony or child support payments, the lender should not consider any proposed or voluntary payments as income.

  • Any other type of written legal agreement or court decree describing the payment terms for the alimony or child support.

  • Documentation that verifies any applicable state law that mandates alimony, child support, or separate maintenance payments, which must specify the conditions under which the payments must be made. Check for limitations on the continuance of the

payments, such as the age of the children for whom the support is being paid or the duration over which alimony is required to be paid. Document no less than six months of the borrower's most recent regular receipt of the full payment. Review the payment history to determine its suitability as stable qualifying income. To be considered stable income, full, regular, and timely payments must have been received for six months or longer. Income received for less than six months is considered unstable and may not be used to qualify the borrower for the mortgage. In addition, if full or partial payments are made on an inconsistent or sporadic basis, the income is not acceptable for the purpose of qualifying the borrower.

- ***Housing or parsonage allowance:*** **A non-military housing or parsonage allowance may be considered qualifying income if the documentation shows that the income has been received for the most recent 12 months and the allowance is likely to continue for the next three years. The housing allowance may not be used to offset the monthly housing payment**

Employed by a Relative

For an applicant employed by a relative or a closely held family business, complete signed federal tax returns form the previous two years (or as per AUS documentation guidelines) with all attachments and schedules are required in addition to the verbal verification of employment.

Employed by the Clergy

For an applicant who is a member of the clergy, signed federal tax returns for the past two years (or as per AUS documentation guidelines) with all attachments and schedules are required. A copy of the signed contract for employment is also required.

Social Security

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

Documentation Requirements		
Type of Social Security benefit	**Borrower is drawing Social Security benefits from own account/ work record[1]**	**Borrower is drawing Social Security benefits from another person's account/ work record[2]**
Retirement	• Social Security Administrator's (SSA) Award letter, or • Proof of current receipt	• SSA Award letter, • Proof of current receipt, **AND** • Three-year continuance (e.g., verification of beneficiary's age)
Disability		
Survivor Benefits	NA	
Supplement Security Income (SSI)	• SSA Award letter, and • Proof of current receipt	NA

1. An SSA Award letter may be used to document the income if the borrower is receiving Social Security payments or if the borrower will begin receiving payments on or before the first payment date of the subject mortgage as confirmed by a recently issued award letter.
2. Examples of how a borrower might draw Social Security benefits from another person's account/work record and use the income for qualifying:

A borrower may be eligible for benefits from a spouse, ex-spouse, or dependent parents (the benefit is paid to the borrower on behalf of the spouse, etc.); or

A borrower may use Social Security income received by a dependent (a minor or disabled dependent).

Tax Exempt Income

All tax-exempt income, once it has been established that such income is likely to continue (and remain untaxed) into the foreseeable future, may be grossed up by a maximum of 25%. <u>A complete copy of the most recent years federal individual income tax return must be provided to evidence the income is tax exempt</u>.

Rental Income

- **Refer to the Conventional/Conforming Rental Income Matrix**

Installment Sales and Land Contracts

Income from an installment sale or land contract may be included in the applicant's income for qualifying purposes if evidence of timely receipt of payments in the past 12 months is provided and payments will continue for more than three years from the date of closing. Complete documentation on any installment sale or land contract must be provided.

UNDERWRITING GUIDELINES

Unemployment and Welfare Benefits

Unemployment and welfare benefits must be verified by letters from the paying agency with the amount, frequency and duration of payment specified. If the applicant receives unemployment as regular income, signed copies of the last two years of federal tax returns are required.

Boarder Income

Income from boarders in the borrower's principal residence or second home is not considered acceptable stable income with the exception of the following:

> **• When a borrower with disabilities receives rental income from a live-in personal assistant, whether or not that individual is a relative of the borrower, the rental payments can be considered as acceptable stable income in an amount up to 30% of the total gross income that is used to qualify the borrower for the mortgage loan. Personal assistants typically are paid by Medicaid Waiver funds and include room and board, from which rental payments are made to the borrower.**

Automobile Allowance:

For an automobile allowance to be considered as acceptable stable income, the borrower must have received payments for at least two years. The lender must include all associated business expenditures in its calculation of the borrower's total DTI ratio.

VA Benefit Income:

The following provides verification requirements for income from VA benefits. Note: Education benefits are not acceptable income because they are offset by education expenses.

- **Document the borrower's receipt of VA benefits with a letter or distribution form from the VA**
- **Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application. (Verification is not required for VA retirement or long-term disability benefits.)**

Employment-Related Assets as Qualifying Income:

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

- **Maximum 80% LTV for borrowers aged 62 and older at closing**
- **Maximum 70% LTV for borrowers aged 61 and younger at closing**
- **Minimum 620 Credit Score**
- **Purchase and limited cash-out refinance only**
- **Principal residence and second home only**
- **One to two-unit properties**

Asset Requirements

Assets used for the calculation of the monthly income stream must be owned individually by the borrower, or the co-owner of the assets must be a co-borrower of the mortgage loan.

Assets must be liquid and available to the borrower and must be sourced as one of the following:

- **A non-self-employed severance package or non-self-employed lump sum retirement package (a lump sum distribution) — these funds must be documented with a distribution letter from the employer (Form 1099–R) and deposited to a verified asset account.**
- **For 401(k) or IRA, SEP, Keogh retirement accounts – the borrower must have unrestricted access to the funds in the accounts and can only use the accounts if distribution is not already set up or the distribution amount is not enough to qualify. The account and its asset composition must be documented with the most recent monthly, quarterly, or annual statement.**
- **Cannot be in the form of virtual currency**

If a penalty would apply to a distribution of funds from the account made at the time of calculation, then the amount of such penalty applicable to a complete distribution from the account (after costs for the transaction) must be subtracted to determine the income stream from these assets.

If the employment–related assets are in the form of stocks, bonds, and mutual funds, 70% of the value (remaining after costs for the transaction and consideration of any penalty) must be used to determine the income stream to account for the volatile nature of these assets.

A borrower shall only be considered to have unrestricted access to a 401(k) or IRA, SEP, Keogh retirement account if the borrower has, as of the time of calculation, the unqualified and unlimited right to request a distribution of all funds in the account (regardless of any possible tax withholding or applicable penalty applied to such distribution).

"Net documented assets" are equal to the sum of eligible assets minus:
(a) the amount of the penalty that would apply if the account was completely distributed at the time of calculation;
(b) the amount of funds used for down payment, closing costs, and required reserves;
(c) 30% of the remaining value of any stocks, bonds, or mutual funds assets (after the calculation in (b)).

Ineligible assets are non-employment-related assets (for example, stock options, non-vested restricted stock, lawsuits, lottery winnings, sale of real estate, inheritance, and divorce proceeds). Checking and savings accounts are generally not eligible as employment-related assets, unless the source of the balance in a checking or savings account was from an eligible employment-related asset (for example, a severance package or lump sum retirement distribution).

Example: Calculation of Net Documented Assets

IRA (made up of stocks and mutual funds)	**$ 500,000**
Minus 10% of $500,000 ($500,000 x .10) **(assumes the borrower is not yet 59 1/2 years of age at the time this income is being calculated; therefore, it is subject to a 10% penalty for early distribution. This penalty must be levied against any cash being withdrawn for closing the transaction as well as the remaining funds used to calculate the income stream.)**	**(-) $50,000**
Total eligible documented assets	**(=) $ 450,000**
Minus funds required for closing **(down payment, closing costs, reserves)**	**(-) $100,000**
(a) Subtotal	**(=) $ 350,000**
Minus 30% of $350,000 ($350,000 x .30) **(assumes funds are in the form of stocks, bonds, and mutual funds)**	**(-) $105,000**

Asset Requirements	
(b) Net Documented Assets	**(=) $245,000**
Monthly income calculation ($245,000/360)	**$680.56/month**

Employment Offers or Contracts

This option is limited to loans that meet the following criteria:

- **purchase transaction**
- **principal residence**
- **one-unit property**
- **the borrower is not employed by a family member or by an interested party to the transaction, and**
- **the borrower is qualified using only fixed based income**

The lender must obtain and review the borrower's offer or contract for future employment. The employment offer or contract must

- **clearly identify the employer and the borrower, be signed by the employer, and be accepted and signed by the borrower,**
- **cleary identify the terms of employment, including position, type and rate of pay, and start date; and**
- **be non-contingent. Note: If conditions of employment exist, the lender must confirm prior to closing that all conditions of employment are satisfied by either verbal verification or written documentation. This confirmation must be noted in the mortgage loan file.**
- **Lender's written analysis must confirm employment contracts are reasonably common to the particular employment field, industry and/or region.**

The lender must document, in addition to the amount of reserves required by AUS or for the transaction, one of the following:

- **financial reserves sufficient to cover principal, interest, taxes, insurance, and association dues (PITIA) for the subject property for six months; or**
- **financial reserves or current income sufficient to cover the monthly liabilities included in the debt-to-income ratio, including the PITIA for the subject property for the number of months between the note date and the employment start date, plus one. Current income refers to income that is currently being received by the borrower (or co-borrower), may or may not be used for qualifying and may or may not continue after the borrower starts employment under the offer or contract. Current income may be used in lieu of or in addition to financial reserves. For this purpose, the lender may use the amount of income the borrower is expected to receive between the note date and the employment start date. If the current income is not being used for qualifying purposes, it can be documented by the lender using income documentation such as a paystub, and no verification of employment is required. For calculation purposes, consider any portion of a month as a full month.**

Note: The Note Date cannot occur more than 90 days prior to the commencement of employment as documented on the offer letter or employment contract.

Retirement, Government Annuity, and Pension Income

Document regular and continued receipt of the income as verified by letters from the organizations providing the income, copies of retirement award letters, copies of signed federal income tax returns, IRS W2 or 1099 forms, or proof of current receipt.

If the retirement income is paid in the form a distribution from a 401(k), IRA, or Keogh retirement account, determine whether the income is expected to continue for a least three years after the date of the mortgage application. In addition, the borrower must have unrestricted access without penalty to the accounts; and if the assets are in the form of stocks, bonds, or mutual funds, 70% of the value (remaining after any applicable costs for the subject transaction) must be used to determine the number of distributions remaining.

Temporary Leave – Employment Requirements

- **The borrower's employment and income history must meet standard eligibility requirements.**
- **The borrower must provide written confirmation of his or her intent to return to work.**
- **The lender must document the borrower's agreed-upon date of return by obtaining, either from the borrower or directly from the employer (or a designee of the employer when the employer is using the services of a third-party to administer employee leave), document evidencing such date that has been produced by the employer or by a designee of the employer.**
- **The lender must receive no evidence or information from the borrower's employer indicating that the borrower does not have the right to return to work after the leave period.**
- **The lender must obtain a verbal verification of employment, if the employer confirms the borrower is currently on temporary leave, the lender must consider the borrower employed.**
- **The lender must document the borrower's income and also obtain**
  - **The amount and duration of the borrower's "temporary leave income" which may require multiple documents or sources depending on the type and duration of the leave period; and**
  - **The amount of the "regular employment income" the borrower received prior to the temporary leave. Regular employment includes but is not limited to, the income the borrower receives from employment on a regular basis that is eligible for qualifying purposes. Income verification may be provided by the borrower, the borrower's employer, or by a third-party employment verification vendor.**

- **Requirements for Calculating Income Used for Qualifying:**
  - **If the borrower WILL return to work as of the first mortgage payment date, the borrower's regular employment income can be used in qualifying.**
  - **If the borrower WILL NOT return to work as of the first mortgage payment date, the lesser of the borrower's temporary leave income (if any) or regular employment income must be used. If the temporary leave income is less than his or her regular employment income, available liquid financial reserves may be used to supplement the income.**

Disability Income – Long Term

Obtain a copy of the borrower's disability policy or benefits statement from the benefits payer (insurance company, employer, or other qualified disinterested party) to determine the borrower's current eligibility for the disability benefits, the total amount and frequency of the disability payments, and if there is a contractually established termination or modification date.

If the borrower is currently receiving short-term disability payments that will decrease to a lesser amount within the next three years because they are being converted to long-term benefits, the

amount of the long-term benefits must be used as income to qualify the borrower. These rules do not apply to Social Security Disability.

Unacceptable Income

The following types of income are not acceptable for qualification:

- **Income paid in the form of virtual currency**
- **Assets used to establish continuance for certain income types cannot be in the form of virtual currency**
- **Deferred income that is not currently available**
- **Education benefits**
- **Rent from the applicant's primary residence or second home and**
- **Any income which cannot be verified**
- **Loans to foreign diplomats**
- **Retained earnings in a corporation**
- **Marijuana Related Business/Employment**
    - **Federal law restricts the following activities and therefore income from the following sources is not permitted for qualifying:**
        - **- Medical marijuana dispensaries**
        - **- Any business or activity related to recreational marijuana use, growing, selling or supplying of marijuana, even if legally permitted under state or local law.**

ASSETS

Any closing costs and/or prepaids normally paid by the property purchaser are considered financing contributions/concessions if they are paid by the seller or other interested party. Financing contributions/concessions may be paid by the property seller or by any other interested party to the transaction, such as the builder, developer, the real estate agent, the lender or any of their affiliates. Any such contributions must be made within underwriting guidelines.

For underwriting purposes, the amount of any financing concessions in excess of the limitations will be considered a sales concession. The lender must make a downward adjustment to the property's sales price to reflect the amount of any contributions such as amounts in excess of the maximum financing concession limitations, contributions such as vacations, furniture, automobiles, or other giveaways granted by any interested party to the transaction. The maximum loan-to-value ratio must then be calculated on the lesser of the reduced sales price or appraised value.

Unsecured borrowing to make the down payment is not permitted, unless otherwise noted in a specific product guideline.

Cash on Hand

Cash-on-hand is not an acceptable source of funds for the down payment or closing costs.

Cash on Deposit

Complete statements from a financial institution must be provided in accordance with AUS guidelines. It is necessary to investigate any indications of borrowed funds such as 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.

Deposit on Sales Contract (Earnest Money Deposit)

When an EMD for a purchase transaction is used to qualify the Borrower for the mortgage transaction, the Lender must obtain evidence that the EMD check cleared the Borrower's account (e.g., copy of the canceled check, asset account statement or written statement from the EMD holder verifying receipt of the funds).
When the EMD is needed to meet the minimum contribution from Borrower personal funds, the Lender must:

- **Verify that the source of the EMD is an eligible asset type and document it in accordance with the applicable requirements in this section**
- **Provide account statement(s) (based on Streamlined Accept or Standard documentation requirements, as applicable) or a direct account verification (i.e., VOD) that covers the period up to and including the date the EMD funds cleared the account**

Trust Account

Funds in a trust account must be verified by a statement from the trustee of the amount of funds that are available, document the conditions under which the borrower has access to the funds, and what effect the withdrawal of funds will have on trust income (if used to qualify the borrower.)

IRA/401K Accounts

Funds in IRA/401k accounts must be verified by account statements or verifications of deposit. These types of accounts may be subject to withdrawal penalties and taxes associated with the liquidation of such funds. The net account balance, (minus applicable fees), must be used to calculate a qualifying asset.

Business Assets

Business assets may be an acceptable source of funds for the down payment, closing costs, and financial reserves when a borrower is self-employed and the individual federal income tax returns have been evaluated by the lender, including, if applicable, the business federal income tax returns for that particular business (non-Schedule C). The borrower must be listed as an owner of the account and the account must be verified. A business cash flow analysis must confirm that the withdrawal of funds for this transaction will not have a negative impact on the business.

Stocks, Stock Options, Bonds, and Mutual Funds

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

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

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

Cash Value of Life Insurance

Net proceeds from a loan against the cash value or from the surrender of a life insurance policy are an acceptable source of funds for the down payment, closing costs, and reserves. The lender must assess repayment or additional obligation considerations to determine the impact on borrower qualification or reserves. If penalties for failure to repay the loan are limited to the surrender of the policy, payments on a loan secured by the cash value of a borrower's life insurance policy do not have to be considered in the total debt-to-income ratio. If additional obligations are indicated, the obligation amount must be factored into the total debt-to-income ratio or subtracted from the borrower's financial reserves.

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

Rent with Option to Purchase

Only the portion of a rental payment that exceeds the market rent can be applied to the down payment if there is a valid rental/purchase agreement in effect. The application file must contain a copy of the rental/purchase agreement to verify the monthly rental and the specific terms of the lease. The original term of the lease must have been at least 12 months. The appraiser must develop the market rent figure and the borrower must provide copies of cancelled checks or money order receipts to document the rental payments for the last 12 months.

Sweat Equity

Sweat equity is not an acceptable source of funds.

Trade Equity

Equity from a property trade (example mobile home trade) if the equity in the property to be traded is verified with a property appraisal and is net of all costs.

The borrower must contribute at least 5% cash towards the downpayment in addition to the equity from the trade unless the LTV or CLTV ratio is less than or equal to 80%.

Land Equity

The value of the land used as a down payment will be determined by the subject property appraisal is such land has been owned by the borrower for more than one year.

If the land is owned less than one year the value used is the lower of the acquisition cost or appraised value.

If the land was a gift from a relative the appraised value may be used, however, it cannot exceed 35% of the acquisition cost.

Equity in Existing Home

If the proceeds from the sale of the applicant's current home are needed for the purchase of the subject property, receipt of the funds must be evidenced by the Closing Disclosure and Settlement Statement, fully executed by all parties in connection with the sale.

Loans Secured by Assets

Borrowed funds that are secured by a borrower owned asset represent a return of equity, because of this, they may be used for the transaction. Assets that may be used to secure funds include certificates of deposit, stocks, bonds, automobiles, real estate, life insurance policies and 401k plans.

Examples of unacceptable borrowed funds include signature loans, lines of credit on credit cards and overdraft protection on checking accounts.

Sale of Assets

Proceeds received from the sale of the borrower's personal assets may be considered as long as the borrower can document the following:

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

Gift Funds

The borrower can use funds received as a gift from a relative (defined as the borrower's spouse, child, or other dependent, or by any other individual who is related to the borrower by blood, marriage, adoption, or legal guardianship), or a fiancé, fiancée, domestic partner, or from a church, municipality or non-profit organization (low-to-moderate income borrower) to pay his or her share of the closing costs and prepaid items. This must be done in accordance with the limitations as defined in the mortgage product guidelines. (The donor may not be, or have any affiliation with, the builder, developer, the real estate agent, or any other interested party to the transaction.)

Gift of Equity

A gift of equity refers to a gift provided by the seller of a property to the buyer. The gift represents a portion of the seller's equity in the property and is transferred to the buyer as a credit in the transaction. A gift of equity is permitted for principal residence and second home purchase transactions. The acceptable donor and minimum borrower contribution requirements for gifts also apply to gifts of equity.

Credit Cards, Cash Advances or Unsecured Line of Credit

The amount charged by a Borrower on a credit card to pay fees associated with the Mortgage Application process (i.e. origination fees, commitment fees, lock-in fees, credit report and appraisal reports, and flood certifications) or a cash advance taken by the borrower on a revolving credit card account or an unsecured line of credit to pay these fees may be used as an acceptable sourse of funds and may be considered Borrower Funds if the following conditions are met:

- **The maximum amount charged or advanced may not exceed 2% of the Mortgage amount or $1,500~~.~~**

- **The amount charged or advanced must be included in the Borrower's total outstanding debt and the repayment of such amount must be included in the ratios**
- **The Borrower has sufficient verified liquid funds to pay these fees (in addition to the funds needed for the down payment, Prepaids/Escrows, other Closing Costs, Financing Costs and reserves as required); however, the Borrower is not required to pay off these charges at closing.**
- **Under no circumstances may credit card financing be used for the down payment.**

Evaluating Large Deposits

When bank statements (typically covering the most recent two months) are used, the lender must evaluate large deposits, which are defined as a single deposit that exceeds 50% of the total monthly qualifying income for the loan.

If the source of a large deposit is readily identifiable on the account statement(s), such as a direct deposit from an employer (payroll), the Social Security Administration, or IRS or state income tax refund, or a transfer of funds between verified accounts, and the source of the deposit is printed on the statement, the lender does not need to obtain further explanation or documentation. However, if the source of the deposit is printed on the statement, but the lender still has questions as to whether the funds may have been borrowed, the lender should obtain additional documentation.

Virtual Currency

Virtual currency that has been exchanged into U.S. dollars is acceptable for the down payment, closing costs, and financial reserves provided

- **There is documented evidence that the virtual currency was exchanged into U.S. dollars and is held in a U.S. or state regulated financial institution, and**
- **The funds are verified in U.S. dollars prior to the loan closing.**

In addition:

- **Income paid in the form of virtual currency may not be considered when qualifying a borrower.**
- **Assets used to establish continuance for certain income types cannot be in the form of virtual currency.**
- **The purchase price of the property and any earnest money deposit may not be designated in virtual currency.**
- **The payment used as rental income must be in U.S. dollars.**
- **Payment on any installment debt secured by virtual currency must be included in the debt-to-income ratio calculation.**

Foreign Assets

When the source of funds needed for down payment, closing costs, or financial reserves originates from assets located outside of the United States and its territories, those assets must be exchanged and transferred into a U.S. or state-regulated financial institution and must be verified prior to the closing of the loan.

LIABILITIES

All liabilities, which will not be paid off by the application of normal monthly payments with 10 months, are considered long-term liabilities. If it appears the applicant will have difficulty carrying the payment debt having 10 or fewer remaining payments, the debt will be considered a long-term obligation. Typically, this payment should not exceed 10% of monthly gross income. Installment payments such as car loans or home improvement loans may be paid in full on or before closing.

Installment Debt

If an installment loan will be paid off in 10 months or less, it does not have to be included in the calculation of the debt ratio unless there is a history of the borrower renewing this type of debt. Secured and unsecured consumer debts are considered installment debt. If the payment amounts are not indicated on the credit report, verification of monthly payment must be documented in the loan file (student loans do not fall under this guideline.)

Revolving Charge Accounts and Checking Account Lines of Credit

The minimum payment for revolving charge accounts and checking account lines of credit is typically the greater of $10 or 5% of the outstanding balance. If the credit report lists a payment amount, this will be used in calculating debt ratios. Caution must be used when paying off revolving debt to qualify for the mortgage.

Open 30-Day Charge Accounts

Open 30–day charge accounts require the balance to be paid in full every month. For open 30-day charge accounts that do not reflect a monthly payment on the credit report, or 30-day accounts that reflect a monthly payment that is identical to the account balance, lenders must verify borrower funds to cover the account balance. The verified funds must be in addition to any funds required for closing costs and reserves. If the borrower paid off the account balance prior to closing, the lender may provide proof of payoff in lieu of verifying funds to cover the account balance.

Alimony, Child Support and Maintenance Payments

Alimony, child support and maintenance payments should be treated as liabilities according to their duration. The amount of such payments should be documented with court records, voluntary payments do not need to be taken into consideration. For alimony obligations, the lender has the option to reduce the qualifying income by the amount of the alimony obligation in lieu of including it as a monthly payment in the calculation of the DTI ratio. If the lender exercises this option, a copy of the divorce decree, separation agreement, court order or equivalent documentation confirming the amount of the obligation must be obtained and retained in the loan file.

Co-signed Loans

Obligations co-signed by borrowers will be counted as a long-term liability unless the borrower provides evidence the last 12 payments have been paid by the primary debtor in a timely matter. This includes debts that may have been assigned to an ex-spouse as part of a divorce.

Leases

Automobile leases are considered a recurring obligation regardless of the number of payments remaining on the lease and must be included in the DTI ratio.

Assigned debt

A liability on a debt, including a Mortgage, may be excluded from the monthly debt payment-to-income ratio if the obligation to make the payments on a debt of the Borrower:

- **Has been assigned to another by court order, such as a divorce decree, regardless of whether the Borrower is legally released from liability by the creditor, and**
- **The Seller documents the order (e.g., provides appropriate pages from the separation agreement or divorce decree)**

Contingent Liabilities

Debt type	Eligibility and documentation requirements
■ **Installment (not including Mortgages)** ■ **Revolving** ■ **Monthly lease payment**	Documentation in the Mortgage file must indicate the following: ■ A party other than the Borrower has been making timely payments for the most recent 12 months (regardless of whether the party is obligated on the debt) ■ The party making the payments is not an interested party to the subject real estate or Mortgage transaction*
Mortgage	Documentation in the Mortgage file must indicate the following: ■ A party other than the Borrower has been making timely payments for the most recent 12 months ■ The party making the payments is obligated on the Note for the Mortgage that is being excluded ■ The Borrower is not on title for the mortgaged property ■ The party making the payments is not an interested party to the subject real estate or Mortgage transaction*

(*interested parties such as the seller or realtor)

Funds Borrowed from Liquid Asset Accounts

Borrowed funds from an account containing liquid assets that were pledged need not be included in the ratios. If liquid assets have been pledged, they cannot be used for down payment, closing costs or reserve requirements.

Student Loans

For all student loans, whether deferred, in forbearance, or in repayment (not deferred), the lender must include a monthly payment in the borrower's recurring monthly debt obligation when qualifying the borrower. If a monthly payment is provided on the credit report, the lender may use that amount as the monthly payment for qualifying purposes. If the credit report does not provide a monthly payment for the student loan, or if the credit report shows $0 as the monthly payment (which may be the case for deferred loans or loans in forbearance), the lender must calculate a qualifying monthly payment using one of the options below:

- **1% of the outstanding student loan balance (even if this amount is lower than the actual fully amortizing payment), or**
- **a fully amortizing payment using the documented loan repayment terms.**

Business Debt in the Borrower's Name

When a self-employed borrower states a monthly obligation that appears on his/her personal credit report is being paid by the borrower's business, the lender must confirm that the obligation is actually paid out of company fund and that this was considered in the cash flow analysis of the business.

The account payment DOES NOT need to be considered as part of the borrower's individual recurring monthly debt obligations if:

- **the account in question does not have a history of delinquency,**
- **the business provides acceptable evidence that the obligation was paid out of company funds (such as 12 months of cancelled company checks), and**
- **the lender's cash flow analysis of the business took payment of the obligation into consideration**

The account payment DOES need to be considered as part of the borrower's individual recurring monthly debt obligations in any of the following situations:

- **if the business does not provide sufficient evidence that the obligation was paid out of company funds.**
- **If the business provides acceptable evidence of its payment of the obligation, but the lender's 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.**

CREDIT STANDARDS

Evaluating the Borrower's credit reputation

For an Accept/Approve Eligible Mortgage the AUS has determined that the Borrower's credit reputation is acceptable.

What constitutes an acceptable credit reputation for non-salable portfolio loans may vary according the credit union investor guidelines or the mortgage product. For example, a mortgage that has significant derogatory credit information and would not receive an Accept/Approve Eligible from the AUS may still be acceptable to the credit union investor.

Adverse or derogatory credit information

Adverse credit information in and of itself does not mean the Borrower's credit reputation is unacceptable. When there is adverse or derogatory information in the Borrower's credit history, you must determine whether the derogatory information is significant.

For Accept/Approve Eligible Mortgages the significance of the derogatory information has already been considered by the AUS and the Borrower's credit reputation has been deemed acceptable. However, regardless of the findings received from the AUS an amount of time must elapse after a significant derogatory credit event before the borrower is eligible for a new secondary market loan. The "waiting period" commences on the completion, discharge, or dismissal date (as applicable) of the derogatory credit event and ends on the disbursement date of the new loan. Because the AUS does not have the disbursement date of the subject loan, it uses the date of the credit report to measure whether or not the applicable waiting period has been met. However, because the credit report date may not result in an accurate calculation of the waiting period, the lender may use the disbursement date to confirm that the waiting period has been met. See the table below for additional information.

Derogatory Event	Waiting Period Requirements	Waiting Period with Extenuating Circumstances
Bankruptcy — Chapter 7 or 11	4 years	2 years
Bankruptcy — Chapter 13	• 2 years from discharge date • 4 years from dismissal date	• 2 years from discharge date • 2 years from dismissal date
Multiple Bankruptcy Filings	5 years if more than one filing within the past 7 years	3 years from the most recent discharge or dismissal date
Foreclosure[1]	7 years	3 years Additional requirements after 3 years up to 7 years: • 90% maximum LTV ratios[2] • Purchase, principal residence • Limited cash-out refinance, all occupancy types
Deed-in-Lieu of Foreclosure, Preforeclosure Sale, or Charge-Off of Mortgage Account	4 years	2 years

<u>Collections, Charge-Off's, Judgments, Garnishments, and Liens</u>

Delinquent credit – including taxes, judgments, charged-off, tax liens, mechanics' liens, and liens that have the potential to affect the lenders lien position or diminish the borrower's equity - must be paid off at or prior to closing (see below and PMI guidelines when applicable for exceptions.)

Collection accounts or charged-off accounts do not have to be paid off at or prior to closing, provided all the following are documented:

- **a strong credit profile (an Accept/Approve Eligible rating through AUS which states payment of these obligations is not required)**
- **meaningful financial reserves**
- **evidence that the accounts pose no threat to the first mortgage lien position, and**
- **evidence the outstanding accounts are not likely to affect the borrower's equity position**

<u>Inquiries</u>

Inquiries on the credit report generally reflect the Borrower's requests for new or additional credit. Inquiries made for other purposes, such as general solicitations not initiated by the Borrower or monitoring inquiries by current creditors, typically are not shown on the credit report.

When the credit report indicates that a creditor has made an inquiry within the previous 120-day period, you must determine whether additional credit was granted. A letter from the creditor or, if such a letter is unobtainable, a signed statement from the Borrower may be used to determine whether additional credit was obtained. If additional credit was granted, you must obtain verification of the debt and must consider the debt when qualifying the Borrower subject to the requirements in Monthly debt payment-to-income ratio.

Several inquiries within the most recent 12 months generally increase risk and, when combined with high balances-to-limits on revolving accounts may indicate that the Borrower is in danger of becoming overextended. In addition, several recent inquiries, combined with a credit history of short duration may make even mild derogatory credit information significant.

To address how risk evidenced by several recent inquiries, layered with other credit reputation risks, affects the Borrower's overall credit reputation, the Seller must look at:

- **The Borrower's payment history**
- **The age of the Borrower's other credit**
- **The type of credit being sought**
- **The total amount of credit outstanding, and**
- **The overall credit utilization reflected on the report**

<u>Age of accounts</u>

Like inquiries, several recently opened accounts may be a warning that the Borrower could become overextended and require a more conservative approach to reviewing both Borrower credit reputation and capacity. A credit history with all recently opened accounts may indicate that the Borrower lacks sufficient experience managing financial obligations.

You should also review the age of accounts to determine if there has been a significant change in the Borrower's credit profile. A change in the Borrower's pattern of credit use, which includes several newly opened revolving accounts, several inquiries and high utilization of revolving

Tradelines, introduces significant layering of risk to the Borrower's credit reputation.

To address how the age of a Borrower's accounts, layered with other credit risks, affects the Borrower's credit reputation, you must consider:

- **The Borrower's payment history**
- **The amount of outstanding credit**
- **The overall utilization of revolving accounts, and**
- **Recent inquiries**

<u>Balances-to-limits/high overall utilization of revolving credit</u>

When reviewing credit, you must compare the current balance for each open account to the high credit or limit to determine whether there is a pattern of accounts with balances at or near their limits. Multiple revolving accounts with balances more than 50 percent of their limits must be considered as additional risk when evaluating credit reputation. The more accounts with high balances-to-limits and the higher the percentage used, the higher the risk.

High balances-to-limits may also indicate the Borrower is making minimum payments on revolving accounts rather than reducing the debt and may be at or near payment capacity. Any derogatory information in a credit history within the most recent two years combined with several revolving accounts at or near their limits should be considered significant derogatory information when evaluating the credit reputation.

In addition to evaluating balances-to-limits, you must compare the overall amount of outstanding revolving credit to the overall amount of revolving credit available to the Borrower, as shown on the credit report, to determine credit utilization. Usage of more than 60 percent of available revolving credit must be considered a risk factor when evaluating credit reputation. The higher the Borrower's overall utilization of revolving credit, the higher the amount of risk.

A pattern of revolving accounts at or near their limits, and utilization of a high proportion of the overall revolving credit available to the Borrower, especially when combined with newly opened accounts, indicates that the Borrower is becoming overextended and there is significant risk in the Borrower's credit reputation. You may not use the lack of adverse or derogatory credit information as an offset for high balances-to-limits or high overall utilization of revolving credit.

When underwriting with FICO scores, a reason code will alert you that the balances on revolving accounts are too high or the proportion of balance to high credit on bank revolving or all revolving accounts is too high and affected the Borrower's FICO score.

The AUS will determine whether the balances-to-limits and overall revolving utilization, combined with other credit information, make the Borrower's credit reputation unacceptable.

UNDERWRITING THE PROPERTY – General requirements for appraisal reports

I. Origin of request

CUSO Mortgage has adopted the Home Valuation Code of Conduct (HVCC) in accordance with Fannie Mae and Freddie Mac guidelines for all conventional loans.

An Appraisal Management Company (AMC) will be utilized for approval and selection of appraisals.

In accordance with the HVCC, appraisals will be delivered to the borrower upon receipt from the AMC to ensure they are provided within 3 days prior to loan closing. In the event this may not occur, a waiver will be required by the borrower.

II. Age of appraisals and certifications

No appraisal may be utilized for lending whose date of valuation does not fall within the 365 days preceding the date of closing.

When the date of valuation of the appraisal report will be more than 120 days old on the date of the note, regardless whether then property was appraised as proposed or existing construction, the appraiser must inspect the exterior of the property and review current market data to determine that the property has not declined in value since the date of the original appraisal. The appraiser may then provide a certification stating that the property has not declined in value. If the mortgage loan does not close within four months of the initial certification one additional certification will be allowed.

New proposed construction – for proposed construction, the appraisal may be based on plans and specifications

Minor items not affecting livability or salability may be incomplete - repairs that are not cosmetic must be completed prior to closing. Cosmetic repairs, defined as those not affecting the safety, structural integrity, mechanical systems or habitability of the improvements, need not be repaired as long as the appraisal is not made subject to repairs and as long as the appraiser has addressed whether the condition affects the value or marketability of the property and made any necessary adjustments to the comparables.

III. Sales Concessions

The appraiser must address the impact of financing contributions or sales concessions on the value of the property and adequately explain the rationale for any adjustments. A sales concession is defined as any inducements to purchase offered by interested parties and/or the amount of contributions that exceed the allowable limits. The amount of permissible seller/builder contributions varies per product.

IV. Arms-length transaction

The sale of the subject property and the comparables should be the result of an independent arms length transaction between a buyer and seller. If the sale is between related parties or is otherwise not an arms length transaction, such relationship must be disclosed, addressed, and appropriately adjusted for in the appraisal.

If the sales price exceeds the appraised value by 10 percent or more, the appraiser must comment on the difference and the applicant must provide a letter acknowledging the discrepancy.

V. Property characteristics:

***Utilities* – the utilities serving the subject property (including the electrical, gas, water and sewer system) must be similar in all material respects to the utilities serving the other properties in the community and must generally be acceptable to other area residents.**

***Mechanical systems* – heating, electrical and plumbing systems must be in operating order and must confirm to all applicable codes and regulations. It is the Lender's responsibility to ensure that all systems meet minimum local requirements.**

***Detrimental conditions* – should the appraiser determine that such conditions exist, or may exist, the appraiser must inform the Lender and obtain the necessary expert opinion and determination of any adverse effect of market value of the subject property. The term "detrimental conditions" includes, but is not limited to:**

- **Expansive soils**
- **special study zones**
- **underground mines**
- **soil subsidence**
- **landfills**
- **superfund sites**
- **active rail road tracks**
- **conditions which could reasonably be expected to affect the stability of the improvements erected on the mortgaged property or drainage on or from the mortgaged property.**

***Neighborhood* – marketability of the property, convenience to employment and public services, conformity to neighborhood property conditions, degree of development, present land use, general appearance, price range and predominant value.**

***Site* – acceptability and conformity of lot to market area, utilities, site improvements, view, easements, encroachments, special assessments, highest and best use of the site, flood hazard information, conformity to area zoning regulations. Legal but non-conforming uses are acceptable on an individual basis if the marketability and value of the property is not adversely affected. "Agriculture" or "No Zoning" are acceptable as long as such zoning is typical for the area, residential property similar to the subject exist in the area, and the highest and best use of the subject is residential.**

***Improvements* – property description, age of property, energy-efficient features, evidence of dampness, termites, settling or repairs required.**

***Room list* – layout and floor plan, gross living area.**

***Interior* – materials and condition of interior surfaces, mechanical equipment, appliances, improvement analysis ratings, remaining economic life.**

***Comments* – additional features, depreciation, repairs, general market conditions and financing terms that affect value.**

***Reconciliation* – estimate of market value, subject to repairs or completion.**

***Photographs of the subject property* –**

Exterior: at least three clear color photos of the subject property are required. The photographs must include: a front view of the property, a street scene indemnifying the location of the property and showing neighboring improvements and a rear view of the property.

Interior: at a minimum, the report must include photographs of the following:

- **the kitchen;**
- **all bathrooms;**
- **main living area;**
- **examples of physical deterioration, if present; and**
- **examples of recent updates, such as restoration, remodeling, and renovation, if present.**

Note: Interior photographs on proposed or under construction properties may be taken by the appraiser at the time of the inspection for the Certification of Completion, and provided with the Form 1004D.

The appraiser must include additional photographs, if necessary to show clearly the improvements, amenities or external influences that have a material impact on value or marketability.

***Building sketch* – the exterior sketch of the improvements must include the dimensions and calculations that the appraiser used to determine the size of the subject property.**

***Location map* – the location map must locate the subject property and all comparable properties.**

***Photographs of comparable sales* – one clear color of the front of each comparable sale is required. If an original photograph of a comparable sale cannot be obtained, a clear copy of the photograph of the comparable from a multiple listing service (MLS) is acceptable. The appraisal report must reasonably justify using the MLS source.**

***Detrimental conditions* – include the presence of:**

expansive soils
underground mines
soil subsidence
landfills
superfund sites
special study zones
active rail road tracks
conditions which could reasonably be expected to affect the stability of the improvements erected on the mortgaged property or the drainage on or from the mortgaged property.

In addition, the appraiser should describe the potential effect of such conditions in estimating the subject property's market value and any effect on marketability.

VI. Valuation Analysis

The valuation section of the appraisal report form must clearly indicate an adequately supported estimate of market value.

"Market value" is defined as the most probably price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and on the assumption the price is not affected by undue influence.

Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

-both buyer and seller are typically motivated;
-both parties are well informed or advised, and each acting in what they considered their own best interest;
-a reasonable time is allowed for exposure in the open market;
-payment is made in cash in U.S. Dollars or financial arrangements comparable thereto; and
-the price represents normal consideration for the property sold, unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Comparables

The proper choice of comparables should minimize the amount of all adjustments. When net, gross or individual line adjustments are excessive, the appraiser must comment on the reasons for not using a more similar comparable. In some cases, the use of comparables with higher than normal adjustments may be warranted and will be allowed provided the appraiser satisfactorily justifies the use of the comparable.

The sale of each comparable property should ideally have occurred within the six months that precede the date of the appraisal. In situations where this is not possible, sales within the 12 months which precede the date of the appraisal will be acceptable provided the appraiser explains the necessity of using comparables over six months old.

For factory built (modular) homes, if the comps used are site-built homes, the appraiser must address the marketability of such factory-produced homes as compared to site-built homes.

Second Homes

Second homes must be suitable for year-round occupancy, are restricted to one-unit dwellings, must not be a rental property or a timeshare arrangement, must be occupied by the borrower for some portion of the year, the borrower must have exclusive control over the property, and it cannot be subject to any agreements that give a management firm control over the occupancy of the property. The property also must be in such a location as to function reasonably as a second home. A two-unit second home must be considered an investment property.

Manufactured and Modular Homes

The secondary market defines "modular homes" as panelized, modular or sectional homes, where some parts of the homes were built off-site and transported to the property where they were assembled. These homes are acceptable if the homes have the characteristics of a site-built home, and meet all applicable state and local zoning and building codes.

The secondary market defines "manufactured homes" as those built on a steel frame in compliance with the Federal Manufactured Home Construction and Safety Standards. See Doublewide Conventional Product Guide for further guidance.

PUD Units

The appraisal report must describe the subject project and any common property. It must also indemnify and analyze any differences between the amenities and monthly unit charge of the subject property and the comparable properties, if the comparables are from competing projects. The appraisal report form must include the project name for the subject property.

Condominium Units

Appraisal reports used for condominium units require the appraiser to analyze project information and individual unit data in estimating the condominium's marketability and market value. The appraiser must also report the project name, amenities, unit charge and the property rights for each comparable sale and must compare them to the subject property in the market data analysis.

2-4 Unit Properties

Comparable rent data **– at least three rental comparables must be analyzed in the "comparable rental data" section. These rental comparables must have current rental information and be units similar to and located near the subject property.**

Subject's rent schedule **– this section contains the subject property's current actual rents and the estimated market rents. The estimated market rents for the subject property must be supported in the appraisal report and be consistent with the data presented throughout the report.**

Sales comparison analysis **– The appraisal must contain the unadjusted units of comparison for the comparable sales. If the appraisal is prepared in conjunction with a sales transaction, the units of the comparison must be provided for the subject property as well. These units of comparison are the sales price per square foot of GBA, per unit and per room and the gross rent multiplier (GRM). The comment area of the sales comparison analysis must reconcile the adjusted sales prices of the comparable sales and the unadjusted units of comparison, as appropriate, according to the manner in which such properties sell in the defined market area. The appraiser must indicate in the comments area what factors are deemed most consistent and what factors typical investors or purchasers in that market consider when purchasing a similar property.**

Accessory Units

A 1-unit attached or detached property may only have one accessory unit. It is eligible if the accessory unit is either legal or legal non-conforming based on the zoning and land use requirements, and any applicable covenants or restrictions (including Condominium Project or Planned Unit Development (PUD) homeowner's association (HOA) requirements.) A Mortgage secured by a 2- to 4-unit property with one or more accessory unit is not eligible.

The accessory unit must include a kitchen and bathroom. (Examples of such properties include a dwelling with a unit above a detached garage, a dwelling with an attached or detached guest apartment, or a dwelling with a basement unit.) For a 1-unit property with an accessory unit (legal or illegal zoning compliance) the appraiser must describe the accessory unit and appraise the property based on its current use. Any effect the accessory unit has on the market value or marketability of the subject property must be analyzed and reported. If the subject property accessory unit complies with the zoning and land use requirements (legal or legal non-conforming zoning compliance), the appraisal report must include at least one comparable sale with only one accessory unit. The accessory unit of the comparable sale must also comply with the zoning and land use requirements to demonstrate the conformity and marketability of the subject property to its market area.

If the subject property accessory unit does not comply with the zoning and land use requirements, the Mortgage is ineligible.

Mixed Use Properties

Mixed use properties are eligible if it can be determined that the nature, intent and primary purpose of the property is residential in use. The following special eligibility criteria must be met:

- **the property must be a one-unit dwelling that the borrower occupies as a principal residence.**
- **the borrower must be both the owner and operator of the business.**
- **the dwelling may not be modified in a manner than has an adverse impact on marketability of the subject as a residential property (the cost to restore the property to solely residential use must not affect its value.)**
- **the property must conform to all applicable use restrictions and must be zoned for residential use, and not commercial or business uses.**

VII. Unacceptable appraisal report practices

The following are unacceptable appraisal practices. Evidence of any of the practices listed below will be a breach of the Lender's warranty as to the professional quality of the report.

1. **Inclusion of inaccurate or incomplete data about the subject property, the neighborhood or any comparable sale used in the appraisal report.**
2. **Failure to report and/or consider any apparent factor that has an adverse effect on the value and/or marketability of the subject property.**
3. **Consideration of the age or location of a dwelling or the age of the neighborhood or census tract where the dwelling is located in a manner that has a discriminatory effect.**
4. **Reliance in the appraisal analysis on comparable sales that were not personally inspected by the appraiser. A personal inspection requires at least a visual inspection of the exterior of the comparable property.**
5. **Reliance in any appraisal analysis on inappropriate comparable sales or the failure to use comparable sales that are more physically and locationally similar, without adequate explanation.**
6. **Use of comparable sales data provided by interested parties to the transaction, without verification by a disinterested party.**
7. **The use of inordinate adjustments for differences between the subject property and the comparable sales that do not reflect the market's reaction to such differences or the failure to make proper adjustments when they are clearly necessary.**
8. **Consideration of the race, color, religion, sex, handicap, familial status or national origin of the prospective owners or occupants of the subject property or of the present owners or occupants of the properties in the vicinity of the subject property.**
9. **Development of value and/or marketability conclusions that are not supported by available market data.**
10. **The appraiser's breach of a certification on any secondary market approved appraisal report form or addendum.**

VIII. Distressed Market Lending Practices

The purpose of an appraisal is to provide us with an accurate and adequately supported opinion of value, based on the definition of market value. Appraisers must determine whether the property they are appraising is located in increasing, stable or declining market. In reporting the property-value trends, appraisers certify that they have performed an objective and complete analysis of quantifiable data supporting their conclusion. Appraisers are required to support their conclusions by providing relevant information relating to the property-value trends, demand/supply and marketing time.

UNDERWRITING GUIDELINES

Appraisers must also provide a description of the prevalence and impact of financing assistance (concessions, gifts, downpayment assistance, etc.) paid on behalf of a Borrower as well as the assistance generally available in the market. They must also research and comment on the days-on-market, including expired listings of the subject and comparables, as well as list-to-sale price ratios, and the availability of financing. The opinions of value must reflect the value and marketability of the property without concessions.

While it is the appraiser's responsibility to indicate the property-value trends in the market, CUSO will also monitor quarterly market trends in our lending areas. If there is a high layering of risk, LTV restrictions may be required.

Condominium Units

Condominium Unit projects can be identified as follows:

Project Type	Identification Criteria
Established condo project	A project for which all of the following are true: • At least 90% of the total units in the project have been conveyed to the unit purchasers; • The project is 100% complete, including all units and common elements; • The project is not subject to additional phasing or annexation; and • Control of the HOA has been turned over to the unit owners.
New condo project	A project for which one or more of the following is true: • Fewer than 90% of the total units in the project have been conveyed to the unit purchasers; • The project is not fully completed, such as proposed construction, new construction, or the proposed or incomplete conversion of an existing building to a condo; • The project is newly converted; or • The project is subject to additional phasing or annexation.
Two-to four-unit condo project	A condo comprised of two, three, or four residential units in which each unit is evidenced by its own title and deed. A two-to four-unit condo project may be either a new or an established project and may be comprised of attached and/or detached units.

Type of review required by the lender:

Unit and Project Type	Project Review Methods
Attached condo unit in a new or newly converted project, including an attached unit in a condo project that includes a mixture of attached and detached units.	Full review by the lender
Attached condo unit in an established project, including an attached unit in a condo project that includes a mixture of attached and detached units.	Based on the LTV, CLTV, and HCLTV ratios, occupancy, and location these projects may be reviewed using a Limited Review
Detached condo unit in a new or established project, including a detached unit in a condo project that includes a mixture of attached and detached units.	No Review*
Attached or detached unit in a new or established two-to four-unit condo project	No Review*

***units exempt from review must still be covered by appropriate insurance and the project must not be an ineligible project as described on pages 44-45.**

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An attached unit in an established condo project is eligible for a Limited Review if it meets the transaction requirements below:

Occupancy Type	**Maximum LTV, CLTV, and HCLTV Ratios**
Principal residence	**90%**
Second home	**75%**
Investment property	**75%**

	Limited Review Eligibility Requirements
	• **The project is not an ineligible project (see pages 44-45)** • **The project does not consist of manufactured homes** • **The project (all condo units, common elements and amenities) and related facilities are complete and not subject to additional phasing** • **At least 90% of the total units in the project have been conveyed to the unit purchasers other than the developer** • **The unit owners control the Homeowners Association**

	Full Review Eligibility Requirement
	Lenders must review the HOA projected budget to determine that it **• is adequate (i.e., it includes allocations for line items pertinent to the type of condo project), and** **• provides for the funding of replacement reserves for capital expenditures and deferred maintenance that is at least 10% of the budget and adequate funding for insurance deductibles. To determine whether the association has a minimum annual budgeted replacement reserve allocation of 10%, the lender must divide the annual budgeted replacement reserve allocation by the association's annual budgeted assessment income (which includes regular common expense fees).** **The following types of income may be excluded from the reserve calculation:** **• incidental income on which the project does not rely for ongoing operations, maintenance, or capital improvements;** **• income collected for utilities that would typically be paid by individual unit owners, such as cable TV or Internet access;** **• income allocated to reserve accounts; and special assessment income. The lender may use a reserve study in lieu of calculating the replacement reserve of 10% provided the following conditions are met:** **• the lender obtains a copy of an acceptable reserve study and retains the study and the lender's analysis of the study in the project approval file,** **• the study demonstrates that the project has adequate funded reserves that provide financial protection for the project equivalent to secondary market standard reserve requirements,** **• the study demonstrates that the project's funded reserves meet or exceed the recommendations included in the reserve study, and** **• the study meets secondary market requirements for replacement reserve studies listed at the end of this section.**
	For projects in which the units are not separately metered for utilities, the lender must **• determine that having multiple units on a single meter is common and customary in the**

	local market where the project is located, and • confirm that the project budget includes adequate funding for utility payments. Note: These requirements are not applicable to two- to four-unit projects.
	No more than 15% of the total number of units in a project are 60 or more days delinquent on payment of their HOA assessments.
	The project must be located on contiguous parcels of land. It is acceptable for a project to be divided by public or private streets.
	The structures within the project must be within a reasonable distance from each other.
	Common elements and facilities, such as recreational facilities and parking, must be consistent with the nature of the project and competitive in the marketplace.
	Unit owners in the project must have the sole ownership interest in, and rights to the use of the project's facilities, common elements, and limited common elements, except as noted below. Shared amenities are permitted only when two or more HOAs share amenities for the exclusive use of the unit owners. The associations must have an agreement in place governing the arrangement for shared amenities that includes the following: • a description of the shared amenities subject to the arrangement; • a description of the terms under which unit owners in the project may use the shared amenities; • provisions for the funding, management, and upkeep of the shared amenities; and • provisions to resolve conflicts between the associations over the amenities. Examples of shared amenities include, but are not limited to, clubhouses, recreational or fitness facilities, and swimming pools. The developer may not retain any ownership interest in any of the facilities related to the project. The amenities and facilities—including parking and recreational facilities—may not be subject to a lease between the unit owners or the HOA and another party. Parking amenities provided under commercial leases or parking permit arrangements with parties unrelated to the developer are acceptable.
	Financing of a single or multiple parking space(s) with the mortgage provided that the parking space(s) and residential unit are included on one deed as evidenced on the legal description in the mortgage is permitted. In such cases, the LTV, CLTV, and HCLTV ratios are based on the combined value of the residential unit and the parking space(s).
	Phase I and II environmental hazard assessments are not required for condo projects unless the lender identifies an environmental problem through the performance of its project underwriting or due diligence.
	For investment property transactions on attached units in established projects, at least 50% of the total units in the project must be conveyed to principal residence or second home purchasers. This requirement does not apply if the subject mortgage is for a principal residence or second home. Financial institution-owned REO units that are for sale (not rented) are considered owner-occupied when calculating the 50% owner-occupancy ratio requirement.
	If the project was a gut rehabilitation project, all rehabilitation work involved in a condo conversion must have been completed in a professional manner. "Gut rehabilitation" refers to the renovation of a property down to the shell of the structure, including the replacement of all HVAC and electrical components (unless the HVAC and electrical components are up to current code). For a conversion that was legally created during the past three years, the architect's or engineer's report (or functional equivalent), that was originally obtained for the conversion must comment favorably on the structural integrity of the project and the condition and remaining useful life of the major project components, such as the heating and cooling systems, plumbing, electrical systems, elevators, boilers, roof, etc.

	ADDITIONAL REQUIREMENTS FOR ATTACHED UNITS IN NEW AND NEWLY CONVERTED CONDO PROJECTS
	The project, or the subject legal phase, must be "substantially complete". There may not be

	more than one legal phase per building. "Substantially complete" means that • a certificate of occupancy or other substantially similar document has been issued by the applicable governmental agency for the project or subject phase; and • all the units and buildings in the legal phase in which the unit securing the mortgage is located are complete, subject to the installation of buyer selection items, such as appliances. At least 50% of the total units in the project or subject legal phase must have been conveyed or be under contract for sale to principal residence or second home purchasers. • For a specific legal phase or phases in a new project, at least 50% of the total units in the subject legal phase(s), considered together with all prior legal phases, must have been conveyed or be under contract for sale to principal residence or second home purchasers. • For the purposes of this review process, a project consisting of one building cannot have more than one legal phase. Individual units in new condo projects must be available for immediate occupancy at the time of loan closing.

Ineligible Projects

The following are ineligible projects:

- **Common interest apartment – A project in which individuals have an undivided interest in a residential apartment building and land and have the right of exclusive occupancy of a specific apartment unit in the building. The project or building is often owned by several owners as tenants in common or by a homeowners' association**
- **Fragmented or segmented ownership – Ownership is limited to a specific period on a recurring basis such as the 15th week of the year, or for a limited period such as for the subsequent five years. Timeshare projects are examples of fragmented or segmented ownership.**
- **Houseboat project – A project comprised of boats that have been designed or modified to be used primarily as dwelling units.**
- **Multi-dwelling unit project – A project in which an owner may hold a single deed evidencing ownership of more than one dwelling unit.**
- **Certain legal non-conforming projects – Legal non-conforming project for which legislation or the local zoning authority does not permit the current improvements to be rebuilt to current density in the event of partial or full destruction.**
- **Project involved in litigation – A project for which the unit owners, association, or developer if the project has not been turned over to the unit owners, is a party to current litigation and the reason for the litigation involves the safety, structural soundness or habitability of the project.**
- **Condominium hotel – A Condo hotel is a project in which any unit owner or the homeowners, association is a party to a revenue-sharing agreement with either the developer or another third-party.**
- **Project with excessive commercial or non-residential space – A project in which more than 35% of the total above and below grade square footage of the project is used as commercial or non-residential space.**

  - **Note: Projects located in flood zones with commercial space greater than 25%, including any commercial parking facilities, may need supplemental or private flood policies, as coverage under NFIP may be inadequate for projects with commercial space greater than 25%.**
- **New Project sold with excessive Seller contributions – a new condominium project where the guilder, developer, or property seller is offering financing or sales arrangements (i.e. rent-backs or leasebacks, payment of PITI, HOA assessments that exceed limitations, or undisclosed contributions not disclosed on the Closing Disclosure.)**
- **Project with excessive single investor concentration – any project in which an individual or single entity such as an investor group, partnership or corporation owns more than the following total number of units in the project:**

  Projects with 5 to 20 units – 2 units
  Projects with 21 or more units – 20%

  Vacant units being actively marketed by the developer are not included in the calculation of the developer's percentage of ownership. Any units leased by the developer must be included in the calculation of the developer's percentage of ownership.

- **Continuing Care Retirement Community (CCRC) – a residential project designed to meet the health and housing needs of seniors as their needs change over time (also known as Life-Care Facilities.)**
- **Manufactured Homes – mortgages secured by manufactured homes**
- **Project with mandatory dues or similar membership fees for use of Amenities such as clubhouses or recreational facilities – projects with mandatory dues or similar membership fees, including initiation or joining fees which allow for the use of amenities such as clubhouses or recreational facilities are ineligible unless the HOA solely owns the amenities and the unit owners within the HOA are the only persons eligible for membership.**
- **Projects that are newly converted non-gut rehabilitation projects with more than four residential units.**

Further guidance on Condominiums

Appropriate steps must be taken to ensure that the condo project is not a Condominium Hotel. To ensure that a project is not a Condo Hotel, careful assessment of the relationships among the developer, any third-party entity, and the unit owners is required. Resources available for a review of a Condo Project include but are not limited to:

- **Internet**
- **Public Records**
- **Sales Contract**
- **Offering circulars relating to sales of the units in the project**
- **Rental Agreements relating to the units in the project**
- **Appraisal Reports of subject unit**
- **Marketing materials relating to sales of units in the project**
- **Written agreements between the homeowner's association and other parties**
- **Subject projects Condo docs**
- **Project Documents of any Master Association**
- **Written agreements between a unit owner and the developer or any third-party entity who succeeds the developer**
- **State law**

Indications a more comprehensive project review is required

A revenue sharing agreement is an arrangement under which the unit owner receives a share of income from the aggregate net income produced from rental of other units in the project or from other commercial activities of the project. Revenue sharing agreements are the trademark of a Condominium Hotel. If any unit owner or the homeowner's association is a party to a revenue sharing agreement, the project is by definition a Condominium Hotel.

There are two general categories of red flag indicators that a project may be a Condo Hotel. They are:

- **Marketing and project management practices that indicate the developer or another third-party entity retains control of the project or portions of the project. The following are examples:**
  - **The sales contract or offering circular states that the unit has been marketed without any representations regarding rental arrangements and/or rental pooling**
  - **The sales contract or offering circular states that ownership may include the opportunity to place the unit in a rental agreement**
  - **Purchasers must meet with the developer or another third-party entity before any purchase can be completed**
  - **The developer or a third-party entity expects to retain ownership or control of the project**
  - **The developer or another third-party entity retains ownership or control of any common elements or amenities**
  - **The condo docs and any amendments are silent on the presence of common elements and/or amenities, their use and/or ownership; or they state that the common elements and/or amenities may be added to, expanded or deleted as determined by the developer or another third-party entity without the consent of the unit owners or the homeowner's association**
  - **Unit owners have no control over any third-party entity that succeeds the developer**
  - **The project includes commercial space over which the unit owners have no control**
- **Physical characteristics indicating that the project has a hotel identity or hotel-like characteristics or offers hotel like services. The following are examples:**
  - **The project name includes "hotel, resort, motel, inn or lodge"; has an affiliation with, and/or is managed by an entity, usually a hotel chain or hospitality entity**
  - **The project is located at the same address as a hotel or resort, or within a hotel or resort**
  - **The project shares facilities, common elements or amenities with a hotel, resort, and/or lodge that is owned and managed by the developer or another third-party entity**
  - **The project is subject to local zoning classification other than residential**
  - **The project is publicly advertised as a Condo Hotel (e.g. the project advertises on travel or hotel websites, or has a website on the internet and presents itself as a Condo Hotel)**
  - **The developer, another third-party entity or the homeowner's association operates commercial facilities within the project or master association, such as retail stores, restaurants, bar/lounge, and/or a golf course**
  - **Common areas, recreational facilities and amenities are available within the project or Master Association that are usually associated with luxury hotels and resorts**
  - **The project has centralized utilities such as central telephone and voicemail**
  - **Access to individual units is controlled by a key system**
  - **The individual units are sold "fully furnished" or purchaser choose from a list of "approved' furniture, floor and wall coverings**

- The units contain lockable storage closets or cabinets, safes and/or mini bars that are uniformly available in many units
- The units have interior doors that adjoin other units
- Vacancy/No Vacancy signs are present on the project grounds
- Concierge and/or bell services, room service and/or food and beverage services are available
- Daily maid service is available. Storage closets are used to store supplies
- Reservations can be made online
- Registration services are available, whether on or off-site

If a project has ANY of the above red flag indicators, an in-depth review must be made to determine whether or not the condo is a Condo Hotel which could render it "ineligible".

Documents Required for a full review for Condominiums

- Bylaws & (recorded) Declarations
- Complete Condo Questionnaire (CUSO Form)
- Current Budget
- Evidence of satisfactory commercial general liability insurance covering all common areas, common elements, commercial spaces and public ways in the project. There must be a "severability of interest" endorsement precluding that the insurer's denial of a unit owner's claim because of negligent acts by the association, the fee simple landowner/lessor or other unit owners. The amount of coverage must be at least $1 million for bodily injury and property damage for any single occurrence.
- Fidelity/Crime Insurance: The HOA must maintain a fidelity/crime policy covering anyone with access to association funds, including a management agent, except for projects that:
- ・ Have 20 units or less; or
- ・ Need no more than $5,000 in required coverage (based on either the maximum funds held or three months of assessments, depending upon which method applies to the project).

Documents Required for a streamline/limited review for Condominiums

- Bylaws & (recorded) Declarations
- Complete Condo Questionnaire (CUSO Form)
- Evidence of satisfactory commercial general liability insurance (declaration page)

INVESTMENT PROPERTY MORTGAGES

Special Underwriting Requirements

- **The borrower may not have a relationship or be affiliated in any way with the builder, developer, or property seller**
- **The expenses related to the Borrower's current primary residence must be used in calculating the Borrower's monthly housing expense-to-income ratio**
- **Regardless of whether rental income from the investment property is used in qualifying the borrower for the mortgage, the Borrower must have satisfactory reserves as determined by AUS.**
- **The aggregate rental income must be added to the borrower's total monthly income if being used to qualify. The negative rental income must be treated as an obligation and considered in calculating the Borrower's monthly debt payment to income ratio**
- **Borrower Funds cannot be gift funds or gifted equity**
- **If rental income is not used for qualifying, the mortgage premises PITI must be used in calculating the monthly debt payment to income ratio**
- **If the borrower is financing an investment property that is underwritten through the AUS, the maximum number of financed properties the borrower can have is six.** If the borrower will have one to six financed properties, secondary market standard eligibility policies apply (for example, LTV ratios and minimum credit scores). ****

****Effective with applications dated 8/20/18 and after:**

When each Borrower individually, and all Borrowers collectively, are obligated on one to six financed properties, including the subject property and the Borrower's Primary Residence:
Required reserves= Two months of the monthly payment amount on each additional second home and/or 1- to 4-unit Investment Property that is financed and on which the Borrower is obligated or per DU findings, whichever is greater

When each Borrower individually, and all Borrowers collectively, are obligated on seven to 10 financed properties, including the subject property and the Borrower's Primary Residence:
Required reserves= Eight months of the monthly payment amount on each additional second home and/or 1- to 4-unit Investment Property that is financed and on which the Borrower is obligated or per DU findings, whichever is greater
Minimum indicator score of 720