Underwriting Guidelines (Conventional)
Underwriting Guidelines (Conventional)
Mortgage Lending Division
Version 1.0 – 02/01/12

DOCUMEN TOVERVIEW

Purpose
The following document describes the responsibilities and requirements of the Carrington Mortgage Services, LLC (CMS) Mortgage Lending Division Underwriter (Underwriter) when reviewing and underwriting Correspondent mortgage loan applications.

Table of Contents

<table>
<thead>
<tr>
<th>Overview</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purpose</td>
<td>10</td>
</tr>
<tr>
<td>Standards</td>
<td>10</td>
</tr>
<tr>
<td>Related Documents</td>
<td>10</td>
</tr>
<tr>
<td>Eligibility</td>
<td>11</td>
</tr>
<tr>
<td>Limited Denial of Participation (LDP)/General Services Administration (GSA) Lists</td>
<td>11</td>
</tr>
<tr>
<td>Loan Application</td>
<td>11</td>
</tr>
<tr>
<td>Identity Verification</td>
<td>12</td>
</tr>
<tr>
<td>Social Security Number Validation</td>
<td>12</td>
</tr>
<tr>
<td>Occupancy Types</td>
<td>13</td>
</tr>
<tr>
<td>Primary Residence</td>
<td>13</td>
</tr>
<tr>
<td>Second Home</td>
<td>14</td>
</tr>
<tr>
<td>Investment Property</td>
<td>14</td>
</tr>
<tr>
<td>Borrower Types</td>
<td>15</td>
</tr>
<tr>
<td>Borrowers</td>
<td>15</td>
</tr>
<tr>
<td>U.S. Citizen</td>
<td>15</td>
</tr>
<tr>
<td>Non-U.S. Citizen</td>
<td>16</td>
</tr>
<tr>
<td>Non-Occupant Co-Borrower</td>
<td>16</td>
</tr>
<tr>
<td>Multiple Properties Financed/Owened</td>
<td>17</td>
</tr>
<tr>
<td>Multiple Properties</td>
<td>17</td>
</tr>
<tr>
<td>Properties Financed</td>
<td>17</td>
</tr>
<tr>
<td>Simultaneous Submissions</td>
<td>17</td>
</tr>
<tr>
<td>Ownership Defined</td>
<td>17</td>
</tr>
<tr>
<td>Ownership Interests</td>
<td>17</td>
</tr>
<tr>
<td>Transactions</td>
<td>18</td>
</tr>
<tr>
<td>Purchase</td>
<td>18</td>
</tr>
<tr>
<td>Purchase</td>
<td>18</td>
</tr>
<tr>
<td>Owner of Record and Chain of Title</td>
<td>19</td>
</tr>
<tr>
<td>Non-Arm's Length Transactions</td>
<td>19</td>
</tr>
<tr>
<td>At-Interest Transactions</td>
<td>20</td>
</tr>
<tr>
<td>Auctioneer's Fees</td>
<td>20</td>
</tr>
<tr>
<td>Redemption Periods</td>
<td>20</td>
</tr>
<tr>
<td>No Cash-out Refinance</td>
<td>21</td>
</tr>
<tr>
<td>Definition</td>
<td>21</td>
</tr>
<tr>
<td>Desktop Underwriter and Loan Prospector Loans</td>
<td>21</td>
</tr>
<tr>
<td>Jumbo Loans</td>
<td>22</td>
</tr>
<tr>
<td>Buyout of a Co-owner</td>
<td>22</td>
</tr>
<tr>
<td>Cash-Out Refinance</td>
<td>23</td>
</tr>
<tr>
<td>Definition</td>
<td>23</td>
</tr>
<tr>
<td>Delayed Financing</td>
<td>23</td>
</tr>
<tr>
<td>Continuity of Obligation</td>
<td>24</td>
</tr>
<tr>
<td>Desktop Underwriter and Loan Prospector Loans</td>
<td>24</td>
</tr>
</tbody>
</table>
Restructured Loan/Short Pay off .......................................................... 24
Purchase or Refinance of Inherited Property ...................................... 25
Pending Sale of Current Primary Residence ........................................ 25
  Primary Residence Pending Sale ....................................................... 25
Conversion of a Primary Residence to Second Home or Investment Property ...... 26
  Conversions of Primary to Second Home ........................................... 26
  Establishing Equity in Retained Property ......................................... 27
Principal Curtailment ........................................................................... 27
  Curtailment ...................................................................................... 27
  Lender Paid Transactions .................................................................. 27
  Borrower Paid Transactions .............................................................. 27
Financing .............................................................................................. 28
  Purpose ............................................................................................. 28
  Determining Amount to be Financed ................................................ 28
    Factors Affecting Eligible Amount ................................................ 28
  Determining Value ............................................................................ 28
    First Mortgage Transaction Value .................................................. 28
  Calculating Loan-to-Value Ratios ...................................................... 29
    Loan-to-Value (LTV) Ratio ............................................................... 29
    Combined LTV (CLTV) Ratio ........................................................... 29
    Home Equity Combined LTV (HCLTV)/Home Equity Total LTV (HTLTV) Ratio 29
Subordinate Financing ........................................................................ 30
  Requirements .................................................................................. 30
  State-Specific Requirements ............................................................ 30
  Ineligible Subordinate Financing ..................................................... 32
  Subordinate Financing Terms ............................................................ 33
  Graduated or Variable Payments ..................................................... 33
  Employer Provided Subordinate Financing ....................................... 34
Interested Party Contributions (IPC) ..................................................... 34
  Overview .......................................................................................... 34
  Financing Concessions ..................................................................... 35
  Sales Concessions ............................................................................ 36
Excessive Marketing Fees ..................................................................... 37
  Definition/ Requirements .................................................................. 37
Escrow for Impounds .......................................................................... 37
  Impounds .......................................................................................... 37
  Funds Escrowed .............................................................................. 38
  Waiver Eligibility ............................................................................ 38
Property Types and Project Standards ............................................... 39
  Purpose ............................................................................................. 39
  Eligible Property Types .................................................................... 39
    Single-Family Residence ............................................................... 39
    Modular Home/Pre-cut/ Panelized Home ........................................ 39
    One-to-Four Units ......................................................................... 39
    Mixed-Use Property ..................................................................... 40
    Condominium .......................................................... 40
    Planned Unit Development (PUD) .................................................. 40
    Deed/Resale Restrictions .............................................................. 41
Ineligible Property Types .................................................................... 41
Underwriting Guidelines (Conventional)
Mortgage Lending Division
Version 1.0 – 02/01/12

Loan Prospector Risk Class ................................................................. 90
Loan Prospector Documentation Level ............................................... 91
Loan Prospector Data and Delivery Information Accuracy .................... 91

Credit ........................................................................................................ 93

- Purpose ................................................................................................. 93
- Underwriting Methods ......................................................................... 93

Documentation Age and Requirements ............................................... 93
Documentation Age ................................................................................ 93
Documentation Standards ..................................................................... 93

Credit Report Requirements ............................................................... 94

- Requirements ....................................................................................... 94
- Credit Report Red Flags ...................................................................... 94
- Merged Credit Reports ...................................................................... 94
- Residential Mortgage Credit Report (RMCR) ..................................... 95
- Credit Report Standards .................................................................... 95
- Non-Traditional Credit Report ............................................................ 97
- Non-U.S. Citizens ................................................................................ 98

Credit Scores .......................................................................................... 99

- Credit Scores ....................................................................................... 99
- Credit Score Risk Factors .................................................................. 99

Selection and Validation of Credit Score ............................................. 101
Selection ................................................................................................. 101
Loan Qualification Score ................................................................. 101
Usable Credit Score ........................................................................ 101
Authorized User Accounts ............................................................... 102
Tradeline Requirements ..................................................................... 103

Credit History Evaluation .................................................................... 103
Desktop Underwriter and Loan Prospector Loans ............................. 103
Jumbo Loans ......................................................................................... 103

Housing Payment History ................................................................... 107
Requirements ....................................................................................... 107
Desktop Underwriter and Loan Prospector Loans ............................. 107
Jumbo Loans ......................................................................................... 107

Significant Derogatory Credit .............................................................. 108
Increased Risk of Default ................................................................... 108
Desktop Underwriter and Loan Prospector Loans ............................. 108
Jumbo Loans ......................................................................................... 108
Recovery Time Periods ....................................................................... 109
Restructured Loan ............................................................................ 113
Consumer Credit Counseling ............................................................. 113
Major Adverse Credit .......................................................................... 114

Assets ....................................................................................................... 115

- Assets ................................................................................................. 115
- Underwriting Methods ..................................................................... 115

Documentation Age .............................................................................. 115

Minimum Down Payment and Cash to Close ................................... 116
Requirements ....................................................................................... 116
Foreign Assets ....................................................................................... 116

Reserve Requirements .......................................................................... 116

- Requirements ....................................................................................... 116
- Acceptable Sources for Liquid Reserves based on Loan Type ........ 117
Liabilities and Debt Ratios ................................................................. 134

Overview ....................................................................................... 134
Ratios .......................................................................................... 134

Monthly Housing Expenses ......................................................... 134

Included Expenses ........................................................................ 134

Qualifying Housing Payment ....................................................... 135

Total Qualifying Debt-to-Income Ratios ....................................... 135

Monthly Debt Obligations ............................................................. 135

Assess Liabilities ........................................................................... 135
Monthly Debt Obligation ............................................................. 136
Alimony, Child Support and Maintenance Payments ................. 136
Authorized User ........................................................................... 136
Bridge Loans ................................................................................ 137
Business Debt in Borrower's Name ............................................. 137
Co-Signed Loans ......................................................................... 137
Court-Ordered Assignment of Debt ............................................ 137
Deferred Installment Debt ............................................................ 137
Home Equity Lines of Credit ....................................................... 138
Installment Debt .......................................................................... 138
Lease Payments ........................................................................... 138
Loans Secured by Financial Assets ............................................. 138
Mortgage Assumptions ................................................................. 139
Open 30-day Charge Accounts ................................................... 139
Other Real Estate Owned ............................................................. 139
Property Settlement Buy-out ....................................................... 140
Revolving Charge/Lines of Credit .............................................. 140
Undisclosed Liabilities ................................................................. 140
Voluntary Recurring Debts .......................................................... 140

Unacceptable Sources of Assets ................................................ 134

Ineligible Sources .......................................................................... 134

Asset Sources .............................................................................. 118

List of Acceptable Asset Sources .............................................. 118
Bank Accounts ............................................................................. 119
Bridge Loan ................................................................................ 120
Business Funds ........................................................................... 120
Credit Card Financing ................................................................. 120
Earnest Money Deposits .............................................................. 120
Employer Assistance Programs ................................................ 120
Equity from Other Assets ........................................................... 120
Gifts .............................................................................................. 121
Income Tax Refund ....................................................................... 121
Life Insurance – Cash Value ....................................................... 121
Lot Equity .................................................................................... 122
Notes Receivable/Repayment of Loans ...................................... 122
Qualified Tuition Plan (529 Plan) ................................................ 122
Real Estate Commissions ............................................................ 122
Rent Credit for Option to Purchase .......................................... 122
Retirement Accounts ................................................................... 123
Savings Bonds ............................................................................ 123
Secondary Financing ................................................................... 123
Stocks/Bonds ............................................................................. 123
Systematic Savings ...................................................................... 123
Trade Equity .............................................................................. 124
Trust Funds Disbursement ........................................................ 124

Ineligible Sources .......................................................................... 133

List of Acceptable Asset Sources .............................................. 118
Bank Accounts ............................................................................. 119
Bridge Loan ................................................................................ 120
Business Funds ........................................................................... 120
Credit Card Financing ................................................................. 120
Earnest Money Deposits .............................................................. 120
Employer Assistance Programs ................................................ 120
Equity from Other Assets ........................................................... 120
Gifts .............................................................................................. 121
Income Tax Refund ....................................................................... 121
Life Insurance – Cash Value ....................................................... 121
Lot Equity .................................................................................... 122
Notes Receivable/Repayment of Loans ...................................... 122
Qualified Tuition Plan (529 Plan) ................................................ 122
Real Estate Commissions ............................................................ 122
Rent Credit for Option to Purchase .......................................... 122
Retirement Accounts ................................................................... 123
Savings Bonds ............................................................................ 123
Secondary Financing ................................................................... 123
Stocks/Bonds ............................................................................. 123
Systematic Savings ...................................................................... 123
Trade Equity .............................................................................. 124
Trust Funds Disbursement ........................................................ 124

List of Ineligible Sources ............................................................. 118
Bank Accounts ............................................................................. 119
Bridge Loan ................................................................................ 120
Business Funds ........................................................................... 120
Credit Card Financing ................................................................. 120
Earnest Money Deposits .............................................................. 120
Employer Assistance Programs ................................................ 120
Equity from Other Assets ........................................................... 120
Gifts .............................................................................................. 121
Income Tax Refund ....................................................................... 121
Life Insurance – Cash Value ....................................................... 121
Lot Equity .................................................................................... 122
Notes Receivable/Repayment of Loans ...................................... 122
Qualified Tuition Plan (529 Plan) ................................................ 122
Real Estate Commissions ............................................................ 122
Rent Credit for Option to Purchase .......................................... 122
Retirement Accounts ................................................................... 123
Savings Bonds ............................................................................ 123
Secondary Financing ................................................................... 123
Stocks/Bonds ............................................................................. 123
Systematic Savings ...................................................................... 123
Trade Equity .............................................................................. 124
Trust Funds Disbursement ........................................................ 124

List of Unacceptable Liabilities .................................................. 118
Bank Accounts ............................................................................. 119
Bridge Loan ................................................................................ 120
Business Funds ........................................................................... 120
Credit Card Financing ................................................................. 120
Earnest Money Deposits .............................................................. 120
Employer Assistance Programs ................................................ 120
Equity from Other Assets ........................................................... 120
Gifts .............................................................................................. 121
Income Tax Refund ....................................................................... 121
Life Insurance – Cash Value ....................................................... 121
Lot Equity .................................................................................... 122
Notes Receivable/Repayment of Loans ...................................... 122
Qualified Tuition Plan (529 Plan) ................................................ 122
Real Estate Commissions ............................................................ 122
Rent Credit for Option to Purchase .......................................... 122
Retirement Accounts ................................................................... 123
Savings Bonds ............................................................................ 123
Secondary Financing ................................................................... 123
Stocks/Bonds ............................................................................. 123
Systematic Savings ...................................................................... 123
Trade Equity .............................................................................. 124
Trust Funds Disbursement ........................................................ 124

List of Unacceptable Liabilities .................................................. 118
Bank Accounts ............................................................................. 119
Bridge Loan ................................................................................ 120
Business Funds ........................................................................... 120
Credit Card Financing ................................................................. 120
Earnest Money Deposits .............................................................. 120
Employer Assistance Programs ................................................ 120
Equity from Other Assets ........................................................... 120
Gifts .............................................................................................. 121
Income Tax Refund ....................................................................... 121
Life Insurance – Cash Value ....................................................... 121
Lot Equity .................................................................................... 122
Notes Receivable/Repayment of Loans ...................................... 122
Qualified Tuition Plan (529 Plan) ................................................ 122
Real Estate Commissions ............................................................ 122
Rent Credit for Option to Purchase .......................................... 122
Retirement Accounts ................................................................... 123
Savings Bonds ............................................................................ 123
Secondary Financing ................................................................... 123
Stocks/Bonds ............................................................................. 123
Systematic Savings ...................................................................... 123
Trade Equity .............................................................................. 124
Trust Funds Disbursement ........................................................ 124

List of Unacceptable Liabilities .................................................. 118
Bank Accounts ............................................................................. 119
Bridge Loan ................................................................................ 120
Business Funds ........................................................................... 120
Credit Card Financing ................................................................. 120
Earnest Money Deposits .............................................................. 120
Employer Assistance Programs ................................................ 120
Equity from Other Assets ........................................................... 120
Gifts .............................................................................................. 121
Income Tax Refund ....................................................................... 121
Life Insurance – Cash Value ....................................................... 121
Lot Equity .................................................................................... 122
Notes Receivable/Repayment of Loans ...................................... 122
Qualified Tuition Plan (529 Plan) ................................................ 122
Real Estate Commissions ............................................................ 122
Rent Credit for Option to Purchase .......................................... 122
Retirement Accounts ................................................................... 123
Savings Bonds ............................................................................ 123
Secondary Financing ................................................................... 123
Stocks/Bonds ............................................................................. 123
Systematic Savings ...................................................................... 123
Trade Equity .............................................................................. 124
Trust Funds Disbursement ........................................................ 124
Employment and Income Analysis and Documentation

Employment Gaps
Furloughed Borrowers

Documentation Age and Standards

Documentation Age
Documentation Standards
Tax Information Authorization IRS Form 4506-T/Tax Transcripts
Paystub
W-2s
Written Verification of Employment
Verbal Verification or Confirmation of Employment (VVOE)
Tax Returns
Income Analysis Forms

Non-Reimbursed Business Expenses

Income Types
Types
Wage Earner
Bonus or Overtime
Commission

Self-Employed Income
Self-Employed Employment Analysis
Documentation Requirements

Rental Income
Income for Qualification Purposes
Treatment of Income
Rental Income Calculation and Documentation
Reporting Rental Income

Other Income Sources
Other Income Sources
Alimony, Child Support and Maintenance Payments
Auto Allowances and Expense Account Payments
Capital Gains & Losses
Disability
Employment by a Relative, Property Seller or Real Estate Broker
Foreign Income
Foster Care Income
Housing or Parsonage Allowance
Interest & Dividend Income
Military Income
Non-Taxable Income
Note Income
Public Assistance Programs
Retirement Pension, Annuity Income and IRA Distributions
Royalty Payments
Seasonal Part-time or Seasonal Second Job Income
Social Security Income
Teachers
Tip and Gratuity Income
Trust Income
Unemployment Benefits
Underwriting Guidelines (Conventional)
Mortgage Lending Division
Version 1.0 – 02/01/12

Union Members ............................................................................................................. 173
VA Benefits ................................................................................................................... 173
Unacceptable Sources of Income .................................................................................. 174

Appraisal Requirements, Documentation, and Evaluation ........................................ 175
Purpose ........................................................................................................................... 175

Appraiser Requirements ............................................................................................. 175

Discontinuance of Appraiser Services ......................................................................... 176

Approved Appraisal Management Service Providers ............................................... 176
Mandatory Use of Approved Appraisal Service Providers ........................................... 176

Neighborhood Analysis .............................................................................................. 191
Analysis .......................................................................................................................... 191
Neighborhood Characteristics ....................................................................................... 192

Trend of Neighborhood Property Values, Demand/Supply and Marketing Time ... 193
Indicators of Market Conditions .................................................................................. 193
Neighborhood Property Values .................................................................................... 193
Demand/Supply ............................................................................................................. 193
Marketing Time ............................................................................................................. 194
Price/Age Range and Predominant Value ..................................................................... 194
Present Land Use of the Neighborhood ....................................................................... 194
Neighborhood Boundaries and Description .................................................................. 194

Site Analysis ................................................................................................................ 195
Multiple Parcels as Mortgage Security ........................................................................ 195
Properties with Acreage .............................................................................................. 195
Site/Land Values .......................................................................................................... 195
Zoning ............................................................................................................................. 195
Highest and Best Use .................................................................................................... 198
Utilities .......................................................................................................................... 198
Flood Zones .................................................................................................................. 198
Lava Zones ................................................................................................................... 198
Off-Site Improvements ............................................................................................... 198
Environmental Hazards ............................................................................................... 199

Property Condition and Quality of Construction ....................................................... 200
UAD Rating .................................................................................................................... 200
Condition ....................................................................................................................... 200
Not Updated, Updated, and Remodeled .................................................................... 202
Quality ........................................................................................................................... 202

Improvement Analysis ............................................................................................... 205
Improvements ................................................................................................................. 205
General Description ..................................................................................................... 205
Foundation ..................................................................................................................... 205
Heating .......................................................................................................................... 206
Finished Area/Square Feet Above Grade ..................................................................... 206
Insulation and Energy Efficiency of the Improvements .............................................. 207
Property Condition ....................................................................................................... 208
Conformity to the Neighborhood .............................................................................. 210
Sales Comparison Approach ....................................................................................... 210
Income Approach .......................................................................................................... 216
Project Information for PUDs ....................................................................................... 216
Valuation Analysis and Final Reconciliation ................................................................. 216

Additional Review Considerations for Two- to Four-Unit Properties, Condominiums,
Mixed-Use Properties, and Leasehold Properties ......................................................... 218
Underwriting Guidelines (Conventional)

Mortgage Lending Division
Version 1.0 – 02/01/12

| Overview .................................................................................................................. | 218 |
| Two- to Four-Unit Properties ................................................................. | 218 |
| Condominiums ......................................................................................... | 219 |
| Mixed-Use Property ................................................................. | 220 |
| Leasehold Properties ........................................................................ | 220 |
| Natural Disasters .................................................................................. | 221 |
| Federal Emergency Management Agency (FEMA) ....................................... | 221 |
| Properties Located in Federally Declared Major Disaster Areas ................ | 221 |
| Inspection Requirements ..................................................................... | 221 |
| Special Disaster Inspection Certification Alternatives ........................ | 221 |
| Property with Significant Damage .................................................... | 222 |
| Property with Minor Damage ............................................................ | 222 |

**Revision History**

<table>
<thead>
<tr>
<th>Date</th>
<th>Version</th>
<th>Description of Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>02/01/12</td>
<td>1.0</td>
<td>New document.</td>
</tr>
</tbody>
</table>
OVERVIEW

Purpose

The purpose of credit and property underwriting is to ensure that each loan meets high quality standards that make the loans acceptable to CMS and its investors.

Standards

This document defines the underwriting standards that apply to all conventional loan programs. Underwriting standards that differ from one loan program to another are described in the CMS Product Guidelines. In most cases, differences will not be referenced in these guidelines. These guidelines are applicable to loans underwritten by Desktop Underwriter, Loan Prospector and Jumbo loans, unless otherwise specified.

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

Related Documents

CMS Product Guidelines
Underwriting Conditions Matrix
Underwriting Guidelines (FHA Loans)
Underwriting Guidelines (VA Loans)
ELIGIBILITY

**Purpose**

This section describes the requirements that must be followed when qualifying a borrower(s) for a conventional loan.

**Note:** See the Underwriting Guidelines (FHA Loans) and Underwriting Guidelines (VA Loans) documents for information on additional loan programs.

For state-specific restrictions, see the Underwriting Conditions Matrix.

**Limited Denial of Participation (LDP)/General Services Administration (GSA) Lists**

**Requirements**

The LDP and GSA lists must be checked to determine whether any company or individuals who are material parties to the transaction are included on these lists.

If any names are included on either of these lists, the loan is not acceptable regardless of the reasons for being included on either list.

**Loan Application**

**Requirements**

The loan application must be fully completed. A completed loan application includes, but not limited to, the following:

- Two-year history of employment and residency for each borrower.
- Personal information for each borrower (e.g., Social Security number, date of birth, address, education, etc.).
- Signatures of the borrower(s) as well as the date that the application was signed.
- Completed declaration questions indicating the method of taking the application: face-to-face, by telephone, or by mail.
- Interviewer's name, employer, and Nationwide Mortgage Licensing System (NMLS) Number.

In addition to the requirements listed above, the final application for closing must include the complete and accurate financial information for all borrowers and be signed and dated by all borrowers. The final loan application must include all debt incurred during the application process and through loan closing. See the Inquiries and Undisclosed Liabilities section of this document for more information.

All transactions must be reviewed for reasonability, including the feasibility of occupancy claims and the overall financial picture of the borrowers. If any conflicting information exists between or within documents, the potential borrowers must provide an adequate explanation and this information must documented and included in the loan file.

Any documents within the loan file that are applicable to the underwriting process must be reviewed for any alterations or fabrications. If any conflicting information exists between or within documents the potential borrowers must provide an adequate explanation and this information must documented and included in the loan file.
Identity Verification

Requirements  The identity of each borrower on the loan application must be confirmed. Evidence that the identification document has been confirmed for each borrower must be provided by the closing agent, Notary Public, or signing attorney. Acceptable forms of identification include:

- Passport (government issued, valid, and unexpired)
- Resident Alien Card (government issued, valid, and unexpired)
- Driving License (state issued, valid, and unexpired)
- State ID Card (state issued, valid, and unexpired)

Social Security Number Validation

Acceptable Documentation  Evidence of a valid Social Security number must be provided for all borrowers. Acceptable documentation for a Social Security number includes, but is not limited to the following:

- Valid Social Security card
- Current paystub
- W-2
- Tax transcripts.

If any Social Security number discrepancies are discovered, they must be resolved.
Occupancy Types

Primary Residence

If a borrower indicates that the subject property will be his or her primary residence, the viability of the borrower occupying the property must be assessed.

For refinance transactions, the current address reported on the loan application must be compared to the addresses listed on the credit report. Any red flags or inconsistencies found within the last 12 months must include a full explanation.

A primary residence is a property that:

- At least one borrower occupies for the major part of the year.
- Is convenient to the borrower's principal place of employment.

The property address of record must be verified. Acceptable forms of verification can be documented by, but are not limited to, one of the following:

- Personal income tax returns
- Voter registration
- Driver's license
- Occupational licensing

The property must be occupied by at least one borrower within 60 days of closing and continue to be occupied for at least one year. If an occupancy finding is issued or at the Underwriter’s discretion, an Occupancy Certification is required. At the Underwriter’s discretion, borrowers may be required to certify occupancy for second homes.

If the borrower makes misrepresentations for any provision of the application, including occupancy, the loan documents must provide that the loan may be declared in default.

The following restrictions apply to primary residence transactions:

1. Multiple primary residence purchases within the past 12 months will be considered on a case-by-case basis when the borrower has satisfactorily explained and documented the following:
   - The reason the current home is no longer owner occupied.
   - The motivation to occupy the subject property.
   - The elapsed time between transactions was reasonable.

2. The borrower must reside in and hold title to the subject property at the time of application for a primary residence refinance transactions to be considered.
Occupancy Types (continued)

**Second Home**

A second home is a one-unit property occupied by the borrower for some portion of the year that is in addition to his or her primary residence. Second homes are often located in a vacation/resort area.

The following requirements must be followed for second home properties:

- Second home properties must be suitable for year-round occupancy and must not be located in the same market area as the borrower's primary residence.
- Second homes may be located in a major metropolitan area that the borrower visits on a regular basis.
- If a second home is not located in a vacation/resort area, a letter of explanation must be obtained from the borrower stating the reason.
- The borrower must have exclusive control over the property and the property must not be subject to any kind of time sharing agreement, rental pools, or agreements that require the borrower to rent, share or give management firm control over occupancy.
- Rental income must not be used to qualify the borrower. Reporting rental income on the borrower’s personal tax returns does not contradict second home status, but must be minimal. The hazard insurance policy may not contain any coverage for loss of rent.

**Note:** Occasional season rental is permitted. See the Employment and Income Analysis and Documentation section for more information.

**Notes:**

- If a property is being purchased for an individual other than the borrower, the transaction should be considered an investment property purchase. See the Investment Property section below for more information.
- See the Non-arm’s Length Transaction section for additional requirements.

**Investment Property**

An investment property is owned but not occupied by the borrower, regardless of revenue generation. The property must be suitable for year-round rental and occupancy.

The following requirements must be followed for investment properties:

- See the Non-arm’s Length Transaction section for requirements.
- See the Employment and Income Analysis and Documentation section for instructions on proper documentation and qualifications for investment properties.
Borrower Types

**Borrowers**

All origination and underwriting procedures must be conducted without regard to the borrower’s race, color, religion, national origin, age, sex, or marital status, or status in any other class of persons protected under state or local law applicable to the jurisdiction of the mortgaged property.

The following are requirements for a borrower:

- A borrower is any person signing an application for a loan and all borrowers must sign the Note.
- A borrower must be an individual.
- Title must be in borrower’s name at time of application for refinance transactions and at time of closing for all transactions.
- Borrowers must meet credit and program eligibility requirements. See the Borrower Eligibility Guidelines below.
- Non-individual legal entities such as corporations, general partnerships, limited partnerships, real estate syndications, or investment trusts are not eligible.

**U.S. Citizen**

Borrowers must have a valid Social Security number and be a citizen of the United States or of a U.S. Possession or Territory.
Borrower Types (continued)

<table>
<thead>
<tr>
<th>Non-U.S. Citizen</th>
<th>Permanent Resident</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A permanent resident is a non-U.S. citizen who is legally eligible to maintain permanent residency in the U.S. and holds a Permanent Resident card. Legal residency must be documented with one of the following:</td>
</tr>
<tr>
<td></td>
<td>• A valid and current Permanent Resident card (form I-551)</td>
</tr>
<tr>
<td></td>
<td>• A passport stamped —processed for I-551, Temporary evidence of lawful admission for permanent residence. Valid until ________. Employment authorized”. This evidence that the holder has been approved for, but not issued, a Permanent Resident card.</td>
</tr>
<tr>
<td></td>
<td>See the U.S. Citizenship and Immigration Services website for more information.</td>
</tr>
</tbody>
</table>

Non-Permanent Resident

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

• Non-permanent residency must be documented with one of the following:
  o See the U.S. Citizenship and Immigration Services website for more information.
  o Expiring Visas: If the authorization for temporary residency status will expire within one year and a prior history of residency status renewals exist, continuation may be assumed. If there are no prior renewals, the likelihood of renewal must be determined, based on information from USCIS.
  o A valid passport, letter from employer/sponsor, and an I-94 proving work authorization.

• A valid Social Security number is required for all borrowers signing the Note.

• Individuals classified under Diplomatic Immunity, Temporary Protected Status, Deferred Enforced Departure, or Humanitarian Parole are not eligible.

• Borrower must meet all other program requirements. See the CMS Product Guidelines for LTV/CLTV/HCLTV limitations.

Non-Occupant Co-Borrower

A non-occupant co-borrower is a credit applicant who:

• Has an ownership interest in the property as indicated on the title.
• Signs the mortgage and deed of trust.
• Signs the Note and thus has joint liability for the Note with the occupant borrower.
• Does not occupy the subject property.
Multiple Properties Financed-Owned

Multiple Properties

To protect CMS and its investors, there are certain requirements that must be followed for multiple properties financed/owned by the same borrower.

Properties Financed

A financed property is a property secured by either a first or a second mortgage by one of CMS’ investors. When the property has both a first and second mortgage financed with one of CMS’ investors, this is considered a single financed property.

There are limits on the total number and aggregate dollar amount of borrower-financed properties permitted.

Simultaneous Submissions

If there are multiple loans being submitted for the same borrower, these loans must be underwritten simultaneously to determine the impact of each transaction upon the other.

Ownership Defined

Partial or joint ownership is considered the same as total ownership in the property. A borrower who is obligated on a mortgage, regardless of whether he or she holds title to the property is included in this limitation.

Exclusion: Ownership in commercial properties, multi-family (five or more units) properties, lots and properties owned free and clear are not included.

A borrower who holds a Limited Partnership interest in an organized Limited Partnership that has been formed for the purpose of real estate investment or development must include all properties owned and financed by that partnership.

A General Partner who has personal liability and whose primary income is derived through the partnership’s long-term investments must include all properties owned and financed by that partnership.

Ownership Interests

At time of application for refinance transactions and at time of closing for all transactions, title must be in borrower’s name.

The borrower must hold title to the property as a fee simple estate. However, loans secured by a Leasehold Estate may be allowed on a case-by-case basis in areas in which they received market acceptance, as described in the Leasehold Estates section below.

Life Estate

A life estate is an interest in real estate held by an individual who is limited to the duration of the life of the individual holding the interest. CMS does not allow properties to be vested in a life estate.

Leasehold Estate

A Leasehold Estate is an estate or interest in real property held by virtue of a lease or sublease. Leasehold refers to land that is leased to the individual who owns appurtenant structures on the land.
TRANSACTIONS

Purpose
This section describes the transaction requirements that must be followed for conventional loans.

- The following are acceptable loan types: Purchase
- No Cash-out Refinance
- Cash-out Refinance
- Lease with Option to Purchase
- Purchase or Refinance of Inherited Property
- Inter-family Transactions
- Pending Sale of a Current Primary Residence
- Conversion of a Primary Residence to Second Home
- Conversion of a Primary Residence to Investment Property

For state-specific restrictions, see the Underwriting Conditions Matrix.

Purchase

Purchase

A purchase money transaction is one in which the proceeds are used to finance the acquisition of a property. The proceeds from the transaction must be used to finance the acquisition of the subject property.

Purchase transactions do not allow for cash back to the borrower at closing. If the borrower receives a refund of the original cash deposit at closing, evidence of payment of the deposit is required (e.g., cancelled check). Unless restricted by the loan program, the borrower may receive cash back for prorated taxes at closing.

Within limitations imposed by applicable state laws, closing costs may not be financed as part of a purchase transaction (with the exception of mortgage insurance).

Purchase transactions require complete purchase agreements, including all addenda. When making an underwriting decision, all purchase agreement terms must be considered. Any undisclosed conditions of the transaction must be investigated. Examples of undisclosed conditions are evidence of straw buyers (i.e., changes in purchaser on the purchase agreement) or possible undisclosed seller concessions, such as making mortgage payments on behalf of the borrower for the first few months of the loan. Loans where the purchase agreement has been assigned are not eligible.
Purchase (continued)

Owner of Record and Chain of Title

The chain of title and ownership record should be verified and meet the following:

- The seller must be the owner of record.
- Proof the property seller has owned the property for 12 months or a chain of title for the last 12 months is required. Acceptable sources for the chain of title include copies of recorded deeds, tax statements, or a 12-month chain of title on the title commitment.
- A transaction where the property has been sold within the last 12 months requires scrutiny to ensure the transaction is legitimate. Some characteristics of fraudulent transactions include but are not limited to foreclosure bailouts, distressed sales, and inflated values due to stated improvements that are unsupported.
- Where the seller is not the current owner, all intervening purchase agreements must be submitted and carefully reviewed to ensure any price increases are supported by data. Where the seller is the current owner, ensure the sales history of the subject is adequately disclosed on the appraisal and any price increases are supported.
- If the seller is a corporation, partnership, or any other business entity, ensure the borrower is not an owner of the business entity or principal/agent selling the subject property.

Non-Arm's Length Transactions

A non-arm's length transaction exists when the borrower has a direct relationship or business affiliation with the builder, developer, or property seller. If there are interested parties to the transaction, other than the builder, developer, or property seller (e.g., broker, loan officer, client, etc.), extra diligence must be exercised. Examples of non-arm's length transactions include family sales, property in an estate, employer/employee sales, and flip transactions.

- Desktop Underwriter and Loan Prospector Loans
  - Existing and new construction second homes and investment property purchase transactions may not be non-arm's length transactions.
- Jumbo Loans
  - Non-arm's length transactions are not permitted unless the transaction is between individuals with an established relationship and the loan is fully amortizing. Only primary residences are allowed.

A non-arm's length transaction is not intended to bail out a family member, employer/employee, or current owner from an existing delinquent mortgage. When individuals wish to purchase or refinance property currently or recently owned by an individual with whom they have an established relationship, the Title Commitment may not evidence Foreclosure Proceedings or Notice of Default.

When the seller is a corporation, partnership, or any other business entity, ensure that the borrower is not an owner of the business entity or principal/agent selling the subject property.
Purchase (continued)

At-Interest Transactions
An at-interest transaction involves persons who are not closely tied or related, but may have a greater vested interested in the transaction, such as a party who plays more than one role in the same transaction (e.g., selling/listing agent, mortgage broker, etc.). At-interest transactions carry increased risk due to the greater vested interest in the transaction by one of the parties. The following are examples of at-interest transactions:

- Builder also acting as realtor/broker
- Realtor/broker selling own property
- Realtor/broker acting as listing/selling agent as well as the mortgage broker

All non-arm’s length transactions are considered at-interest transactions; however, at-interest transactions are not always non-arm’s length transactions. Loans for second homes or investment properties are not allowed if the transaction includes non-arm’s length and/or at-interest characteristics.

Auctioneer’s Fees
The auctioneer’s fee may be added to the accepted bid to determine the total purchase price when a property is purchased at auction and may be used to determine LTV/CLTV/HCLTV. There must be the final written purchase contract for the subject property that includes all applicable information for the transaction, including but not limited to:

- Final bid price by the purchaser
- Auctioneer fee (i.e., buyer's premium)
- Total purchase price which includes the final bid amount and the auctioneer fee

All of the documentation for the transaction should reflect the total purchase price as referenced in the written purchase contract, including the HUD-1 Settlement Statement, any legal documents filed in conjunction with the transaction and the sales price referenced on the appraisal.

Redemption Periods
Properties with unexpired redemption periods have unacceptable title defects. Redemption periods do not automatically expire upon the sale of the property to a new owner. If the property is a foreclosed property in a state that allows redemption periods, the loan must not close until the redemption period has expired.
No Cash-out Refinance

**Definition**
A no cash-out refinance transaction refers to a loan that is used to pay off an existing loan by obtaining a new first mortgage secured by the same property.

**Desktop Underwriter and Loan Prospector Loans**
A no cash-out refinance transaction is a loan where proceeds are distributed for one or more of the following reasons:

- Payoff of the outstanding principal balance of an existing first loan plus any required per diem interest.
- Payoff of the outstanding principal balance of any existing subordinate mortgage that was used in whole to acquire the subject property. Written confirmation must be obtained to show that all proceeds of an existing subordinate lien were used to fund part of the purchase price of the subject property. A copy of the HUD-1 Settlement Statement or other documentation must be obtained.
- Reasonable and customary loan cost or fees (including prepaid items) within limitations imposed by applicable laws.
- Incidental cash back not to exceed the lesser of 2 percent of the balance of the new mortgage or $2000.
- Payoff of prepayment penalties associated with the payoff of the existing mortgage.
- Continuity of Obligation must be demonstrated.

See the CMS Product Guidelines for properties that have recently been listed for sale, subordination of secondary financing, and length of ownership requirements.

When borrowers want to refinance a property recently owned by an individual with whom they have an established relationship, the payoff from the purchase transaction must reflect that the mortgage was current at the time the borrower purchased the property, if the borrower has been on title less than six months from date of application.

A Short-term Refinance mortgage is a loan that combines an existing first mortgage and a non-purchase money subordinate mortgage into a new first mortgage within six months of closing the prior transaction or a previous transaction was a cash-out refinance transaction. A Short-term Refinance is ineligible for a no cash-out refinance transaction and must be considered a cash-out refinance. All previous HUD-1 Settlement Statements from any transactions within the past six months are required to determine eligibility.
No Cash-out Refinance (continued)

Jumbo Loans
A no cash-out refinance transaction is a loan where proceeds are distributed for one or more of the following purposes:

- Payoff of the outstanding principal balance of an existing first loan and lien plus any required per diem interest
- Payoff of subordinate financing is permitted if:
  - The subordinate lien (HELOC and Closed End loans) was used to acquire the subject property or for documented home improvements.
  - Incurred for any other purpose at least 12 months preceding the date of the loan.
  - HELOC: Funds received in excess of 1 percent of the new loan amount or $2,000 whichever is greater, within 12 months prior to a new loan will be considered a cash-out refinance transaction.
- Reasonable and customary loan cost or fees (including prepaid items) within limitations imposed by applicable laws.
- Incidental cash back not to exceed the lesser of 1 percent of the new refinance mortgage or $2,000.
- Pay off prepayment penalties associated with the payoff of the existing mortgage.

See the CMS Product Guidelines for properties that have recently been listed for sale, subordination of secondary financing and length of ownership requirements.

When a borrower wants to refinance his or her property that was recently owned by an individual with whom he or she has an established relationship, and if the borrower has been on title less than six months from date of application, the payoff demand from the purchase transaction must reflect that the mortgage was current at the time the borrower purchased the property.

Buyout of a Co-owner
A no cash-out refinance is a refinance transaction that results in a buyout of the other party's interest in his or her primary residence is considered (e.g., divorce settlement, or buyout of a sibling, etc.). Refinance to buyout a co-owner or ex-spouse is permitted subject to the following:

- All parties must have jointly owned the subject property for 12 months preceding the date of the loan application.
  
  **Note:** Parties who inherit an interest in the property do not have to satisfy this requirement.
- All parties must be able to demonstrate they occupied the subject property as their primary residence (e.g., driver's license, bank statement, credit card bill, utility bill, etc. mailed to the individual at the subject property).
  
  **Note:** Parties who inherit an interest in the property do not have to satisfy this requirement.
- All parties must provide a signed, written agreement that states the terms of the property transfer and the disposition of the proceeds (divorce decree or separation agreement, buy-out agreement).
- The borrower who acquires sole ownership of the property may receive no cash-out from the proceeds of the refinance.
- The party who is buying out the other party's interest must be able to qualify for the loan.
Cash-Out Refinance

Definition

Cash-out refinance transactions are loans used to remove equity from the subject property. Funds received from a cash-out refinance loan is not limited to a specific purpose.

See the Continuity of Obligation section for requirements.

See the CMS Product Guidelines for properties that have recently been listed for sale, subordination of secondary financing and length of ownership requirements.

Delayed Financing

Desktop Underwriter

Borrowers who purchased the subject property less than six months are eligible for a cash-out refinance if all of the following requirements are met:

- The new loan amount must not be more than the actual documented amount of the borrower's initial investment in purchasing the property plus the financing of closing costs, prepaid items, and points.
- The purchase transaction was not a non-arm's length transaction.
  - If the seller of the property was an LLC, the principals of the LLC must be documented.
- The purchase transaction is documented by the HUD-1 Settlement Statement, which confirms that no mortgage financing was used to obtain the subject property.
- The LTV/CLTV/HCLTV must be based on the lesser of the original sales price or the current appraised value.
- The source of funds for the purchase transaction must be documented.
  - The preliminary title search or report must not reflect any existing liens on the subject property.
  - If the source of funds to acquire the subject property was an unsecured loan or HELOC secured by another property, the new HUD-1 Settlement Statement must reflect that source being paid off with the proceeds of the new refinance transaction.
- All other cash-out refinance eligibility requirements are met and cash-out pricing is applied.

Loan Prospector and Jumbo Loans

- Delayed Financing is not eligible for Loan Prospector and Jumbo loans.
Continuity of Obligation

If there is currently an outstanding lien that will be satisfied with the refinance transaction, there must be continuity of obligation. Loans with an acceptable continuity of obligation may be underwritten as either a no cash-out or a cash-out refinance transaction based on the definitions in this document.

Acceptable Continuity of Obligation

- At least one borrower obligated on the new loan was also a borrower obligated on the existing loan being refinanced.
- The borrower has been on title and residing in the property for at least 12 months and has either paid the mortgage for the last 12 months or can demonstrate a relationship (relative, domestic partner, etc.) with the current obligor.
- The loan being refinanced and the title to the property are in the name of a natural person or limited liability company (LLC) as long as the borrower was a member of the LLC prior to transfer. Title should not be transferred back to the LLC after closing. Transfer of ownership from a corporation to an individual does not meet the continuity of obligation requirement.
- The borrower has recently inherited or was legally awarded the property (divorce or separation).

No Acceptable Continuity of Obligation

If the borrower is currently on title but is unable to demonstrate an acceptable continuity of obligation, or there is no outstanding lien against the property, the loan is still eligible as a cash-out refinance transaction with these additional limits:

- No outstanding liens (i.e., purchased for cash or previous mortgage loans that have been paid off)
  - If the property was purchased within the 6 to 12 month period prior to the application date, the LTV/CLTV/HCLTV ratios will be based on the lesser of the original sales price/acquisition cost (documented by the HUD-1 Settlement Statement) or the current appraised value.
  - If the property was purchased more than 12 months prior to the application date, the current appraised value will be used to calculate the LTV/CLTV/HCLTV ratios.
- Outstanding liens with no continuity of obligation
  - If the borrower has been on title for at least 6 months but continuity of obligation does not exist, the maximum LTV/CLTV/HCLTV ratios will be limited to 50 percent based on the current appraised value.

Jumbo Loan

Continuity of Obligation does not apply to Jumbo loan transactions.

Restructured Loan/Short Pay off

See the Credit section for information on restructured loans or short pay offs.
Purchase or Refinance of Inherited Property

Limitation

Properties that are inherited eligible for all occupancy types. The following are limitations where the subject property was inherited within the prior 12 months:

- The title must be clear or a copy of probate showing that the borrower was awarded the property must be provided.
- If the borrower is buying out additional heirs identified in the will or probate document, the transaction may be considered a no cash-out refinance. A copy of the will or probate document must be provided, along with the buy-out agreement signed by all beneficiaries.
- Additional restrictions and maximum LTV/CLTV/HCLTV limits may vary by loan program. See the CMS Product Guidelines for more information.

Pending Sale of Current Primary Residence

If the borrower's current primary residence is on the market and the sale will not close before the closing on the new primary residence, the following requirements must be met:

<table>
<thead>
<tr>
<th>DU and LP</th>
<th>Jumbo</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Primary Residence Pending Sale</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Qualification</strong></td>
<td></td>
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<tr>
<td>Qualify with the PITIA of both the retained</td>
<td>Qualify with the PITIA of both the retained</td>
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<tr>
<td>property and new primary residence</td>
<td>the retained property and new primary</td>
</tr>
<tr>
<td>Qualify based on new primary residence if the</td>
<td>residence</td>
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<tr>
<td>following are met:</td>
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<tr>
<td>o Executed, non-contingent sales contract</td>
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<td>for the current residence.</td>
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<tr>
<td>o Executed, contingent sales contract and</td>
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<tr>
<td>confirmation that any financing</td>
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<tr>
<td>contingencies have been cleared.</td>
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<tr>
<td>Qualify with the PITIA of both the retained</td>
<td>Qualify based on new primary residence</td>
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<tr>
<td>property and new primary residence</td>
<td>only if the following are met:</td>
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<tr>
<td>Qualify based on new primary residence if the</td>
<td>o Executed, non-contingent sales contract</td>
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<tr>
<td>following are met:</td>
<td>for the current residence.</td>
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<td>confirmation that any financing</td>
<td>for the current residence.</td>
</tr>
<tr>
<td>contingencies have been cleared.</td>
<td>o Executed, contingent sales contract</td>
</tr>
<tr>
<td>Reserve requirement determined by DU/JP:</td>
<td>and confirmation that any financing</td>
</tr>
<tr>
<td>o If documented equity is at least 30%, 2</td>
<td>contingencies have been cleared.</td>
</tr>
<tr>
<td>months PITIA for retained property and</td>
<td></td>
</tr>
<tr>
<td>subject property.</td>
<td></td>
</tr>
<tr>
<td>o If 30% equity cannot be documented, 6</td>
<td></td>
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<tr>
<td>months liquid PITIA reserves for retained</td>
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<tr>
<td>property and subject property.</td>
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<tr>
<td>6 months liquid PITIA reserves for the retained</td>
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<tr>
<td>property.</td>
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<tr>
<td>The greater of 6 months PITIA reserves or</td>
<td></td>
</tr>
<tr>
<td>program requirements for the subject property</td>
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</tr>
<tr>
<td>See the CMS Product Guidelines for more</td>
<td></td>
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<tr>
<td>information.</td>
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</tr>
</tbody>
</table>
**Conversion of a Primary Residence to Second Home or Investment Property**

**Conversions of Primary to Second Home**

If the borrower’s current primary residence is being converted to a second home or investment property, and/or has relocated to temporary housing, an explanation may be required when the property being purchased is of lesser value or in the same geographic location, and the following must be met:

<table>
<thead>
<tr>
<th>DU and LP</th>
<th>Jumbo</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Conversion of Primary Residence to Second Home</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Qualification</strong></td>
<td>Qualify with the PITIA of both the retained property and new primary residence</td>
</tr>
<tr>
<td><strong>Reserves</strong></td>
<td>Reserve requirement determined by DU (Interest Only Product, see the CMS Product Guidelines)</td>
</tr>
<tr>
<td></td>
<td>LP:</td>
</tr>
<tr>
<td></td>
<td>o &gt;= 30% documented equity: 2 months liquid PITIA reserves for retained and subject property</td>
</tr>
<tr>
<td></td>
<td>o &lt;30% documented equity: 6 months liquid PITIA reserves for retained and subject property</td>
</tr>
</tbody>
</table>

| **Conversion of Primary Residence to Investment Property** | | |
| **Qualification** | Must have 30% documented equity in retained property to use rental income for qualification | Must have 30% documented equity in retained property to use rental income for qualification |
| | See the Employment and Income Analysis and Documentation section for more information | See the Employment and Income Analysis and Documentation section for more information |
| **Reserves** | Reserve requirement determined by DU, (Interest Only Product, the CMS Product Guidelines) | 6 months liquid PITIA reserves for the retained property |
| | LP: | The greater of 6 months PITIA reserves or program requirements for the subject property |
| | o >= 30% documented equity: 2 months liquid PITIA reserves for retained and subject property | See the CMS Product Guidelines |
| | o <30% documented equity: 6 months liquid PITIA reserves for retained and subject property | | |
Conversion of a Primary Residence to Second Home or Investment Property (continued)

Establishing Equity in Retained Property

- Desktop Underwriter and Jumbo Loans
  No more than 60 days prior to the Note Date, equity in the retained property may be evidenced by an automated valuation model (AVM), Broker Price Opinion (BPO), or an exterior-only inspection dated. A report of value provided by a borrower is never acceptable to establish value.

- Loan Prospector Loans
  A 2055 exterior-only inspection, dated no more than 60 days prior to the Note Date must be provided to prove equity in the retained property. A report of value provided by a borrower is never acceptable to establish value.

Principal Curtailment

Curtailment

Principal curtailments are permitted in accordance with the requirements in this section.

Lender Paid Transactions

On transactions where the loan originator is paid by the lender, CMS will permit a Principal Curtailment on purchase and refinance loans unless noted below as a result of excess premium rate credit. The excess premium must be identified on the HUD-1 Settlement Statement and is limited to the amount of the excess premium rate credit below. The premium rate credit is the amount associated with the lowest pricing rate option that allows for some or all of the borrower's closing costs to be paid so the borrower does not have to pay those closing costs out of pocket.

- If the premium rate credit is less than or equal to $2,000 for loan amounts up to $350,000, or $4,000 for loans amounts exceeding $350,000, then no further documentation is required.

- For premium credits exceeding these thresholds, evidence that the next lower pricing option would require the borrower to pay closing costs out of pocket must be documented in the file (GFE, Pricing/Rate sheet, etc.).

If the borrower was not provided with the best rate, the loan is not eligible to be closed or purchased by CMS.

If the program permits, the borrower may also receive cash back within program guidelines in addition to the amount of the curtailment. See the CMS Product Guidelines for cash back eligibility criteria.

As a reminder, DU Refi Plus products with excess premium rate credit are limited to the lesser of 2% or $2,000 principal curtailment and are excluded from the policy above.

Borrower Paid Transactions

On transactions where the loan originator is paid by the consumer, principal curtailments are not permitted. The premium rate credit may not exceed the amount of third party costs.
FINANCING

Purpose

This section describes the financing requirements that must be followed for conventional loans. Financing requirements that differ from one loan program to another are described in the CMS Product Guidelines.

For state-specific restrictions, see the Underwriting Conditions Matrix.

Determining Amount to be Financed

Factors Affecting Eligible Amount

The eligible amount of financing for any loan is determined by factors specific to that Loan, including, but not limited to the following:

- Type of financing
- Loan-to-Value (LTV) ratio
- Loan amount
- Property type
- Income determination

Determining Value

First Mortgage Transaction Value

Purchases

The lesser of the purchase price or appraised value of the subject property is considered the value in a purchase transaction.

Rate & Term Refinance

The appraised value of the subject property is considered the value in rate and term refinance transactions.

Cash-Out Refinance

- Desktop Underwriter and Loan Prospector Loans

  The appraised value of the subject property regardless of how long the borrower has held title is considered the value in a cash-out refinance transaction.

  If the property has no lien(s) and has been owned less than 12 months, see the Continuity of Obligation section for more information.

- Jumbo Loans

  o If the borrower has held title to the property with a habitable structure for 12 months or more, the value is based on the current appraised value. Evidence that the borrower has held title to the property for 12 months or more must be provided. Acceptable forms of evidence include the original HUD-1 Settlement Statement or transfer of ownership documentation, such as a warranty deed.

  o If the borrower has held title to the property with a habitable structure for less than 12 months, the value is based on the lesser of current appraised value or original sales price plus the costs of any documented improvements. If the value has increased greater than 15 percent, photographs of improvements are required.
## Calculating Loan-to-Value Ratios

<table>
<thead>
<tr>
<th>Loan-to-Value (LTV) Ratio</th>
<th>Desktop Underwriter and Loan Prospector Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtain the LTV ratio by dividing the first mortgage amount by the value. See the <a href="#">Determining Value</a> section for more information.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Combined LTV (CLTV) Ratio</th>
<th>Desktop Underwriter and Loan Prospector Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtain the CLTV/TLTV ratio by dividing the sum of the first mortgage amount and disbursed amount of the HELOC and any other secondary financing by the value. See the <a href="#">Determining Value</a> section for more information.</td>
<td></td>
</tr>
</tbody>
</table>

### Jumbo Loans

Obtain the CLTV ratio by dividing the sum of first mortgage amount and the current principal balance of subordinated closed-end second liens and/or the maximum available credit line of subordinated open-end second liens by the value. See the [Determining Value](#) section for more information.

<table>
<thead>
<tr>
<th>Home Equity Combined LTV (HCLTV)/Home Equity Total LTV (HTLTV) Ratio</th>
<th>Desktop Underwriter and Loan Prospector Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtain the HCLTV/HTLTV by dividing the sum of the first mortgage amount and the total HELOC credit line limit and any other secondary financing by value. See the <a href="#">Determining Value</a> section for more information.</td>
<td></td>
</tr>
</tbody>
</table>

The HCLTV must be calculated using the amount designated on the recorded mortgage/deed of trust and must not be based on any modified amount designated in writing.

### Jumbo Loans

Jumbo loans do not use an HCLTV/HTLTV ratio calculation.
Subordinate Financing

Requirements

Subordinate financing is permitted in accordance with the requirements in this section. Any subordinate financing must be subordinate to the investor’s first mortgage and be recorded as such.

Mortgages subject to secondary financing have guidelines for LTV/CLTV/HCLTV ratios, terms, and disclosures of the second mortgage. See the CMS Product Guidelines for LTV/CLTV/HCLTV guidelines.

State-Specific Requirements

Texas Rate and Term Refinances Not Subject to Section 50(a)(6)

If the first mortgage lien loan is a rate and term refinance in Texas and the first lien loan is being renewed and extended, a subordination agreement for a second lien on the property is not required unless the title company requires a subordination agreement in order to insure that the lien will remain in first lien position.

Virginia Automatic Subordination

CMS and its investors permits lenders to rely upon the automatic subordination of certain subordinate liens as provided in Va. Code Ann. § 55-58.3. The following conditions apply:

- The original principal amount of the second lien may not exceed $50,000 ($150,000 after July 1, 2011).
- The real estate cannot contain more than one dwelling unit.
- With respect to the refinance of the first mortgage:
  - The security instrument must state on the first page in bold or capitalized letters: “THIS IS A REFINANCE OF A (DEED OF TRUST, MORTGAGE OR OTHER SECURITY INTEREST) RECORDED IN THE CLERK’S OFFICE, CIRCUIT COURT OF (NAME OF COUNTY OR CITY), VIRGINIA, IN DEED BOOK ________, PAGE ________, IN THE ORIGINAL PRINCIPAL AMOUNT OF ________, AND WITH THE OUTSTANDING PRINCIPAL BALANCE WHICH IS ________.”;
  - The principal amount secured by the refinance mortgage may not exceed the outstanding principal balance secured by the prior mortgage plus $5,000; and
  - The interest rate stated in the refinance mortgage at the time it is recorded does not exceed the interest rate set forth in the prior mortgage.
Subordinate Financing (continued)

Key Definitions:

- *Refinance mortgage*: The mortgage, deed of trust, or other instrument creating a security interest in real estate given to secure a refinancing.

- *Refinancing*: The replacement of a loan secured by a prior mortgage with a new loan secured by a mortgage, deed of trust, or other instrument and the payment in full of the debt owed under the original loan secured by the prior mortgage.

- *Subordinate mortgage*: A mortgage or deed of trust securing an original principal amount not exceeding $150,000, encumbering or conveying an interest in real estate containing not more than one dwelling unit that is subordinate in priority (i) under subdivision A 1 of Virginia Code § 55-96 to a mortgage, deed of trust or other security interest in real estate (otherwise known as the prior mortgage); or (ii) as a result of a previous refinancing.

The following second liens are not eligible:

- A subordinate mortgage securing a promissory note payable to any county, city or town or any agency, authority or political subdivision of the Commonwealth if such subordinate mortgage is financed pursuant to an affordable dwelling unit ordinance adopted pursuant to § 15.2-2304 or § 15.2-2305, or pursuant to any program authorized by federal or state law or local ordinance or resolution, for (i) low- and moderate-income persons or households or (ii) improvements to residential potable water supplies and sanitary sewage disposal systems made to address an existing or potential public health hazard, and which mortgage, if recorded on or after July 1, 2003, states on the first page thereof in bold or capitalized letters: "THIS (DEED OF TRUST, MORTGAGE OR OTHER SECURITY INTEREST) SHALL NOT, WITHOUT THE CONSENT OF THE SECURED PARTY HEREUNDER, BE SUBORDINATED UPON THE REFINANCING OF ANY PRIOR MORTGAGE."
Subordinate Financing (continued)

<table>
<thead>
<tr>
<th>Ineligible Subordinate Financing</th>
<th>Desktop Underwriter and Loan Prospector Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Tax and judgment liens.</td>
</tr>
<tr>
<td></td>
<td>• Subordinate mortgages subject to an interest rate buydown plan.</td>
</tr>
<tr>
<td></td>
<td>• Subordinate mortgages that allow negative amortization (this does not include language in the Note warning borrowers that the lack of payment may result in negative equity and negative amortization is not a feature of the product).</td>
</tr>
<tr>
<td></td>
<td>• Subordinate mortgages that have wraparound terms.</td>
</tr>
<tr>
<td></td>
<td>• Subordinate mortgages through a Community Second Mortgage/Down Payment Assistance Program.</td>
</tr>
<tr>
<td></td>
<td>• Subordinate mortgages that have a prepayment penalty except when the following apply:</td>
</tr>
<tr>
<td></td>
<td>• The subordinate lien is a home equity line of credit.</td>
</tr>
<tr>
<td></td>
<td>• A prepayment penalty, or flat fee, closure or early termination fee (not associated with a “no closing cost” option) does not exceed $500.</td>
</tr>
</tbody>
</table>

HELOCs or closed-end second mortgages that pay for some or all of the closing costs with terms that allow the lender to recoup the closing costs paid on behalf of the borrower if the HELOC or second mortgage pays off early, are not defined as a prepayment penalty and is acceptable for the purpose of subordinate financing.

Jumbo Loans

• Tax and judgment liens.
• Subordinate mortgages subject to an interest rate buydown plan.
• Subordinate mortgages that allow negative amortization (this does not include language in the Note warning borrowers that the lack of payment may result in negative equity and negative amortization is not a feature of the product).
• Subordinate mortgages that have wraparound terms.
• Subordinate mortgages through a Community Second Mortgage/Down Payment Assistance Program.
• Subordinate mortgages held by the property seller.
Subordinate Financing (continued)

<table>
<thead>
<tr>
<th>Subordinate Financing Terms</th>
<th>All terms of any subordinate financing must be fully disclosed, documented and comply with the following requirements:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Desktop Underwriter and Loan Prospector Loans</strong></td>
<td></td>
</tr>
<tr>
<td>• Requires interest at a market rate (no more than 2 percent below the posted net yield in effect for second mortgages at the time of closing for closed end loans). If provided by the property seller, the interest rate may be at below market rate.</td>
<td></td>
</tr>
<tr>
<td>• Mortgage cannot have a maturity date or a balloon or call provision of less than five years from the Note date of the new mortgage, unless the junior lien is fully amortizing.</td>
<td></td>
</tr>
<tr>
<td>• Monthly payments on subordinate financing must be included in housing and debt ratio analysis.</td>
<td></td>
</tr>
<tr>
<td>• Scheduled payments under the secondary financing must be due on a regular, monthly basis.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Jumbo Loans</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Mortgage cannot have a maturity date or a call option date of less than five years (from closing date), unless it is fully amortizing.</td>
<td></td>
</tr>
<tr>
<td>• Monthly payments on subordinate financing must be included in housing and debt ratio analysis.</td>
<td></td>
</tr>
<tr>
<td>• Scheduled payments under the subordinate financing must be due on a regular basis (e.g., monthly, quarterly, or semi-annually, but no less than semi-annually) and must be at least sufficient to meet the interest due.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Graduated or Variable Payments</th>
<th>Desktop Underwriter and Loan Prospector Loans</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• The monthly payment must remain constant for each 12-month period over the term of the subordinate mortgage, excluding HELOCs.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• The subordinate financing must fully amortize during its term, with the exception of employer subordinate financing that has deferred payments.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Jumbo Loans</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Subordinate financing must fully amortize during its term.</td>
<td></td>
</tr>
<tr>
<td>• The combined annual payments are graduated to increase not more than the lesser of a 2 percent interest rate increase or 8.5 percent payment increase (first and second mortgage).</td>
<td></td>
</tr>
</tbody>
</table>
Subordinate Financing (continued)

<table>
<thead>
<tr>
<th>Employer Provided Subordinate Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subordinate financing received from the borrower’s employer may be in the form of an unsecured loan or a mortgage loan and does not need to require regular payments of either principal and interest or interest only. A copy of the contract from the employer describing the terms must be obtained. The employer provided financing may be structured in any of the following ways:</td>
</tr>
<tr>
<td>- Fully amortizing level monthly payments.</td>
</tr>
<tr>
<td>- Deferred payments for some period changing to fully amortizing level payments.</td>
</tr>
<tr>
<td>- Deferred payment over the entire term.</td>
</tr>
<tr>
<td>- Forgiveness of the debt over time.</td>
</tr>
</tbody>
</table>

The financing terms must permit the borrower to continue making payments on the loan in the event the borrower no longer works for the employer and may not require repayment in full unless one of the following reasons occur:

- The borrower terminates his or her employment for any reason.
- The employer terminates the borrower’s employer for any reason other than long-term disability, the elimination of the employee’s position, or reduction in the workforce.

Interested Party Contributions (IPC)

Overview

IPCs are costs that are typically the responsibility of the borrower that are paid directly or indirectly by someone else who has a financial interest in or can influence the terms and the sale or transfer of, the subject property.

Interested parties to the transaction may include direct participants (e.g., the builder/developer, seller, real estate agent or an affiliate) who may benefit from the sale of the property. Interested parties may also include people with whom the borrower has an established relationship, but are not directly involved in the transaction. Contribution limits do not include lender-paid fees.

A lender or employee is not considered an interested party to a sales transaction unless the lender or employee is the property seller or is affiliated with the property seller or another interested party to the transaction.

Contributions from someone with whom the borrower has an established relationship are not considered financing contributions. These types of contributions are not subject to the requirements listed in the following section. These funds are considered gifts. See the Gifts sub-section in the Assets section for more information.

The HUD-1 Settlement Statement must include all interested party contributions must be disclosed on.
Interested Party Contributions (IPC) (continued)

**Financing Concessions**

Financing concessions that are paid on the borrower’s behalf are subject to limitations outlined in the CMS Product Guidelines. Financing contributions include, but are not limited to, the following:

- Buydown subsidy
- Contribution toward financing fees normally paid by the borrower
- Discount points
- Commitment fees
- Appraisal fees
- Origination fees
- Builder commitment fees that are attributable to a specific mortgage transaction
- Contribution toward other costs related to the transaction that are normally paid by the borrower being paid by another individual:
  - Transfer taxes
  - Stamps
  - Attorney’s fees
  - Surveys
  - Title insurance
  - Interest charges (limited to not more than 30 days interest)
  - Hazard insurance (limited to no more than 14 months)
  - Real estate taxes covering any period after settlement date
  - Real estate tax service fees
  - Homeowner association dues covering any period after the settlement date (limited to no more than 12 months)
  - Initial and/or renewal mortgage insurance premiums
  - Escrow accruals required for renewal of borrower-purchased mortgage insurance coverage

The following are requirements for financing concessions:

- The financing concessions cannot exceed actual costs.
- A downward adjustment to the property sales price, by the amount of the financing concessions exceeding the limitations, must reflect the amount of the lesser of the adjusted sales price or appraised value.
- Typical fees and/or closing costs paid by a seller in accordance with local custom, known as common and customary fees or costs, are not subject to interested party contribution limits.
Interested Party Contributions (IPC) (continued)

Sales Concessions

Sales concessions are interested party contributions that take the form of non-realty items as well as financing concessions that exceed the set limits. For underwriting and eligibility purposes, the value of the sales concessions must be deducted from the sales price when calculating the LTV/CLTV/HCLTV.

Sales concessions include, but are not limited, to the following:

- Any financial obligations of the borrower (e.g., revolving debt and installment debt) being paid by the seller
- Assignment of rent payments
- Automobiles
- Contributions in excess of actual costs
- Decorator and upgrade allowances if funds are placed in an escrow account
- Furniture
- Homeowners' association dues covering any period after the settlement date beyond 12 months
- Moving costs
- Other items considered to be "giveaways"
- Reimbursement to borrower for payment of short sale fees (short sale facilitation fees, buyer discount fees, short sale buyer fees)
- Repair allowances or credits and decorator allowances
- Vacations

Any loan with an abatement (i.e., funds provided to a lender or third party by an interested party to pay or reimburse a certain number of monthly payments of principal, interest, taxes, insurance HOA dues or fees on the borrower's behalf in excess of prepaids/escrows associated with the mortgage) are not eligible for Loan Prospector loans.
Excessive Marketing Fees

**Definition/Requirements**

Excessive marketing fees are defined as total real estate commissions and marketing fee payouts (in cash or in kind) that exceed 8 percent of the sales price. These fees must be deducted from the sales price for underwriting purposes.

Total commissions/marketing fees include, but are not limited to, the following:

- Marketing fees
- Finder’s fees
- Referral fees
- Consulting fees
- Assignment of sales fees.

Total commissions/marketing fees cannot be omitted from the Settlement Statement. RESPA Regulation X, Appendix A states the following:

The settlement agent shall complete the HUD-1 Settlement Statement to itemize all charges imposed upon the borrower and the seller by the lender and all sales commissions, whether to be paid at settlement or outside of settlement, and any other charges which either the borrower or the seller will pay for at settlement. Charges to be paid outside of settlement, including cases where a non-settlement agent (i.e., attorneys, title companies, escrow agents, real estate agents or brokers) holds the borrower's deposit against the sales price (earnest money) and applies the entire deposit towards the charge for the settlement service it is rendering, shall be included on the HUD-1 Settlement Statement but marked POC, Paid Outside of Closing, (settlement) and shall not be included in computing totals.

Escrow for Impounds

**Impounds**

All funds collected by CMS and/or Servicer to cover expenses of the borrower that are required to be paid under the Security Instrument are considered escrow for impounds. The funds may include, but are not limited to, the following:

- Taxes
- Special assessments
- Ground rents
- Water
- Sewer
- Other governmental impositions or charges that are or may become liens on the subject property prior to that of the loan
- Hazard insurance premiums
- Mortgage insurance premiums

Non-supplemental states have taxing authorities that wait to revise tax amounts due until the normal billing cycles. In supplemental tax states, taxes are based on the reasonable estimate of the improvement value, not the supplemental value.

The following escrow/impound requirements must be followed.
Escrow for Impounds (continued)

Funds Escrowed

The following funds are required to be escrowed/impounded:

- Mortgage insurance (unless a single premium was paid in full at closing, or unless lender-paid mortgage insurance was obtained).
- Property taxes
- Hazard insurance premiums
- Flood insurance.

If required by law or regulation, interest on escrow/impounds must be paid to the borrower.

Waiver Eligibility

Property tax and/or insurance escrows may be waived with the following criteria:

<table>
<thead>
<tr>
<th>Escrow Waiver Eligibility</th>
<th>Primary Residence</th>
<th>Second Home</th>
<th>Investment Property</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Jumbo</strong></td>
<td>Single family only</td>
<td>Not Eligible</td>
<td>N/A</td>
</tr>
<tr>
<td>All states excluding CA</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>and NM: &lt;= 80% LTV</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>California: &lt;= 90% LTV</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Mexico: &lt; 80% LTV</td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>Conforming</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All states excluding CA</td>
<td>All states excluding CA</td>
<td>All states excluding CA</td>
<td></td>
</tr>
<tr>
<td>and NM: &lt;= 80% LTV</td>
<td>&lt;= 80% LTV</td>
<td>&lt;= 80% LTV</td>
<td></td>
</tr>
<tr>
<td>California: &lt;= 90% LTV</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Mexico: &lt; 80% LTV</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans receiving an Expanded Approval decision are not eligible for an escrow waiver.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
PROPERTY TYPES AND PROJECT STANDARDS

Purpose
This section describes the property types and project standard requirements that must be followed for conventional loans. For additional property requirements see the Appraisal Requirements, Documentation, and Evaluation section of the document.

The PUD, condominium, and cooperative sections detail the project approval process for all types of PUD, condominium and cooperative projects. This process consists of a review of specific eligibility requirements and submission of the appropriate documentation for approval.

For state-specific restrictions, see the Underwriting Conditions Matrix.

Eligible Property Types

The following are eligible property types:

- Single-family Residence (one unit, attached or detached including town homes and row homes)
- Modular Home, Pre-cut Home, Panelized Home
- Two-to four-unit property
- Mixed-use Property
- Condominium
- Planned Unit Development (PUD)
- Deed/Resale Restrictions
  - 55+ Age Restricted Communities
  - Financial Institution REO Resale Restrictions

Not all property types listed above are eligible under all loan programs. See the CMS Product Guidelines.

Single-Family Residence
An attached or detached single-family dwelling, including town homes and row homes.

Modular Home/Pre-cut/Panelized Home
A modular home is a factory-built home constructed to the state, local or regional building codes where the home will be located. A modular home is constructed in two or more three-dimensional sections, including interior and exterior finish, plumbing, wiring, and mechanical systems.

The modular home is transported to the property site after it is completed and then joined together on a permanent foundation. A modular home may be transported on a steel undercarriage, but this is not a permanent structural component of the improvements, and it is usually removed at the time the house is attached to the foundation. The modular home assumes the characteristics of a site-built home.

Modular homes are treated the same as single-family residences.

One-to-Four Units
A one-to four unit property is a residential property with more than one unit but not more than four units.
Underwriting Guidelines (Conventional)
Mortgage Lending Division
Version 1.0 – 02/01/12

Eligible Property Types (continued)

**Mixed-Use Property**

A mixed-use property is a property primarily used as a residence, but is also being used for a business purpose (e.g., small store, day care, hair shop, etc.)

A mixed-use property must meet the following criteria:

- The property must be a one-unit property that the borrower occupies as his or her principal residence.
- The borrower must be both the owner and the operator of the business.
- The property must be primarily residential in nature, located in a residential neighborhood, and be typical for properties in the market area.
- The use must represent a legal, permissible use of the property under local zoning laws.
- The dwelling may not be modified in a manner that has an adverse impact on its marketability as a residence.
- The commercial use must not have an adverse effect on the habitability and safety of the property or site.
- The Appraisal Requirements, Documentation, and Evaluation section for information on appraisal requirements.

**Condominium**

A condominium is a unit in a project in which each unit owner has title to his or her individual unit, an undivided interest in the project's common areas, and in some cases, exclusive use of certain limited common areas.

A condominium project is created based on local and state statutes. The structure is two or more units with the interior airspace individually owned. The balance of the property (land and building) is owned in common by the individual unit owners.

See the Approval Authority and Process for PUD and Condominium Projects section for more information.

There are also Detached Condominiums that consist of one-unit dwellings that are detached.

**Planned Unit Development (PUD)**

A PUD is a real estate project in which each unit owner has title to a residential lot and building and a nonexclusive easement on the common areas of the project. The owner may have an exclusive easement over some parts of the common areas (e.g., parking space).

- The individual unit owners own a parcel of land improved with a dwelling. This ownership is not in common with other unit owners.
- The development is administered by a homeowners' association (HOA) that owns and is obligated to maintain the common elements (i.e., greenbelts, recreation facilities, and parking areas) within the development for the common use and benefit of the unit owners.
- The unit owners have an automatic, non-severable interest in the HOA and pay a mandatory assessment.

See the Approval Authority and Process for PUD and Condominium Projects section for more information.
Eligible Property Types (continued)

<table>
<thead>
<tr>
<th>Deed/Resale Restrictions</th>
<th>The following resale restrictions are eligible:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Communities where the minimum age requirement is 55</td>
</tr>
<tr>
<td></td>
<td>• Financial Institution REO Resale Restrictions</td>
</tr>
</tbody>
</table>

Deed/resale restrictions, other than those noted above, are not permitted.

Ineligible Property Types

<table>
<thead>
<tr>
<th>Unacceptable Properties</th>
<th>Loans for properties with any of the following property characteristics are not acceptable:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Assisted Living Projects</td>
</tr>
<tr>
<td></td>
<td>• Builder Model Leaseback</td>
</tr>
<tr>
<td></td>
<td>• Houseboats</td>
</tr>
<tr>
<td></td>
<td>• Investment Securities</td>
</tr>
<tr>
<td></td>
<td>• Manufactured Home</td>
</tr>
<tr>
<td></td>
<td>• Mobile Home</td>
</tr>
<tr>
<td></td>
<td>• Multi-family dwelling containing more than four units</td>
</tr>
<tr>
<td></td>
<td>• Properties not suitable for year-round occupancy</td>
</tr>
<tr>
<td></td>
<td>• Properties with resale restrictions</td>
</tr>
<tr>
<td></td>
<td>• Property without full utilities installed to meet all local health and safety standards</td>
</tr>
<tr>
<td></td>
<td>• Property used for commercial or industrial purposes</td>
</tr>
<tr>
<td></td>
<td>• Residential property with a permanently affixed manufactured home on property</td>
</tr>
<tr>
<td></td>
<td>• Tax-sheltered syndicate</td>
</tr>
<tr>
<td></td>
<td>• Timeshare unit</td>
</tr>
<tr>
<td></td>
<td>• Unimproved land</td>
</tr>
<tr>
<td></td>
<td>• Working farm, ranch, or orchard</td>
</tr>
</tbody>
</table>
Approval Authority and Process for PUD and Condominium Projects

<table>
<thead>
<tr>
<th>Requirements</th>
<th>Underwriter must warrant.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CMS or its investor may warrant the following PUD projects</td>
</tr>
<tr>
<td></td>
<td>- Fannie Mae Established PUD (Type E)</td>
</tr>
<tr>
<td></td>
<td>- Fannie Mae New or Proposed PUD (Type F)</td>
</tr>
<tr>
<td></td>
<td>- Freddie Mac Established PUD (E/III)</td>
</tr>
<tr>
<td></td>
<td>- Freddie Mac New or Proposed PUD (F/III)</td>
</tr>
<tr>
<td></td>
<td>CMS or its investor must warrant all Condominium Projects, including</td>
</tr>
<tr>
<td></td>
<td>- Fannie Mae Detached New or Proposed Condominium (Type P)</td>
</tr>
<tr>
<td></td>
<td>- Fannie Mae Limited Review Established (Type Q)</td>
</tr>
<tr>
<td></td>
<td>- Fannie Mae CPM Expedited Review or Lender Full Review - Established Project (Type S)</td>
</tr>
<tr>
<td></td>
<td>- Fannie Mae CPM Expedited Review or Lender Full Review - New or Newly Converted Project (Type R)</td>
</tr>
<tr>
<td></td>
<td>- Freddie Mac Detached Condominium (Class III)</td>
</tr>
<tr>
<td></td>
<td>- Freddie Mac Streamline Review (Class III)</td>
</tr>
<tr>
<td></td>
<td>- Freddie Mac Established Project (Class II)</td>
</tr>
<tr>
<td></td>
<td>- Freddie Mac- New or Newly Converted Project (Class I)</td>
</tr>
<tr>
<td></td>
<td>- Freddie Mac- 2-to 4-Unit Project (Class III)</td>
</tr>
</tbody>
</table>

If the loan was submitted to an MI contract underwriter, the MI contract underwriter will place a condition on loan that CMS must warrant the project.

If the loan was submitted to CMS for underwriting, the underwriter and loan decision letter will provide direction of additional documentation required for warranty, up to and including prior investor review and approval.
Approval Authority and Process for PUD and Condominium Projects (continued)

<table>
<thead>
<tr>
<th>Fannie Mae Project Eligibility Review Service (PERS)</th>
<th>Fannie Mae's Project Eligibility Review Service (PERS) is required for the following project types:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• New and newly converted attached condominium projects located in Florida.</td>
</tr>
<tr>
<td></td>
<td>• New non-gut rehabilitation condominium projects.</td>
</tr>
<tr>
<td></td>
<td>• New condominium projects that contain one or more units with less than 400 square feet.</td>
</tr>
</tbody>
</table>

See the [Fannie Mae](http://www.fanniemae.com) website for complete details for submission of a condominium project to Fannie Mae's PERS. Upon completion of the review, Fannie Mae issues one of the following determinations:

- Final Project Approval
- Ineligible
- Suspension of the Application

PERS approved projects are posted on the [Fannie Mae](http://www.fanniemae.com) website. Final Project Approval decisions will expire one year after issuance. PERS-reviewed projects determined to be ineligible for delivery are identified as well.

CMS must obtain PERS approval from Fannie Mae.
Ineligible PUD/Condominium Projects

<table>
<thead>
<tr>
<th>Unacceptable Projects</th>
<th>The following are unacceptable PUD/Condominium projects:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Condo-Hotel</td>
<td>• Condo-Hotel</td>
</tr>
<tr>
<td>Cooperative</td>
<td>• Cooperative</td>
</tr>
<tr>
<td>Common Interest Apartments</td>
<td>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 unit in the building. The project or building is often owned by several owners as tenants in common or by a homeowners’ association.</td>
</tr>
<tr>
<td>Hotel or motel conversions (or conversions of other similar transient properties).</td>
<td>• Hotel or motel conversions (or conversions of other similar transient properties).</td>
</tr>
<tr>
<td>Houseboat projects.</td>
<td>• Houseboat projects.</td>
</tr>
<tr>
<td>Investment Securities project that have documents on file with the Securities and Exchange Commission or projects where unit ownership is characterized or promoted as an investment opportunity.</td>
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</tr>
<tr>
<td>Manufactured home projects.</td>
<td>• Manufactured home projects.</td>
</tr>
<tr>
<td>Multi-family condominium dwelling with ownership of more than one unit evidenced by a single deed and mortgage. Projects that permit lockout units are considered multi-family.</td>
<td>• Multi-family condominium dwelling with ownership of more than one unit evidenced by a single deed and mortgage. Projects that permit lockout units are considered multi-family.</td>
</tr>
<tr>
<td>New projects where the seller is offering sales/financing contributions/concessions in excess of established limitations for individual loans.</td>
<td>• New projects where the seller is offering sales/financing contributions/concessions in excess of established limitations for individual loans.</td>
</tr>
<tr>
<td>Non-warranteable condominium.</td>
<td>• Non-warranteable condominium.</td>
</tr>
<tr>
<td>PUD and condominium projects that represent a legal but nonconforming use of the land; if zoning regulations prohibit rebuilding the improvements to current density in the event of its full or partial destruction.</td>
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</tr>
<tr>
<td>Projects where the homeowners’ association is named as a party to pending litigation or any project that has not been turned over to the homeowners' association for which the project sponsor or developer is named as party to pending litigation that relates to the safety, structural soundness, habitability, or functional use of the project.</td>
<td>• Projects where the homeowners’ association is named as a party to pending litigation or any project that has not been turned over to the homeowners' association for which the project sponsor or developer is named as party to pending litigation that relates to the safety, structural soundness, habitability, or functional use of the project.</td>
</tr>
<tr>
<td>Projects that restrict the owner’s ability to occupy the unit, have mandatory rental pools, or guaranteed rent-backs.</td>
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</tr>
<tr>
<td>Projects where more than 15 percent of the total units more than one-month delinquent on HOA fees, dues, or assessment payments.</td>
<td>• Projects where more than 15 percent of the total units more than one-month delinquent on HOA fees, dues, or assessment payments.</td>
</tr>
<tr>
<td>Projects where more than 20 percent of the total space is used for non-residential purposes.</td>
<td>• Projects where more than 20 percent of the total space is used for non-residential purposes.</td>
</tr>
<tr>
<td>Projects where a single entity owns more than 10 percent of the total units in the project.</td>
<td>• Projects where a single entity owns more than 10 percent of the total units in the project.</td>
</tr>
<tr>
<td>Projects with recreational leases.</td>
<td>• Projects with recreational leases.</td>
</tr>
<tr>
<td>Projects with non- incidental business operations owned or operated by the homeowners’ association such as, but not limited to, a restaurant, spa, health club, etc.</td>
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</tr>
<tr>
<td>Timeshare or segmented ownership projects.</td>
<td>• Timeshare or segmented ownership projects.</td>
</tr>
</tbody>
</table>
Ineligible PUD/Condominium Projects (continued)

<table>
<thead>
<tr>
<th>Identification of Condominium Hotels</th>
<th>Use the following web sites to help determine whether a Condominium project is operating as a hotel:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• <a href="http://www.condohotels.com">www.condohotels.com</a></td>
</tr>
<tr>
<td></td>
<td>• <a href="http://www.condotelsgolf.com/specials">www.condotelsgolf.com/specials</a></td>
</tr>
<tr>
<td></td>
<td>• <a href="http://www.condohotelcenter.com">www.condohotelcenter.com</a></td>
</tr>
<tr>
<td></td>
<td>• <a href="http://www.floridahomes4u.co.uk">www.floridahomes4u.co.uk</a></td>
</tr>
<tr>
<td></td>
<td>• <a href="http://www.condominiumcentral.net">www.condominiumcentral.net</a></td>
</tr>
<tr>
<td></td>
<td>• <a href="http://www.condotels.com">www.condotels.com</a></td>
</tr>
</tbody>
</table>

Review the above websites as well as conduct a due diligence to determine whether the project is a condominium hotel and is therefore not eligible.

The appraisal report may identify project characteristics that do not clearly indicate that the project is a condominium hotel, but it will give indicate that additional research should be conducted. The contract for sale must also be thoroughly examined to determine, among other information, if there are guaranteed rent-backs, references to rental pooling or management agreements, and Securities and Exchange Commission (SEC) filing references and/or prospectus documents.

Condominium hotel characteristics include, but are not limited to, the following:

- Advertising of rental rates
- Central key systems
- Central telephone service
- Daily cleaning service
- Interior doors that adjoin other units
- Franchise agreements
- Location of the project in a resort area
- Owner-occupancy density - the project may have a few or even no owner occupants
- Registration service
- Restrictions on interior decorating
- Room service
- Units that do not contain full-sized kitchen appliances
- Projects that are managed and operated as a hotel or motel, even though the units are individually owned
- Projects that converted from a hotel or motel
- Projects that include registration services and offer rentals of units on a daily basis
- Projects that restrict the owner's ability to occupy the unit
Ineligible PUD/Condominium Projects (continued)

Identification of Condominium Hotels (continued)

- Projects with mandatory rental pooling agreements that require the unit owners to rent their units or give a management firm control over the occupancy of the unit. These formal agreements between the developer, homeowners’ association, and/or the individual unit owners, obligate the unit owner to rent the property on a seasonal, monthly, weekly, or daily basis. These agreements may include blackout dates, continuous occupancy limitations, and other such use restrictions. The unit owner receives a share of the revenue generated from the rental of the unit.

- Projects with names that include the words “hotel” or “motel”

A project may be part of a Master Association, which is a homeowners’ association in a large condominium project that consists of representatives from associations covering specific areas within the project. A Master Association is a second level association that handles matters affecting the entire development while the first level association handles matters affecting a particular portion of the subject development. If a project is part of the Master Association and the Master Association operates as a hotel, resort, motel, inn, or lodge the entire project is ineligible.

Example: A Master Association consists of five condominium projects within a development. Each of the five projects has its own legal documents including Declaration of Condominium, By-Laws, Articles of Incorporation, and Master Deed. All five condominium projects are part of a Master Association that also has legal documents. Although the individual projects do not have the amenities of a condominium hotel, the Master Association offers hotel-like amenities, as previously defined; therefore, the entire project is ineligible.

PUD Project Classification and Warranties

Fannie Mae Type E PUD - Detached Units

Type E PUD projects are established projects. Detached units have no eligibility requirements.

Fannie Mae Type E PUDs – Attached Units

Type E PUDs are established projects. PUD projects are warranted as Type E if the following eligibility requirements are met:

Eligibility Requirements

- The individual unit securing the mortgage is 100 percent complete
- Project does not consist of single-width manufactured housing units
- Project is not ineligible

Legal Requirements

No legal review is required
PUD Project Classification and Warranties (continued)

<table>
<thead>
<tr>
<th>Fannie Mae Type E PUDs – Attached Units (continued)</th>
<th>Insurance Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Project consists of common buildings</td>
<td></td>
</tr>
<tr>
<td>o Minimum $1 million liability coverage per occurrence</td>
<td></td>
</tr>
<tr>
<td>o Insured on 100 percent of its replacement cost or guaranteed replacement cost</td>
<td></td>
</tr>
<tr>
<td>• Projects has no common buildings</td>
<td></td>
</tr>
<tr>
<td>• Minimum $1 million liability coverage per occurrence</td>
<td></td>
</tr>
</tbody>
</table>

**Documentation Requirements**

- Appraisal Report
- Delegated Correspondent - Conventional Limited/Streamline Project Review Certification
- Non-Delegated Correspondent - Conventional Homeowners' Association Questionnaire for Limited Review
- Copy of the Master Insurance declaration page of the Master Insurance Policy

Leasehold Estate – See the Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties section for more information.

<table>
<thead>
<tr>
<th>Fannie Mae Type F PUD – Attached Units</th>
<th>Eligibility Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type F PUDs are new or proposed PUD projects. PUDs are warranted as Type F if the following eligibility requirements are met:</td>
<td></td>
</tr>
</tbody>
</table>

**Eligibility Requirements**

- The individual unit securing the mortgage is 100 percent complete
- Project does not consist of single-width manufactured housing units
- Project is not ineligible

**Legal Requirements**

No legal review is required

**Insurance Requirements**

- Project consists of common buildings
  - Minimum $1 million liability coverage per occurrence
  - Insured on 100 percent of its replacement cost or guaranteed replacement cost
- Projects has no common buildings
  - Minimum $1 million liability coverage per occurrence
PUD Project Classification and Warranties (continued)

<table>
<thead>
<tr>
<th>Fannie Mae Type F PUD – Attached Units (continued)</th>
<th>Documentation Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Uniform Residential Appraisal Report, if applicable</td>
</tr>
<tr>
<td></td>
<td>• Delegated Correspondent - Conventional Limited/Streamline Project Review Certification</td>
</tr>
<tr>
<td></td>
<td>• Non-Delegated Correspondent - Conventional Homeowners’ Association Questionnaire for Limited Review</td>
</tr>
<tr>
<td></td>
<td>• Copy of the Master Insurance declaration page of the Master Insurance Policy</td>
</tr>
<tr>
<td></td>
<td>• Leasehold Estate – See the Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties section for more information.</td>
</tr>
</tbody>
</table>

Freddie Mac PUD Project Classification and Warranties — Conforming Only

Freddie Mac PUD projects are new, proposed, or established projects. PUD projects are warranted if the following eligibility requirements are met:

Eligibility Requirements

- New, proposed, or established
- Project is not ineligible

Legal Requirements

- No legal review is required

Insurance Requirements

- Project consists of common buildings
  - Minimum $1 million liability coverage per occurrence
  - Insured on 100 percent of its replacement cost or guaranteed replacement cost
- Projects has no common buildings
  - Minimum $1 million liability coverage per occurrence
- Projects with minimal amenities (e.g., entrance gates, parking areas, etc.) do not require liability coverage.

Documentation Requirements

- Appraisal Report, if applicable
- Delegated Correspondent - Conventional Limited/Streamline Project Review Certification
- Non-Delegated Correspondent - Conventional Homeowners’ Association Questionnaire for Limited/Streamline Review
- Copy of the declaration page of the Master Insurance Policy
- Leasehold Estate – See the Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties section for more information.
Condominiums

Overview

CMS must not be aware of any circumstances that would make the project ineligible for approval.

Maximum Exposure within a Project

Project exposure is limited to 20 percent of loans purchased by CMS or its investor in any one condominium project. For small (two- to four-units) projects, the maximum exposure is 50 percent.

Litigation

If a homeowners' association is named as a party to pending litigation or any project that has not been turned over to the homeowners' association for which the project sponsor or developer is named as party to pending litigation that relates to the safety, structural soundness, habitability, or functional use of the project are not acceptable.

If a project has a pending litigation matter that involves a minor matter, it may acceptable if the following requirements are met:

- Non-monetary litigation involving neighbor disputes or rights of quiet enjoyment.
- Litigation for which the claimed amount is known, the insurance carrier has agreed to provide the defense, and the amount is covered by the homeowners' association's insurance.
- The homeowners' association is named as the plaintiff in a foreclosure action, or as a plaintiff in an action for past due homeowners' association dues.

Legal Review and Requirements for Condominiums

The review of certain project types Fannie Mae Type R New Construction (CPM Expedited Review or Lender Full Review) projects and Freddie Mac Established and New Projects are required to determine whether the projects are acceptable. If the legal review is performed, certain legal documents must be reviewed to determine that the rights and responsibilities of all the parties involved are defined and in compliance with standard guidelines. An outside attorney may also warrant that the legal documents comply with all Fannie Mae or Freddie Mac requirements. See the Attorney's Review section for more information. If CMS or its investor conducts the legal review, all legal documents must be submitted to the investor in the early stages of processing to avoid delays at underwriting.

Legal Documentation

If a legal review is required, the condominium documents required include, but are not limited to, the following:

- Recorded Declaration and any amendments with its description, table of allocated interests, and plat plans (attached or incorporated by reference)
- Recorded Articles of Incorporation for the homeowners' association
- Recorded bylaws for the homeowners' association adopted as its organizational meeting and made part of its corporate records
- Standard form purchase agreement for the purchase of a condominium in the project
Condominiums (continued)

Legal Review and Requirements for Condominiums (continued)

These documents must include the following:

- Complete and correct legal description of the units, common areas, and any limited common areas
- Repair and maintenance responsibilities
- A mechanism for amending the documents and the allocation of unit owners’ voting rights and assessments.

The documents must comply with the law and be recorded if that is required in the location of the property. If an unacceptable risk is identified, loans for properties within the development are ineligible for financing.

Fannie Mae Condominium Project Classifications and Warranties

Fannie Mae Limited Review – New/Established Detached Condominiums

Condominium projects are warranted as Detached Condominium with a limited review of the project if the following eligibility requirements are met:

Eligibility Requirements

- The subject property is a detached single-family residence
- Primary residence or second home
- Investment property is eligible with a DU Approve Eligible decision
- The appraiser commented on, and reflected in the appraisal report, any effect that buyer resistance to the condominium form of ownership has on the market value of the individual unit
- The mortgage title insurance policy meets special title insurance requirements for units in condominium projects
- Subject is not a manufactured home
- Project is an eligible project
- Project is not located in the state of Florida

Legal Requirements

- No legal review is required

Insurance Requirements

- The property is either covered by:
  - Unit consists of the entire structure and site and air space
    - Hazard coverage for a single family detached dwelling
  - Unit consists of only air space and improvements and site is considered common areas or limited common areas
    - Minimum $1 million liability coverage per occurrence
    - Insured on 100% of its replacement cost or guaranteed replacement cost
Fannie Mae Condominium Project Classifications and Warranties (continued)

Fannie Mae Limited Review – New/Established Detached Condominiums (continued)

<table>
<thead>
<tr>
<th>Documentation Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Appraisal Report, if applicable</td>
</tr>
<tr>
<td>• Desktop Underwriter Findings Report</td>
</tr>
<tr>
<td>• Conventional Condominium/PUD Warranty</td>
</tr>
<tr>
<td>• Conventional Limited/Streamline Project Review Certification and Warranty</td>
</tr>
<tr>
<td>• Copy of the Declaration Page of the Master Insurance Policy</td>
</tr>
<tr>
<td>• Leasehold Estate – See the Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties section for more information.</td>
</tr>
</tbody>
</table>

Fannie Mae Limited Review (Type Q) - Established Attached Projects

Condominium projects are warranted as Limited Review for an established, attached project if the following eligibility requirements are met:

**Eligibility Requirements**

<table>
<thead>
<tr>
<th>Occupancy</th>
<th>DU Approve Eligible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Residence</td>
<td>&lt;=90%</td>
</tr>
<tr>
<td>Second Home</td>
<td>&lt;=75%</td>
</tr>
<tr>
<td>Investment Property</td>
<td>Ineligible</td>
</tr>
</tbody>
</table>

- The unit must be located within an established project:
  - All units and common elements, including units and common elements owned by any Master Association, are 100 percent complete. The project is not subject to any additional phasing or additions.
  - At least 90 percent of the total number of units in the project have been conveyed to unit purchasers other than the developer.
    - 2- to 4-unit Projects: All but one unit is occupied as a primary residence or second home.
  - No more than 15 percent of the total units within the project can be more than one-month delinquent on homeowners’ association fees, due or assessments
  - No single entity (the same individual, investor group, partnership or corporation) owns > 10 percent of the total units
    - 2- to 4-unit Projects: No single entity (same individual, investor group, partnership, or corporation) may own more than one unit within the project.
  - Control of the homeowners’ association has been turned over to the unit owners
  - Project does not contain any manufactured homes
  - Project is an eligible project
  - Project is not located in the state of Florida
Fannie Mae Condominium Project Classifications and Warranties (continued)

**Fannie Mae Limited Review (Type Q) - Established Attached Projects (continued)**

- The unit must secure a mortgage originated on a spot-loan basis and not part of bulk or multiple originations of mortgages secured by units in the same condominium project as a result of a direct marketing campaign.
- If the originator has targeted the project with specific marketing efforts or is named as a preferred lender by either the developer or the applicable Homeowner's Association, the project is ineligible for Limited Review and CMS must use one of the other project review processes.

**Legal Requirements**

- No legal review is required

**Insurance Requirements**

- Minimum $1 million liability coverage per occurrence
- Insured on 100 percent replacement cost basis or guaranteed replacement cost
- Fidelity Insurance is required for all attached condominium projects with more than 20 units
- HO6 policy is required if master policy does not reflect walls-in coverage or betterments. Must be at least 20 percent of appraised value

**Documentation Requirements**

- Appraisal Report, if applicable
- Desktop Underwriter Findings Report
- Conventional Condominium/PUD Warranty
- Conventional Limited/Streamline Project Review Certification and Warranty
- Copy of Declaration Page of the Master Insurance Policy and Fidelity Insurance
- Leasehold Estate – See the **Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties** section for more information.

**Fannie Mae Type S Condominiums**

Type S condominiums are established projects and established 2-to 4-unit projects. Type S Condominium Project may be validated through Fannie Mae CPM or through Lender Full Review by CMS’ investor or CMS.

Condominiums are warranted as Type S if the following eligibility requirements are met

**Eligibility Requirements**

- All units and common elements, including units and common elements owned by any Master Association, are 100 percent complete. The project is not subject to additional phasing or additions.
- At least 90 percent of the total units in the project have been sold and conveyed to unit purchasers other than the developer.
- At least 51 percent of the total units in the project are occupied as a primary residence or second home if the subject unit is to be used as an investment property. The owner occupancy pre-sale requirement may be waived if property is a primary residence or second home.
  - 2- to 4-unit projects – All but one unit must be a primary residence or second home.
Fannie Mae Condominium Project Classifications and Warranties (continued)

Fannie Mae
Type S
Condominiums
(continued)

- Control of the homeowners' association has been turned over to the unit owners. (Not required for 2- to 4-unit projects.) All facilities related to the project must be owned by the unit owners or the homeowners' association. The developer may not retain any ownership interest in any of these facilities. In addition, the amenities, and facilities—including parking and recreational facilities—may not be subject to a lease between the unit owners or the homeowners' association and another party.

- No more than 15 percent of the total units can be more than one month delinquent on homeowners' association fees, dues or assessments.

- No single entity (same individual, investor group, partnership or corporation) may own more than 10 percent of the total units in the project.
  - 2- to 4-unit projects - no single entity (same individual, investor group, partnership, or corporation) may own more than one unit within the project.

- Project does not include any manufactured homes.

- Project is an eligible project.

- Commercial space may constitute up to 20 percent of the total space in the project, as long as the following requirements are met:
  - Commercial usage is common and customary for the area.
  - Comparable sales have similar commercial usage.
  - Appraiser must comment on any negative impact that such commercial use has on the value of the subject, if any.
  - Any commercial space in the project must be compatible with the overall residential nature of the project.

- Budget (not required for 2- to 4-units)
  The budget must be consistent with the nature of the project and appropriate assessments must be established to manage the project:
  - Appropriate allocations must be available for line items pertinent to the type and status of the project.
  - Operating budget must be at least 10 percent of the budget provides funding for replacement reserves for capital expenditures, deferred maintenance, and replacement cost of major common elements.
  - Homeowners' association must have adequate reserves for funding the insurance deductible or the budget must be allocating funds sufficient to replenish the reserves for the deductible.
  - Increased insurance costs have resulted in associations increasing their insurance deductible amounts to reduce annual premiums. Insurance deductible can be quite substantial. Fannie Mae does not require a separate budget line item for insurance deductible, but the potential cost of deductible must be accounted for in the budget. Insurance deductible may be included in the reserve fund or may be a separate item. In either case, the lender must determine that the project has the ability to fund insurance deductible.
Fannie Mae Condominium Project Classifications and Warranties (continued)

- **Conversions**
  
  A 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.
  
  - If the project is a conversion that does not involve a gut rehabilitation, the underwriter must review an engineer's report, or other substantially similar report, to verify that (a) all necessary repairs are complete and (b) replacement reserves are identified for all capital improvements and noted as adequate by the party evaluating the project.
  
  - 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.
  
  - All rehabilitation work involved in a conversion must have been completed in a professional manner.
  
  - New non-gut rehabilitation condominium projects must be approved by PERS.

- **Environment Hazard Assessments – Phase I and II environmental hazard assessments are not required for condominium projects unless the CMS identifies an environmental problem through performance of his or her project underwriting and/or due diligence. In the event environmental problems are identified, they must be determined to be acceptable.**

**Legal Requirements**

No legal review required.

**Insurance Requirements**

- Minimum $1 million liability insurance coverage per occurrence.
- Insured on 100 percent of its replacement cost or guaranteed replacement cost.
- Fidelity Insurance is required for all attached projects with more than 20 units.
- HO6 policy is required if master policy does not reflect walls-in coverage or betterments. Must be at least 20 percent of appraised value.

**Documentation Requirements**

- Appraisal Report
- Conventional Condominium/PUD Warranty
- Conventional Condominium HOA Questionnaire
- Copy of the Declaration Page of the Master Insurance Policy and evidence of Fidelity Insurance, if applicable
- Current Operating Budget (not required for 2-to 4-unit projects)
- Engineer's Report, description of renovations and rehabilitation, if applicable
- Management Contract
- Agreement of Sale
- Leasehold Estate – See the Additional Review Considerations for Two-to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties section for more information.
Fannie Mae Condominium Project Classifications and Warranties (continued)

**Fannie Mae Type R Condominium**

Type R Condominiums may be new condominiums or existing buildings that are being converted to condominiums, including projects in which all units and common elements, common elements owned by a Master Association are not fully complete or the project is subject to additional phasing or annexation or fewer than 90 percent of the total number of units in the project have been conveyed to unit purchasers or the developer has not turned control of the homeowners' association over to the unit owners.

A Type R Condominium Project may be validated through Fannie Mae CPM system or through Investor Full Review.

Condominium projects are warranted as Type R if the following eligibility requirements are met:

**Eligibility Requirements**

- Project must consist of at least 5 units.
- The project or the subject legal phase, are substantially complete. A Certificate of Occupancy or equivalent has been issued by the applicable governmental agency for the project or subject phase and all units in the subject unit building are complete.
- At least 70 percent of the total units in the project must have been conveyed or under contract for purchase of a primary residence or second home.
- If the project does not meet occupancy requirements all of the following must be met:
  - At least 70 percent of the units in the subject legal phase must have been conveyed or be under contract for purchase of a primary residence or second home.
  - At least 70 percent of the units in the subject legal phase + the total number of units in all prior legal phase, in which units have been offered for sale, must have been conveyed or be under contract for purchase of a primary residence or second home.
- For the purposes of this review process, a project consisting of one building cannot have more than one legal phase.
- No more than 15 percent of the total units within the project can be more than one month delinquent on homeowners' association fees, dues, or assessments.
- Homeowners' association – No additional requirements.
- No single entity (the same individual, investor group, partnership, or corporation) may own more than 10 percent of the total units in the project (other than the developer during the initial sales period).
- Project does not include any manufactured homes.
- Project is an eligible project.
- Project is not any of the following:
  - Located in the state of Florida.
  - New or newly converted non-gut rehabilitation project.
  - New project with at least one unit with less than 400 square feet.
Fannie Mae Condominium Project Classifications and Warranties (continued)

Fannie Mae Type R Condominiums (continued)

- Commercial space may constitute 20 percent of the total space in a project as long as the following requirements are met:
  - Commercial usage is common and customary for the area.
  - Comparable sales have similar commercial usage.
  - Appraiser must comment on any negative impact that such commercial use has on the value of the subject, if any.
  - Any commercial space in the project must be compatible with the overall residential nature of the project.

- Budget

  The budget must be consistent with the nature of the project and appropriate assessments must be established to manage the project:
  - Appropriate allocations must be available for line items pertinent to the type and status of the project.
  - Operating budget must be at least 10 percent of the budget provides funding for replacement reserves for capital expenditures, deferred maintenance, and replacement cost of major common elements.
  - Homeowners’ association must have adequate reserves for funding the insurance deductible or the budget must be allocating funds sufficient to replenish the reserves for the deductible.

  When making the determination of adequate funding of insurance deductible amounts, the portion of the deductible amount covered by Unit Owner's HO6 policy may be taken into consideration. A copy of the Unit Owner's HO6 is required as confirmation of deductible coverage.

- Conversions

  A 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.
  - If the project is a conversion that does not involve gut rehabilitation, an engineer's report must be reviewed, or other substantially similar report, to verify the following:
    - All necessary repairs are complete.
    - Replacement reserves are identified for all capital improvements and noted as adequate by the party evaluating the project.
  - 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 (e.g., heating and cooling systems, plumbing, electrical systems, elevators, boilers, roof, etc.).
  - All rehabilitation work involved in a conversion must have been completed in a professional manner.
  - New non-gut rehabilitation condominium projects must be approved by PERS.
Fannie Mae Condominium Project Classifications and Warranties (continued)

Fannie Mae
Type R
Condominiums
(continued)

- Environment Hazard Assessments - Phase I and II environmental hazard assessments are not required for condominium projects unless the CMS identifies an environmental problem through performance of their project underwriting and/or due diligence. In the event that environmental problems are identified, they must be determined to be acceptable.

Legal Requirements
The investor must represent and warrant that a qualified attorney engaged by CMS or its investor issued a written legal review based upon a review of the project's recorded legal documents, which states compliance with the legal requirements discussed herein.

The attorney may be the same person who prepared the legal documents but he or she cannot be an employee, principal, or officer of the developer or sponsor of the project. The attorney's written review must be available upon request for the purposes of a Fannie Mae Quality Assurance review.

- Compliance with Laws
  The condominium project must have been created and exist in full compliance with the state law requirements of the jurisdiction where the condominium project is located and all other applicable laws and regulations.

- Amendments to Documents
  - The project documents must provide that amendments of a material adverse nature to mortgagees be agreed to by mortgagees that represent at least 51 percent of the votes of unit estates that are subject to mortgages.
  - The project documents must provide for any action to terminate the legal status of the project after substantial destruction or condemnation occurs or for other reasons to be agreed to by mortgagees that represent at least 51 percent of the votes of the unit estates that are subject to mortgages.
  - The project documents may provide for implied approval to be assumed when a mortgagee fails to submit a response to any written proposal for an amendment within 60 days after it receives proper notice of the proposal, provided the notice was delivered by certified or registered mail, with a "return receipt" requested.

  Notwithstanding the foregoing, project documents that were recorded prior to August 23, 2007 may provide for implied approval to be assumed when a mortgagee fails to submit a response to any written proposal for an amendment within 30 days after it receives proper notification of the proposal. This is provided that the notice was delivered by certified or registered mail, with a return receipt.
Fannie Mae Condominium Project Classifications and Warranties (continued)

- **Limitations on Ability to Sell/Right of First Refusal**
  Any right of first refusal in the condominium project documents will not adversely impact the rights of a mortgagee or its assignee to complete any of the following tasks:
  - Foreclose or take title to a condominium unit pursuant to the remedies in the mortgage.
  - Accept a deed or assignment in lieu of foreclosure in the event of default by a mortgagor.
  - Sell or lease a unit acquired by the mortgagee or its assignee.

- **Rights of Condo Mortgagees and Guarantors**
  The project documents must give the mortgagee and guarantor of the mortgage on any unit in a condominium project the right to timely written notice of the following:
  - Any condemnation or casualty loss that affects either a material portion of the project or the unit securing its mortgage; Any 60-day delinquency in the payment of assessments or charges owed by the owner of any unit on which it holds the mortgage.
  - A lapse, cancellation, or material modification of any insurance policy maintained by the homeowners' association.
  - Any proposed action that requires the consent of a specified percentage of mortgagees.

- **First Mortgagee's Rights Confirmed**
  No provision of the condominium project documents gives a condominium unit owner or any other party priority over any rights of the first mortgagee of the condominium unit pursuant to its mortgage in the case of payment to the unit owner of insurance proceeds or condemnation awards for losses to or a taking of condominium units and/or common elements.

- **Unpaid Homeowners' Association Assessments**
  Any first mortgagee who obtains title to a condominium unit pursuant to the remedies in the mortgage or through foreclosure will not be liable for more than six months of the unit's unpaid regularly budgeted dues or charges accrued before acquisition of the title to the unit by the mortgagee. If the condominium association's lien priority includes costs of collecting unpaid dues, the lender will be liable for any fees or costs related to the collection of the unpaid dues.

- **Project Configuration**
  The condominium project must be located on one contiguous parcel of land although a public street may run through the project. The structures within the project must be within a reasonable distance from each other.
Fannie Mae Condominium Project Classifications and Warranties (continued)

Fannie Mae Type R Condominiums (continued)

- Ownership and Use of the Common Elements
  Common elements (e.g., parking and recreational facilities) must be consistent with the nature of the project and be competitive in the market.
    - The unit owners must be the sole owners of and have the right to the use of common elements including, but not limited to, the following:
      - All buildings
      - Roads
      - Parking
      - Amenities
    - The developer must not retain any ownership interest in any of them.
      - The common elements including amenities such as parking and recreational facilities must not be subject to a lease between the unit owners or homeowners' association and any other party.
      - Condominium projects may be constructed in individual legal phases. A project review may be completed on the entire project or on a particular legal phase.

- Project Management – The management of the project must demonstrate that it is managed well, and in good financial and physical condition. Any contract with an independent professional management firm must be for a reasonable term and must include equitable provisions for its termination.

- Unit Occupancy – The individual units in new condominium projects must be available for immediate occupancy at the time of closing of the mortgage.

- Marketing Units in the Condominium Project
  The sales program developed for marketing units in a project must recognize and provide procedures for complying with all laws pertaining to the advertising and sale of real estate, the form and content of sales contracts and the method for handling deposits connected with the sale.

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

Insurance Requirements

- Minimum $1 million liability insurance coverage per occurrence
- Project must be insured on 100 percent replacement cost or guaranteed replacement cost
- Fidelity Insurance is required for all projects with greater than 20 units
- HO6 policy is required if master policy does not reflect walls-in coverage or betterments. Must be at least 20 percent of appraised value
<table>
<thead>
<tr>
<th>Fannie Mae Type R Condominiums (continued)</th>
<th>Documentation Requirements</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>• Appraisal Report</td>
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<td>• Conventional Condominium/PUD Warranty</td>
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<td>• Conventional Condominium Homeowners' Association Questionnaire</td>
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<td>• Copy of the Declaration Page of the Master Insurance Policy including Fidelity Insurance</td>
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<td>• Projected operating budget</td>
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<td>• Recorded legal documents for complete legal review included in file</td>
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<td></td>
<td>o Articles of Incorporation</td>
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<td></td>
<td>o Master Deed/Declaration</td>
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<td>o By-laws</td>
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<td></td>
<td>• Recorded Plat Map</td>
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<td>• Recorded Site Plans</td>
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<td>• Management Contract</td>
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<td>• Agreement of Sale</td>
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<td>• Engineer's report, descriptions of renovations and rehabilitation, if applicable</td>
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<td>• Leasehold Estate – See the Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties section for more information.</td>
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Fannie Mae Condominium Project Classifications and Warranties (continued)

**Fannie Mae Type T Condominiums**

Type T condominiums are established or new projects that have been reviewed by Fannie Mae and received a Final Project Approval (PERS).

PERS is required for the following project types:

- Attached, new and newly converted condominium projects located in the state of Florida.
- Newly converted non-gut rehabilitation condominium projects.
- New condominium projects that contain one or more units with less than 400 square feet.

See the Fannie Mae website for complete details on submission of a condominium project and for a complete list of condominium projects with an Unexpired Final or Conditional Final Project Acceptance status.

A qualified attorney engaged by CMS must review the legal documents for all condominium projects submitted to PERS and determine that the documents are in compliance with the legal requirements. This determination must be documented by the attorney in writing but need not rise to the level of a formal, written legal opinion. The attorney may be the same person who prepared the legal documents or an attorney employed by CMS. The attorney may not be an employee, principal or officer of the developer or sponsor of the project. CMS must complete the Fannie Mae form 1054 and attach the attorney review as part of the PERS submission process. All legal documents must be retained and available upon request.

CMS is responsible for submitting and obtaining and obtaining PERS approval from Fannie Mae. CMS’ investor is not responsible for the submission of a condominium project to Fannie Mae.

CMS must provide documentation in the individual mortgage file evidencing that the project meets Fannie Mae presale and/or construction completion requirements prior to mortgage delivery to CMS’ investor. See the Fannie Mae Condominium-PUD Matrix for additional documentation required by CMS.

Warranty of Presales form 1029 and Appraisal Update and/or Completion Report Fannie Mae Form 1004D, or other warranty documentation approved by CMS’ investor. CMS must also represent and warrant that all other requirements for delivering mortgages to an investor, as described for PUD/Condominiums in the Property Types and Project Standards section.

**Fannie Mae FHA Approved Projects Type U**

FHA, HRAP, or DELRAP approval is not eligible for delivery to CMS’ investor.
Freddie Mac Condominium Project Warranties (Conforming Loans Only)

Condominium projects are warranted as Detached Condominium with a streamline review of the project if the following eligibility requirements are met.

**Eligibility Requirements**

- The project consists solely of single-family detached residences
- Primary residence or second home
- The appraiser commented on, and reflected in the appraisal report, any effect that buyer resistance to the condominium form of ownership has on the market value of the individual unit
- The mortgage title insurance policy meets special title insurance requirements for units in condominium projects
- Subject is not a manufactured home
- Project is an eligible project
- Project is not located in the state of Florida

**Conversions**

For a condominium project that is formed as a result of a conversion, the project must meet the following requirements:

- For Newly Converted Condominium Projects, the appraiser or other licensed professional has stated that the project is structurally sound, and the condition and remaining useful life of the major project components are sufficient to meet the residential needs of the project, or that the appraiser has found no evidence that any of these conditions are not met. Major components include the roof, elevators, and mechanical systems such as HVAC, plumbing, and electricity.
- All rehabilitation work involved in a conversion to a Condominium Project has been completed in a professional manner.
- If the conversion was a partial rehabilitation, verify all repairs affecting soundness and habitability are complete and replacement reserves have been allocated for all capital improvements, and the underwriter has determined that the reserves are sufficient to fund the improvements.

**Legal Requirements**

No legal review is required

**Insurance Requirements**

The property is either covered by

- Unit consists of the entire structure and site and air space
  - Hazard coverage for a single family detached dwelling
- Unit consists of only air space and improvements and site is considered common areas or limited common areas
  - Minimum $1 million liability coverage per occurrence
  - Insured on 100% of its replacement cost or guaranteed replacement cost
Freddie Mac Condominium Project Warranties (Conforming Loans Only) (continued)

**Freddie Mac Detached Condominium (continued)**

**Documentation Requirements**
- Appraisal Report, if applicable
- Loan Prospector Feedback Certificate
- Conventional Condominium/PUD Warranty
- Conventional Limited/Streamline Project Review Certification and Warranty
- Copy of the Master Insurance declaration page of the Master Insurance Policy
- Engineer's report, description of renovations and rehabilitation, if applicable
- Leasehold Estate – See the Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties section for more information.

**Freddie Mac Streamline Review**

Condominium projects are warranted as Streamline Review if the following eligibility requirements are met:

**Eligibility Requirements**

<table>
<thead>
<tr>
<th>Occupancy</th>
<th>LP Accept</th>
<th>LTV/TLTV/HTLTV</th>
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<tbody>
<tr>
<td>Primary Residence</td>
<td>&lt;= 90%</td>
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</tr>
<tr>
<td>Second Home</td>
<td>&lt;= 75%</td>
<td></td>
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<tr>
<td>Investment Property</td>
<td>Ineligible</td>
<td></td>
</tr>
</tbody>
</table>

- The unit must be located within an established project:
  - All units and common elements, including units and common elements owned by a Master Association, are 100 percent complete.
  - Not subject to any additional phasing or additions.
  - At least 90 percent of the total number of units in the project have been conveyed to unit purchasers other than the developer. Multiple purchases or condominiums by one owner are counted as one sale when determining if the pre-sale requirement has been met.
  - No more than 15 percent of the total units within the project can be more than one-month delinquent on homeowners' association fees, due or assessments.
  - No single entity (the same individual, investor group, partnership or corporation) owns >10 percent of the total units.
  - Control of the homeowners' association has been turned over to the unit owners.

- Subject unit is not a manufactured home.
- Project is an eligible project.
- Project is not located in the state of Florida.
Freddie Mac Condominium Project Warranties (Conforming Loans Only) (continued)

Freddie Mac Streamline Review (continued)

- Conversions

  For a Condominium Project that is formed as a result of a conversion, the project must meet the following requirements:

  - For newly converted condominium projects (is a project with prior use for which the completion of the conversion is no more than three years before the date of the Mortgage application. The project typically also meets the definition of a New Condominium Project), the appraiser or other licensed professional has stated that the project is structurally sound, and the condition and remaining useful life of the major project components are sufficient to meet the residential needs of the project, or that the appraiser has found no evidence that any of these conditions are not met. Major components include the roof, elevators, and mechanical systems such as HVAC, plumbing, and electricity.

  - All rehabilitation work involved in a conversion to a condominium project has been completed in a professional manner.

  - If the conversion was a partial rehabilitation, verify all repairs affecting soundness and habitability are complete and replacement reserves have been allocated for all capital improvements, and the underwriter has determined that the reserves are sufficient to fund the improvements.

  The unit must secure a mortgage originated on a spot-loan basis and not part of bulk or multiple originations of mortgages secured by units in the same condominium project as a result of a direct marketing campaign.

  If the lender has targeted the project with specific marketing efforts or is named as a preferred lender by either the developer or the applicable homeowners' association, the project is ineligible for Streamline Review and the lender must use one of the other project review processes.

Legal Requirements

No legal review is required

Insurance Requirements

- Minimum $1 million liability coverage per occurrence.

- Insured on 100 percent of its replacement cost or guaranteed replacement cost.

- Fidelity Insurance is required for projects with more than 20 units.

- HO6 policy is required if master policy does not reflect walls-in coverage or betterments. Must be at least 20 percent of appraised value.

- The deductible for fire, water (non-flood related), or wind damage to the insured improvements may not exceed 5 percent of the limit of the building coverage.
### Freddie Mac Condominium Project Warranties (Conforming Loans Only) (continued)

#### Documentation Requirements

- Appraisal Report, if applicable
- Loan Prospector Feedback Certificate
- Conventional Condominium/PUD Warranty
- Conventional Limited/Streamline Project Review Certification and Warranty
- Copy of Declaration Page of the Master Insurance Policy and Fidelity Insurance, if applicable
- Engineer's report, description of renovations and rehabilitation, if applicable
- Leasehold Estate – See the Additional Review Considerations for Two- to Four- Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties section for more information.

**Note:** CMS warrants that he or she is not aware of any changes in circumstance, since their review of the project that would result in the project no longer satisfying Freddie Mac Streamline Review qualification.

#### Eligibility Requirements

**Condominiums projects are warranted as Established if the following eligibility requirements are met:**

**Eligibility Requirements**

- All units, common elements, and amenities within the project, including those that are part of a Master Association, are 100 percent complete. The project is not subject to additional phasing or additions.
- At least 90 percent of the total units in the project have been sold and conveyed to purchasers other than the developer. Multiple purchases or condominiums by one owner are counted as one sale when determining if the pre-sale requirement has been met.
- At least 51 percent of the total units in the project must be occupied as a primary residence or second homes if the subject unit is to be used as an investment property. The owner occupancy pre-sale requirement may be waived if the subject property is a primary residence or second home.
- Control of the homeowners' association has been turned over to the unit owners.
- No more than 15 percent of the total units can be more than one-month delinquent in homeowners' association fees, dues or assessments.
- No single entity (same individual, investor group, partnership or corporation) may own more than 10 percent of the total number of units in the project.
- Project does not include any manufactured homes.
- Project is an eligible project.
- Project is not located in the state of Florida.
- Commercial space may constitute up to 20 percent of the total space in the project. Any commercial space in the project must be compatible with the overall residential nature of the project.
Freddie Mac Condominium Project Warranties (Conforming Loans Only) (continued)

Freddie Mac Established Condominiums (continued)

- **Budget**
  
  The budget must be consistent with the nature of the project and appropriate assessments are established to manage the project:
  
  o Appropriate allocations must be available for line items pertinent to the type and status of the project.
  
  o Operating budget must be at least 10 percent of the budget provides funding for replacement reserves for capital expenditures, deferred maintenance and replacement cost of major common elements.
  
  o Homeowners’ association must have adequate reserves for funding the insurance deductible or the budget must be allocating funds sufficient to replenish the reserves for the deductible.

- **Conversions**
  
  o For newly converted condominium projects (is a project with prior use for which the completion of the conversion is no more than three years before the date of the Mortgage application. The project typically also meets the definition of a New Condominium Project), the appraiser or other licensed professional has stated that the project is structurally sound, and the condition and remaining useful life of the major project components are sufficient to meet the residential needs of the project, or that the appraiser has found no evidence that any of these conditions are not met. Major components include the roof, elevators and mechanical systems such as HVAC, plumbing and electricity.
  
  o All rehabilitation work involved in a conversion to a condominium project has been completed in a professional manner.
  
  o If the conversion was a partial rehabilitation, verify all repairs affecting soundness and habitability are complete and replacement reserves have been allocated for all capital improvements, and the underwriter has determined that the reserves are sufficient to fund the improvements.

**Legal Requirements**

The investor must represent and warrant they have conducted an acceptable legal review based upon a review of the project’s recorded legal documents. The review must confirm the legal documents comply with the legal requirements discussed herein and evidence of the investor’s review must be located within the file.

- **Compliance with Laws**
  
  The condominium project must have been created and exist in full compliance with the state law requirements of the jurisdiction where the condominium project is located and all other applicable laws and regulations.

- **Limitations on Ability to Sell/Right of First Refusal**
  
  Any right of first refusal in the condominium project documents will not adversely impact the rights of a mortgagee or its assignee to complete any of the following tasks:
  
  o Foreclose or take title to a condominium unit pursuant to the remedies in the mortgage.
  
  o Accept a deed or assignment in lieu of foreclosure in the event of default by a mortgagor.
  
  o Sell or lease a unit acquired by the mortgagee or its assignee.
Freddie Mac Condominium Project Warranties (Conforming Loans Only) (continued)

Freddie Mac
Established
Condominiums
(continued)

- Project Ownership
  The unit owners must have an undivided ownership of the land on which the
  condominium project is located in Fee Simple, or have a Leasehold interest in
  the ground lease on which the project is located. Any ground lease must meet
  the requirements of this section.

- Ownership and Use of the Common Elements
  Common elements such as parking and recreational facilities must be
  consistent with the nature of the project and be competitive in the market.
  
  - The unit owners must be the sole owners of and have the right to the
    use of common elements including but not limited to all buildings,
    roads, parking, and amenities. The developer must not retain any
    ownership interest in any of them.
  
  - The common elements including amenities such as parking and
    recreational facilities must not be subject to a lease between the unit
    owners or homeowners' association and any other party.
  
  - Condominium projects may be constructed in individual legal phases. A
    project review may be completed on the entire project or on a particular
    legal phase.

- Continuing Project Eligibility
  CMS is not aware of any change in circumstances since its review of the project
  that would result in the project no longer satisfying the investor requirements.

- Amendments to Documents
  
  - The project documents must provide that amendments of a material
    adverse nature to mortgagees be agreed to by mortgagees that
    represent at least 51 percent of the votes of unit estates that are
    subject to mortgages.
  
  - The project documents or applicable state law must provide for any
    action to terminate the legal status of the project after substantial
    destruction or condemnation occurs or for other reasons to be agreed
    to by mortgagees that represent at least 51 percent of the votes of the
    unit estates that are subject to mortgages.
  
  - The project documents may allow for implied approval to be assumed
    when a mortgagee fails to submit a response to any written proposal for
    an amendment within 60 days after it receives proper notice of the
    proposal, provided the notice was delivered by certified or registered
    mail, with a return receipt requested.

- Rights of Condo Mortgagees and Guarantors – The project documents must
give the mortgagee and guarantor of the mortgage on any unit in a
condominium project the right to timely written notice of the following:
  
  - Any condemnation or casualty loss that affects either a material portion
    of the project or the unit securing its mortgage.
  
  - Any 60-day delinquency in the payment of assessments or charges
    owed by the owner of any unit on which it holds the mortgage.
  
  - A lapse, cancellation, or material modification of any insurance policy
    maintained by the homeowners' association.
  
  - Any proposed action that requires the consent of a specified
    percentage of mortgagees.
Freddie Mac Condominium Project Warranties (Conforming Loans Only) (continued)

- First Mortgagee's Rights Confirmed – No provision of the condominium project documents gives a condominium unit owner or any other party priority over any rights of the first mortgagee of the condominium unit pursuant to its mortgage in the case of payment to the unit owner of insurance proceeds or condemnation awards for losses to or a taking of condominium units and/or common elements.

- Unpaid Homeowners' Association Assessments – Any first mortgagee who obtains title to a condominium unit pursuant to the remedies in the mortgage or through foreclosure will not be liable for more than six months of the unit's unpaid regularly budgeted dues or charges accrued before acquisition of the title to the unit by the mortgagee. If the homeowners' association's lien priority includes costs of collecting unpaid dues, the lender will be liable for any fees or costs related to the collection of the unpaid dues.

- Project Configuration – The condominium project must be located on one contiguous parcel of land although a public street may run through the project. The structures within the project should be within a reasonable distance from each other.

- Developer Interest in Project – Once the condominium project has been turned over to the unit owners, the developer must not retain any ownership interest in the project except for interest in any unsold units.

- Project Management – The management of the project must demonstrate that it is managed well. Any contract with an independent professional management firm must be for a reasonable term and must include equitable provisions for its termination. The contract must not require the payment of any penalty or an advance notice more than 90 days.

- Unit Occupancy – The subject unit in the condominium project must be available for immediate occupancy at the time of closing of the mortgage.

- Marketing Units in the Condominium Project

  The sales program developed for marketing units in a project must recognize and provide procedures for complying with all laws pertaining to the advertising and sale of real estate, the form and content of sales contracts and the method for handling deposits connected with the sale.

  When the Project Documents allow the homeowners' association to retain the right of first refusal (the right to provide a substitute buyer of to have the first option to purchase a unit), that right cannot be exercised in any way that could be interpreted as unlawful discrimination, or that could impair the marketability of the units in the project.

Insurance Requirements

- Minimum $1 million liability insurance coverage per occurrence.
- Insured on 100 percent of its replacement cost or guaranteed replacement cost.
- Fidelity Insurance is required for all projects with more than 20 units.
- HO6 policy is required if master policy does not reflect walls-in coverage or betterments. Must be at least 20 percent of appraised value.
### Documentation Requirements

- Appraisal Report, if applicable
- Conventional Condominium/PUD Warranty
- Condominium Homeowners' Association Questionnaire
- Copy of the Declaration Page of the Master Insurance Policy, including Fidelity Insurance, if applicable
- Current operating budget
- Recorded legal documents for complete legal review included in the file:
  - Articles of Incorporation
  - Master Deed/Declaration
  - By-laws
- Management Contract
- Agreement of Sale, if applicable
- Engineer's report, description of renovations and rehabilitation for conversions completed within the past three years
- Leasehold Estate – See the [Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties](#) section for more information.
Fredrick Mac Condominium Project Warranties (Conforming Loans Only) (continued)

Fredrick Mac New Condominium

These projects may be new condominiums or existing buildings that are being converted to condominiums. These may include projects where all units and common elements, including common elements owned by a Master Association are not fully complete or the project is subject to additional phasing or fewer than 90 percent of the total number of units in the project have been conveyed to unit purchasers (other than the developer) or the developer has not turned control of the homeowners’ association over to the unit owners.

Condominium projects are warranted as Fredrick Mac New if the following eligibility requirements are met:

Eligibility Requirements

- The project or subject legal phase is substantially completed. A Certificate of Occupancy or equivalent has been issued by the applicable governmental agency for the project or subject phase and all units in the subject unit building are completed.

- At least 70 percent of the total units in the project have been conveyed or are under contract (other than the developer) for purchase of a primary residence or second home. Multiple purchases of condominium units by the same owner are counted as one sale when determining pre-sale requirements.

If the project does not meet occupancy requirements, one of the following must be met:

- At least 70 percent of the units in the subject legal phase must have been conveyed or be under contract for purchase (other than the developer) of a primary residence or second home.

- At least 70 percent of the units in the subject legal phase plus the total number of units in all prior legal phases, in which units have been offered for sale, must have been conveyed or be under contract for purchase (other than the developer) of a primary residence or second home.

- No more than 15 percent of the total units within the project can be more than one month delinquent on homeowners' association fees, dues or assessments.

- The developer has transferred or will transfer control of the Homeowners Association to the unit owners within a reasonable period of time.

- No single entity (the same individual, investor group, partnership, or corporation) may own more than 10 percent of the units in the project.

- Project does not include any manufactured homes.

- Project is an eligible project.

- Project is not located in the state of Florida.

- Commercial space may constitute up to 20 percent of the total space in the project. Any commercial space in the project must be compatible with the overall residential nature of the project.
Budget

The homeowners' association assessments must begin on a specific date whether or not all units have been sold. When assessments are established, the developer must be responsible for the assessments attributable to the unsold units.

The project's operating budget, or its projected budget if the project has not been turned over to the unit owners, must be consistent with the nature of the project and appropriate assessments established to manage the project.

- There must be appropriate allocations for line items pertinent to the type and status of the condominium project.
- At least 10 percent of the budget must provide funding for replacement reserves for capital expenditures and deferred maintenance based on the project's age and remaining life, and on the quality and replacement cost of major items comprising the common elements including the heating system, elevators, and roof.
- If the project was recently converted, the developer must have initially funded a working capital fund in an amount consistent with the estimated remaining life of the individual common elements.
- Homeowners' association must have adequate reserves for fund the insurance deductible or the budget must be allocating funds sufficient to replenish the reserves for deductible.

Conversions

- For newly converted condominium projects, the appraiser or other licensed professional has stated that the project is structurally sound, and the condition and remaining useful life of the major project components are sufficient to meet the residential needs of the project, or that the appraiser has found no evidence that any of these conditions are not met. Major components include the roof, elevators and mechanical systems such as HVAC, plumbing, and electricity.
- If the conversion was a partial rehabilitation, verify that all repairs affecting soundness and habitability are complete and replacement reserves have been allocated for all capital improvements, and the underwriter has determined that the reserves are sufficient to fund the improvements.
- All rehabilitation work involved in a conversion must have been completed in a professional manner.
Freddie Mac Condominium Project Warranties (Conforming Loans Only) (continued)

<table>
<thead>
<tr>
<th>Freddie Mac New Condominium (continued)</th>
<th>Legal Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>CMS must represent and warrant that an acceptable legal review has been conducted based upon a review of the project's recorded legal documents. The review must confirm the legal documents comply with the legal requirements discussed herein and evidence of CMS' review must be located within the file.</td>
<td></td>
</tr>
<tr>
<td>● Compliance with Laws</td>
<td></td>
</tr>
<tr>
<td>○ The condominium project has been created and exists in full compliance with the state law requirements of the jurisdiction where the condominium project is located and all other applicable laws and regulations.</td>
<td></td>
</tr>
<tr>
<td>● Amendments to Documents</td>
<td></td>
</tr>
<tr>
<td>○ The project documents must provide that amendments of a material adverse nature to mortgagees be agreed to by mortgagees that represent at least 51 percent of the votes of unit estates that are subject to mortgages.</td>
<td></td>
</tr>
<tr>
<td>○ The project documents must provide for any action to terminate the legal status of the project after substantial destruction or condemnation occurs or for other reasons to be agreed to by mortgagees that represent at least 51 percent of the votes of the unit estates that are subject to mortgages.</td>
<td></td>
</tr>
<tr>
<td>○ The project documents may provide for implied approval to be assumed when a mortgagee fails to submit a response to any written proposal for an amendment within 60 days after it receives proper notice of the proposal, provided the notice was delivered by certified or registered mail, with a return receipt requested.</td>
<td></td>
</tr>
<tr>
<td>● Limitations on Ability to Sell/Right of First Refusal</td>
<td>Any right of first refusal in the condominium project documents will not adversely impact the rights of a mortgagee or its assignee to complete any of the following tasks:</td>
</tr>
<tr>
<td>○ Foreclose or take title to a condominium unit pursuant to the remedies in the mortgage.</td>
<td></td>
</tr>
<tr>
<td>○ Accept a deed or assignment in lieu of foreclosure in the event of default by a mortgagor.</td>
<td></td>
</tr>
<tr>
<td>○ Sell or lease a unit acquired by the mortgagee or its assignee.</td>
<td></td>
</tr>
<tr>
<td>● Rights of Condo Mortgagees and Guarantors – The project documents must give the mortgagee and guarantor of the mortgage on any unit in a condominium project the right to timely written notice of:</td>
<td></td>
</tr>
<tr>
<td>● Any condemnation or casualty loss that affects either a material portion of the project or the unit securing its mortgage</td>
<td></td>
</tr>
<tr>
<td>● Any 60-day Delinquency in the payment of assessments or charges owed by the owner of any unit on which it holds the mortgage</td>
<td></td>
</tr>
<tr>
<td>● A lapse, cancellation, or material modification of any insurance policy maintained by the homeowners' association</td>
<td></td>
</tr>
<tr>
<td>● Any proposed action that requires the consent of a specified percentage of mortgagees</td>
<td></td>
</tr>
</tbody>
</table>
Freddie Mac Condominium Project Warranties (Conforming Loans Only) (continued)

- First Mortgagee's Rights Confirmed – No provision of the condominium project documents gives a condominium unit owner or any other party priority over any rights of the first mortgagee of the condominium unit pursuant to its mortgage in the case of payment to the unit owner of insurance proceeds or condemnation awards for losses to or a taking of condominium units and/or common elements.

- Unpaid Homeowners' Association Assessments – Any first mortgagee who obtains title to a condominium unit pursuant to the remedies in the mortgage or through foreclosure will not be liable for more than six months of the unit's unpaid regularly budgeted dues or charges accrued before acquisition of the title to the unit by the mortgagee. If the homeowners' association's lien priority includes costs of collecting unpaid dues, the lender will be liable for any fees or costs related to the collection of the unpaid dues.

- Project Configuration – The condominium project must be located on one contiguous parcel of land although a public street may run through the project. The structures within the project should be within a reasonable distance from each other.

- Ownership and Use of the Common Elements
  Common elements such as parking and recreational facilities must be consistent with the nature of the project and be competitive in the market.

  - The unit owners must be the sole owners of and have the right to the use of common elements including but not limited to all buildings, roads, parking, and amenities. The developer must not retain any ownership interest in any of them except for unsold units
  - The unit owners must have an undivided ownership of the land on which the condominium project is located in Fee Simple, or have a Leasehold interest in the ground lease on which the project is located. Any ground lease must meet the requirements of this section
  - The common elements including amenities such as parking and recreational facilities must not be subject to a lease between the unit owners or homeowners' association and any other party

- Project Management - The management of the project must demonstrate that it is managed well. Any contract with an independent professional management firm must be for a reasonable and must include equitable provisions for its termination. The contract must not require the payment of any penalty or an advance notice more than 90 days.

- Unit Occupancy – The subject unit in the condominium project must be available for immediate occupancy at the time of closing of the mortgage.

- Marketing Units in the Condominium Project
  The sales program developed for marketing units in a project must recognize and provide procedures for complying with all laws pertaining to the advertising and sale of real estate, the form and content of sales contracts and the method for handling deposits connected with the sale.

- When the Project Documents allow the homeowners’ association to retain the right of first refusal (the right to provide a substitute buyer of to have the first option to purchase a unit), that right cannot be exercised in any way that could be interpreted as unlawful discrimination, or that could impair the marketability of the units in the project.
Freddie Mac Condominium Project Warranties (Conforming Loans Only) (continued)

<table>
<thead>
<tr>
<th>Insurance Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Minimum $1 million liability insurance coverage per occurrence</td>
</tr>
<tr>
<td>• Insured on 100 percent of its replacement cost or guaranteed replacement cost</td>
</tr>
<tr>
<td>• Fidelity Insurance is required for all projects with more than 20 units.</td>
</tr>
<tr>
<td>• HO6 policy is required if master policy does not reflect walls-in coverage or betterments. Must be at least 20 percent of appraised value</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Documentation Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Appraisal Report</td>
</tr>
<tr>
<td>• Conventional Condo/PUD Warranty</td>
</tr>
<tr>
<td>• Conventional Homeowners' Association Questionnaire</td>
</tr>
<tr>
<td>• Copy of Declaration Page of the Master Insurance Policy and Fidelity insurance, if applicable</td>
</tr>
<tr>
<td>• Projected Budget</td>
</tr>
<tr>
<td>• Recorded legal documents for complete legal review must be included in file</td>
</tr>
<tr>
<td>o Articles of Incorporation</td>
</tr>
<tr>
<td>o Master Deed/Declaration</td>
</tr>
<tr>
<td>o By-laws</td>
</tr>
<tr>
<td>• Recorded Plat Map</td>
</tr>
<tr>
<td>• Recorded Site Plans</td>
</tr>
<tr>
<td>• Management Contract</td>
</tr>
<tr>
<td>• Agreement of Sale</td>
</tr>
<tr>
<td>• Engineer's report, description of renovations and rehabilitation, if applicable</td>
</tr>
<tr>
<td>• Leasehold Estate – See the Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties section for more information.</td>
</tr>
</tbody>
</table>
Freddie Mac Condominium Project Warranties (Conforming Loans Only) (continued)

**Freddie Mac Two- to-Four Unit Condominiums**

A Two- to Four-Unit condominium project is a project that is comprised of at least two but no more than four 1-unit dwellings that are each separately owned with separate legal descriptions.

Condominium projects are warranted as Two- to-Four condominium projects if the following eligibility requirements are met.

**Eligibility Requirements**

- All units, common elements, including units and common elements owned by a Master Association, are 100 percent complete
- No more than one unit in the project has been conveyed as an investment property
- No single entity owns more than one unit in project
- Unit owners own the condominium in Fee Simple or Leasehold, and the unit owners are the sole owners of and have rights to the use of the project's common elements
- No requirements for control of homeowners' association
- Project does not include any manufactured homes
- Project is an eligible project
- Project is not located in the state of Florida

**Insurance Requirements**

- Minimum $1 million liability insurance coverage per occurrence
- Insured on 100 percent of replacement costs basis or guaranteed replacement cost
- HO6 policy is required if master policy does not reflect walls-in or betterments. Must be at least 20 percent of appraised value
- If the exterior is described as being a common element, a master policy must be obtained together with a homeowner’s policy for the interior of the unit. If the exterior is not a common element, then a homeowner’s policy must be obtained

**Legal Requirements**

- No legal review is required
Freddie Mac Condominium Project Warranties (Conforming Loans Only) (continued)

<table>
<thead>
<tr>
<th>Freddie Mac Two- to-Four Unit Condominiums (continued)</th>
<th>Documentation Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Appraisal Report</td>
</tr>
<tr>
<td></td>
<td>• Conventional Condominium/PUD Warranty</td>
</tr>
<tr>
<td></td>
<td>• Conventional Condominium Homeowners' Association Questionnaire</td>
</tr>
<tr>
<td></td>
<td>• Copy of Declaration Page of the Master Insurance Policy</td>
</tr>
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<td></td>
<td>• Recorded legal documents for complete legal review must be included in file</td>
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<td></td>
<td>• Leasehold Estate – See the <a href="#">Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties</a> section for more information.</td>
</tr>
</tbody>
</table>

Freddie Mac Reciprocal Project Review

<table>
<thead>
<tr>
<th>Fannie Mae Project Acceptance</th>
<th>See Fannie Mae CPM Expedited Lender Full Review or PERS Approval for details. In addition, for CPM Expedited Lender Full Review projects, Freddie Mac Established Condominium legal review must be met when warranting an Established Project.</th>
</tr>
</thead>
<tbody>
<tr>
<td>FHA Approved Projects</td>
<td>FHA HUD Review and Approval Process (HRAP) and Direct Endorsement Lender Review and Approval Process (DELRAP) approvals are not eligible for delivery.</td>
</tr>
</tbody>
</table>
Environmental Hazard Assessment

An environmental assessment is only required if CMS or CMS' investor has identified environmental problems through the performance of its project review process and due diligence review.

The following are the two types of environmental assessments:

- **Phase I assessment**: Occurs when a qualified environmental consultant is hired to gather information from various sources to evaluate the environmental soundness of the project.

- **Phase II assessment**: Occurs if the Phase I assessment identifies any problems or is inconclusive with regard to any particular hazard. A qualified environmental engineer must conduct the Phase II assessment. A new condominium (or existing building which has been converted to a condominium) must be acceptable under either the Phase I or the Phase II assessment.

**Phase I Assessment**

A Phase I Assessment is a screening process that focuses on the following tasks:

- Reviewing the available documentation.
- Interviewing people who are knowledgeable about the site operations.
- Inspecting the site, the building, and adjoining properties.

This assessment enables the lender to ascertain whether sufficient information currently exists to clearly evaluate a property's environmental status.

The Phase I Assessment must be completed and submitted as part of the project submission package. Fannie Mae does not require a specific form for a Phase I Assessment, although a suggested format is provided. Use of Fannie Mae's suggested format (or a similar one) will assure that all the relevant points are addressed in the assessment.

**Phase II Assessment**

A Phase II Assessment provides a more detailed review of the site, including specific physical sampling for each hazard that was not acceptable under the Phase I assessment, and a review of historical records. This assessment determines the presence or absence of specific environmental liabilities (e.g., asbestos or leaking underground storage tanks) or quantifies the extent of an observed or suspected environmental liability (e.g., such as soil or ground water contamination). Examples of the kind of testing or sampling that occurs under a Phase II assessment include the following:

- Investigating the status of any enforcement actions related to neighboring properties under the Superfund or Resource, Conservation, and Recovery Acts:
- Testing for underground storage leaks
- Sampling and analyzing the soil
- Sampling and analyzing the ground water
- Testing soil or facilities that are suspected as being contaminated by polychlorinated biphenyl's
- Sampling and analyzing bulk asbestos and developing related abatement and maintenance programs, if necessary
Environmental Hazard Assessment (continued)

| Phase II Assessment (continued) | The specialized nature of the investigations conducted under a Phase II assessment requires the knowledge and experience of a qualified engineer. Always be diligent when choosing firms to perform environmental hazard assessments. Ensure that the consultant chosen is not affiliated with the buyer or seller of the property, or with a firm engaged in a business that might present a conflict of interest. Always evaluate whether the consulting firm’s personnel have adequate and appropriate education and training to carry out the required duties. The local EPA office should be contacted for recommendations.

The following requirements must be followed:

- The consultant’s report for a Phase II Environmental Assessment must include a full description of the sampling procedures, the laboratory results, and the consultant’s recommendations.

- The consultant must follow all regulatory standards and good management practices at all times, especially when physical sampling and laboratory analysis are involved.

- The report must be thorough and professionally prepared. Fannie Mae does not specify an exact format for the consultant’s report.

- The consultant must certify in his or her report that the assessment was performed diligently and in accordance with all regulatory and good management standards, and that, to the best of his or her knowledge, the results are complete and accurate.

- An officer of the consulting firm that performed the work must sign the report.

Fannie Mae reserves the right to notify a lender that a particular consultant is no longer acceptable to them. They also reserve the right to refuse to accept (at any time) any future environmental assessment, report, warranty, or certification from individual consultants, specific consulting firms, or specific branch offices of consulting firms.

When a Phase II Assessment is required to address those hazards identified as being unacceptable under the Phase I Assessment, the Phase II Assessment may be included as part of the project submission package that is submitted to obtain Fannie Mae’s preliminary acceptance of the project or the Phase II assessment may wait until after Fannie Mae has completed their preliminary review of the application before the consultant conducts the Phase II Assessment. When a Phase II Assessment is required, Fannie Mae will not issue either a Conditional Project Acceptance (form 1027) or a Final Project Acceptance (form 1028) until they have received and reviewed the Phase II Assessment.
Environmental Hazard Assessment (continued)

Unacceptable Environmental Conditions

A property must be acceptable under either the Phase I or the Phase II Environmental Hazard Assessment in order for a new condominium to be an acceptable project under a Type B project classification. The existence of one or more unacceptable environmental conditions will generally result in a project being ineligible.

Examples of unacceptable environmental conditions include, but are not limited to the following:

- A property that is (or has been) used as a landfill or other solid, hazardous, or municipal waste disposal site.
- A property that is (or has been) used for activity related to the storage of oil, hazardous waste, or other toxic substances except that the property may have been used for the storage of small quantities of hazardous substances that are generally recognized as appropriate for residential uses and maintenance of the property.
- A property that is the subject of outstanding environmental or public health litigation or administrative action from private parties or public officials.
- High-risk neighboring properties that have evidence of hazardous waste spills or soil or groundwater contamination on or around the site.
- A property that has documented soil or groundwater contamination and/or a documented tank leak that is leaking at more than 0.05 gallons per hour (which is the National Fire Protection Association's standard).

<table>
<thead>
<tr>
<th>A property with soil sampling that has value for metal in excess of the following concentration limits (in parts per million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chromium</td>
</tr>
<tr>
<td>Zinc</td>
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<tr>
<td>Lead</td>
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<tr>
<td>Copper</td>
</tr>
<tr>
<td>Arsenic</td>
</tr>
<tr>
<td>Cadmium</td>
</tr>
<tr>
<td>Nickel</td>
</tr>
<tr>
<td>Selenium</td>
</tr>
</tbody>
</table>
Environmental Hazard Assessment (continued)

### Unacceptable Environmental Conditions (continued)

<table>
<thead>
<tr>
<th>A property with soil sampling that has value for organic materials in excess of the following concentration limits (in parts per million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total volatile organics</td>
</tr>
<tr>
<td>Total hydrocarbons</td>
</tr>
<tr>
<td>Total petroleum hydrocarbons</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>A property with groundwater sampling that has value for other organic materials in excess of the following concentration limits (in parts per million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total organics (volatiles &amp; base neutrals)</td>
</tr>
<tr>
<td>Total petroleum hydrocarbons</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>A property with groundwater sampling that has values for metals in excess of the following concentration limits (in parts per million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arsenic</td>
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<td>Boron</td>
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</tr>
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<td>Lead</td>
</tr>
<tr>
<td>Mercury</td>
</tr>
<tr>
<td>Selenium</td>
</tr>
<tr>
<td>Silver</td>
</tr>
</tbody>
</table>

- A property with high radon levels (above 4 pico curies per liter) that can be corrected only through large capital improvements and/or extensive on-going maintenance programs that is beyond the financial or technical abilities of the Homeowners’ Association for the project.
- A property that has conditions representing material violations of applicable local, state, or federal environmental or public health statutes and laws.
- A property that is contaminated by friable asbestos-containing materials or polychlorinated biphenyl's (PcBs).
Environmental Hazard Assessment (continued)

Unacceptable Environmental Conditions (continued)
Remedial actions and then retests may be performed for Properties that fail to meet a particular standard. Remedial actions should be undertaken only with the advice and written endorsement of a qualified environmental consultant. All remedial actions must be taken in accordance with all regulatory and good management standards.

The completion and effectiveness of remedial actions must be confirmed before CMS’ investor will issue a project warranty for a specific condominium project. CMS’ investor will consider issuing a conditional project warranty before the completion of remedial work under the following conditions:

- A qualified environmental consultant states in writing that remedial work needed to make the property eligible under the environmental standards can be completed within 90 days after issuing of the conditional project acceptance (or within any additional time allowed for completion of any repair or moderate rehabilitation work required under our conditional project acceptance).
- The project developer or sponsor must provide a performance escrow equal to 150 percent of the gross contract amount to assure the completion of the remedial work.
- The project's developer or sponsor signs a contract with a qualified firm to perform the remedial work within 90 days after CMS' investor issues a conditional project warranty (or within any additional time allowed for completion required under the conditional project acceptance).

When CMS’ investor issues a Conditional Project Warranty before the completion of remedial work, a written statement is required from a qualified consultant when the work is finished, certifying that the job has been completed satisfactorily and that the property meets the environmental eligibility standards.

Attorney’s Review

Both preliminary and final Attorney's Reviews must be prepared in a letter format, using the attorney's letterhead and addressed to the lender that requested the review.

A review should be separated into the following five parts:

1. The project identification
2. A statement on the specific assignment
3. A list of the project legal documents that were reviewed
4. A statement on the attorney’s qualifications for rendering the review
5. The Attorney's Review.

Project Identification

Project identification should include the following information:

- The name of the project.
- The location of the project, including the address, city, state, and zip code.
- Information on whether the project is legally phased, including the number of legal phases to be developed and the specific identities.
Underwriting Guidelines (Conventional)
Mortgage Lending Division
Version 1.0 – 02/01/12

Attorney’s Review (continued)

Statement of Assignment
A statement similar in substance to the following should be included.

“You have requested the undersigned to provide certain legal services required for the [insert legal name of the condominium or cooperative] project. I understand that this review will be relied on by the Federal National Mortgage Association (Fannie Mae) in determining whether certain requirements have been met in connection with Fannie Mae’s acceptance of unit mortgages in the project.”

Documents Reviewed
The attorney should list each of the legal documents for the project that he or she reviewed in connection with developing the Attorney's Review. For a condominium project, these documents must include, at a minimum, the following:

- Declaration (or an equivalent document applicable to the project), which must include a description, a table of allocated interests, plat and the project plans (either incorporated by reference or as an attachment). The attorney should indicate whether or not the document is recorded and, if it is recorded, provide the date of recordation. If the document is not recorded, the Attorney’s Review will be considered a preliminary review.

- Articles of Incorporation for the Homeowners’ Association (or an equivalent document applicable to the project), minutes of the Homeowners’ Association’s organizational meeting and minutes from the first meeting of the Homeowners’ Association’s executive board.

- Bylaws for the Homeowners’ Association, which were adopted at the organization meeting of the Homeowners’ Association and made part of its corporate records. The attorney should specify whether the bylaws are, or will be, recorded.

- Public Offering Statement for the project.

- Standard form of Purchase Agreement that is used to document the purchase of a condominium in the project.

The attorney should specify and list any amendments to the above documents, as well as, listing any other documents or materials on which his or her review is based.

Attorney’s Qualifications
A statement similar to the following should be included.

“The undersigned is experienced in the practice of real estate law in [name of jurisdiction and locality in which the project is located] and is familiar with the necessary laws, ordinances, regulations, and other legal requirements that, as of the date the project was created, were applicable with respect to the establishment and administration of projects within the aforementioned
Attorney’s Review (continued)

The attorney must provide the effective date of his or her review and indicate whether it is a preliminary or final review. The review should include, but not be limited to, the following information:

- Establishment of the project and compliance of the condominium documents, as implemented in the applicable provisions of the Public Offering Statement, indicating that all requirements of state legislation governing creation of condominiums have been complied with and identifying the legislation by name and citation and providing the name of the jurisdiction in which the project is located. References to any local laws, ordinances, regulations, and legal requirements regarding the establishment of a condominium project and the need for compliance by its project documents should be included.

- Compliance of the condominium’s legal documents with the requirements of the Fannie Mae Selling Guide as of the date they were last amended, indicating the date of the last amendment and listing and explaining any variations to those requirements (including failure to comply with a specific requirement).

- Provisions for the project’s amenities or facilities (including any recreational or parking facility related to, or associated with the project) to be leased to the homeowners’ association or the unit owners. It should confirmed whether the project documents do not permit any of the amenities or facilities to be subject to any restriction or reservation in favor of the developer or declarant) or list any special declarant rights to them that are set out in the project documents.

- Association of the project or project units with any “master” project, documents, Homeowners’ Association or a similar entity to which assessments are paid, indicating whether the unit owners will or will not pay assessments to more than one association). If there is a “master” project, the name and form of organization should be provided, copies of the related project documents should be attached, and details about its amenities and fees should be discussed.

- A statement regarding the use of his or her review by the lender, Fannie Mae, and Fannie Mae’s successors and assigns should be included.

- An indication of whether the review is without qualification or subject to specific qualifications should be included, and list each such qualification.

The review must be signed and dated by the attorney, include his or her name and title, and the name of the firm with which he or she is associated.
AUTOMATED UNDERWRITING

Purpose
This section describes automated underwriting requirements that must be followed for conventional loans. To determine underwriting decisions, CMS uses Desktop Underwriter, Loan Prospector, and the Investor’s Automated Underwriting System (AUS).

For state-specific restrictions, see the Underwriting Conditions Matrix.

Underwriting Methods
Guidelines contained in this section are applicable to loans underwritten by Desktop Underwriter, Loan Prospector, and Jumbo loans unless otherwise stated. Loans may be underwritten by any one of the following methods:

- Automated Underwriting: Loans underwritten by Desktop Underwriter or Loan Prospector
  - Loans underwritten by Desktop Underwriter and Loan Prospector may follow the DU Underwriting Findings Report or LP Feedback Certificate unless otherwise stated in this guide or the specific CMS Product Guideline.
  - Loan Prospector Streamlined Accept documentation may be used if the LP Feedback Certificate is approved as such. See the Freddie Mac Seller/Servicer Guide for Loan Prospector Streamlined Accept documentation requirements.

- Jumbo Loans
  Loan amounts that exceed the conforming loan limit and are not underwritten to agency guidelines. Jumbo loans should be submitted to the investor’s Automated Underwriting System (AUS).
Desktop Underwriter (DU)

Fannie Mae Underwriting System

CMS uses the Desktop Underwriter (DU), which is Fannie Mae's automated underwriting system. The DU completes the following tasks:

- Evaluates mortgage default risk and provides an underwriting recommendation by examining the primary and contributory risk factors in a mortgage application.
- Analyzes the information in the loan file to deliver an overall credit risk assessment to determine eligibility for delivery to Fannie Mae.

DU General Requirements

The following tasks must be completed when underwriting loans using the DU:

- Use careful underwriting judgment to determine whether a loan file should be approved.
- Verify the data that was submitted and ensure that all necessary data was submitted that might affect the DU outcome.
- Review the DU Underwriting Findings Report and ensure that the loan complies with all of the verification messages and approval conditions specified in the report.
- Complete a thorough due diligence review of the documentation in the loan file.
- Verify that all data is entered accurately into the DU to ensure the appropriate verification messages and approval (e.g., commission income, bonus income, gift information) is received.
- Confirm that the credit report used by the DU to evaluate the potential borrower was accurate and comprehensive.
- Determine whether any potentially derogatory or contradictory data exists outside of the data analyzed by the DU. If any incorrect data is found in the credit report or contradictory or derogatory information is found in the loan file that would justify additional investigation or would provide grounds for a decision that is different from the recommendation that the DU delivered, ensure that all issues are resolved.

Comply with all of the verification messages and approval conditions listed on the DU Underwriting Findings Report and document the loan file accordingly for approved loans using the DU Underwriting Findings Report. Any CMS underwriting overlays would apply. See the CMS Product Guidelines for underwriting overlays.
Desktop Underwriter (DU) (continued)

When a loan is submitted to the DU, the DU Underwriting Findings Report returns one of the following recommendations:

See the CMS Product Guidelines for eligibility and overlays.

<table>
<thead>
<tr>
<th>Decision</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Approve/Eligible</strong></td>
<td>Indicates that the loan meets Fannie Mae’s credit risk and eligibility requirements.</td>
</tr>
</tbody>
</table>
| Expanded Approval I, II, or III/Eligible | Indicates that the loan meets Fannie Mae’s eligibility requirements, but does not meet the credit risk requirements. Based on the data submitted, the DU evaluated a combination of risk factors, but was not able to recommend approval of the loan. The DU Underwriting Findings Report identifies the overriding factors(s) that resulted in the loan being referred. When determining whether to approve the loan, review the following items:  
  - The accuracy of the data submitted.  
  - All relevant risk factors,  
  - Any factors outside of the data considered by the DU.  
  If it is determined that the loan meets the credit risk requirements for manually underwritten loans and all requirements on the DU Underwriting Findings Report have been met, the loan is eligible for delivery to Fannie Mae.  
  Any additional compensating factors that cannot be obtained based on the DU recommended documentation must be documented.  
  The limited waiver of underwriting representations and warranties does not apply to loans that receive a Refer/Eligible recommendation. |
| **Refer/Eligible**        | Indicates that the loan meets Fannie Mae’s eligibility requirements, but does not meet the credit risk requirements. Based on the data submitted, the DU evaluated a combination of risk factors, but was not able to recommend approval of the loan. The DU Underwriting Findings Report identifies the overriding factors(s) that resulted in the loan being referred. When determining whether to approve the loan, review the following items:  
  - The accuracy of the data submitted.  
  - All relevant risk factors,  
  - Any factors outside of the data considered by the DU.  
  If it is determined that the loan meets the credit risk requirements for manually underwritten loans and all requirements on the DU Underwriting Findings Report have been met, the loan is eligible for delivery to Fannie Mae.  
  Any additional compensating factors that cannot be obtained based on the DU recommended documentation must be documented.  
  The limited waiver of underwriting representations and warranties does not apply to loans that receive a Refer/Eligible recommendation. |
| **Approve/Ineligible**    | Indicates that the loan appears to meet Fannie Mae’s credit risk requirements, but; the loan does not appear to meet Fannie Mae’s eligibility requirements. In order to deliver this loan to Fannie Mae, it must be guaranteed that the reason for ineligibility is acceptable to CMS investor.  
  The limited waiver of underwriting representations and warranties does not apply to loans that receive an Approve/Ineligible recommendation. |
| **Expanded Approval I, II or III/Ineligible** | Indicates that the loan meets Fannie Mae’s expanded range of credit risk subject to appropriate EA price adjustments, but the loan does not meet Fannie Mae’s eligibility requirements and is not eligible for delivery to Fannie Mae.  
  The limited waiver of underwriting representations and warranties does not apply to loans that receive an Expanded Approval/Ineligible recommendation. |
### Desktop Underwriter (DU) (continued)

<table>
<thead>
<tr>
<th>Decision</th>
<th>Description</th>
</tr>
</thead>
</table>
| **Refer/Ineligible**      | Indicates that the DU cannot determine if the loan meets Fannie Mae's eligibility requirements, but it is determined that the loan does **not** meet Fannie Mae's eligibility requirements. Based on the data submitted, the DU evaluated a combination of risk factors, but was not able to recommend approval of the loan. The DU Underwriting Findings Report identifies the overriding factors(s) that resulted in the loan being referred. When determining whether to approve the loan, review the following items:  
  - The accuracy of the data submitted.
  - All relevant risk factors,
  - Any factors outside of the data considered by the DU. In order to deliver this loan to Fannie Mae, it must be guaranteed that the reason for ineligibility is acceptable to CMS’ investor. If it is determined that the loan meets the credit risk requirements for manually underwritten loans and all requirements on the DU Underwriting Findings Report have been met, the loan is eligible for delivery to Fannie Mae. Any additional compensating factors that cannot be obtained based on the DU recommended documentation must be documented. The limited waiver of underwriting representations and warranties does not apply to loans that receive a Refer/Ineligible recommendation. |
| **Refer with Caution-IV/Ineligible** | Indicates that the loan does not represent a level of risk that is acceptable to Fannie Mae for DU loans. The loan is not eligible for delivery to Fannie Mae as a DU loan if the data considered was an accurate representation of the borrower's income, assets, liabilities, and credit profile. |
| **Out of Scope**           | Indicates that the DU does not contain the rules or models that are necessary in order to underwrite the product, borrower, or type of loan submitted. The DU does not produce messages on the Underwriting Analysis report for Out of Scope loans. Desktop Underwriter continues to identify in a message the reason that a loan is Out of Scope. Out of Scope loans must be manually underwritten. |
Desktop Underwriter (DU) (continued)

<table>
<thead>
<tr>
<th>DU Data and Delivery Information Accuracy</th>
</tr>
</thead>
<tbody>
<tr>
<td>All data submitted to the DU must reflect the loan as it was closed, including the following items:</td>
</tr>
<tr>
<td>- Occupancy type</td>
</tr>
<tr>
<td>- Product type</td>
</tr>
<tr>
<td>- Amortization</td>
</tr>
<tr>
<td>- Loan term</td>
</tr>
<tr>
<td>- Property type</td>
</tr>
<tr>
<td>- Loan purpose</td>
</tr>
<tr>
<td>- Sales price</td>
</tr>
<tr>
<td>- Appraised value</td>
</tr>
</tbody>
</table>

Review all verification documents and compare the verified values to the data submitted to the DU. The terms of the closed loan must match the terms of the final loan submission in the DU or be within the tolerances listed in the table below.

The DU is constantly being updated by Fannie Mae with new versions of the system. Any underwriting updates for a loan should be run through the same version of the DU that the loan was initially run through. Any updated DU versions do not apply to previously submitted loans.

The following table describes the acceptable tolerances for which a resubmission to the DU is required. Only one of these tolerances may be used on any loan transaction. If the loan transaction contains more than one of the tolerances covered under the resubmission policy, all of the items in the loan file must be updated and resubmitted to the DU.
## Desktop Underwriter (DU) (continued)

<table>
<thead>
<tr>
<th>Data Element</th>
<th>Resubmission Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appraised Value</td>
<td>Resubmit if any change in value.</td>
</tr>
<tr>
<td>Assets</td>
<td>Resubmit if the verified assets are less than the assets required by DU.</td>
</tr>
<tr>
<td>Borrowers Added/Deleted</td>
<td>Resubmit if any borrowers are added or deleted.</td>
</tr>
<tr>
<td>Debt Income Interest Rate</td>
<td>For any decreases to income, increase to debt, or interest rate, manually re-calculate DTI and proceed based on the following results:</td>
</tr>
<tr>
<td></td>
<td>- DTI is &gt;45%, resubmit</td>
</tr>
<tr>
<td></td>
<td>- DTI is &lt;=45% and DTI has increased &gt;=3%, resubmit</td>
</tr>
<tr>
<td></td>
<td>- Final DTI is &lt;=45% and DTI has increased &lt;3%, do not resubmit</td>
</tr>
<tr>
<td></td>
<td>For soft pull credit refresh without credit scores, follow the above guidelines.</td>
</tr>
<tr>
<td></td>
<td>In addition, if the new refresh credit report has any new derogatory credit,</td>
</tr>
<tr>
<td></td>
<td>credit scores must be obtained and the loan must be resubmitted to the DU to</td>
</tr>
<tr>
<td></td>
<td>determine loan eligibility, regardless of DTI ratios.</td>
</tr>
<tr>
<td>Loan Amount</td>
<td>For purchase loans, resubmit if any change in the loan amount.</td>
</tr>
<tr>
<td></td>
<td>For refinance loans, resubmit unless the:</td>
</tr>
<tr>
<td></td>
<td>- Loan amount decreases by &lt;=5%</td>
</tr>
<tr>
<td></td>
<td>- Loan amount increases by the lesser of $500 or 1%</td>
</tr>
<tr>
<td>Note: The new LTV/CLTV/HCLTV</td>
<td>The new LTV/CLTV/HCLTV cannot result in change to MI or a different loan level price adjustment.</td>
</tr>
<tr>
<td>Loan Purpose</td>
<td>Resubmit if loan purpose changes.</td>
</tr>
<tr>
<td>Loan Type (product)</td>
<td>Resubmit if loan type changes.</td>
</tr>
<tr>
<td>LTV/CLTV/HCLTV</td>
<td>Resubmit if LTV/CLTV/HCLTV changes.</td>
</tr>
<tr>
<td>Occupancy Type</td>
<td>Resubmit if occupancy type changes.</td>
</tr>
<tr>
<td>Property Type</td>
<td>Resubmit if property type changes.</td>
</tr>
<tr>
<td>Sales Price</td>
<td>Resubmit if sales price changes.</td>
</tr>
</tbody>
</table>
## Loan Prospector

**Freddie Mac Underwriting System**  
CMS uses Loan Prospector, which is Freddie Mac's automated underwriting system. This system makes a purchase decision for Freddie Mac using statistical models and judgmental rules to analyze the date received to arrive at an underwriting decision.

**Loan Prospector General Requirements**  
The following tasks must be completed when underwriting loans using Loan Prospector:

- Use careful underwriting judgment to determine whether a loan file should be approved.
- Verify the data that was submitted and ensure that all necessary data was submitted that might affect Loan Prospector’s outcome.
- Review the LP Feedback Certificate and ensure that the loan complies with all of the verification messages and approval conditions specified in the report.
- Complete a thorough due diligence review of the documentation in the loan file.
- Verify that all data is entered accurately into Loan Prospector.
- Confirm that the credit report used by Loan Prospector to evaluate the potential borrower was accurate and comprehensive.
- Determine whether any potentially derogatory or contradictory data exists outside of the data analyzed by Loan Prospector. If any incorrect data is found in the credit report or contradictory or derogatory information is found in the loan file that would justify additional investigation or would provide grounds for a decision that is different from the recommendation that Loan Prospector delivered, ensure that all issues are resolved.

## Loan Prospector Risk Class

After a loan is submitted to Loan Prospector, one of the following decisions is returned on the LP Feedback Certificate:

- **Accept:** Indicates that Loan Prospector has determined that the borrower's credit worthiness is acceptable. All underwriting guidelines in this document must be met.
- **Caution:** Indicates that the mortgage will most likely not comply with Freddie Mac's eligibility and underwriting requirements because there is a strong indication of excessive layering of risk.
  
  To determine whether the loan is acceptable, the loan must manually underwritten and must comply with the Comprehensive Risk Assessment Worksheet for Manually Underwritten Loans as well as all underwriting guidelines within this document and any other guidelines specified by CMS' investors.

- **Caution/A-Minus:** Indicates that the mortgage may be eligible for sale as an Affordable Merit Rate Mortgage. The Feedback Certificate will specify if a mortgage is eligible for A-minus.
  
  These types of loans are not eligible for delivery to CMS' investors.

- **Incomplete/Invalid:** Indicates that Loan Prospector does not contain the rules or models that are necessary in order to underwrite the product, borrower, or type of loan submitted. Loan Prospector will not produce messages on a Feedback Certificate.

See the CMS Product Guidelines for eligibility and overlays.
Loan Prospector (continued)

The Documentation Level shown on the LP Feedback Certificate indicates the minimum level of documentation acceptable for the mortgage.

- Streamlined Accept Documentation
- Standard Documentation

See the Freddie Mac Seller/Servicer Guide for documentation requirements.

The final Loan Prospector Risk Class and Documentation Level must reflect the loan as it was closed, including the following items:

- Occupancy type
- Product type
- Amortization
- Loan term
- Property type
- Loan purpose
- Sales price
- Appraised value.

Review all verification documents and compare the data submitted to Loan Prospector. The terms of the closed loan must match the terms of the final loan submission in Loan Prospector or be within the tolerances listed in the following table.

Some loans may not require additional underwriting submissions as long as the requested income and asset documentation supports the information disclosed on the loan application and are within allowable tolerances.

Loans must resubmitted to Loan Prospector prior to closing if any of the following are true:

- Information on the previous submission was not true, complete, or accurate.
- The most recent submission (including the date of the Loan Prospector credit report) exceeds the data requirements.

The final Transmittal Summary must be included in the permanent loan file documenting the verified values of the data used to perform the underwriting analysis. The requested income and asset documentation may be within allowable tolerances, thereby avoiding any requirement to resubmit the application to Loan Prospector, the final Transmittal Summary must be updated with the verified values and executed by the appropriate underwriter.

Loan Prospector is constantly being updated by Freddie Mac with new versions of the system. Any underwriting updates for a loan should be run through the same version of Loan Prospector that the loan was initially run through. Any updated Loan Prospector versions do not apply to previously submitted loans.

The following table describes the acceptable tolerances for which a resubmission to Loan Prospector is not required. Only one of these tolerances may be used on any loan transaction. If the loan transaction contains more than one of the tolerances covered under the resubmission policy, all of the items in the Loan file must be updated and resubmitted to Loan Prospector.
# Loan Prospector (continued)

<table>
<thead>
<tr>
<th>Data Element</th>
<th>Resubmission Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Loan Prospector</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Appraised Value</strong></td>
<td>Resubmit if appraised value changes.</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td>- Resubmit if the verified reserves decrease &gt;10%.</td>
</tr>
<tr>
<td></td>
<td>- Resubmit if the verified assets decrease.</td>
</tr>
<tr>
<td><strong>Borrowers Added/Deleted</strong></td>
<td>Resubmit if any Borrowers are added or deleted.</td>
</tr>
<tr>
<td><strong>Debt Income Interest Rate</strong></td>
<td>For any decreases to income, increase to debt, or interest rate, manually re-calculate DTI and proceed based on the following rules:</td>
</tr>
<tr>
<td></td>
<td>- DTI is &gt;45%, resubmit</td>
</tr>
<tr>
<td></td>
<td>- DTI is &lt;=45% and DTI has increased &gt;=3%, resubmit</td>
</tr>
<tr>
<td></td>
<td>- Final DTI is &lt;= 45% and DTI has increased &lt;3%, do not resubmit</td>
</tr>
<tr>
<td></td>
<td>For soft pull credit refresh without credit scores, follow the above guidelines. In addition, if the new refresh credit report has any new derogatory credit, credit scores must be obtained and the loan must be resubmitted to Loan Prospector to determine loan eligibility, regardless of DTI ratios.</td>
</tr>
<tr>
<td><strong>Loan Amount</strong></td>
<td>- For purchase loans, resubmit if any change in the loan amount.</td>
</tr>
<tr>
<td></td>
<td>- For refinance loans, resubmit unless the:</td>
</tr>
<tr>
<td></td>
<td>- Loan amount increases by &lt;1%</td>
</tr>
<tr>
<td></td>
<td>- Loan amount increases &lt;1%</td>
</tr>
<tr>
<td></td>
<td>- Loan amount increases by the lesser of $500 or 1%</td>
</tr>
<tr>
<td></td>
<td><strong>Note:</strong> The new LTV cannot result in a change to MI or a different loan level price adjustment.</td>
</tr>
<tr>
<td><strong>Loan Purpose</strong></td>
<td>Resubmit if loan purpose changes.</td>
</tr>
<tr>
<td><strong>Loan Type (product)</strong></td>
<td>Resubmit if loan type changes.</td>
</tr>
<tr>
<td><strong>LTV/TLTV/HTLTV</strong></td>
<td>Resubmit if LTV/TLTV/HTLTV changes.</td>
</tr>
<tr>
<td><strong>Occupancy Type</strong></td>
<td>Resubmit if occupancy type changes.</td>
</tr>
<tr>
<td><strong>Property Type</strong></td>
<td>Resubmit if property type changes.</td>
</tr>
<tr>
<td><strong>Sales Price</strong></td>
<td>Resubmit if sales price changes.</td>
</tr>
</tbody>
</table>
CREDIT

Purpose
This section describes the credit requirements that must be followed for conventional loans.
For state-specific restrictions, see the Underwriting Conditions Matrix.

Underwriting Methods
Guidelines contained in this section are applicable to loans underwritten by Desktop Underwriter, Loan Prospector, and Jumbo loans unless otherwise stated. Loans may be underwritten by any one of the following methods:

- Automated Underwriting: Loans underwritten by Desktop Underwriter or Loan Prospector
  - Loans underwritten by Desktop Underwriter and Loan Prospector may follow the DU Underwriting Findings Report or LP Feedback Certificate unless otherwise stated in this guide or the specific CMS Product Guidelines.
  - Loan Prospector Streamlined Accept documentation may be used if the LP Feedback Certificate is approved as such. See the Freddie Mac Seller/Servicer Guide for Loan Prospector Streamlined Accept documentation requirements.
- Jumbo Loans
  Loan amounts that exceed the conforming loan limit and are not underwritten to agency guidelines. Jumbo loans should be submitted to the investor’s Automated Underwriting System (AUS).

Documentation Age and Requirements

Documentation Age
For existing construction, the credit report must be dated no more than 90 days prior to the Note date.
For new construction, the credit report must be dated no more than 120 days prior to the Note date.

Documentation Standards
All accounts, revolving and installment, reported by the borrower on the application must be verified on the credit report or directly by a credit reference. The following information must be provided:

- Current balance
- Current status
- Rating
- Monthly payment amount
- Payment history for the most recent 12 months

If a verification of mortgage, rent, or credit is used, it must be sent by the lender directly to the creditor. The return address on the verification must be the lender's address. The hand carrying of verifications is strictly prohibited.
Credit Report Requirements

Requirements  This section provides the requirements regarding credit reports and authorization.

- One of the following types of credit reports for each borrower must be in the loan file:
  - A three repository, merged in-file report including credit scores from an independent credit-reporting agency is preferred. However, a two repository, merged in-file report will be accepted if that is the extent of the information available. If a merged in-file report is upgraded to a Residential Mortgage Credit Report (RMCR), the original merged in-file report must remain in the file.
  - Full Residential Mortgage Credit Report (RMCR), which conforms to all applicable Fannie Mae and Freddie Mac requirements.

- If a new or retyped credit report is provided, all prior credit reports must be included in the loan file. The retyped credit report/supplement must indicate the reason and authorization for any changes, additions, and/or deletions.

- The credit reports used to evaluate a loan for purchase must not have Frozen Credit. A new three-file merged credit report must be obtained to reflect current updated information from all repositories if a borrower unfreezes his or her credit after the date that the original credit report was ordered. Nontraditional credit is not acceptable as a replacement for Frozen Credit.

- Nontraditional credit must be developed for a borrower who has no traditional credit history available or an in-file report or RMCR. See the Non-Traditional Credit Report section for more information and the CMS Product Guidelines for eligibility and overlays.

- All credit reports must include FACT Act messages, at least one repository fraud alert product (Hawk Alert, FACS+, or SafeScan), and an OFAC check.

- When the credit report shows a victim statement under the FACT Act, the steps taken to validate that the loan application is not the result of identity theft must be documented in writing. The actions must be reasonable and compliant with applicable laws.

- Credit report alerts must be reasonably resolved and all supporting documentation must be included in the loan file.

  Note: Although due diligence is required, it does not release CMS from representations and warranties regarding misrepresentation.

Credit Report Red Flags  The borrower's credit use and limits must be reviewed to ensure consistency with the reported income, assets, and application information when underwriting a credit report. The borrower's address history must be reviewed for consistency with other file documentation. All discrepancies must be adequately explained and questionable explanations researched.

Merged Credit Reports  A merged credit report includes the credit information from at least two credit repositories and is issued by a credit repository or a consumer reporting agency or bureau. A merged credit report includes all credit repository credit data for an individual borrower. A joint merged credit report includes all credit repository credit data on two individual borrowers.
Credit Report Requirements (continued)

Residential Mortgage Credit Report (RMCR)

A RMCR is a detailed account of the credit, employment and residence history as well as public records information prepared by a consumer reporting agency for an individual borrower or two individual borrowers. Credit information from two national repositories is merged and verified by a consumer reporting agency or bureau before it is sent to the user. The consumer reporting agency or bureau may also verify other information not contained in repository records.

Credit Report Standards

The following table describes the applicable standards that all credit reports must meet:

<table>
<thead>
<tr>
<th>Standard</th>
<th>Merged Credit Report</th>
<th>RMCR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Must have no erasures, alterations, correction fluid, or correction tape and must be filed in the Mortgage file</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>• Show the names of the national credit repositories from which the information was obtained and include a certification that it meets the standards for a RMCR.</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>• The report must contain information from at least two national credit repositories for each area in which the borrower has resided during the most recent two-year period.</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>• Separate credit repository inquiries are necessary when multiple borrowers have maintained credit individually.</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>The report must be issued by a consumer reporting agency that obtains or verifies all information from sources other than the applicant.</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>The report must present all credit data in a format that is easy to read and free of excessive coding. All codes must be clearly defined.</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Identify the full name, address, and telephone number of the repository, consumer reporting agency or bureau issuing the report.</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Identify who ordered the report and who was billed for it (if different from the party who ordered it), unless the billed party has a documented agent or corporate relationship with the lender who ordered the report.</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Be delivered to the office of the requestor.</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Show responsive statements concerning items on the report (e.g., the consumer reporting agency must report &quot;unable to verify&quot; or &quot;employer refused to verify&quot;). The same responsive reporting applies to trade and credit history.</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>• For DU loans and Jumbo loans: List all inquiries made within the previous 90 days.</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>• For Loan Prospector loans: List all inquiries made within the previous 120 days.</td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>
Credit Report Requirements (continued)

<table>
<thead>
<tr>
<th>Credit Report Standards (continued)</th>
<th>Standard</th>
<th>Merged Credit Report</th>
<th>RMCR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Includes a positive statement that the consumer reporting agency attempted to verify the borrower's current employment and, if obtainable, income. The report must show the date of verification. Verification may be made by telephone. If there has been a change in employment in the past two years, the report must also state the borrower's previous employment and income. In cases in which employment was not verified, the report must indicate why it was not.</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Include all available public records information. The legal search must disclose whether any judgments, foreclosures, tax liens, or bankruptcies were discovered in the public records. Adverse items must be reported as provided under the Fair Credit Reporting Act.</td>
<td>X X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>List, in all cases, the historical status of each account. This status must be in a &quot;number of times past due&quot; format. Freddie Mac prefers the format of &quot;0 x 30, 0 x 60, 0 x 90 days&quot; late. However, the format of R1, R2, etc., is acceptable if the meaning of the ratings is given and the credit report also gives historical negative ratings, such as &quot;was R3 in 6/84.&quot; As long as its meaning is clear from the credit report, a consecutive numbering sequence for payment history — such as &quot;00010000...&quot; is also acceptable. Statements such as &quot;current,&quot; &quot;as agreed,&quot; or &quot;satisfactory&quot; are not acceptable by themselves because they are too vague.</td>
<td>X X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The consumer reporting agency must interview the subjects of the credit report when the agency has incomplete information or when it discovers information that indicates the possible existence of undisclosed credit information or public records. The interview may be conducted by telephone and should obtain any information necessary to provide a credit report that is factually correct and complete.</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indicate the dates the accounts were last updated with the creditors. Each account with a balance must have been checked with the creditor within 90 days of the date of the credit report.</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indicate the dates the accounts were last updated with the creditors.</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contain all discovered credit and legal information that is not considered obsolete under the Fair Credit Reporting Act. Currently, this time frame includes all credit and legal activity that has occurred in the last seven years and any bankruptcies within the last 10 years. (The Fair Credit Reporting Act permits information related to a bankruptcy to be reported for 10 years.) Reports that restrict information collection to shorter time periods are not acceptable.</td>
<td>X X</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Credit Report Requirements (continued)

**Non-Traditional Credit Report**

A non-traditional credit report is designed to assess the credit history for borrowers without the types of trade references typically appearing on a traditional credit report. Non-traditional credit must be developed for a borrower without a traditional credit history available on a merged credit report or residential mortgage credit report.

The following are reasons that non-traditional credit may not be used:

- To offset recent derogatory credit references found in the borrower’s traditional credit report.
- If a usable credit score was obtained.

In developing non-traditional credit, the credit-reporting agency must first verify that all three national repositories were accessed in an attempt to establish traditional credit. Once an attempt to verify traditional credit has been made, non-traditional credit references may be developed in one of the following two ways:

- Through a non-traditional mortgage credit report from a credit bureau.
- A verification of credit reference directly from the creditor.

Whichever method is used, a minimum of four references must be developed. These references require monthly or quarterly payments and a minimum 12-month history.

Non-traditional credit references must contain the following minimum requirements:

- Date completed
- Creditor name
- Balance
- High credit
- Payment amount and frequency of payment
- Date credit established
- Payment history (0x30, 0x60, 0x90, etc.)

The following items are suggested sources of non-traditional credit:

Follow the orders of the tiers and only proceed to the next tier if no referenced can be developed in the initial tier.

1. **Tier I Credit**
   - Rental housing
   - Necessary utilities such as electricity, gas, and water
   - Optional utilities such as telephone service or cable television

2. **Tier II Credit**
   - Insurance payments not included in payroll deductions
   - Payments for automobile insurance
   - Payments for life insurance policies not included in payroll deductions
   - Payments for household or renters insurance
Credit Report Requirements (continued)

Non-Traditional Credit Report (continued)

3. Tier III Credit
   - Open or revolving accounts with local retailers
   - Furniture or appliance rental
   - Medical bill
   - Tuition
   - Child care
   - 12-month savings pattern

If a divorced borrower does not have sufficient credit established in his or her name (because all previous credit was in the name of the spouse only), a non-traditional credit history may be developed for this borrower. However, a non-traditional credit history cannot be developed to offset derogatory credit of any kind (including joint obligations with a former spouse).

- **Loan Prospector Loans:** The following transaction types are not eligible for borrowers without a credit score:
  - 2- to 4-unit primary residences
  - Second homes
  - Investment properties
  - Cash-out refinances
  - Borrowers who have had a prior bankruptcy, foreclosure, deed-in-lieu of foreclosure or short sale

- **Jumbo Loans:** Non-traditional credit reports are not acceptable.

Non-U.S. Citizens

If a non-U.S. citizen borrower does not have sufficient tradeline references in the United States, credit references from foreign countries must be obtained.

A minimum of four credit references must be developed. These references require monthly or quarterly payments and a minimum 12-month payment history. If a foreign credit report is obtained and has a credit score, the credit score must be disregarded.

**Jumbo Loans:** A credit score is required and therefore foreign credit is not acceptable.
Credit Scores

A credit score represents a comprehensive view of a borrower’s credit history risk factors. In assigning a credit score, all of the credit information that is stored in the borrower’s credit file is taken into consideration. While some of the information in the credit file may be more predictive of default risk than other information, the relationship, or interaction of the various factors that are present are considered. This approach is more predictive of default risk than an evaluation of each of the factors in isolation.

The majority of merged in-files will include a credit score for each borrower. There are minimum requirements that must be met in order to score a person’s credit profile. If these requirements are not available, a score will not be provided.

The credit bureau scores range from 300 to 850. The higher the score the lower the risk of default. For example, a score of 760 indicates that the credit profile was a better than average risk and therefore a detailed review of the credit report should not be necessary. In addition, the score in combination with the dates and severity of late payments should be considered before requesting a credit explanation letter from a borrower. The score can always be used as a measure for determining the reasonableness of the request.

Credit score models are periodically updated by credit vendors. To ensure the most predictive score is used, each credit report vendor must use the most current version credit score model in their report.

While the models are very similar, each repository uses a different name.

- Experian FICO V2
- Equifax Beacon 5.0
- Trans Union FICO Risk Score Classic 04

Credit Score Risk Factors

Credit scores are usually accompanied by reason codes identifying various risk factors affecting the borrower’s credit score. The use of reason codes aides in the evaluation of a borrower’s credit history.

<table>
<thead>
<tr>
<th>Equifax</th>
<th>TransUnion</th>
<th>Experian</th>
<th>Reason Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>01</td>
<td>01</td>
<td>A/01</td>
<td>Amount owed on accounts is too high</td>
</tr>
<tr>
<td>02</td>
<td>02</td>
<td>B/02</td>
<td>Level of delinquency on accounts</td>
</tr>
<tr>
<td></td>
<td></td>
<td>C/03</td>
<td>Proportion of loan balances to loan amounts is too high</td>
</tr>
<tr>
<td>33</td>
<td>03</td>
<td>I/33</td>
<td>Too many bank national revolving accounts</td>
</tr>
<tr>
<td>04</td>
<td></td>
<td>D/04</td>
<td>Lack of recent installment loan information</td>
</tr>
<tr>
<td>32</td>
<td>04</td>
<td>Y/32</td>
<td>Too many accounts with balances</td>
</tr>
<tr>
<td>05</td>
<td>05</td>
<td>E/05</td>
<td>Too many consumer finance company accounts</td>
</tr>
<tr>
<td>06</td>
<td>06</td>
<td>F/06</td>
<td>Account payment history is too new to rate</td>
</tr>
<tr>
<td>07</td>
<td>07</td>
<td>G/07</td>
<td>Too many inquiries last 12 months</td>
</tr>
<tr>
<td>08</td>
<td>08</td>
<td>H/08</td>
<td>Too many accounts recently opened</td>
</tr>
<tr>
<td>09</td>
<td>09</td>
<td>J/09</td>
<td>Proportion of balance to credit limits is too high on bank revolving and other revolving accounts</td>
</tr>
<tr>
<td>10</td>
<td>10</td>
<td>K/10</td>
<td>Amount owed on revolving accounts is too high</td>
</tr>
<tr>
<td>11</td>
<td>11</td>
<td>L/11</td>
<td>Length of time revolving accounts have been established</td>
</tr>
<tr>
<td>12</td>
<td>12</td>
<td>M/12</td>
<td>Time since delinquency too recent or unknown</td>
</tr>
<tr>
<td>13</td>
<td>13</td>
<td>N/13</td>
<td>Length of time accounts have been established</td>
</tr>
</tbody>
</table>
### Credit Scores (continued)

<table>
<thead>
<tr>
<th>Equifax</th>
<th>TransUnion</th>
<th>Experian</th>
<th>Reason Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>14</td>
<td>14</td>
<td>O/14</td>
<td>Lack of recent bank revolving information</td>
</tr>
<tr>
<td>15</td>
<td>15</td>
<td>P/15</td>
<td>Lack of recent revolving account information</td>
</tr>
<tr>
<td>16</td>
<td>16</td>
<td>Q/16</td>
<td>No recent non-mortgage balance information</td>
</tr>
<tr>
<td>17</td>
<td>17</td>
<td>R/17</td>
<td>Number of accounts with delinquency</td>
</tr>
<tr>
<td>18</td>
<td>18</td>
<td>S/18</td>
<td>Number of accounts with delinquency</td>
</tr>
<tr>
<td>19</td>
<td>27</td>
<td>T/19</td>
<td>Too few accounts currently paid as agreed</td>
</tr>
<tr>
<td></td>
<td>19</td>
<td>—</td>
<td>Date of last inquiry too recent</td>
</tr>
<tr>
<td>20</td>
<td>20</td>
<td>V/20</td>
<td>Time since derogatory public record or collection too short</td>
</tr>
<tr>
<td>21</td>
<td>21</td>
<td>W/I</td>
<td>Amount past due on accounts</td>
</tr>
<tr>
<td>22</td>
<td>22</td>
<td>X/22</td>
<td>Amount past due on accounts</td>
</tr>
<tr>
<td>23</td>
<td>—</td>
<td>23</td>
<td>Serious delinquency, derogatory public record or collection</td>
</tr>
<tr>
<td>24</td>
<td>24</td>
<td>U/I</td>
<td>Number of bank or national revolving accounts with balances</td>
</tr>
<tr>
<td></td>
<td>—</td>
<td>—</td>
<td>No recent revolving balances</td>
</tr>
<tr>
<td>I/O</td>
<td>—</td>
<td>I/O</td>
<td>Length of time installment loans have been established</td>
</tr>
<tr>
<td>I/O</td>
<td>—</td>
<td>I/O</td>
<td>Number of revolving accounts</td>
</tr>
<tr>
<td>I/O</td>
<td>27</td>
<td>T/27</td>
<td>Too few accounts currently paid as agreed</td>
</tr>
<tr>
<td>19</td>
<td>28</td>
<td>I/O</td>
<td>Number of established accounts</td>
</tr>
<tr>
<td>28</td>
<td>29</td>
<td>29</td>
<td>No recent bankcard balances</td>
</tr>
<tr>
<td></td>
<td>19</td>
<td>—</td>
<td>Date of last inquiry too recent</td>
</tr>
<tr>
<td>30</td>
<td>30</td>
<td>Z/30</td>
<td>Time since most recent account opening is too short</td>
</tr>
<tr>
<td>31</td>
<td>—</td>
<td>I/O</td>
<td>Too few account with recent payment information</td>
</tr>
<tr>
<td>34</td>
<td>I/O</td>
<td>34</td>
<td>Amount owed on delinquent accounts</td>
</tr>
<tr>
<td>32</td>
<td>04</td>
<td>Y/32</td>
<td>Lack of recent installment loan information</td>
</tr>
<tr>
<td>33</td>
<td>03</td>
<td>I/33</td>
<td>Proportion of loan balances to loan amounts is too high</td>
</tr>
<tr>
<td>34</td>
<td>31</td>
<td>I/O</td>
<td>Amount owed on delinquent accounts</td>
</tr>
<tr>
<td></td>
<td>—</td>
<td>45</td>
<td>Payment due on accounts</td>
</tr>
<tr>
<td></td>
<td>—</td>
<td>I/O</td>
<td>Length of time open installment loans have been established</td>
</tr>
<tr>
<td></td>
<td>—</td>
<td>I/O</td>
<td>Number of consumer finance company established relative to length of consumer finance history</td>
</tr>
<tr>
<td>38</td>
<td>38</td>
<td>38</td>
<td>Serious delinquency and public record or collection filed</td>
</tr>
<tr>
<td>39</td>
<td>39</td>
<td>39</td>
<td>Serious delinquency</td>
</tr>
<tr>
<td>40</td>
<td>40</td>
<td>40</td>
<td>Derogatory public record or collection filed</td>
</tr>
<tr>
<td></td>
<td>I/O</td>
<td>98</td>
<td>Lack of recent auto loan information</td>
</tr>
<tr>
<td></td>
<td>98</td>
<td>—</td>
<td>Length of time consumer finance company loans have established</td>
</tr>
<tr>
<td></td>
<td>97</td>
<td>—</td>
<td>Lack of recent auto loan information</td>
</tr>
<tr>
<td>I/O</td>
<td>—</td>
<td>—</td>
<td>Lack of recent auto finance loan information</td>
</tr>
<tr>
<td>I/O</td>
<td>I/O</td>
<td>I/O</td>
<td>Lack of recent consumer finance company account information</td>
</tr>
</tbody>
</table>
Selection and Validation of Credit Score

Selection

The credit score is used as a component in evaluating the credit quality of the loan.

The credit score selected for loan qualification must follow the steps below:

1. Select the credit score for each individual borrower.
2. Select the credit score used for loan qualification.

Select the credit score for each borrower by using one of the following methods:

- The lower score of two repositories
- The middle score of three repositories

If more than one credit score is supplied from the same repository, always use the lowest score:

<table>
<thead>
<tr>
<th>Number of Available Repository Scores</th>
<th>Score Used</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>Middle score</td>
</tr>
<tr>
<td>2</td>
<td>Lower of the two</td>
</tr>
<tr>
<td>1</td>
<td>Not eligible</td>
</tr>
</tbody>
</table>

If two repositories report identical credit scores, use that score for qualification.

Loan Qualification Score

Always use the lowest selected credit score among all borrowers. All borrowers must meet the minimum credit score and all other credit evaluation requirements.

Usable Credit Score

Review the credit report to determine that the data evaluated is accurate. If a borrower indicates that there is significant information, such as reported accounts that do not belong to the borrower or derogatory information that is reported in error, the credit score must be disregarded. All borrowers must have a usable credit score.

If the borrower disagrees with multiple derogatory tradelines or a derogatory mortgage tradeline, an acceptable explanation and documentation to support the erroneous credit, such as a supplement to the credit report or documentation from the credit provider that reported the tradelines in error must be provided by the borrower.

If some information used to create the score is inaccurate, the credit score must not be manually adjusted. If the score obtained from that repository was not based on similar inaccurate information, obtain and use a different credit score from another repository.
Selection and Validation of Credit Score (continued)

**Authorized User Accounts**
An authorized user of the credit account is when a credit account owner permits another person to have access to and use an account. This practice is intended to assist related individuals in legitimately establishing a credit history and credit score based on the account and payment history of the account owner, even though the authorized user is not the account owner.

- **Desktop Underwriter**: The DU issues a message providing the name of the creditor and account number for each authorized user tradeline identified and will take into consideration credit report tradelines in which the borrower has been designated as an "authorized user".

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

  - The relationship of the borrower to the owner of the account.
  - If the borrower uses the account.
  - If the borrower makes the payments on the account.

  Based on the research:

  - If the authorized user tradeline belongs to another borrower on the mortgage loan, no additional investigation is needed.
  - If the borrower has several tradelines in good standing and only a minor number of authorized user accounts, the determination may be made that:
    - The authorized user accounts had minimal, if any, impact on the borrower's overall credit profile.
    - The information reported on the credit report is an accurate reflection of the borrower's credit history.

  Authorized user tradelines that belong to the borrower's spouse when the spouse is not on the mortgage transaction does not need to be reviewed.

- **Loan Prospector Loans**: Credit report tradelines that list a borrower as an authorized user cannot be considered in the underwriting decision, except when one of the following exist:

  - Another borrower in the mortgage transaction is the owner of the tradeline.
  - The borrower can provide written documentation (e.g., canceled checks, payment receipts, etc.) that he or she has been the actual and sole payer of the monthly payment on the account for at least 12 months preceding the date of the application.
  - The tradeline is owned by a spouse and the spouse is not on the loan transaction.

  If written documentation of the borrower’s monthly payments on the authorized user tradeline is provided, then the payment history must be considered in the credit analysis and the monthly payment obligation must be included in the debt-to-income ratio.

- **Jumbo loans**: Authorized user accounts cannot be considered in the underwriting decision.
Selection and Validation of Credit Score (continued)

**Tradeline Requirements**

- **Desktop Underwriter and Loan Prospector Loans**: There are no minimum tradeline requirements. The DU determines whether there are sufficient tradelines to evaluate the borrower's credit history.

- **Jumbo Loans**: All loans require a credit score based on the following minimum credit history and tradeline requirements:
  - A minimum of 3 active tradelines, each rated and paid satisfactorily for at least 12 months.
  - A minimum 24 month credit history.

Authorized User accounts may not be used to satisfy the tradeline requirements. Active tradelines are defined by the date of the last activity on the account within 6 months from the current date.

**Credit History Evaluation**

A borrower's credit profile may be established by one of the following methods:

- Submitting the loan to Desktop Underwriter.
- Submitting the loan to Loan Prospector.

**Desktop Underwriter and Loan Prospector Loans**

A borrower's credit profile is acceptable and further review is not needed if the following decisions are returned:

- For loans underwritten by the DU: An Approve decision must be received.
- For loans underwritten by Loan Prospector: An Accept decision must be received.

The **Inquiries and Undisclosed Liabilities sections must be reviewed** to determine if the borrower's credit profile established by the DU or Loan Prospector is valid based on possible undisclosed debt.

**Jumbo Loans**

The borrower's credit profile must be traditionally evaluated.

The entire credit history documented in the loan file The evaluation of the borrower's credit profile must be based on. The method in which the borrower has managed his or her previous credit is a strong indication of how he or she will manage future performance. When performing a subjective evaluation of credit, many factors should be considered, including the following:

- Credit utilization
- Inquiries
- Number and age of accounts
- Payment history
- Public record information
- Undisclosed Liabilities
Credit History Evaluation (continued)

**Jumbo Loans (continued)**

The following factors must not be used as offsets for weaknesses in the borrower’s credit reputation since they are evaluated when the credit score is created:

- The absence of, or age of, derogatory information.
- The number/proportion of accounts paid as agreed versus delinquent.
- The types of accounts paid as agreed versus the type of accounts that are delinquent.
- Recent paydown or consolidation of account balances by the borrower.
- The length of the borrower’s credit history.
- Any combinations of the above factors.

**Credit Utilization**

The credit report must be reviewed to evaluate the borrower’s use of revolving credit by comparing the current balance on each account to the amount of credit that is available to determine whether the borrower has a pattern of using revolving accounts up to (or approaching) the credit limit. Revolving credit spending patterns indicate a credit risk.

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

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

**Inquiries and Undisclosed Liabilities**

All debt incurred during the application process and through loan closing of the mortgage must be disclosed on the final application and included in the loan qualification. If the credit report reveals a significant debt not listed on the application, a written explanation from the borrower addressing the omission may be required and if it is not included, the loan may not be acceptable.

The section of the borrower’s credit report that includes creditor inquiries must be reviewed. Recent inquiries may indicate that the borrower has been actively seeking new credit accounts. If there are a large number of unrelated inquiries, this may signify a higher risk (whether or not the borrower obtained credit as a result of the inquiry). The presence of many recent inquiries in combination with a significant number of recently opened accounts or delinquent accounts is considered a high credit risk.

If the credit report indicates recent inquiries, confirm that the borrower has not applied for and/or been approved for or obtained any additional credit that is not reflected in the credit report or the mortgage application. If additional credit was applied for and/or approved or obtained, a verification of that debt must be provided and the borrower must be qualified with the monthly payment.
Credit History Evaluation (continued)

Jumbo Loans (continued)

- Desktop Underwriter and Jumbo Loans: All credit inquiries made within 90 days must be validated.

- Loan Prospector Loans: All credit inquiries made within 120 days must be validated.

The following methods must be validated and the applicable documentation must be provided in the loan file:

- Retrieving a refreshed credit report and reviewing it for additional credit lines. If a new inquiry is identified on the refreshed credit report, a detailed letter of explanation from the borrower must be provided.

- Direct verification with a creditor that is listed on the credit report under recent inquires to determine whether a prospective borrower did in fact enter into a financial arrangement with a creditor, which may not be listed on the loan application.

- Third Party Vendor debt monitoring service.

- A detailed letter of explanation from the borrower is acceptable if the loan closes within 30 calendar days of the date of the initial credit report.

Note: Based on the borrower’s explanation letter, additional research and documentation may be needed.

In addition, a MERS report should be run to determine whether the borrower has undisclosed liens or another mortgage being established simultaneously may also be used to reduce the risk of undisclosed obligations.

Any debts identified post-closing affecting loan eligibility guidelines may impede the purchase of the loan by a CMS investor.

See the Automated Underwriting section for more information.

- Desktop Underwriter and Loan Prospector Loans: If additional debt has been incurred and the inclusion of the additional debt would increase the total debt-to-income ratio to a level outside of the acceptable Desktop Underwriter or Loan Prospector tolerances, the loan must be resubmitted to automated underwriting and the new findings must be followed.

See the Automated Underwriting section for more information on resubmission tolerances.

- Jumbo Loans: If additional debt has been incurred, the loan must be go through the underwriting process with the new debt to ensure the debt-to-income ratio is still within program guidelines.
Credit History Evaluation (continued)

Jumbo Loans (continued)

Number and Age of Accounts
The age of the borrower’s credit history must be reviewed to determine whether the borrower has an older established credit history or a newly established credit history, and whether there is a significant number of recently opened accounts or a mix of new account and older accounts.

Credit histories that include older, established accounts generally represent lower credit risk. However, an older, established credit history that includes a significant number of recently opened accounts may indicate that the borrower is overextended, and may represent a higher credit risk.

A newly established credit history does not automatically represent a higher credit risk, since making payments as agreed on newly opened accounts represents less of a risk than not making payments as agreed on older, established accounts.

A change in the borrower’s pattern of credit use, which includes several newly opened revolving accounts, several inquiries and high utilization of revolving trade lines, indicates significant layering of risk to the borrower’s credit profile.

Payment History
The credit report must be reviewed to determine the current status of each credit account, including mortgages, the timeliness of payments, and the frequency, recency, and severity of any delinquent payments.

- Credit histories that include no late payments, collection, or charged-off accounts, foreclosures, deeds-in-lieu, bankruptcies, or other public records information represent a lower credit risk.

- Credit histories that include recent late payments represent a higher credit risk than those with late payments that occurred more than 24 months ago. If there are payments that were 30, 60, or 90+ days past due, it must be determined whether the late payments represent isolated incidences or frequent occurrences. Delinquent payments must be evaluated in the context of the borrower's overall credit history, including the number and age of accounts, credit utilization, and recent attempts to obtain new credit.

- Credit histories that include foreclosures, deed-in-lieu, and public records information (such as bankruptcies, judgments, and liens) represent a higher credit risk. The greater the number of such incidences and the more recently they occurred, the higher the credit risk.
Housing Payment History

Requirements

No additional documentation is necessary if a mortgage rating is 45 days old or less as listed on the credit report and the rating covers a 12-month period. If these requirements are not met, the mortgage rating must be updated through a supplement to the credit report or verification of the mortgage. Acceptable sources of verification include a VOM, VOR, canceled checks, or a payoff statement. The current balance, current status, monthly payment amount, and payment history for the most recent 12 months must be obtained.

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

Payment history on any property, regardless of occupancy, is considered mortgage credit. Payment histories on all mortgage tradelines, including first and second mortgage liens, HELOCs, mobile homes, and manufactured home are considered mortgage credit, even if reported as an installment loan. Additionally, any repossession or payment greater than or equal to 120 days late will be considered a foreclosure.

Desktop Underwriter and Loan Prospector Loans

Mortgage

See the CMS Product Guidelines for mortgage payment history requirements.

Landlord

A 12-month satisfactory landlord reference is required unless waived by automated underwriting.

Jumbo Loans

Mortgage

See the CMS Product Guidelines for mortgage payment history requirements.

Landlord

A 12-month satisfactory reference from a landlord is required. If the landlord is an interested party to the transaction (e.g., seller, broker, etc.) or a relative or employer of the borrower, 12-months canceled checks reflecting a satisfactory payment history must be provided. A copy of the lease to verify the due date in lieu of a landlord reference must be also provided.

First-time homebuyers may not be acceptable under all loan programs. See the CMS Product Guidelines for restrictions.

See the CMS Product Guidelines for acceptable housing payment history requirements.
Significant Derogatory Credit

Increased Risk of Default

If a borrower has significant derogatory credit, this increases the possibility of future defaults and represents a significantly higher level of default risk. Examples of significant derogatory credit include bankruptcies, deeds-in-lieu, foreclosures, and short sales.

The following must be completed when significant derogatory credit is found:

- Determine the cause and significance of the derogatory information.
- Verify that sufficient time has elapsed since the date of the last derogatory information.
- Confirm that the borrower has reestablished an acceptable credit history.

Desktop Underwriter and Loan Prospector Loans

The significance of the derogatory information is taken into consideration by automated underwriting, except for short sales. If the borrower has a short sale, the short sale must be manually applied following the guidelines in the Recovery Time Periods Table below.

The DU and Loan Prospector do not identify loans where the borrower's derogatory credit history was the result of extenuating circumstances. Loans that do not receive an approval from the DU or an Accept recommendation from Loan Prospector due to a bankruptcy or foreclosure that was caused by extenuating circumstances may be manually underwritten. See the Significant Adverse or Derogatory Credit Caused by Extenuating Circumstances section below for documentation and reestablishing credit requirements.

Jumbo Loans

See the Recovery Time Periods Table below for guidelines for bankruptcy, foreclosure and prior restructured loan in the borrower's credit history. Jumbo loans do not have a shorter recovery time from a bankruptcy or foreclosure when due to extenuating circumstances.
Significant Derogatory Credit (continued)

Recovery Time Periods

Recovery time requirements are based on the discharge, dismissal, or completion date to the date of the application.

Recovery time requirements are based on the discharge, dismissal or completion date to the date of the application.

<table>
<thead>
<tr>
<th>Event</th>
<th>Desktop Underwriter</th>
<th>Loan Prospector</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Recovery Time</td>
<td>Maximum LTV/CLTV</td>
</tr>
<tr>
<td>Foreclosure</td>
<td>7 years</td>
<td>Maximum financing</td>
</tr>
<tr>
<td>Pre-foreclosure/Short Sale/DIL</td>
<td>2 years</td>
<td>80% 90%</td>
</tr>
<tr>
<td></td>
<td>4 years and up to 7 years</td>
<td></td>
</tr>
<tr>
<td>Prior Restructure Reflected in Credit History</td>
<td>With mortgage delinquencies: 4 years No mortgage delinquencies: Follow DU</td>
<td>Maximum financing</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

DU and LP cannot read the following and therefore the Recovery Time and LTV/CLTV must be manually applied:

- Pre-foreclosure/short sale/deed-in-lieu
- Prior Restructure Reflected in Credit History. An existing restructured loan being refinanced is not eligible.
- Extenuating Circumstances. See next Table for loans with extenuating circumstances.
### Significant Derogatory Credit (continued)

#### Recovery Time Periods (continued)

<table>
<thead>
<tr>
<th>Event</th>
<th>Desktop Underwriter</th>
<th>Loan Prospector</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Event</strong></td>
<td><strong>Recovery Time</strong></td>
<td><strong>Maximum LTV/CLTV</strong></td>
</tr>
<tr>
<td>Bankruptcy – Excluding Chapter 13</td>
<td>4 years discharge/ dismissal</td>
<td>Maximum financing</td>
</tr>
<tr>
<td>Bankruptcy – Chapter 13</td>
<td>2 years: discharge 4 years: dismissal</td>
<td>Maximum financing</td>
</tr>
<tr>
<td>Multiple Bankruptcy Filings</td>
<td>5 years if &gt; 1 BK discharge/ dismissal up to 7 years</td>
<td>Maximum financing</td>
</tr>
<tr>
<td>Other Significant Adverse Credit</td>
<td>Follow DU</td>
<td>Follow DU</td>
</tr>
</tbody>
</table>

### Jumbo Loans

<table>
<thead>
<tr>
<th>Event</th>
<th>Recovery Time</th>
<th>Maximum LTV/CLTV</th>
<th>Credit Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bankruptcy</td>
<td>7 years from discharge/ dismissal</td>
<td>Maximum financing</td>
<td>No 30-day mortgage/rental delinquency in the past 12 months and no 60+ day mortgage/rental delinquency in the past 24 months. If a mortgage is included and discharged in the bankruptcy, it should be treated as a forbearance, and therefore, a foreclosure.</td>
</tr>
<tr>
<td>Foreclosure</td>
<td>7 years from discharge/ dismissal</td>
<td>Maximum financing</td>
<td>No 30-day mortgage/rental delinquency in the past 12 months and no 60+ day mortgage/rental delinquency in the past 24 months.</td>
</tr>
<tr>
<td>Prior Restructured Loan in Borrower's Credit History</td>
<td>7 years from discharge/ dismissal</td>
<td>Maximum financing</td>
<td>If the borrower has had a prior restructured loan or short pay off, the new loan is eligible for financing subject to compliance with all foreclosure guidelines.</td>
</tr>
</tbody>
</table>
### Significant Derogatory Credit (continued)

**Recovery Time Periods (continued)**

<table>
<thead>
<tr>
<th>Event</th>
<th>Desktop Underwriter</th>
<th>Loan Prospector</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Recovery Time</td>
<td>Maximum LTV/CLTV</td>
</tr>
</tbody>
</table>
| Foreclosure | 3 years and up to 7 years | Purchase Primary: 90% Limited Cash Out  
  - Maximum financing  
  - All occupancy types  
  Ineligible:  
  - Cash Out: All occupancy types  
  - Purchase second home and investment property | 3 years and within 7 years | Purchase Primary: 90% Limited Cash-Out:  
  - Maximum financing  
  - All occupancy types  
  Ineligible:  
  - Cash-Out: All occupancy types  
  - Purchase second home and investment property |
| Pre-foreclosure/Short Sale/DIL | 2 years and up to 7 years | 90% | 2 years and up 7 years | Purchase Primary: 90% Limited Cash-Out:  
  - Maximum financing  
  - All occupancy types  
  Ineligible:  
  - Cash-Out: Refinance: All occupancy types  
  - Purchase second home and investment property |
## Significant Derogatory Credit (continued)

### Recovery Time Periods (continued)

<table>
<thead>
<tr>
<th>Event</th>
<th>Desktop Underwriter</th>
<th>Loan Prospector</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Recovery Time</td>
<td>Maximum LTV/CLTV</td>
</tr>
<tr>
<td>Prior Restructure Reflected in Credit History</td>
<td>With mortgage delinquencies: 2 years</td>
<td>Maximum financing</td>
</tr>
<tr>
<td></td>
<td>No mortgage delinquencies: Follow DU</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Ineligible</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bankruptcy – Excluding Chapter 13</td>
<td>2 years discharge/dismissal</td>
<td>Maximum financing</td>
</tr>
<tr>
<td>Bankruptcy – Chapter 13</td>
<td>2 years discharge/dismissal</td>
<td>Maximum financing</td>
</tr>
<tr>
<td>Multiple Bankruptcy Filings</td>
<td>3 years discharge/dismissal</td>
<td>Maximum financing</td>
</tr>
<tr>
<td>Other Significant Adverse Credit</td>
<td>Follow DU</td>
<td>Follow DU</td>
</tr>
</tbody>
</table>

### Jumbo Loans

**Extenuating Circumstances**

Extemuating circumstances are not applicable to Jumbo loans. See above Table for Jumbo guidelines for loans with significant derogatory credit.
A restructured loan is a mortgage loan in which the terms of the original transaction have been changed resulting in either absolute forgiveness of debt or a restructure of debt through either a modification of the original loan or origination of a new loan that results in:

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

Borrowers may not disclose that their existing mortgage loan has been restructured. The credit report may show a restructured loan as “settled for less than owed”. If the credit report does not specify “settled for less than owed”, the mortgage balance reported on the credit report versus the payoff balance must be analyzed. If the two balances do not match and the difference is more than unpaid interest or prepayment penalties, this may indicate that the loan has been restructured.

If the existing loan was restructured, it is not eligible for financing as a No Cash-Out or Cash-Out Refinance transaction.

If the borrower has a previously restructured loan which is reflected in his or her credit history, see the Recovery Time Periods Table for eligibility.

**Desktop Underwriter and Loan Prospector Loans**: If reviewing the credit history of a borrower who has completed or is participating in Consumer Credit Counseling, the major goal is to evaluate the borrower’s credit history.

- Desktop Underwriter and Loan Prospector Loans: Follow the AU recommendation.

**Jumbo Loans**: A satisfactory explanation for participating in Consumer Credit Counseling must be provided by the borrower. A borrower is eligible while he or she is participating in Consumer Credit Counseling (CCC) only if all of the following criteria are met:

- Credit score requirements are met.
- Qualifying ratios must be calculated on the creditor’s minimum monthly payment (per the credit report) versus the reduced consumer credit counseling payment.
- All accounts must be current.
- No cash in hand unless all accounts included in the consumer credit counseling are paid.
Significant Derogatory Credit (continued)

**Major Adverse Credit**

**Desktop Underwriter and Loan Prospector Loans:** Judgments, garnishments, and liens must be paid off at or prior to closing and documentation proving that these were paid off must be provided. Any past due accounts that are not yet reported as a collection account must be brought current. Satisfaction of tax liens may be a condition of loan approval. When the credit report or title report show federal, state or local tax liens, a letter of explanation and proof that the lien is paid must be provided. No payment plans or subordination is allowed.

Verification of sufficient funds to satisfy these obligations must be documented.

- Collection or charged-off accounts and repossessions may not have to be paid off at or prior to closing.
  - Desktop Underwriter and Loan Prospector Loans: Follow the AU decision.

- Disputed Accounts:
  - Desktop Underwriter Loans: Follow the DU decision and confirm the accuracy of disputed tradelines reported on the borrower's credit report. If it is determined that the disputed tradeline information is accurate, the disputed tradelines must be considered in the credit risk assessment.
  - Loan Prospector Loans: Disputed accounts with supporting documentation and a written explanation from the borrower may be considered by the loan underwriter.

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

- Major Adverse accounts reporting within the past 24 months are permitted when isolated accounts have less than a $500 cumulative balance. These accounts may be left open provided they do not affect title.

- Major adverse accounts reporting older than 24 months are permitted based on the following:
  - All State, IRS, and property tax liens (subject property and other properties), regardless of seasoning, are required to be paid whether or not they currently affect title. No payment plans or subordination is allowed.
  - All other adverse accounts over 24 months old that do not affect title are not required to be paid.
ASSETS

Assets

This section provides the asset requirements that apply to all CMS Conventional loan programs. The requirements that differ from one loan program to another are found in the CMS Product Guidelines.

Additional information may be requested at the discretion of the underwriter.

For state-specific restrictions, see the Underwriting Conditions Matrix.

Underwriting Methods

Guidelines contained in this section are applicable to loans underwritten by Desktop Underwriter, Loan Prospector, and Jumbo loans unless otherwise stated. Loans may be underwritten by any one of the following methods:

- **Automated Underwriting**: Loans underwritten by Desktop Underwriter or Loan Prospector:
  - Loans underwritten by Desktop Underwriter and Loan Prospector may follow the DU Underwriting Findings Report or LP Feedback Certificate unless otherwise stated in this guide or the specific CMS Product Guideline.
  - Loan Prospector Streamlined Accept documentation may be used if the LP Feedback Certificate is approved as such. See the Freddie Mac Seller/Servicer Guide for Loan Prospector Streamlined Accept documentation requirements.

- **Jumbo Loans**: A Jumbo loan is a loan with a loan amount that exceeds the conforming loan limit and is not underwritten to agency guidelines. Jumbo loans should be submitted to the investor’s Automated Underwriting System (AUS).

Documentation Age

Requirements

All asset documents must be dated, as follows:

- No more than 90 days prior to the Note date for existing construction.
- No more than 120 days prior to the Note date for new construction.
Minimum Down Payment and Cash to Close

Requirements

A minimum down payment from the borrower’s own assets is required for most loan programs. The down payment requirements are provided in the CMS Product Guidelines. Evidence that the borrower has sufficient funds to pay the down payment, prepaid items, and closing costs as well as adequate additional cash reserves as required by the specific loan program must be provided.

When a down payment is required, all down payment funds and cash to close must be documented and verified. Electronic verifications are acceptable.

Foreign Assets

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

Reserve Requirements

Requirements

Reserves are used as an indication of the borrower’s capacity to demonstrate a savings pattern. Specific loan programs may require different levels of remaining liquid reserves after closing. When required, reserves must come from the borrower’s own funds and must be documented and verified. Reserves are calculated using the monthly housing expense, including:

- Principal and interest
- Hazard and flood insurance
- Mortgage insurance premiums
- Real estate taxes
- Ground rent
- Special assessments
- Homeowners’ association dues (excluding any utility charges that apply to the individual unit)
- Subordinate financing payments on mortgages secured by the subject property

Liquid reserves are those liquid assets that are readily available to a borrower after the mortgage closes. Liquid reserves include cash and other assets that are easily converted to cash by the borrower, such as:

- Withdrawing funds from an account
- Selling an asset
- Redeeming vested funds
- Obtaining a loan secured by assets from a fund administrator or an insurance company

The table below provides acceptable and unacceptable sources of funds for liquid reserves.
### Acceptable Sources for Liquid Reserves based on Loan Type

<table>
<thead>
<tr>
<th>Asset</th>
<th>Conforming</th>
<th>Jumbo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank account</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>CD/Money Market</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Stocks/bonds</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Funds in an IRA and SEP-IRA account</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Funds in an IRA and SEP-IRA account for borrowers of retirement age</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Qualified Tuition Plan (529 Plan)</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Proceeds from the sale of non-real estate assets</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Vested funds from 401(k), KEOGH or 403(b) retirement account</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Vested funds from 401(k), KEOGH or 403(b) retirement account for borrowers of retirement age</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Loan secured by insurance</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Loan secured by assets or assets from a fund administrator</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Business assets (other than Schedule C)</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Funds that have not been vested</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Funds that cannot be withdrawn under circumstances other than the account owner’s retirement, employment termination or death</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Stock held in an unlisted corporation</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Stock options and non-vested restricted stock</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Unsecured borrowed funds</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Interested party contributions</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Cash proceeds from a cash-out refinance transaction</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Proceeds from a home equity loan or line of credit, bridge loan or cash-out from any other property</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>
## Asset Sources

Acceptable sources of assets are listed below. Detailed information on each source is provided after the list.

<table>
<thead>
<tr>
<th>List of Acceptable Asset Sources</th>
<th>Acceptable sources of assets are listed below. Detailed information on each source is provided after the list.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Accounts</td>
<td>- Bank Accounts</td>
</tr>
<tr>
<td>Bridge Loan</td>
<td>- Bridge Loan</td>
</tr>
<tr>
<td>Business Funds Used for Closing</td>
<td>- Business Funds Used for Closing</td>
</tr>
<tr>
<td>Credit Card Financing</td>
<td>- Credit Card Financing</td>
</tr>
<tr>
<td>Earnest Money Deposits</td>
<td>- Earnest Money Deposits</td>
</tr>
<tr>
<td>Employer Assistance Programs</td>
<td>- Employer Assistance Programs</td>
</tr>
<tr>
<td>Equity from Other Assets</td>
<td>- Equity from Other Assets</td>
</tr>
<tr>
<td>Loans Secured by Other Assets</td>
<td>- Loans Secured by Other Assets</td>
</tr>
<tr>
<td>Proceeds from a 1031 Tax Deferred Exchange</td>
<td>- Proceeds from a 1031 Tax Deferred Exchange</td>
</tr>
<tr>
<td>Sale of Other Assets</td>
<td>- Sale of Other Assets</td>
</tr>
<tr>
<td>Sale of Real Estate</td>
<td>- Sale of Real Estate</td>
</tr>
<tr>
<td>Gifts</td>
<td>- Gifts</td>
</tr>
<tr>
<td>Gift of Equity</td>
<td>- Gift of Equity</td>
</tr>
<tr>
<td>Wedding Gift</td>
<td>- Wedding Gift</td>
</tr>
<tr>
<td>Pooled Funds</td>
<td>- Pooled Funds</td>
</tr>
<tr>
<td>Donated Funds</td>
<td>- Donated Funds</td>
</tr>
<tr>
<td>Income Tax Refund</td>
<td>- Income Tax Refund</td>
</tr>
<tr>
<td>Life Insurance - Cash Value</td>
<td>- Life Insurance - Cash Value</td>
</tr>
<tr>
<td>Lot Equity</td>
<td>- Lot Equity</td>
</tr>
<tr>
<td>Notes Receivable/Repayment of Loans</td>
<td>- Notes Receivable/Repayment of Loans</td>
</tr>
<tr>
<td>Qualified Tuition Plan (529 Plan)</td>
<td>- Qualified Tuition Plan (529 Plan)</td>
</tr>
<tr>
<td>Real Estate Commission</td>
<td>- Real Estate Commission</td>
</tr>
<tr>
<td>Rent Credit/Lease with Option to Purchase</td>
<td>- Rent Credit/Lease with Option to Purchase</td>
</tr>
<tr>
<td>Retirement Accounts</td>
<td>- Retirement Accounts</td>
</tr>
<tr>
<td>Savings Bonds</td>
<td>- Savings Bonds</td>
</tr>
<tr>
<td>Stocks/Bonds</td>
<td>- Stocks/Bonds</td>
</tr>
<tr>
<td>Stock - Privately Held Corporation</td>
<td>- Stock - Privately Held Corporation</td>
</tr>
<tr>
<td>Secondary Financing</td>
<td>- Secondary Financing</td>
</tr>
<tr>
<td>Systematic Savings</td>
<td>- Systematic Savings</td>
</tr>
<tr>
<td>Trade Equity</td>
<td>- Trade Equity</td>
</tr>
<tr>
<td>Trust Funds</td>
<td>- Trust Funds</td>
</tr>
</tbody>
</table>
Asset Sources (continued)

**Bank Accounts**

Bank accounts include funds on deposit in any of the following:

- savings accounts,
- checking accounts,
- certificate of deposits, and
- money market accounts.

The borrower must have immediate access to the funds in the account for the funds to be used for the down payment, closing costs, and reserves.

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

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

**Bank Statements**

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

The following must be clearly identified on the bank statements:

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

If a supplemental statement is necessary, any bank-generated form (such as deposit or withdrawal slips) that shows a machine-printed account number, balance and date is acceptable. Supplemental information must be on a bank form indicating the name of the bank or on bank letterhead signed by a bank representative. ATM receipts are not permitted.

Bank statements may be online account or portfolio statements obtained by the borrower, provided such are printed and the Internet Uniform Resource Locator (URL) address is included identifying the source of information as well as all of the other information listed above for standard bank statements or protected bank statements retrieved online. Statements downloaded directly from the Internet to a Word document or Excel spreadsheet, as well as printed directly from the website, are not acceptable.
Asset Sources (continued)

Bank Accounts (continued)  Verification of Deposit

To document the borrower's assets, a Verification of Deposit (VOD) issued by the depository institution may be obtained.

The following must be clearly identified on the each VOD:

- The name and address of the depository or investment institution
- The borrower as the account holder
- The account number
- The type of account
- The date the account was opened
- The account balance as of the date of the VOD
- The average balance for the previous two months
- For written verifications of deposit, the most recent monthly bank statement for the account must be provided and must support the information in the written verification of deposit. Written verifications of deposit are not acceptable as standalone documentation to substantiate the borrower's assets regardless of the automated underwriting requirements.

When average balances are not available, the most recent two months bank statements must be provided.

The VOD must be remitted directly to the depository. A VOD should never be mailed to a Post Office Box or to an individual's attention. If the borrower indicates that it is necessary to mail a VOD to a Post Office Box or to an individual’s attention, the depository must be independently contacted to verify this requirement and the contact must be documented in the loan file. The return address on the verification must be the originator's address. The hand carrying of verifications is strictly prohibited.

Review of Bank Account Statements

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

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

In any of these cases, the source of funds must be explained by the borrower and verified. If a large deposit is from another account that is verified in the loan file, that account must be verified after the withdrawal to ensure that the assets are not counted twice. Unverified funds are not acceptable sources for the down payment, closing costs and/or reserves.

Asset documentation must be examined for signs of fabrication or alteration. Analyzing the documentation to calculate interest, and reviewing deposits against income levels and sources are necessary to validate the documents.
Asset Sources (continued)

**Bank Accounts (continued)**

**Review of Settlement Statements**
Settlement Statements must be computer-generated or typed and signed by the buyer and the seller, or their authorized agents. The Settlement Statement must identify:

- the borrower as the seller of the property
- the property sold
- the proceeds to the property seller
- the disposition of all liens against the property

**Bridge Loan**
Bridge loans\(^1\) are an acceptable source of cash to close provided the following requirements are met:

- The terms of the bridge loan must be included and verified in the credit package, including a copy of the executed Note.
- The bridge loan must be included as a liability on the application.
- If the bridge loan requires payments of principal and/or interest, the bridge loan payment must be included in the borrower’s long-term debt calculation.
- If the bridge loan payment is not monthly, it must be converted to an Interest Only payment at the contractual interest rate. If this rate is unavailable, it is acceptable to use CMS's current 30-year, fixed market rate for qualification purposes.
- The bridge loan cannot be cross-collateralized against the subject property

Bridge loans are not an eligible source of funds for cash reserves.

See the [Transactions](#) and the [Liabilities and Debt Ratios](#) sections of this document for more information.

**Business Funds**
If business funds are used for down payment, closing costs and/or reserves, the borrower must be the sole proprietor or 100 percent owner of the business or provide verification from the other business’s owners that the borrower has access to the funds.

The impact of the withdrawal must be considered in the analysis of the business based on the personal and/or business tax returns. The analysis must indicate that withdrawal of funds will not have a detrimental effect on the borrower’s business.

**Jumbo Loans**: Business funds from a business other than a sole proprietor (Schedule C) are not an eligible source of funds for cash reserves.

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\(^1\) A bridge loan is a loan secured by the borrower’s present home, which is for sale. The borrower uses funds from the bridge loan to close on a new home before selling the present home and paying off the bridge loan.
Asset Sources (continued)

Credit Card Financing
Credit cards may be used to pay for certain costs that must be paid early in the application process (such as those for application lock-in fees, credit reports, or appraisal reports).

- **Desktop Underwriter**: The amount of credit card financing is limited to a maximum of 2 percent of the loan amount.
- **Loan Prospector Loans**: The amount of credit card financing is limited to the greater of maximum of 2 percent of the loan amount or $1500.
- **Jumbo Loans**: Credit Card Financing is not permitted.

When verifying the funds available for closing for a borrower who paid for such costs with a credit card, confirmation that the borrower has sufficient funds to cover these charges is required or the payment for the credit card account must be recalculated to account for the new charges and must be included in the loan payment used in the qualifying ratio calculation. However, the borrower does not need to actually pay off these charges at closing.

Earnest Money Deposits
Earnest money deposits must be verified in the following instances:

- When the borrower needs these assets to demonstrate sufficient funds to close
- If the borrower receives a refund of the original cash deposit at closing

Earnest money deposits that are excessive or atypical, generally in excess of 2 percent, should be closely scrutinized. Verification may be necessary at the underwriter’s discretion.

Earnest money deposits are verified by one of the following:

- Copy of the cancelled check.
- Copy of the deposit check and proof the check was cashed.
- Verification of sufficient funds on deposit in the depository account for the down payment, closing costs, etc.

The source of funds for the deposit must be verified (e.g., bank statement) as well as the source of the deposit check. The deposit cannot be counted twice in the file (deducted from the funds to close and counted in assets).
### Asset Sources (continued)

#### Employer Assistance Programs

An owner-occupant borrower may use funds provided by his or her employer to pay part of the closing costs, down payment, and reserves after the borrower has met the minimum required investment, if the funds are provided as part of an established company program (cannot be an accommodation for an individual employee).

The assistance must come directly from the employer (including through an employer-affiliated credit union) and may be in the form of:

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

In addition, the following apply:

- When the assistance is a secured second mortgage, the transaction must satisfy standard Secondary Financing guidelines.
- An unsecured loan may be used for closing costs or down payment only. The unsecured loan may not be considered reserves.
- If regular payments are required for a secured second mortgage, the payments must be included in the calculation of the borrower’s debt-to-income ratio.

#### Jumbo Loans: Employer Assistance Programs are not permitted.

There must be documentation that describes the terms of any loan agreement and other employee assistance being offered to the borrower (such as relocation benefits), including the employer's written verification of the dollar amount of the assistance. When the assistance is funded prior to settlement, there must be confirmation of receipt of the funds.

See the Financing section of this document for more information.

#### Equity from Other Assets

**Loans Secured by Other Assets**

Borrowed funds secured by an asset owned by the borrower are an acceptable source of funds for down payment, closing costs, and reserves. Examples that may be used to secure funds include certificates of deposit, savings plans, stocks, bonds, other real estate owned by the borrower and life insurance policies.

To use funds secured by an asset owned by the borrower, the following documentation is required:

- Terms of the loan.
- Verification that the party providing the secured loan is not a party to the sale or financing of the property (other than a financial institution).
- Confirmation that the funds have been transferred to the borrower.
- Evidence that the loan is secured by an asset owned by the borrower
- Value of the Asset (e.g., copy of the appraisal, copy of Blue Book value)

The payment must be included in the debt-to-income ratio unless excluded as outlined in the Liabilities and Debt Ratios section of this document.
Asset Sources (continued)

Equity from Other Assets (continued)

Jumbo Loans: Loans secured by other assets are not an eligible source of funds for cash reserves.

Proceeds from a 1031 Tax Deferred Exchange

A 1031\textsuperscript{2} tax deferred exchange is an acceptable source of funds on an investment property or second home purchase transaction subject to the following:

- The 1031 Exchange cannot be an exchange of a partnership or limited liability corporation interest.
- The name of the taxpayer on the sale of relinquished property must be the same as the purchaser of the subject property.
- The relinquished property sale must close before or simultaneously with the acquired property sale.
- Documentation requirements for a 1031 tax deferred exchange:
  - For all exchanges, a statement of borrower’s equity, calculated as the lower of:
    - Sales price from the sales contract
    - Gross trade value from the sales contract less the sum of the transfer fees and all lien balances on the currently owned property, and transfer fees on the new property
    - Appraised value of the borrower’s currently owned property plus any new transfer fees on the new property
  - For an exchange with simultaneous closings, the following documentation is required for both of the properties:
    - Sales contract or escrow instructions
    - Appraisal
    - Preliminary title report
    - Exchange agreement identifying the holder of funds, buyer and seller, expiration date, agreed upon value, closing date, closing costs, conditions of transfer and repairs, if required
  - For an exchange occurring prior to the purchase of the new property
    The following documentation is required:
    - HUD-1 Settlement Statement for both properties
    - Exchange agreement
    - Sales contract or escrow instructions for both properties
    - Verification of funds from the Exchange holder

\textsuperscript{2} Section 1031 of the Internal Revenue Code permits investors to defer payment of capital gains taxes by exchanging a like-kind property rather than selling property.
Asset Sources (continued)

<table>
<thead>
<tr>
<th>Equity from Other Assets (continued)</th>
<th>Sale of Other Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sale of Other Assets</strong></td>
<td>Funds derived from the sale of assets other than real estate, must be verified by all of the following documentation:</td>
</tr>
<tr>
<td></td>
<td>• Proof of ownership</td>
</tr>
<tr>
<td></td>
<td>• Support for the value of the asset (appraisal)</td>
</tr>
<tr>
<td></td>
<td>• Evidence of the transfer of ownership (e.g., a copy of the bill of sale)</td>
</tr>
<tr>
<td></td>
<td>• Evidence of receipt of the purchase proceeds (e.g., deposit slip or bank statement)</td>
</tr>
<tr>
<td></td>
<td>• Evidence that a party to the property sale or the mortgage financing transaction did not purchase the asset</td>
</tr>
<tr>
<td></td>
<td>The lesser of the value of the asset or the amount of funds received will be considered eligible assets.</td>
</tr>
</tbody>
</table>

**Jumbo Loans:** The proceeds of the sale of other assets are not an eligible source of funds for cash reserves.

**Sale of Real Estate**

The borrower may use funds from the sale of real estate. The net proceeds that will be generated from the sale of an existing property must be established.

Both the actual sale price and net proceeds must be documented by one of the following:

- Fully executed HUD-1 Settlement Statement
- Fully executed buy-out agreement accompanying a Settlement Statement that is part of an employer's relocation plan where the employer/relocation company takes responsibility for the outstanding mortgage verifying required net proceeds must be provided.

To determine the amount of equity the borrower holds in the property prior to closing, a copy of the executed contract of sale must be obtained and the following formula may be used:

\[
\text{Sales price minus (sales costs plus pay off of all outstanding liens) = equity}
\]

If a sales price has not been established, anticipated equity may be calculated with the following formula:

\[
\text{Listing price minus (10% of listing price plus pay off of all outstanding liens) = equity}
\]

The 10 percent adjustment factor may need to be adjusted depending on market conditions in the area of sale. True net equity (proceeds) must be verified upon sale of the property through an executed HUD-1 Settlement Statement regardless of the adjustment factor used.
Asset Sources (continued)

**Gifts**
The borrower may use funds received as a gift from an individual with whom the borrower has an established relationship to satisfy part of the cash requirement for closing provided the minimum borrower investment for the loan program is met.

A gift letter that provides the following must be included in the loan file:

- The amount of the gift.
- The donor’s name, address, and telephone number.
- The donor’s relationship to the borrower
- A statement from the donor that repayment is not required.
- The subject property address
- The donor’s signature

The gift funds must be verified and documented, as follows:

- When the funds are not transferred prior to settlement, the donor’s ability to provide the gift funds must be documented using one of the following:
  - Certified check (stamped & validated by bank – front and back) given to the closing agent
  - Other official check for the amount of the gift
- Acceptable evidence of transfer of gift funds includes one of the following:
  - Copy of the donor’s cancelled check/withdrawal slip and the borrower’s deposit slip
  - A copy of the donor’s check to the closing agent
  - HUD-1 Settlement Statement showing receipt of the donor’s check

**Gift of Equity**
A gift of equity is acceptable for primary residence and second home transactions. Borrowers may receive a gift of equity from the seller of the subject property, provided the seller is someone with whom the borrower has an established relationship. The gift will be reflected as a credit on the HUD-1 Settlement Statement and must be clearly labeled as a gift of equity. A gift of equity is not considered a seller contribution. A donor-signed gift letter, as described above, is required.

The donor must have sufficient equity in the property to cover the gift. The HUD-1 Settlement Statement will satisfy verification of the donor’s ability to cover the gift and receipt of the gift.

**Wedding Gifts**
When funds are obtained from wedding gifts the following must be provided:

- A copy of the marriage certificate (not more than six months old)
- Verification of receipt of the funds through a bank statement or deposit slip
Asset Sources (continued)

**Gifts**

(continued)

**Gifts**

- **Pooled Funds**
  - If the borrower receives a gift from a relative or domestic partner who has lived with the borrower for the last 12 months, the gift is considered the borrower’s own funds and may be used to satisfy the minimum borrower contribution requirement as long as both individuals will use the home being purchased as their primary residence.
  
  In addition to a donor-signed gift letter, as described above, a certification from the donor stating that he or she has lived with the borrower for the past 12 months and will continue to do so in the new residence is required. The donor must provide appropriate documentation to demonstrate a history of shared residency (e.g., copy of a driver's license, bill, or bank statement that shows the donor’s address as being the same as the borrower’s address).

  **Jumbo Loans:** Pooled funds are not permitted.

**Donated Funds**

- A church, a municipality, a nonprofit organization or a public agency may donate funds to pay part of the closing costs or to supplement the borrower's reserves if the gift is part of a formal gift program (cannot be an accommodation for an individual member). Donated funds may not be applied to satisfy the borrower's minimum down payment requirements.

- A gift or grant from a church, municipality, or non-profit organization must be evidenced by either a copy of the letter awarding the gift or grant or a copy of the legal agreement that specifies the terms and conditions of the gift or grant and includes the organization's mailing address. This supporting document must include language indicating that no repayment of the gift or grant is expected and must indicate how the funds will be transferred. Evidence of the transfer of the funds (e.g., a copy of the donor's canceled check or a HUD-1 Settlement Statement showing receipt of the check) must be provided.

  **Jumbo Loans:** Donated funds are not permitted.

**Income Tax Refund**

- If an income tax refund that has not yet been received will be used as funds for down payment or closing costs, the borrower must provide a copy of their signed personal tax return to verify the anticipated refund. Verification of receipt of the Refund Anticipation Loan via a copy of the refund check or electronic deposit and evidence the Refund Anticipation Loan has been repaid is required.

**Life Insurance – Cash Value**

- When the borrower uses the net value from a loan against the cash value of a life insurance policy or from the surrender value as funds for down payment and/or closing costs, the value must be verified by a written statement from the life insurance company. The statement must specify the amount of net cash value currently available to the borrower. Verification of receipt of the funds is required.
Lot Equity

If the borrower holds title to the lot on which a property is being constructed and financed with a construction-to-permanent mortgage, the value of the land may be credited toward the borrower's minimum required contribution.

The borrower's equity contribution equals the difference between any outstanding liens against the land and the market value of the land.

The following table describes how to calculate the market value of the land and provides documentation requirements:

<table>
<thead>
<tr>
<th>When was land acquired</th>
<th>Market Value of Land</th>
<th>Documentation Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>12 or more months preceding the loan application</td>
<td>Current appraised value</td>
<td>N/A</td>
</tr>
<tr>
<td>Less than 12 months preceding the loan application</td>
<td>The lesser of the sales price or current appraised value</td>
<td>Document borrower's cash investment by:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Certified copy of the HUD-1 Settlement Statement</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Copy of warranty deed showing that there are no outstanding liens against the property</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Copy of release of any prior liens</td>
</tr>
<tr>
<td>Borrower acquired the land at any time as a gift, an inheritance, or other non-purchase transaction</td>
<td>Current appraised value</td>
<td>If the borrower acquired the land less than 12 months preceding the loan application, document the acquisition of the land and transfer of ownership of the land.</td>
</tr>
</tbody>
</table>

Notes Receivable/Repayment of Loans

When funds are obtained from repayment of a previous loan made by the borrower, the following information must be provided:

- Written agreement between the borrower and the recipient of the loan
- Verification the borrower had the ability to lend the funds. Provide evidence that the funds were withdrawn from the borrower's account.
- Verification that repayment has been made. Provide statements verifying the funds were withdrawn from the recipient's account and deposited into the borrower's account
Asset Sources (continued)

**Qualified Tuition Plan (529 Plan)**

A 529 plan is a tax-advantaged savings plan designed to encourage saving for future college costs. 529 plans, legally known as “qualified tuition plans,” are sponsored by states, state agencies, or educational institutions and are authorized by Section 529 of the Internal Revenue Code.

To account for any applicable withdrawal penalties or income tax, a "net" withdrawal must be determined based on the following percentage for deduction:

- **Desktop Underwriter and Manually Underwritten Loans**: Subtract 40 percent from the vested amount less any outstanding loans
- **Loan Prospector Loans**: Subtract 30 percent from the vested amount less any outstanding loans
- **Jumbo loans** do not permit qualified tuition plans for cash reserves.

When funds from these sources are used for down payment or closing costs, the funds must be withdrawn and proof of withdrawal must be provided. When funds from these sources are used to support the cash reserve requirement, it is not required to withdraw the funds from the account but the above percentages must be used to determine the "net" amount eligible for withdrawal and therefore reserves.

**Real Estate Commissions**

A commission of no more than 1.5 percent is acceptable when the borrower is also the selling agent of the property.

**Jumbo Loans**: Real estate commission is not permitted as funds for the transaction.

**Rent Credit for Option to Purchase**

Rent credit for option to purchase is an acceptable source of funds toward the down payment or minimum borrower contribution. Borrowers are not required to make a minimum borrower contribution from their own funds in order for the rental payments to be credited toward the down payment.

Credit for the down payment is determined by calculating the difference between the market rent and the actual rent paid for the last 12 months. The market rent is determined by the appraiser in the appraisal for the subject property.

The transaction must be a purchase of a primary residence. The following information must be provided:

- A copy of the rental/purchase agreement that clearly states the monthly rental amount and the term of the lease (must be at least 12 months).
- Copies of the borrower's canceled rent checks or money order receipts for the last 12 months evidencing the rental payments
- Market rent as determined by the subject property appraisal. Market rent may be determined by one of the following:
  - Operating Income Statement
  - Comparable Rent Schedule
  - Fair Market Rent letter from a realtor
  - Current fully executed lease agreement

If the above requirements are not met, the rental payments over and above fair market rent may not be included toward the down payment.
Asset Sources (continued)

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

- **Down payment and Closing Costs**  
  When funds from these sources are used for the down payment or closing costs, the funds must be withdrawn and proof of withdrawal must be provided.

- **Cash Reserves**  
  When funds from these sources are used to support the cash reserve requirement, it is not required to withdraw the funds from the account. However, the percentages below must be used to determine the "net" amount eligible for withdrawal and therefore reserves. Use caution when considering retirement accounts as reserves as these accounts often feature significant penalties for early withdrawals, allow limited access, or have vesting requirements. Retirement accounts that do not allow for any type of withdrawal may not be used for reserves. In addition, retirement accounts that only allow for withdrawal in connection with the borrower's employment termination, retirement or death, the vested funds must not be considered as reserves (e.g. PERS or like accounts).

To account for any applicable withdrawal penalties or income tax, a "net" withdrawal must be determined based on the following percentage for deduction:

- **Desktop Underwriter and Manually Underwritten Loans**: Subtract 40 percent from the vested amount less any outstanding loans
- **Loan Prospector Loans**: Subtract 30 percent from the vested amount less any outstanding loans
- **Jumbo Loans**:  
  - Borrowers of retirement age (generally 59 1/2): Subtract 30 percent from the vested amount less any outstanding loans
  - Borrowers not of retirement age: Subtract 50 percent from the vested amount less any outstanding loans
  - See the Reserve Requirements section and the CMS Product Guidelines for requirements on the use of Retirement Accounts as cash reserves for Jumbo loans.

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

If the assets are required for closing, proof of liquidation is required.
Asset Sources (continued)

Secondary Financing

Secondary Financing is any loan secured by the subject property other than the first mortgage. The lien created by the second mortgage must be clearly subordinate to the first mortgage.

The monthly payment on the second mortgage must be included with the PITIA on the subject property when calculating the housing expense-to-income ratio.

See the Subordinate Financing section of this document for more information.

Stocks/Bonds

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

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

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

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

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

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

Stock – Privately Held Corporation/Unlisted Corporation

When the stock of a privately held (not publicly traded) corporation will be used as funds for down payment, closing costs and/or reserves, the price per share must be validated by a CPA for the corporation. A copy of the Buy/Sell Agreement is also required. Verification of receipt of the funds from the sale of the stock is required.

When using the funds for reserves, only 70 percent of the value may be used.

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

Systematic Savings

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

- 80 percent of the required assets must be documented
- The ability of the borrower to save based on his/her income and debts must be documented
- The required assets must be documented and verified in the borrower's account prior to closing
Asset Sources (continued)

Trade Equity

The property seller may take a property owned by the borrower as part of the down payment on the property being sold to the borrower, as long as the borrower has made a 5 percent cash down payment unless one of the following exist:

- The LTV/CLTV/HCLTV is less than or equal to 80 percent or
- The borrower is purchasing a single family primary residence

The borrower's equity contribution must be a true value consideration supported by a current appraisal.

The following documentation must be provided:

- A copy of an interior/exterior appraisal report ordered by the lender, on the property being traded
- A copy of the trade-in contract
- Title search proving that the borrower owns the real estate and verifying any liens associated with the property
- Proof of title transfer and satisfaction of any existing mortgage liens for which the borrower was liable. Transfer deed must be recorded.

To calculate borrower's equity, use the following formula:

\[
\text{Borrower's equity} = \text{lesser of current appraised value or trade-in price) - (outstanding liens plus transfer fees)}
\]

The above apply to all trade-in transactions, including those evidenced with two separate contracts in which buyer and seller reverse roles.

When the property being traded is a Manufactured Home, the equity contribution is determined by:

\[
\text{Borrower's equity} = \text{lesser of trade-in value or (appraised value for the land being traded +90% of the retail value of the Manufactured Home) - (outstanding liens plus transfer fees)}
\]

1 The retail value is based on the National Automobile Dealers Association Manufactured Housing Appraisal Guide.

Trust Funds Disbursement

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

- Identify the trustee including name, address, telephone number and individual contact. The trustee must be an independent party that typically handles trust accounts (trust company, financial institution, CPA, lawyer)
- Identify the borrower as the beneficiary
- Show that the borrower has access to all or certain specific amount of the funds
- The Trust has the assets to disburse funds to the borrower
- If the assets are required for closing, proof of receipt is required
Unacceptable Sources of Assets

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

- Cash advance on a revolving charge account or unsecured line of credit
- Cash for which the source cannot be verified (e.g., garage sales)
- Contribution Limitations
- Donated funds in any form, such as cash or bonds donated by the seller, builder or selling agent outside of approved financing contributions in the Seller Concession
- Funds from a Community Second Mortgage/Down Payment Assistance Program
- Funds from an unapproved non-profit organization
- Funds in a Custodial or “In Trust For” account
- Gift that must be repaid in full or in part
- Labor performed by the borrower, also referred to as “sweat equity”
- Materials furnished by the borrower that are not part of a pre-closing agreement with a builder
- Salary advance
LIABILITIES AND DEBT RATIOS

Overview
The Liabilities & Debt Ratios standards apply to all CMS Conventional Loan Programs. Generally, requirements that vary from one loan program to another are described in the CMS Product Guidelines and, in most cases, those program-specific differences will not be referenced in this section.

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

For state-specific restrictions, see the Underwriting Conditions Matrix.

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

Loan ratio requirements are discussed under the following topics:

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

Monthly Housing Expenses

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

- Principal and Interest payments on the first mortgage loan
- Interest payments for Interest Only loans
- Subordinate financing payments on mortgages secured by the subject property
- Hazard insurance premiums
- Flood insurance premiums
- Mortgage insurance premiums
- Real estate taxes
- Homeowners’ association dues
- Leasehold payments
- Ground rent
- Special assessments
Qualifying Housing Payment

Generally, the principal and interest payment, based on the actual interest rate is used to determine the borrower's monthly housing expense.

See the CMS Product Guidelines for specific requirements on qualifying rates, formulas, and limitations.

Total Qualifying Debt-to-Income Ratios

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

The debt-to-income ratio is a factor in determining the Loan Program for which borrower is eligible. The maximum allowable debt-to-income ratio will vary by individual Loan Programs. See the CMS Product Guidelines for debt-to-income ratio limits.

Monthly Debt Obligations

Assess Liabilities

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

The total monthly debt obligations considered is the sum of all housing expenses plus any other monthly expenses incurred by the borrower. Any additional debt obtained as a result of a recent inquiry on the credit report must be included in the monthly debt obligation. See the Debt Pay Off/Pay Down section in this section for information regarding paying off or paying down debt to qualify.
## Monthly Debt Obligations (continued)

<table>
<thead>
<tr>
<th>Monthly Debt Obligation</th>
<th>Monthly expenses include:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Alimony, Child Support, and Maintenance Payments</td>
</tr>
<tr>
<td></td>
<td>• Authorized User</td>
</tr>
<tr>
<td></td>
<td>• Bridge Loans</td>
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<tr>
<td></td>
<td>• Business Debt in Borrower’s Name</td>
</tr>
<tr>
<td></td>
<td>• Co-Signed Loans</td>
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<tr>
<td></td>
<td>• Court-ordered Assignment of Debt</td>
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<td></td>
<td>• Deferred Installment Debt</td>
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<tr>
<td></td>
<td>• Home Equity Lines of Credit</td>
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<tr>
<td></td>
<td>• Installment Debt</td>
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<tr>
<td></td>
<td>• Lease Payments</td>
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<tr>
<td></td>
<td>• Loans Secured by Financial Assets</td>
</tr>
<tr>
<td></td>
<td>• Mortgage Assumptions</td>
</tr>
<tr>
<td></td>
<td>• Open 30-day Charge Accounts</td>
</tr>
<tr>
<td></td>
<td>• Other Real Estate Owned</td>
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<tr>
<td></td>
<td>• Property Settlement Buy-out</td>
</tr>
<tr>
<td></td>
<td>• Revolving Charges/Lines of Credit</td>
</tr>
<tr>
<td></td>
<td>• Undisclosed Liabilities</td>
</tr>
<tr>
<td></td>
<td>• Voluntary Recurring Debt</td>
</tr>
</tbody>
</table>

See the [Transactions](#) section of this document for qualification information, if the current primary residence is a pending sale or is a conversion to a second home or investment property.

### Alimony, Child Support and Maintenance Payments

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

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

- A copy of a written legal agreement or court decree describing the payment terms for the obligation, the amount of the award and the period of time over which it will be received

- Any applicable state law that mandates the obligation document, which must specify the conditions under which payments must be made

### Authorized User

See the [Credit](#) section of this document for treatment of an authorized user account.
Monthly Debt Obligations (continued)

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

See the Transactions and the Assets sections of this document for more information.

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

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

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

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

- If the account in question has a history of delinquency.

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

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

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

**Note:** On a case-by-case basis, less than 12 months of evidence may be acceptable.

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

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

- Copy of the court order assigning the debt
- Proof of transfer of ownership

The payments history of the debt need not be taken into consideration after the transfer date occurred, after the assignment to another party.
# Monthly Debt Obligations (continued)

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

For deferred student loans only, if the credit report does not indicate the monthly amount that will be payable at the end of the deferment period, 2 percent of the original principal balance of the student loan may be used to determine the monthly payment used for loan qualification.

## Home Equity Lines of Credit
When the subject property has a home equity line of credit that has a balance and monthly payment, that payment must be considered part of the borrower's recurring monthly debt obligations. If the HELOC does not require a payment and there is no recurring monthly debt obligation, no monthly payment need be included in the recurring debt obligations.

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

Installment debts cannot be paid down to qualify. Installment debts or mortgage accounts must be paid in full.

For loans underwritten by Desktop Underwriter, Desktop Underwriter determines whether to include installment debts with fewer than ten monthly payments remaining.

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

## Loans Secured by Financial Assets
The borrower may use his or her financial assets (life insurance policies, 401k accounts, individual retirement accounts, certificates of deposit, stocks, bonds, etc.) as security for a loan. The payment on this type of loan is not required to be included in the debt-to-income ratio provided the applicable loan instrument shows the borrower's financial asset as collateral for the loan. If the borrower intends to use the same asset to satisfy reserve requirements, reduce the value of the asset by the proceeds from the secured loan and any related fees to determine whether the borrower has sufficient reserves.
Underwriting Guidelines (Conventional)
Mortgage Lending Division
Version 1.0 – 02/01/12

Monthly Debt Obligations (continued)

**Mortgage Assumptions**

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

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

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

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

**Open 30-day Charge Accounts**

Open 30-day charge accounts with account balances are required to be paid off unless one of the following is satisfied:

- Borrower has sufficient assets to cover the unpaid balance
- Borrower will receive reimbursement of the charges from his or her employer

**Other Real Estate Owned**

Mortgage payments and related expenses on any non-income producing real estate must be included in the borrower's recurring debt obligations. This includes mortgage payments and related expenses on any property which is currently pending sale (not closing prior to subject transaction), or a property retained as a second home or investment property.

- Aggregate net negative rental income from all rental properties
- Current rental payment (when borrower is currently renting and purchasing a second home or investment)

For details regarding the qualifying impact of other real estate owned, see the **Transactions** section of this document.

When the loan application reflects the borrower owns other real estate free and clear of mortgage liens or encumbrances, evidence is typically not required. However, under certain circumstances the underwriter may require documentation confirming the real estate is unencumbered. The borrower must qualify with the applicable taxes, hazard insurance, homeowners' association dues/fees (if applicable), and any other related expenses, which must be documented.
## Monthly Debt Obligations (continued)

| **Property Settlement Buy-out** | When the borrower’s interest in a property is “bought-out” by another co-owner of the property, the mortgage lender may not release the borrower from liability under the mortgage, thus creating a contingent liability for the borrower. This contingent liability does not need to be included in the debt-to-income ratio provided there is documentation to evidence the transfer of title of the property. |
| **Revolving Charge/Lines of Credit** | Revolving charge accounts and unsecured lines of credit are open-ended and should be treated as long-term debts and must be considered part of the borrower’s recurring monthly debt obligations. These tradelines include credit cards, department store charge cards, and personal lines of credit. If the credit report does not show a required minimum payment amount and there is no supplemental documentation to support a payment of less than 5 percent, use 5 percent of the outstanding balance as the recurring monthly debt obligation. For Desktop Underwriter, if a revolving debt is provided on the loan application without a monthly payment amount, Desktop Underwriter will use the greater of $10 or 5 percent of the outstanding balance as the monthly payment when calculating the total debt-to-income ratio. |
| **Undisclosed Liabilities** | See the Credit section of this document for undisclosed liabilities. |
| **Voluntary Recurring Debts** | Voluntary recurring debts should generally not be considered in the underwriting analysis or subtracted from gross income (401k contributions, 401k loans, union dues, commuting expenses, open accounts with zero balances, federal, state, and local taxes, or other voluntary deductions). Specific circumstances in an individual file must always be analyzed. See the Employment and Income Analysis and Documentation section of this document for treatment of business expenses. |
Debt Pay Off/Pay Down

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

- **Pay Off of Revolving Debt for Loan Qualification**
  - Desktop Underwriter, Loan Prospector, Manually Underwritten and Jumbo Loans: This is generally not allowed, but permitted if the revolving account is paid off and closed. If the revolving account is not closed, the debt must be included in the debt-to-income ratio. The Underwriter should evaluate the loan to consider past credit performance and to determine whether the borrower’s assets show sufficient reserves to help cover the borrower’s debts.

- **Pay Off of Installment Debt for Loan Qualification**
  - Desktop Underwriter, Loan Prospector, and Manually Underwritten Loans: Permitted.
  - Jumbo Loans: Permitted.

- **Pay Down of Revolving Debt for Loan Qualification**
  - Desktop Underwriter, Loan Prospector, and Manually Underwritten Loans: Not permitted.
  - Jumbo Loans: Not permitted.

- **Pay Down of Installment Debt for Loan Qualification**
  - Desktop Underwriter, Loan Prospector, and Manually Underwritten Loans: Not permitted. The installment debt must be paid off.
  - Jumbo Loans: Not permitted. The installment debt must be paid off.

If debts are being paid off or paid down, the source of funds must be documented and verified. In addition, documentation must be provided to reflect the revolving account is closed prior to closing. If an installment debt is paid off at closing, the creditor must provide a payoff statement which same balance must be reflected as the payoff amount on the HUD-1 Settlement Statement.
EMPLOYMENT AND INCOME ANALYSIS AND DOCUMENTATION

Purpose

This section describes the standards that apply to all CMS Conventional Loan Programs. Generally, requirements that differ from one Loan Program to another are described in the CMS Product Guidelines.

Additional information may be requested at the discretion of the underwriter.

For state-specific restrictions, see the Underwriting Conditions Matrix.

Stability and Continuance of Employment & Income

A minimum of two years employment history and continuance of income for three years is generally required for all borrowers whose income is being used to qualify. If a borrower’s employment history includes unemployment, the application must reflect at least two years of employment, therefore covering a longer period of time.

Consider both the length of the borrower’s employment with any one employer and the stable and reliable flow of income. When evaluating a borrower who has frequent job changes or unemployment, focus on whether the changes have affected the borrower's ability to repay their obligations. If the borrower provides documentation of a consistent level and type of income and the ability to pay his/her obligations despite changes in the source of that income, it can be presumed that the borrower's income level is stable. Automated underwriting recommends acceptable levels of documentation, which may not be adequate for every borrower and every situation (such as long periods of unemployment). In these cases, additional documentation may be required.

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

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

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

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

Borrowers who change jobs for advancement and maintain a stable earning capacity and good credit history, as well as borrowers with demonstrated job stability, will be eligible. Education or training to enhance job opportunities and income will receive favorable consideration. If a borrower does not meet the employment history requirement for the two full years prior to the date of the loan application, and was previously in school or the military, obtain copies of borrower diploma/transcripts or discharge papers.
Stability and Continuance of Employment & Income (continued)

Employment Gaps

The stability of employment and income and its likelihood of continuance should be factored into the underwriting decision when there are gaps of employment.

- Desktop Underwriter Loans:
  - Written letters of explanation for employment gaps are not required. However, borrower's re-entering the workforce with less than 6 months employment should be carefully reviewed to ensure a two-year work history prior to the absence from the workforce, is established. Additional documentation may be required (documentation supporting job loss, prior employment in same or related field, education or training supporting new job, etc.).

- Loan Prospector, Manually Underwritten and Jumbo Loans:
  - Written letters of explanation for employment gaps over 60 days in the last two years must be provided. In addition, borrowers who are re-entering the workforce after an extended absence may have stable employment if the following are met:
    - The borrower has been employed in his or her current job for six months or more
    - A two-year work history prior to the absence from the workforce is documented

Furloughed Borrowers

Borrowers in a state with an active furlough policy must qualify with the reduced income. Payments from a third party (credit union or other source) to supplement unfunded budgets are not permitted, even if the source is approved by the employer.

Full pay may be used if there is evidence from the employer or third party documentation that the furlough will end within the next 60 days and there is no discussion to extend the furlough.
Documentation Age and Standards

Documentation Age

All employment and income documents must be dated no more than 90 days prior to the Note date for existing construction and 120 days for new construction.

Documentation Standards

Each income documentation form and requirements are discussed below:

- Tax Information Authorization IRS Form 4506-T/Tax Transcripts
- Paystubs
- W-2s
- Written Verification of Employment
- Verbal Verification of Employment (Verbal VOE)
- Personal Tax Returns
- Income Calculation Worksheet
Documentation Age and Standards (continued)

Tax Information Authorization
IRS Form 4506-T/Tax Transcripts

All borrowers whose income is used to qualify must sign and date a completed and unexpired IRS Form 4506-T at application, authorizing CMS or its assigns, to obtain income information. The form must not expire before a reasonable time to allow CMS to process, if needed. In addition, the borrowers must sign a new IRS Form 4506-T at closing to allow for possible post funding quality control processing.

The IRS Form 4506-T must be processed and tax transcripts obtained to validate the borrower's tax returns and/or W-2s for the number of years of income documentation required by Desktop Underwriter/Loan Prospector or two years for Manually Underwritten and Jumbo loans. Evaluate the information provided by the IRS during the underwriting process. Significant differences must be reviewed, resolved and detailed comments provided regarding the resolution documented on the Transmittal Summary by the underwriter.

If a borrower is not required to file last year's tax return and the source of income cannot be validated through the IRS Form 4506-T process, documentation supporting the lack of filing tax returns must be provided. See Table 1-1.2010 Filing Requirements for Most Taxpayers.

In some circumstances and after completion of the loan review, CMS may require a signed IRS Form 4506-T with Box 8 checked to obtain W-2s or 1099 series transcripts. This may be required when the borrower was not required to file tax returns.

The IRS Form 4506-T must be completed as follows:

<table>
<thead>
<tr>
<th>Line #</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 4.</td>
<td>Complete with appropriate borrower information</td>
</tr>
<tr>
<td>5.</td>
<td>Third Party Information</td>
</tr>
<tr>
<td>6.</td>
<td>Transcript requested:</td>
</tr>
<tr>
<td>a.</td>
<td>Return Transcript</td>
</tr>
<tr>
<td>b.</td>
<td>Account Transcript</td>
</tr>
<tr>
<td>c.</td>
<td>Record of Account</td>
</tr>
<tr>
<td>7.</td>
<td>Verification of Non-filing</td>
</tr>
<tr>
<td>8.</td>
<td>Form W-2, Form 1099 series, Form 1096 series, or Form 5496 series transcript</td>
</tr>
<tr>
<td>9.</td>
<td>Year or period requested</td>
</tr>
</tbody>
</table>
Documentation Age and Standards (continued)

**Paystub**
The paystub must clearly identify the following:

- Borrower as the employee
- Gross earnings for the current pay period and year-to-date earnings. For Loan Prospector loans, year-to-date earnings must cover the most recent 30-day period
- Reflect pay period
- Employer name

Additional paystub requirements:

- If the borrower is paid hourly, the number of hours must be noted on the paystub
- Paystubs must be dated no earlier than 30 days prior to the loan application for Desktop Underwriter, Manually Underwritten and Jumbo loans. Loan Prospector loans have no age requirement prior to the loan application
- Paystubs must be computer generated or typed. If the employer does not provide an acceptable computer generated or typed paystub, the most recent years income tax return and W-2 is required
- Paystubs must not have any alterations
- Paystubs that are issued electronically, via e-mail or downloaded from the Internet are acceptable and must include the following:
  - Internet Uniform Resource Locator (URL Internet address) identifying the source of the information
  - Date and time printed
  - Verbal verification of employment
  - The documentation must also contain information identifying the place of origin and/or the author of the documentation, all of which must be confirmed on the verbal verification
  - Documents downloaded directly from the Internet to a Word document or Excel spreadsheet are not acceptable

**W-2s**
The W-2 must clearly identify the borrower as the employee and the employer’s name. In addition, W-2s:

- Should be the employee copy provided by the employer
- Must be computer-generated or typed
- Must not have any alterations
Documentation Age and Standards (continued)

**Written Verification of Employment**

Written verification of employment must contain the following information:

- Dates of employment
- Position
- Prospect of continued employment, when available
- Base pay amount and frequency; for employees paid on an hourly basis, the verification must state the hourly wages, including the number of hours worked each week
- Additional salary information, which itemizes bonus, overtime, tip, gratuity, or commission income, if applicable
- A paystub and W-2 must support all written verifications of employment. Written verifications of employment are not acceptable as standalone documentation to substantiate the borrower's current employment/income regardless of the automated underwriting requirements.

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

**Verbal Verification or Confirmation of Employment (VVOE)**

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

If the borrower is in the military, a military Leave and Earnings Statement (LES) dated within 30 calendar days of closing is acceptable in lieu of a verbal verification.

If using a third party service to verify employment (e.g., The Work Number, Quick Confirm, etc.), the following policy applies:

- **Request** to third party must be within 10 business days of the Note date (or funding date for escrow states).
- **Employment Verification** between employer and third party must be within 35 calendar days of the Note date.

To comply with a verbal verification of employment (or telephone confirmation) requirement, independently obtain the phone number and address for the borrower's employer. This can be accomplished using a telephone book, directory assistance, or by contacting the applicable licensing bureau.
Verbal Verification or Confirmation of Employment (VVOE) (continued)

- Verbal Verification of Employment Requirements
  A verbal verification of employment must contain the following information:
  - Date of contact
  - Borrower's date of employment
  - Borrower's employment status and job title
  - Name, phone number and title of individual contacted at entity
  - Name of the entity contacted
  - Name and title of associate contacting employer
  - Method and source used to obtain the phone number

- Self-Employed Confirmation of Employment Requirements
  Verification of the existence of a self-employed borrower's business must meet one of the following:
  - Verification of the existence of the borrower's business from a third party, such as a CPA, regulatory agency, or the applicable licensing bureau
  - Verify the listing and address for the borrower's business using a telephone book, the internet, or directory assistance

If contact is made verbally with a third party, document the source of the information obtained and the name and title of associate.

Tax Returns
The following standards apply when using Personal Tax Returns to verify income:

- Personal Tax Returns must be:
  - Complete with all schedules and W-2s, 1099s, K-1 schedules, etc.
  - Signed and dated
  - Borrower's copy filed with the IRS

- Business Tax Returns must be:
  - Complete with all schedules
  - Signed and dated
  - Borrower's copy filed with the IRS

- Amended Tax Returns: Tax returns that are amended and filed by the borrower with the IRS are acceptable in the following circumstances:
  - Tax Returns Filed Prior to the Loan Application Date
    Tax returns filed prior to application are acceptable for underwriting purposes. Both the original filed return and the amended return are required. If the file was amended 60 days or less prior to the application, evidence of payment must also be provided.
Documentation Age and Standards (continued)

**Tax Returns (continued)**

- **Tax Returns Filed After the Loan Application Date**
  
  Tax returns filed after the application date may be acceptable when accompanied by the following:
  
  - A letter of explanation regarding the reason for the re-file
  - Evidence of filing
  - Payment and the ability to pay the tax if the check has not cancelled
  - Borrower does not require use of amended income for qualification
  
  Closely examine the original tax return and the amended tax return for consistency with previous filings to determine whether the use of the amended return is warranted. If the borrower requires the amended income for qualification, an exception must be submitted and approved for the use of the amended income. A copy of the original and amended tax returns must be submitted with the exception. When using an amended return after application, the underwriter must provide justification and commentary on the Transmittal Summary regarding its use.

**Income Analysis Forms**

The following Income Analysis forms are acceptable:

- Cash Flow Analysis (Fannie Mae Form 1084)
- Income Analysis (Freddie Mac Form 91)
- CMS Income Calculation Worksheet
- CMS Self-Employed Income Analysis Worksheet
- Income calculation comments on the Transmittal Summary (Fannie Mae Form 1008/ Freddie Mac Form 1077) or similar form

**Non-Reimbursed Business Expenses**

When a borrower has non-reimbursed business expenses, such as classroom supplies, uniforms, meals, gasoline, automobile insurance, and/or automobile taxes, determine the recurring monthly debt obligation for such expenses by developing an average of the expenses. Review the Schedule A and/or IRS Form 2106 from one of the following for the number of years required:

- Personal income tax returns including all schedules
- Tax transcripts

When calculating the total debt-to-income ratio, the average for non-reimbursed expenses should be subtracted from the borrower’s stable monthly income.

See the [Auto Allowances & Expense Account Payments](#) section for treatment of these business expenses.
Income Types

Types

Income types are defined as follows and detailed throughout this section:

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

Wage Earner

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

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

All of the following income documentation is required:

- Desktop Underwriter and Loan Prospector Loans: Follow automated underwriting documentation requirements
- Manually Underwritten and Jumbo Loans:
  - Most recent paystub(s)
  - Most recent two years W-2s
  - Verbal Verification of Employment

Second Job or Multiple Job Employment

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

Income will be averaged over the past 24 months.

- Desktop Underwriter Loans: Desktop Underwriter requires a 12-month history of receipt of second job or multiple job employment. Follow automated underwriting documentation requirements.
- Loan Prospector Loans: Follow automated underwriting documentation requirements.
- Manually Underwritten and Jumbo Loans:
  - Most recent paystub(s)
  - Most recent two years W-2s
  - Verbal Verification of Employment
Income Types (continued)

**Bonus or Overtime**

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

All of the following income documentation is required:

- Desktop Underwriter and Loan Prospector Loans: Follow automated underwriting documentation requirements. Automated underwriting must recognize bonus or overtime income.
- Manually Underwritten and Jumbo Loans
  - Current paystub(s)
  - Most recent two years W-2s

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

**Commission**

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

For Desktop Underwriter and Manually Underwritten loans, commission income that has been received for 12 to 24 months may be acceptable, as long as the borrower's loan application demonstrates that there are positive factors to reasonably offset the shorter income history and there is a likelihood that the borrower will continue to receive such income.

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

- Desktop Underwriter and Loan Prospector Loans
  - Follow automated underwriting documentation requirements. Automated underwriting must recognize commission income. A minimum of 6 months commission income must be reflected on the borrower's personal tax returns to include as qualifying income.
- Manually Underwritten Loans: A minimum of 12 months must be reflected on the borrower's personal tax returns to include as qualifying income.
  - Most recent paystub(s)
  - Most recent two years W-2s or 1099s
  - Most recent two years personal tax returns with all schedules
- Jumbo Loans:
  - Most recent paystub(s)
  - Most recent two years W-2s or 1099s
  - Most recent two years personal tax returns with all schedules

See Wage Earner for borrower(s) whose commission is less than 25 percent.

If it is more than 60 days from the date of the latest personal tax return, obtain a current paystub, W-2 or 1099 and confirm that current earnings support the income on the personal tax return.
Income Types (continued)

**Commission (continued)**

This amount must be averaged over the most recent two years unless declining, and then the most recent 12 months will be averaged, deducting non-reimbursed business expenses as reported on IRS Form 2106.

For loans originated **between January 1 and April 15**: If the borrower has not yet filed his or her prior year's personal tax return, determine if alternative documentation, including 1099s or W-2s from the previous year, is sufficient to document the commission income. Taking into consideration business expenses that are deducted from earnings, develop an average monthly net income for qualifying purposes. If the commission income on the paystub does not support the commission income reported on the IRS Form 1099 or W-2s from the prior year, adjust qualifying income accordingly.
Self-Employed Income

**Self-Employed Employment Analysis**

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

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

**Desktop Underwriter, Loan Prospector and Manually Underwritten Loans:** A shorter history of self-employment — 12 to 24 months — may be considered as long as the borrower’s most recent personal tax returns reflect the receipt of such income as the same or greater level in a similar field as the current business or in an occupation in which the borrower had similar responsibilities to those undertaken in connection with the current business. Careful consideration must be given to the nature of the borrower’s level of experience, and the amount of business debt. In order to use the income for qualification, the borrower must demonstrate:

- At least two years of previous experience in the same occupation or related field and a two-year history of receipt of income at the same or greater level in the same or similar occupation or
- A combination of one year of experience and one year of professional training or education in an area related to the occupation may be considered on a case-by-case basis. Consider the acceptance of the company's service or products in the marketplace before considering the income for qualifying purposes.
- In all cases, personal tax returns must reflect at least one year of self-employment income. Self-employment of less than one year will not be considered for qualifying purposes.

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

When a borrower uses funds for down payment, closing costs or reserves (as applicable) from their self-employed business, the impact must be considered in the analysis of the business. See the [Assets](#) section for more information.

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

- A one-time occurrence prevented the borrower from working or earning full income for a period of time
- Proof that the borrower is back to the income amount that they previously earned
Self-Employed Income (continued)

**Documentation Requirements** All of the following income documentation is required:

- Desktop Underwriter and Loan Prospector Loans: Follow automated underwriting documentation requirements. In addition, the receipt of income history must reflect the following:
  - Desktop Underwriter Loans: The personal tax returns must reflect a minimum six months self-employment income
  - Loan Prospector Loans: The personal tax returns must reflect a minimum twelve months self-employment income
  - CMS Self-Employed Income Analysis Worksheet or comparable form
  - See below for borrowers with a 12-24 month self-employment history to document similar field, etc.

- Jumbo Loans
  - Most recent two years personal tax returns with all schedules

- Most recent two years business income tax returns (except for sole proprietorships)

- CMS Self-Employed Income Analysis Worksheet or comparable form

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

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

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

Depending on when the personal tax return was filed, the documentation listed above is required along with the following for all loan applications:

<table>
<thead>
<tr>
<th>Underwritten or Submission Date</th>
<th>Desktop Underwriter and Loan Prospector Loans</th>
<th>Manually Underwritten and Jumbo Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1 through June 15</td>
<td>Most recent year(s) available tax transcripts for the number of years required</td>
<td>Most recent year(s) available tax transcripts for the number of years required</td>
</tr>
<tr>
<td></td>
<td>After April 15, copy of filed extension with any tax payment made, if applicable</td>
<td>After April 15, copy of filed extension with any tax payment made, if applicable</td>
</tr>
<tr>
<td></td>
<td>W-2s for a corporation</td>
<td>W-2s for a corporation</td>
</tr>
<tr>
<td></td>
<td>1099s for commission income</td>
<td>1099s for commission income</td>
</tr>
<tr>
<td>June 16 through October 31</td>
<td>Most recent year(s) available tax transcripts for the number of years required</td>
<td>Most recent year(s) available tax transcripts for the number of years required</td>
</tr>
<tr>
<td></td>
<td>Copy of the filed extension with any tax payments made</td>
<td>Copy of the filed extension with any tax payments made</td>
</tr>
<tr>
<td></td>
<td>Year-end profit and loss for last year</td>
<td>Current year profit and loss</td>
</tr>
<tr>
<td></td>
<td>W-2s for corporations</td>
<td>Year-end profit and loss for last year</td>
</tr>
<tr>
<td></td>
<td>1099s for commission income</td>
<td>W-2s for corporations</td>
</tr>
<tr>
<td></td>
<td>At the underwriter's discretion, a Balance Sheet for the prior calendar may be required if the business is a sole proprietorship that has significant assets, has employees other than the owner and spouse, and regularly prepares separate business financial balance sheets</td>
<td>099s for commission income</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Balance Sheet for the prior calendar year if the business is a sole proprietorship that has significant assets, has employees other than the owner and spouse, and regularly prepares separate business financial balance sheets</td>
</tr>
<tr>
<td>After October 31</td>
<td>Most recent year(s) available tax transcripts for the number of years required</td>
<td>Most recent year(s) available tax transcripts for the number of years required</td>
</tr>
<tr>
<td></td>
<td>Most recent years personal tax return (year-end profit and loss statement will not be accepted) is required</td>
<td>Most recent years personal tax return (year-end profit and loss statement will not be accepted) is required</td>
</tr>
<tr>
<td></td>
<td>The current year's personal tax returns may be a condition of loan approval based on the application date. For example, if the borrower applies for the loan on October 23 and is not closing until November 15, the most recent years personal tax returns may be required</td>
<td>Current year profit and loss</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The current year’s personal tax returns may be a condition of loan approval based on the application date. For example, if the borrower applies for the loan on October 23 and is not closing until November 15, the most recent years personal tax returns may be required</td>
</tr>
</tbody>
</table>
Rental Income

Income for Qualification Purposes

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

- Mortgage Premises
  - Owner occupied property two- to four-unit
  - Investment property one- to four-unit
- Other Real Estate Owned
- Proposed Rental Income

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

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

Loans for investment properties that generate a negative cash flow must be closely scrutinized and must make sense for the borrower's circumstances. Some Loan Programs have restrictions on negative cash flow. See the CMS Product Guidelines for details.

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

- Operating Income Statement
- Comparable Rent Schedule
- Fair Market Rent letter from a realtor
- Current fully executed lease agreement
- Verbal confirmation from borrower noted on Loan Application or Transmittal Summary

Treatment of Income

Any monthly net rental income must be added to the borrower's total monthly income

Any net rental loss must be added to the borrower's total monthly obligations

If total debt (PITIA) for the subject property is used in the borrower's debt-to-income ratio (and not using rental income to qualify), rental income must still be reported on the Loan Application.
Rental Income (continued)

Rental Income Calculation and Documentation

If using personal tax returns to calculate net rental income (loss), the Schedule E does not account for the full amount of the mortgage payment for the rental property. Any depreciation, interest, taxes, and insurance must be added back in the cash flow analysis before subtracting the PITI payment, to avoid double-counting the expenses.

If using the lease agreement, net rental income is 75% of the gross rent from the lease agreements, with the remaining 25% being absorbed by vacancy losses and ongoing maintenance expenses.

When calculating the net rental income (or loss), use one of the following forms to calculate rental income:

- Cash Flow Analysis (Fannie Mae Form 1084)
- Income Analysis (Freddie Mac Form 91)
- CMS Rental Income Worksheet

When using rental income to qualify, use the following to determine cash flow and applicable documentation:

| Desktop Underwriter and Manually Underwritten Loans |
|-------------------------------------------|-------------------------------------|----------------------------------|
| **Length of Ownership** | **Net Cash Flow Calculation** | **Documentation** |
| **Owner Occupied 2 - 4 Unit Property** | | |
| Purchase: N/A | Amount established by appraiser in the Operating Income Statement | Operating Income Statement |
| Refinance: One or more complete tax years | 12-month average from Schedule E | Most recent personal tax returns (page 1, 2 and Schedule E) evidencing history of receiving rental income from subject property |
| Refinance: Acquired property subsequent to filing personal tax returns | 75% of gross rental income | Income is based on the lesser of:
  - Appraiser’s opinion of market rent with either a Single Family Comparable Rent Schedule or Small Residential Income Property Appraisal Report or
  - Actual rent from fully executed lease agreement(s) |

Proprietary and confidential. For Internal use only. Do not distribute externally.
### Rental Income (continued)

#### Desktop Underwriter and Manually Underwritten Loans (continued)

<table>
<thead>
<tr>
<th>Investment Property 1 - 4 Unit</th>
<th>Net Cash Flow Calculation</th>
<th>Documentation</th>
</tr>
</thead>
</table>
| Purchase: N/A                  | Amount established on the Operating Income Statement | ● Operating Income Statement  
● Borrowers must currently own a primary residence or own other investment properties in order to use rental income for loan qualification. If these requirements are not met, the borrower must qualify with the full PITIA payment. |
| Refinance: One or more complete tax years | 12-month average from Schedule E | ● Most recent personal tax returns (page 1, 2 and Schedule E) evidencing a history of receiving rental income from subject property |
| Refinance: Acquired property subsequent to filing personal tax returns | 75% of gross rental income | Income based on the lesser of:  
● Appraiser’s opinion of market rent with either a Single Family Comparable Rent Schedule or Small Residential Income Property Appraisal Report or  
● Actual rent from fully executed lease agreement(s) |

#### Rental Income From Other Real Estate Owned

| One or more complete tax years | 12-month average from Schedule E | Most recent personal tax return (page 1, 2 and Schedule E) evidencing a history of receiving rental income from subject property |
| Less than one complete tax year | 75% of gross rental income | Fully executed lease agreement(s) |

#### Proposed Rental Income from Current Primary Residence

See the CMS Product Guidelines and Section B601 Transaction Types; Conversion of a Primary Residence to an Investment Property for reserves and additional requirements

| N/A                              | 1-unit: 75% of actual rent 2- to 4-units:  
● 75% of actual rent for unit previously occupied by borrower  
● Schedule E from IRS 1040 | 1-unit: Fully executed lease agreement 2- to 4-units:  
● Fully executed lease agreement for unit previously occupied by borrower AND  
● Two years personal tax returns for properties not previously occupied by borrower OR fully executed lease agreements if property was not owned for one complete tax year and not on Schedule E  
1-4 units:  
● Receipt of security deposit from the tenant and deposited into the borrower’s bank account  
● A family member, an individual with an established relationship with those involved in the transaction, or an interested party may not sign the lease agreement as the tenant. |
| 1-unit: 75% of actual rent 2- to 4-units:  
● 75% of actual rent for unit previously occupied by borrower  
● Schedule E from IRS 1040 | 1-unit: Fully executed lease agreement 2- to 4-units:  
● Fully executed lease agreement for unit previously occupied by borrower AND  
● Two years personal tax returns for properties not previously occupied by borrower OR fully executed lease agreements if property was not owned for one complete tax year and not on Schedule E  
1-4 units:  
● Receipt of security deposit from the tenant and deposited into the borrower’s bank account  
● A family member, an individual with an established relationship with those involved in the transaction, or an interested party may not sign the lease agreement as the tenant. |
## Rental Income (continued)

### Loan Prospector Loans

<table>
<thead>
<tr>
<th>Length of Ownership</th>
<th>Net Cash Flow Calculation</th>
<th>Documentation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Owner Occupied 2 - 4 Unit Property</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Purchase: N/A       | Amount established by appraiser in the Operating Income Statement | ● Operating Income Statement  
● Fully executed lease agreement(s), if applicable  
● Recent two-year rental property management history  
● Borrowers must currently own a primary residence or own other investment properties in order to use rental income for loan qualification. If these requirements are not met, the borrower must qualify with the full PITIA payment. |
| Refinance: One or more complete tax years | 24-month average from Schedule E | Income is based on the lesser of:  
● Two years personal tax returns (page 1, 2 and Schedule E) evidencing a history of receiving rental income from subject property  
● Operating Income Statement |
| Refinance: Acquired property subsequent to filing personal tax returns | Amount established by appraiser on the Operating Income Statement | Income is based on the lesser of:  
● Appraiser's opinion of market rent with either a Single Family Comparable Rent Schedule or Small Residential Income Property Appraisal Report  
● Fully executed lease agreement(s) |

### Investment Property 1 - 4 Unit

<table>
<thead>
<tr>
<th>Length of Ownership</th>
<th>Net Cash Flow Calculation</th>
<th>Documentation</th>
</tr>
</thead>
</table>
| Purchase: N/A       | Amount established on the Operating Income Statement | ● Operating Income Statement  
● Fully executed lease agreement(s)  
● Proof of six months rent loss insurance  
● Recent two-year rental property management history |
| Refinance: One or more complete tax years | 24-month average from Schedule E | ● Most recent two years personal tax returns (page 1, 2 and Schedule E)  
● Operating Income Statement  
● Proof of six month rent loss insurance  
● Recent two-year rental property management history |
| Refinance: Acquired property subsequent to filing personal tax returns | Amount established on the Operating Income Statement | ● Most recent two years personal tax returns (page 1, 2 and Schedule E)  
● Operating Income Statement  
● Proof of six month rent loss insurance  
● Recent two-year rental property management history |
## Rental Income (continued)

### Rental Income Calculation and Documentation (continued)

<table>
<thead>
<tr>
<th>Loan Prospector Loans</th>
<th>Net Cash Flow Calculation</th>
<th>Documentation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rental Income From Other Real Estate Owned</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>At least two complete tax years</td>
<td>24-month average from Schedule E</td>
<td>Most recent two years personal tax returns (page 1, 2 and Schedule E)</td>
</tr>
<tr>
<td>Acquired property subsequent to filing personal tax returns</td>
<td>75% of gross rental income</td>
<td>Must demonstrate a recent two-year rental property management history on Schedule E from other REO</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Proposed Rental Income From Current Primary Residence</strong></th>
<th><strong>See the CMS Product Guidelines and Section B601 Transaction Types; Conversion of a Primary Residence to an Investment Property for reserves and additional requirements</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>N/A</td>
<td>1-unit: 75% of actual rent 2- to 4-units:</td>
</tr>
<tr>
<td></td>
<td>● 75% of actual rent for unit previously occupied by borrower</td>
</tr>
<tr>
<td></td>
<td>● Schedule E from IRS 1040</td>
</tr>
<tr>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Rental Income (continued)

#### Jumbo Loans

<table>
<thead>
<tr>
<th>Length of Ownership</th>
<th>Net Cash Flow Calculation</th>
<th>Documentation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner Occupied 2 - 4 Unit Property</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase: N/A</td>
<td>Amount established on the Operating Income Statement</td>
<td>Operating Income Statement</td>
</tr>
<tr>
<td>Refinance: One or more complete tax years</td>
<td>24-month average from Schedule E</td>
<td>Income is based on the lesser of:</td>
</tr>
<tr>
<td>Refinance: Acquired property subsequent to filing personal tax returns</td>
<td>Amount established on the Operating Income Statement or 75% of actual rent</td>
<td>Income is based on the lesser of:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Appraiser's opinion of market rent with either a Single Family Comparable Rent Schedule or Small Residential Income Property Appraisal Report</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Fully executed lease agreement(s)</td>
</tr>
</tbody>
</table>

#### Rental Income From Other Real Estate Owned

<table>
<thead>
<tr>
<th>Length of Ownership</th>
<th>Net Cash Flow Calculation</th>
<th>Documentation</th>
</tr>
</thead>
<tbody>
<tr>
<td>At least two complete tax years</td>
<td>24-month average from Schedule E</td>
<td>Most recent two years personal tax returns, including Schedule E</td>
</tr>
<tr>
<td>Acquired property subsequent to filing personal tax returns</td>
<td>75% of gross rental income</td>
<td>Fully executed lease agreement(s)</td>
</tr>
</tbody>
</table>

#### Proposed Rental Income From Current Primary Residence

*See the CMS Product Guidelines and Section B601 Transaction Types; Conversion of a Primary Residence to an Investment Property for reserves and additional requirements*

<table>
<thead>
<tr>
<th>Length of Ownership</th>
<th>Net Cash Flow Calculation</th>
<th>Documentation</th>
</tr>
</thead>
<tbody>
<tr>
<td>N/A</td>
<td>1-unit: 75% of actual rent 2- to 4-units:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• 75% of actual rent for unit previously occupied by borrower</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Schedule E</td>
<td></td>
</tr>
<tr>
<td>1-unit: Fully executed lease agreement</td>
<td>2- to 4-units:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Fully executed lease agreement for unit previously occupied by borrower AND</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Most recent two years personal tax returns, including Schedule E, for units not occupied by borrower OR fully executed lease agreement(s) if property was not acquired subsequent to filing personal tax returns AND</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1- to 4-units</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Receipt of security deposit from the tenant and deposited into the borrower’s bank account</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• A family member, an individual with an established relationship with those involved in the transaction, or an interested party may not sign the lease agreement as the tenant.</td>
<td></td>
</tr>
</tbody>
</table>

### Reporting Rental Income

The monthly rental income and number of bedroom data must be provided for primary residence (2- to 4-units) and investment properties (1- to 4-units). These figures are commonly found on the Operating Income Statement. If the Operating Income Statement is not required, ask the borrower what the current rent or approximate projected rent is for each unit, the number of bedrooms in each unit, and note it on the Uniform Residential Loan Application or the comment section of the Transmittal Summary.
Other Income Sources

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

- Alimony, Child Support and Maintenance Payments
- Auto Allowances and Expense Account Payments
- Capital Gains and Losses
- Disability
- Employment by a Relative, Property Seller or Real Estate Broker
- Foreign Income
- Foster Care Income
- Housing or Parsonage Allowance
- Interest and Dividend Income
- Military Income
- Non-taxable Income
- Note Income
- Public Assistance
- Retirement, Pension, Annuity, and IRA Distributions
- Royalty Payments
- Seasonal Part-time and Seasonal Second Job Income
- Social Security Income
- Teachers
- Tip and Gratuity Income
- Trust Income
- Unemployment Benefits Income
- VA Benefits
Other Income Sources (continued)

Alimony, Child Support and Maintenance Payments

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

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

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

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

One of the following types of income documentation is required:

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

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

- Desktop Underwriter and Loan Prospector Loans: Follow automated underwriting documentation requirements
- Manually Underwritten and Jumbo Loans
  - Court records
  - Most recent personal tax returns with all schedules
  - Bank statements or deposits slips showing regular deposit of funds
Other Income Sources (continued)

Auto Allowances and Expense Account Payments

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

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

Actual Cash Flow Approach

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

Any expenses in excess of the monthly allowance must be included in the borrower’s total monthly obligations. When the borrower uses IRS Form 2106 and recognized “actual expenses” instead of the standard mileage rate, look at the actual expenses section to identify the borrower’s actual lease payments, and then make the appropriate adjustments.

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

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>Add-Back per Mile</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>$0.29</td>
</tr>
<tr>
<td>2009</td>
<td>$0.21</td>
</tr>
<tr>
<td>2010</td>
<td>$0.23</td>
</tr>
</tbody>
</table>

Income and Debt Approach

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

Capital Gains & Losses

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

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

All of the following income documentation is required:

- A minimum of the most recent two years personal tax returns with all schedules. In some cases, additional years tax returns may be required.
- Evidence of ownership of additional property or assets
Other Income Sources (continued)

**Disability**

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

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

- **Temporary Disability or Workman's Compensation**

  Benefits that have a defined expiration date must have a remaining term of at least three years from the date of the mortgage application in order to be used for loan qualification.

  If a borrower is currently receiving short-term disability benefits that will decrease to a lesser amount within the next three years because they are being converted to long-term benefits, the long-term benefits must be used as qualifying income.

  If a borrower is currently on temporary disability (including maternal/parental leave), the borrower must provide a letter of intent to return to work and the employer must provide a letter or other communication of the borrower's right to return to work and a description of the employment terms (same as prior to leave). The temporary disability benefits must be used for loan qualification and must not terminate prior to the borrower returning to work, unless the borrower(s) has liquid reserves sufficient to cover the gap between the benefits expiration and the return to work dates.

  A copy of the borrower's disability policy or benefits statement is required to document income.

  - Desktop Underwriter and Loan Prospector Loans

    If a loan receives an Ineligible decision due to debt-to-income ratio, the loan may be Manually Underwritten. The borrower(s) must have liquid reserves sufficient to cover the gap between the benefits expiration and the return to work dates.

**Employment by a Relative, Property Seller or Real Estate Broker**

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

All of the following income documentation is required:

- Most recent paystub(s)
- Most recent two years W-2s
- Most recent two years personal tax returns
Other Income Sources (continued)

Foreign Income
Foreign income is income that is earned by a borrower employed by a foreign corporation or a foreign government and paid in foreign currency.

Borrowers may use foreign income to qualify with all of the following documentation:

- Most recent paystub(s) and two years W-2s or Written Verification of Employment and most recent paystub(s)
- Most recent two years U.S. personal tax returns that include the foreign income, with all schedules

All income must be translated into U.S. currency.

- Desktop Underwriter and Loan Prospector Loans: Foreign income is permitted.
- Jumbo Loans: Foreign income is not permitted.

Foster Care Income
Foster care income is acceptable if it is verified that the borrower has a minimum two-year history of providing foster care services under a recognized state- or county-sponsored program and is likely to continue to provide such services.

One of the following types of income documentation is required:

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

Desktop Underwriter and Manually Underwritten Loans: Foster care income may be considered stable with documentation evidencing that the borrower has been receiving the income for at least 12 months and the income does not represent more than 30 percent of the total gross income.

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

All of the following income documentation is required:

- Written Verification of Employment, letter from employer, or paystubs reflecting the amount of the housing or parsonage allowance
- Terms under which the housing or parsonage allowance is paid
- Proof of receipt of housing allowance for most recent 12 months
Other Income Sources (continued)

**Interest & Dividend Income**

A two-year average of interest and dividend income may be used to qualify if supported by sufficient assets after closing to support continuance of the interest or dividend income for at least three years. The asset providing the interest and dividend income may not be liquidated for cash to close unless that portion used is deducted and the interest and/or dividend amount is recalculated based on the unused portion of the asset. Interest and dividend income is eligible only after deducting that portion, listed on Schedule B of IRS Form 1040, derived from a partnership or S corporation.

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

- Most recent two years personal tax returns with all schedules
- Most recent 24 months personal bank statements
- Most recent two years 1099s

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

**Military Income**

**Military Personnel**

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

**Reserves or National Guard**

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

- Called to Active Duty
  
  If one of the borrowers is on active duty or has been called to active duty after the loan application has been made, the loan is in process and wants to refinance his or her primary residence, which the family does not currently occupy, comply with the following:

  - The borrower must certify that the subject property is their primary residence
  - The subject property must be vacant, will remain vacant and will again be the borrower's primary residence when the temporary assignment is completed
  - The borrower must certify that they will return to the subject property as their primary residence upon completion of the temporary assignment
  - The borrower must provide documentation regarding the temporary assignment (orders supporting the assignment including duration)
Other Income Sources (continued)

**Military Income (continued)**

- **Borrower Qualification**
  - If the loan is a primary residence rate and term refinance and the borrower's mortgage payment is not changing or is being reduced, the transaction is qualified based on the borrower's current job and income.
  - If the loan is a:
    - Purchase, rate and term refinance or a cash out refinance of a primary residence and the mortgage payment is increasing or
    - Second home or investment property, the borrower's income must be re-evaluated for qualification purposes. The borrower must be qualified using the lesser of the following:
      - Reservist pay
      - Current job (or a combination of reservist pay and current job pay i.e., current employer pays reservist his/her standard pay minus reservist income)

**Non-Taxable Income**

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

If the income is verified as non-taxable, and the income and its tax-exempt status are likely to continue, develop an “adjusted gross income” for the borrower by adding an amount equivalent to 25 percent of the non-taxable income to the borrower’s income. Filing requirements for most taxpayers can be found on the [IRS](https://www.irs.gov) website.

**Note Income**

Ongoing revenue received from Note income may be eligible for loan qualification. Verification that the income can be expected to continue for a minimum of three years is required.

Obtain a copy of the Note documenting the amount, frequency and duration of payments.

- **Desktop Underwriter, Loan Prospector Loans**: One of the following types of income documentation must be provided for the most recent 12 months:
  - Most recent personal tax returns with all schedules
  - Bank statements showing regular deposits of funds
- **Jumbo Loans**: One of the following types of income documentation must be provided for the most recent two years:
  - Most recent personal tax returns with all schedules
  - Bank statements showing regular deposits of funds
Other Income Sources (continued)

Public Assistance Programs

Public assistance may be considered as acceptable income provided the income has been received for the last two years and is expected to continue for the next three years. See the [Unemployment Benefits](#) section for details regarding the use of unemployment income.

All of the following income documentation is required:

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

Retirement Pension, Annuity Income and IRA Distributions

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

One of the following types of income documentation is required:

- Letter from the organization providing the income
- Copy of retirement award letters
- Most recent personal income tax returns with all schedules
- Most recent 1099
- Bank statements for the most recent 12 months showing regular deposit of funds

Income Derived From Severance and Lump Sum Retirement Package, or Retirement Accounts

CMS recognizes an income stream from employment-related assets as eligible for loan qualification.

- Desktop Underwriter Loans: Eligible for the use of income derived from severance and lump sum retirement packages or retirement accounts based on the Table below.
- Loan Prospector and Jumbo Loans: Must evidence a two-year history of documented draws or interest/dividend income. If, based on that history, the income will continue for at least three years, the income may be used for loan qualification.
Other Income Sources (continued)

<table>
<thead>
<tr>
<th>Income Derived From Assets</th>
<th>Eligibility</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>● Desktop Underwriter and Manually Underwritten loans</td>
</tr>
<tr>
<td></td>
<td>● Assets must be owned by one or more of the borrowers</td>
</tr>
<tr>
<td></td>
<td>● Assets must be liquid, unrestricted and available to the borrower without penalty</td>
</tr>
<tr>
<td></td>
<td>● Maximum 70% LTV/CLTV/HCLTV</td>
</tr>
<tr>
<td></td>
<td>● Minimum credit score 620</td>
</tr>
<tr>
<td></td>
<td>● Purchase and limited cash out refinance</td>
</tr>
<tr>
<td></td>
<td>● Primary residence and second homes</td>
</tr>
</tbody>
</table>

| Eligible Assets |● Non-self-employed severance package, or |
|                |● Non-self-employed lump sum retirement package |
|                |● Document with a distribution letter from the employer (1099R) and deposited into a verified asset account |
|                |● 401k, KEOGH or IRA and SEP-IRA, retirement accounts are eligible if: |
|                |   o Distribution is not yet set up, or |
|                |   o Distribution is set up and being received, yet the distribution amount is not enough to qualify. Evidence of distribution change is not required. |
|                |   o Document with the most recent monthly, quarterly, or annual statement |

<table>
<thead>
<tr>
<th>Value and Income Calculation</th>
<th>Net Value Determination</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Documented Assets</td>
<td>● Retirement accounts: Use 70 percent of the value</td>
</tr>
<tr>
<td></td>
<td>● Stocks, bonds, and mutual funds: Use 70 percent of the value</td>
</tr>
<tr>
<td></td>
<td>Eligible assets less 30% (Net Value - if retirement, stocks, bonds, mutual funds) less any funds that will be used for closing or required for reserves</td>
</tr>
<tr>
<td></td>
<td>Income Calculation</td>
</tr>
<tr>
<td></td>
<td>Divide the “Net Documented Assets” by 360 months (regardless of the loan term)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Ineligible Assets</th>
<th>The following non-employment related assets are not eligible:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>● Divorce proceeds</td>
</tr>
<tr>
<td></td>
<td>● Inheritance</td>
</tr>
<tr>
<td></td>
<td>● Stock options</td>
</tr>
<tr>
<td></td>
<td>● Lawsuits</td>
</tr>
<tr>
<td></td>
<td>● Lottery winnings</td>
</tr>
<tr>
<td></td>
<td>● Non-vested restricted stock</td>
</tr>
<tr>
<td></td>
<td>● Sale of real estate</td>
</tr>
<tr>
<td></td>
<td>This list is not all-inclusive.</td>
</tr>
</tbody>
</table>
Other Income Sources (continued)

**Royalty Payments**

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

**Desktop Underwriter and Jumbo Loans:**

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

**Loan Prospector Loans:** Follow automated underwriting decision and documentation requirements.

**Seasonal Part-time or Seasonal Second Job Income**

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

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

If income received cannot meet this requirement, it should only be considered a compensating factor.

**Social Security Income**

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

Evidence of continuance of Social Security retirement income need not be documented.

One of the following types of income documentation is required:

- Copy of the Social Security Administration award letter
- Most recent personal tax returns with all schedules
  - Loan Prospector loans require the most recent 2 years personal tax returns
- Most recent 1099s
  - Loan Prospector loans require the most recent 2 years 1099s
- Most recent 12 months bank statements
Other Income Sources (continued)

Teachers

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

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

- Final year-end paystub from the school
- Verbal Verification of Employment
- Copy of fully executed, guaranteed contract, with no contingencies, indicating that the borrower is paid over a 10-month period

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

Tip and Gratuity Income

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

All of the following income documentation is required:

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

Trust Income

Confirm trust income and its continuance for at least three years by obtaining a copy of the Trust Agreement or Trustee Statement to document the following:

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

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

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

A borrower's trust income may be taxed at a lower rate or it may be part of a partnership that writes off losses, which may result in no tax liability. Trust income is reported on the 1041 fiduciary income tax return, which includes a K-1 schedule. All beneficiaries of trust income receive IRS Form K-1 from the trust.
Underwriting Guidelines (Conventional)
Mortgage Lending Division
Version 1.0 – 02/01/12

Other Income Sources (continued)

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

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

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

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

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

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

Income from sources considered ineligible include, but is not limited to the following:

- Any unverified source of income
- Future income
- Income derived from sources outside the United States
- Income derived from the subject property with land being leased to another party
- Income derived from farm income when the property is being used for a specific purpose, such as a vineyard or bottling barns
- Income derived from gambling
- Income determined to be temporary or one-time in nature
- Lump sum payments such as inheritances or lawsuit settlements
- Lump sum payments of lottery earnings that are not on-going
- Mortgage credit certificates
- Non-incidental income received from farming/agricultural use of a property
- Rental income received from the borrower's single family primary residence or second home
- Retained earnings in a company
- Stock options
- Taxable forms of income not declared on personal tax returns
- Trailing co-borrower income
- Unverifiable income
- VA education benefits
APPRAISAL REQUIREMENTS, DOCUMENTATION, AND EVALUATION

Purpose

This section provides the standards that apply to all CMS Conventional Loan Programs. Generally, requirements that vary from one loan program to another are described in the CMS Product Guidelines and, in most cases, those program-specific differences will not be referenced in this section.

The appraisal report forms require the appraiser to certify that the appraiser did not base, either partially or completely, their analysis and/or opinion of value in the appraisal report on the race, color, religion, sex, age, marital status, handicap, familial status, or national origin of either the prospective owners or occupants of the subject property or of the present owners or occupants of the properties in the vicinity of the subject property or on any other basis prohibited by law.

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

For state-specific restrictions, see the Underwriting Conditions Matrix.

Appraiser Requirements

The following describe the requirements for appraisers:

- Appraiser must be a state licensed or certified appraiser. Verification must be provided by one of the following forms:
  - A copy of the appraiser’s current license (preferred documentation)
  - A copy of the National Registry Appraiser Report at http://www.asc.gov/

Navigating the Website

<table>
<thead>
<tr>
<th>Step</th>
<th>Instruction</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>On the left side of the screen, select “National Registry”</td>
</tr>
<tr>
<td>2</td>
<td>Select “Find an Appraiser”</td>
</tr>
<tr>
<td>3</td>
<td>Enter name and/or address of appraiser</td>
</tr>
<tr>
<td>4</td>
<td>Locate the appraiser’s name by either scrolling through the list of names or by using the alphabetized bookmark as a shortcut.</td>
</tr>
<tr>
<td>5</td>
<td>Click on the appraiser’s name to generate a National Registry Appraiser Report. This report will provide the following specifics: licensing state, license number, appraiser’s last name, and the effective date and expiration date of the license. Include a copy of the report in the loan file.</td>
</tr>
</tbody>
</table>

- Appraiser must comply with the independent appraiser requirements specified by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the FDIC, and the Office of Thrift Supervision.

- Appraiser must comply with real estate appraisal regulations adopted in accordance with Title XI of the Financial Institutions Reform or Recovery and Enforcement Act of 1989 (regardless of whether Client is subject to those regulations).
Appraiser Requirements (continued)

- Appraiser must be experienced in the appraisal of properties similar to the type being appraised.
- Appraiser must be actively engaged in appraisal work.
- Appraiser may not be an interested party in the subject transaction.
- Appraiser must subscribe to a code of ethics that is at least as strict as the code of the American Institute of Real Estate Appraisers or the American Society of Appraisers.

Discontinuance of Appraiser Services

At any time, CMS may elect not to originate, approve, or purchase loans secured by a subject property appraised by a particular appraiser. CMS will notify Client of its election, and following such notification, CMS will have no obligation to purchase loans on properties evaluated by that appraiser, even if the loans have been registered or locked.

Approved Appraisal Management Service Providers

Mandatory Use of Approved Appraisal Service Providers

On the following loans, appraisals must be ordered through Appraisal Management Service Provider:

- For loans referred to CMS, the appraisals must be ordered through one of the following approved Appraisal Management Service Providers:
  - StreetLinks
  - Pro Teck
  - HVCC
  - LSI
- For Jumbo loans, appraisals must be ordered through the Versos Appraisal Management Service provided by the investor.

Appraisal Document Standards

Standards

All appraisals must be performed in strict accordance with and comply with all applicable local, state and federal laws, regulations and orders, and must conform to the current Uniform Standards of Professional Appraisal Practice adopted by the Appraisal Standards Board of the Appraisal Foundation.

All appraisals must be reviewed in detail for completeness, accuracy, and assessment of the current fair market value.
### Appraisal Document Standards (continued)

<table>
<thead>
<tr>
<th>Age of Appraisal</th>
<th>Desktop Underwriter and Loan Prospector Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>For existing and new construction properties, the appraisal report must be dated within 120 days of the date of the Note.</td>
</tr>
<tr>
<td></td>
<td>If the date of the appraisal report is more than 120 days but less than 360 days from the date of the Note, an update from the original appraiser must be provided using his or her knowledge of current market conditions. The appraiser must acknowledge that the value of the subject property has not declined since the date of the original appraisal. The appraiser must complete the update on Fannie Mae Form 1004D/Freddie Mac Form 442 and the form must be dated within 120 days of the date of the Note.</td>
</tr>
<tr>
<td></td>
<td>A new appraisal is required in the following cases:</td>
</tr>
<tr>
<td></td>
<td>- The appraisal date is more than 360 days from the date of the Note.</td>
</tr>
<tr>
<td></td>
<td>- The appraiser indicates in an Appraisal Update that the property value has declined.</td>
</tr>
<tr>
<td></td>
<td>For loans underwritten by Desktop Underwriter, a Property Inspection Report (Fannie Mae Form 2075) is used. The Property Inspection Report must be dated within 120 days of the Note date. A Property Inspection Report must not be updated.</td>
</tr>
<tr>
<td></td>
<td>An Appraisal Update (Fannie Mae Form 1004D) or a new appraisal (Fannie Mae Form 2055 Exterior Only/Freddie Mac Form 442) supporting the original appraised value is required for loans purchased more than 75 days after the closing (i.e., from the Note date to the purchase date). If an Appraisal Update indicates that the value has declined, a new appraisal (Fannie Mae Form 2055 Exterior Only/Freddie Mac Form 442) must be obtained to support the original appraised value. The Appraisal Update or New Appraisal must be dated within 60 days of the date that CMS' investor purchases the loan.</td>
</tr>
</tbody>
</table>

#### Jumbo Loans

For existing and new construction properties, the appraisal report must be dated within 120 days of the date of the Note. 

If the date of the appraisal report is more than 120 days but less than 180 days from the date of the Note, the original appraiser must conduct an exterior inspection of the subject property and provide an update to the appraisal using his or her and knowledge of current market conditions. The appraiser must acknowledge that the value of the subject property has not declined since the date of the original appraisal. The appraiser must complete this update on the Fannie Mae Form 1004D or Freddie Mac Form 442 and the form must be dated within 180 days of the date of the Note. 

A new appraisal is required in the following cases: 

- The appraisal date is more than 180 days from the date of the Note. 
- The appraiser indicates in an Appraisal Update that the property value has declined. 

| Appraisal Assignment | An appraisal assignment is the transfer of the appraisal from one lender to another lender. CMS does not allow transferred or ported appraisals. |
Appraisal Document Standards (continued)

**Electronically Transmitted Appraisal Reports**

Electronically transmitted appraisal reports are acceptable provided the appraisal report meets the following requirements:

- Adequately identifies the appraiser.
- Is created by the appraiser identified on the appraisal report.
- Includes a reproduced signature of the appraiser whose name appears on the report.
- Is the unaltered report submitted by the appraiser.
- Photographs of the subject property and comparable sales are clear.
- The appraiser electronically transmits the electronic appraisal or inspection report directly to CMS or any third party specifically authorized by CMS, as applicable.

Electronically transmitted appraisal reports must comply with Electronic Verification requirements and must be in a standard format as outlined in Required Appraisal Forms.

**Photographs**

The following are requirements for photographs:

- Photographs must be original photographs or electronic images and be illustrative of the property.
- Photographs must be clear, appropriately identified and must clearly show the improvements and conditions that have a material effect on the market value or marketability of the subject property.

**Appraisal Forms**

The appraisal form must be prepared and signed by an approved appraiser. The appraisal report must be on the current version of the appropriate appraisal form listed below. The following are two types of appraiser inspections of the subject property:

- Interior and exterior inspection: The appraiser is required to perform a complete visual inspection of the interior areas of the subject property and report the condition of the improvements in factual and specific terms.
- Exterior-only inspection: The appraiser is required to perform a visual inspection of the exterior areas of the subject property from at least the street and report the condition of the improvements in factual and specific terms. The appraiser is expected to identify and report any physical deficiencies that could affect the livability, soundness, or structural integrity of the property.

See the CMS Product Guidelines for Appraisal Form Requirements. Uniform Residential Appraisal Report (Fannie Mae Form 1004/Freddie Mac Form 70) (URAR).

This form is used for appraisals of one-unit properties and units in PUDs, including a one-unit property with an accessory apartment) based on interior and exterior property inspections. The URAR may also be used for units in a Detached Condominium project if the appraiser includes an adequate description of the project and information about the homeowners’ association fees and the quality of the project maintenance. An interior and exterior inspection of the subject property is required.

Desktop Underwriter and Loan Prospector Loans: The appraisal report must be UAD compliant.
### Appraisal Document Standards (continued)

<table>
<thead>
<tr>
<th>Appraisal Forms (continued)</th>
<th>Exterior-Only Inspection Residential Report (Fannie Mae and Freddie Mac Form 2055)</th>
</tr>
</thead>
<tbody>
<tr>
<td>This form is used for appraisals of one-unit properties and units in a PUD or a one-unit property with an accessory unit. It may also be used for a unit in a Detached Condominium project if the appraiser includes information about the project and its condition. An exterior-only inspection of the subject property is required. The appraisal report must be UAD compliant.</td>
<td></td>
</tr>
</tbody>
</table>

#### Desktop Underwriter Upgrade Requirements

- The appraiser cannot adequately view the property from the street.
- The property does not conform to the neighborhood.
- There are apparent adverse physical deficiencies or environmental conditions.
- Data sources do not provide sufficient information about the property to perform the appraisal.
- Purchase transactions when the transaction is the result of the sale of an REO property.
- The last transaction on the property being purchased was a foreclosure.
- The condition rating is C5 or C6 based on the UAD and the data sources used to develop the appraisal or the appraiser's observations during the exterior-only property inspection.
- The quality rating is Q6 based on the UAD and the data sources used to develop the appraisal or the appraiser's observations during the exterior-only inspection.

#### Loan Prospector Upgrade Requirements

- An exterior-only inspection does not provide sufficient information about the property to perform the inspection.
- The appraiser cannot obtain sufficient information about both the interior and exterior physical characteristics of the subject property from third-party data sources in order to develop an accurate and adequately supported appraisal.
- The appraiser cannot reconcile all significant discrepancies (e.g., size, condition, etc.) among available data sources.
- The appraiser's exterior-only inspection does not provide sufficient information to develop an accurate and adequately supported appraisal, including the inability to view the property from the street.
- Apparent adverse physical deficiencies or environmental conditions are observed.
- The borrower is affiliated or related to the seller of the subject property.
Appraisal Document Standards (continued)

Appraisal Forms (continued)

- The subject property is new construction and has not yet been occupied.
- The subject property is undergoing renovation or rehabilitation.
- The data sources used to develop the appraisal (e.g., the sales contract for purchase transactions) indicate the presence of physical deficiencies or an adverse condition, or the appraiser observes apparent physical deficiencies or adverse property conditions during the exterior property inspection.
- The subject property is not structurally sound or not habitable as of the date appraisal. If the photographs provided with the original appraisal report do not reflect the conditions and marketability of the subject property as of the Note date, updated photographs are required.
- The condition rating is C5 or C6 based on the UAD and the data sources used to develop the appraisal or the appraiser’s observations during the exterior-only property inspection.
- The qualify rating is Q6 based on the UAD and the data sources used to develop the appraisal or the appraiser's observations during the exterior-only inspection.

Individual Condominium Unit Appraisal Report (Fannie Mae Form 1073 and Freddie Mac Form 465)

This form is used for appraisals of one-unit properties in condominium projects. An interior and exterior property inspection is required.

Desktop Underwriter and Loan Prospector Loans: The appraisal report must be UAD compliant.

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

This form is used for appraisals of one-unit properties in condominium projects. An exterior-only property inspection is required.

The appraisal report must be UAD compliant.

Small Residential Income Property Appraisal Report (Fannie Mae Form 1025 and Freddie Mac Form 72)

This form is used for appraisals of two- to four-unit properties (including two- to four-unit properties in PUD or condominium projects. An interior and exterior property inspection is required.
Underwriting Guidelines (Conventional)
Mortgage Lending Division
Version 1.0 – 02/01/12

Appraisal Document Standards (continued)

<table>
<thead>
<tr>
<th>Appraisal Forms (continued)</th>
<th>Desktop Underwriter Property Inspection Report (Fannie Mae Form 2075)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The Desktop Underwriter Property Inspection Report is not an appraisal report. It is a Property Inspection Report that requires an exterior-only inspection of the subject property, completed by an appraiser.</td>
</tr>
<tr>
<td></td>
<td>• Upgrade Requirements</td>
</tr>
<tr>
<td></td>
<td>When Desktop Underwriter recommends a Property Inspection Waiver, an interior and exterior inspection is required when the following conditions apply:</td>
</tr>
<tr>
<td></td>
<td>o The appraiser cannot adequately view the property from the street.</td>
</tr>
<tr>
<td></td>
<td>o The property does not conform to the neighborhood.</td>
</tr>
<tr>
<td></td>
<td>o Apparent adverse physical deficiencies or environmental conditions are observed.</td>
</tr>
<tr>
<td></td>
<td>o The appraiser needs additional information about the physical conditions of the property.</td>
</tr>
<tr>
<td></td>
<td>o Purchase transactions when the transaction is the result of the sale of an REO property.</td>
</tr>
<tr>
<td></td>
<td>o The last transaction on the property being purchased was a foreclosure.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Loan Prospector Condition and Marketability Report (Form 2070)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Loan Prospector Condition and Marketability Report is not an appraisal report. It is a Property Inspection Report that requires an exterior-only inspection of the subject property, completed by an appraiser.</td>
</tr>
<tr>
<td></td>
<td>• Upgrade Requirements</td>
</tr>
<tr>
<td></td>
<td>When Loan Prospector recommends a Condition and Marketability Report, an interior and exterior inspection is required when the following conditions apply:</td>
</tr>
<tr>
<td></td>
<td>o The appraiser is unable to adequately view the subject property from the street.</td>
</tr>
<tr>
<td></td>
<td>o The appraiser observes any factor that may have an adverse effect on the marketability of the subject property.</td>
</tr>
<tr>
<td></td>
<td>o The quality or condition of the property appears unacceptable to the typical purchaser in the area in which the subject property is located.</td>
</tr>
<tr>
<td></td>
<td>o The Condition and Marketability Factors section indicates an upgrade is required.</td>
</tr>
</tbody>
</table>
Property Inspection Waiver (PIW)

A Property Inspection Waiver (PIW) is a Desktop Underwriter recommendation that provides a waiver of both the property inspection and appraisal report.

The determined value of the subject property is the stated value of the subject property provided at the time of application and submitted to Desktop Underwriter resulting in the PIW. The stated value must not arbitrarily be increased and submitted to Desktop Underwriter. If an appraisal or inspection has been performed, the Property Inspection Waiver must not be used.

- Upgrade Requirements
  - When Desktop Underwriter recommends a Property Inspection Waiver, an interior and exterior inspection is required when the following conditions apply:
    - The subject property does not conform to the neighborhood.
    - There are apparent adverse physical deficiencies or environmental conditions.
    - New or proposed construction. An escrow for postponed improvements is not permitted.
    - Home inspection report or other information in the file indicates the presence of adverse condition and/or marketability factors.
    - Purchase transactions when the transaction is the result of the sale of an REO property.
    - The last transaction on the property being purchased was a foreclosure.

Property Inspection Alternative (PIA)

A Property Inspection Alternative (PIA) is a Loan Prospector recommendation that results in the waiver of both the property inspection and appraisal report. CMS’ investors will not purchase a loan with a Property Inspection Alternative (PIA).
Appraisal Document Standards (continued)

### Appraisal Update

When performing an appraisal update, the appraiser is expected to complete the following tasks:

- Research, verify, and analyze current market data.
- Perform at least an exterior-only inspection of the subject property.

Appraisal updates may be completed by a substitute appraiser. The original appraisal must be reviewed by the substitute appraiser and he or she must express an opinion about whether the original appraiser's opinion of market value was reasonable on the date of the appraisal report. In addition, a note explaining why the original appraiser was not used must be added to the loan file.

The type of inspection required is dependent on the nature of the appraisal conditions or changes to the subject property.

- If the appraisal is completed "as is", an interior inspection is not required unless there are any known changes to the subject property that would have an adverse effect on condition or marketability.
- If the appraisal is subject to completion per plans and specifications, an interior and exterior inspection is required. Exterior and interior photographs are required.
- If the appraisal is subject to repairs that affect safety, soundness, or habitability, an interior and exterior inspection is required if repairs are required for the interior of the dwelling. Exterior and interior photographs are required. Otherwise, an exterior-only inspection with exterior photographs is required.

### Field Review Appraisal

The following forms are required when a Field Review appraisal is required by the Loan Program or at the discretion of the Valuation Department:

- **One-unit properties**
  - One-Unit Residential Appraisal Field Review Report (Fannie Mae Form 2000 or Freddie Mac Form 1032)
  - Original front and street photos of the subject property
  - Photos of the comparable sales must be used for all review of one-unit residential appraisal reports

- **Two- to four-unit properties**
  - Two- to Four-Unit Residential Appraisal Field Review Report (Fannie Mae Form 2000A or Freddie Mac Form 1072)
  - Original front and street photos of the subject property
  - Photos of the comparable sales must be used for all review of two- to four-unit residential appraisal report

An analysis comparing the original appraisal and the review appraisal must be performed. The original appraiser must address any significant differences or discrepancies.
The appraisal attachments must be prepared and signed (if applicable) by an approved appraiser. The appraisal attachments must be on the current version.

<table>
<thead>
<tr>
<th>Attachments</th>
<th>URAR Forms 1004/70</th>
<th>Exterior Only Form 2055</th>
<th>Property Inspection Report Forms 2075/2070</th>
<th>Condo Forms 1073/465</th>
<th>Exterior Only Condo Forms 1075/466</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original photograph or electronic image of the subject property—front scene</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Three original photographs or electronic images of the subject property—front, rear and street scene</td>
<td>X</td>
<td>n/a</td>
<td>n/a</td>
<td>X</td>
<td>n/a</td>
</tr>
<tr>
<td>Original photographs or electronic images, of the interior, including the kitchen, all bathrooms, main living area, examples of any physical deterioration, examples of recent property updates</td>
<td>X</td>
<td>n/a</td>
<td>n/a</td>
<td>X</td>
<td>n/a</td>
</tr>
<tr>
<td>Original photographs or electronic images, of any improvements made supporting an increase in value due to remodeling or renovation</td>
<td>X</td>
<td>n/a</td>
<td>n/a</td>
<td>X</td>
<td>n/a</td>
</tr>
<tr>
<td>Original photograph or electronic image of each sale comparable used on the Residential Appraisal Report—front scene with the subject matter filling the full frame</td>
<td>X</td>
<td>n/a</td>
<td>n/a</td>
<td>X</td>
<td>n/a</td>
</tr>
<tr>
<td>Interior Building Sketch</td>
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<td>n/a</td>
<td>n/a</td>
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<td>Location map showing the subject property</td>
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<td>n/a</td>
<td>X</td>
<td>n/a</td>
<td>n/a</td>
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<tr>
<td>Location map showing the subject property and the comparable sales</td>
<td>X</td>
<td>X</td>
<td>n/a</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Diagram of the floor plan detailing room layout</td>
<td>X</td>
<td>n/a</td>
<td>n/a</td>
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<td>n/a</td>
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<tr>
<td>Appraiser’s cover letter explaining unusual items not adequately addressed in the appraisal</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Market Conditions Addendum to the Appraisal Report (Fannie Mae Form 1004MC)</td>
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<td>n/a</td>
<td>n/a</td>
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<tr>
<td>Operating Income Statement (Fannie Mae Form 216/Freddie Mac Form 998, if applicable)</td>
<td>X</td>
<td>n/a</td>
<td>n/a</td>
<td>X</td>
<td>n/a</td>
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<tr>
<td>Single Family Comparable Rent Schedule for all single-family investment properties (Fannie Mae Form 1007/Freddie Mac Form 100), if applicable</td>
<td>X</td>
<td>X</td>
<td>n/a</td>
<td>X</td>
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<tr>
<td>Statement of Assumptions and Limiting Conditions and Appraiser’s Certification (Fannie Mae Form 1004B/Freddie Mac Form 439)</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
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Appraisal Document Standards (continued)

<table>
<thead>
<tr>
<th>JUMBO</th>
<th>1-to 4-Unit Condominiums and PUDs</th>
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<tr>
<td>Attachments</td>
<td></td>
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<tr>
<td>Three original photographs or electronic images of the subject property—front, rear and street scene</td>
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<tr>
<td>Original photographs or electronic images of any improvements made supporting an increase in value due to remodeling or renovation</td>
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<tr>
<td>Original photograph or electronic image of each sale comparable used on the Residential Appraisal Report—front scene</td>
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<td>Location map showing the subject property and the comparable sales</td>
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<td>X</td>
</tr>
</tbody>
</table>

Appraisal Evaluation

**Purpose**

The purpose of property underwriting is to determine whether a loan is secured by property that provides sufficient value to recover the investment if the loan goes into default. An accurate assessment of the current fair market value and condition of the property is required to establish the adequacy of the collateral for an investment quality loan requires. Any factors likely to affect the property’s future value must be addressed by the appraiser and a visual picture of the neighborhood, site, and improvements must be provided. The comments section of the report must be used to achieve this goal and any additional documentation must be attached, if necessary.

**Appraisal Evaluation Requirements**

Each appraisal must be reviewed in detail to evaluate the following:

- Adequate support for the value of the property.
- Present and future marketability of the property.
- Completeness and correctness of the appraisal forms and exhibits.
- Applicability and timeliness of data used to determine marketability.
- Consistency, logic and accuracy of the appraisal.
- Originating lender ordered the appraisal.
Unacceptable Appraisal Practices

The following are examples of unacceptable appraisal practices:

- Development of a valuation conclusion based either partially or completely on the race, color or national origin of either the prospective owners or occupants of the subject property or of the present owners or occupants of the properties in the vicinity of the subject property.

- Development and/or reporting an opinion of market value that is not supportable by market data or is misleading.

- Development of a valuation conclusion based on factors that local, state, or federal law designate as discriminatory, and thus, prohibited.

- Misrepresentation of the physical characteristics of this subject property, improvements, or comparable sales.

- Failure to comment on negative factors with respect to the subject neighborhood, subject property, or proximity of the subject property to adverse influences.

- Failure to adequately analyze and report any current contract of sale, option, offering, or listing of the subject property and the prior sales of the subject property and the comparable sales.

- Selection and use of inappropriate comparable sales.

- Failure to use comparable sales that are located in similar locations and physically similar to the subject property.

- Creation of comparable sales in the valuation process when the appraiser has not personally inspected the exterior of the comparable property.

- Use of comparable sales in the valuation process where the appraiser has not personally inspected the exterior of the comparable property.

- Use of adjustments to the comparable sales not reflective of the market’s reaction to the differences between the subject property and the comparable sales.

- Not supporting adjustments in the sales comparison approach.

- Failure to make adjustments when they are clearly indicated.

- Use of data, particularly comparable sales data, provided by parties who have a financial interest in the sale or financing of the subject property without the appraiser’s verification of the information from a disinterested source.

- Development on an appraisal or reporting an appraisal in a manner or direction that favors the cause of either the client or any related party, the amount of the opinion of value, the attainment of a specific result, or the occurrence of a subsequent event in order to receive compensation and/or employment for performing the appraisal and/or in anticipation of receiving future assignments.

- Development of and/or reporting an appraisal in a manner that is inconsistent with the requirements of the Uniform Standards of Professional Appraisal Practice in place as the effective date of the appraisal.

- Failure to address and note adverse factors or conditions that affect value or marketability with respect to the neighborhood, site, or improvements.
Appraisal Evaluation (continued)

Unacceptable Appraisal Practices (continued)

- Use of unsupported descriptive comments or drawing unsupported conclusions from subjective observations. These actions may have a discriminatory effect.
- Use of unsupported assumptions, interjections of personal opinion, or perceptions about factors in the valuation process. These actions may have a discriminatory effect, and may or may not affect the use and value of a property.
- Use of unacceptable terminology including but not limited to:
  - "Pride of ownership," “no pride of ownership,” and -lack of pride of ownership”
  - “Poor neighborhood”
  - “Good neighborhood”
  - “Grime-ridden area”
  - “Desirable neighborhood or location”
  - “Undesirable neighborhood or location”

Other subjective terminology that can result in erroneous conclusions is equally unacceptable.

CMS will reject any loan supported by an appraisal report that refers to race or the racial composition of the neighborhood.

Appraisal Review

Analysis

The appraisal information must provide a logical basis for evaluation. A concise picture of the neighborhood, site, and improvements must be presented by the appraiser to support an indicated value. Three comparables of a similar nature must be provided to support the subject property’s value. The Sales Comparison Approach must adequately support the estimate of market value. It must be determined that the appraiser has adequately supported his or her opinion of the subject property’s value.

When a new appraisal is required, an underwriting analysis of the following items must be performed:

- The appraisal report to ensure that the report is of professional quality and is prepared in a way that is consistent with CMS’s appraisal standards.
- The property based on the appraisal.
- The property's acceptability as security for the mortgage requested in view of its value and marketability.
- The current contract for sale for the subject property, if applicable.
- The current offering or listing for sale, if applicable.
- The current ownership for the subject property.
- The sale or transfer history of the subject property, and comparable sales.
- The sales of the subject property and the sales price trend in relation to the appraiser's opinion of value to confirm that they are reasonable and representative of the market.
Appraisal Review (continued)

Subject Property

The first part of the appraisal report is used as follows:

- Identifies and describes the location of the subject property.
- Provides information about property taxes and special assessments.
- Indicates the current occupancy status of the subject property (owner, tenant or vacant).
- Describes the subject property rights to be appraised (fee simple or leasehold).
- Summarizes financing data and sales concessions.
- Identifies the borrower, current owner of public record, client, and appraiser.
- Provides information pertinent to the subject purchase transaction, if applicable.
- Identifies any subject property offerings for sale in the past 12 months, including whether the property is currently for sale.
- States the data source(s), offering price(s), and the days on the market for the subject property.

The appraiser must complete the following:

- Identify the subject property by its complete property address and complete and correct legal description; a post office box number is not acceptable. The appraiser should indicate the nearest intersection if a house number is not available. When the legal description is lengthy, the appraiser may attach the complete and correct (full) description as an addendum to the appraisal report, or may refer simply to its location in the public records.
- Confirm and document that the property seller in a purchase transaction or the borrower in a refinance transaction is the owner of the subject property.
- Identify the subject property rights to be appraised as Fee Simple or Leasehold. In addition, the appraiser must indicate whether the subject property is located in a PUD or condominium.
- Identify the type of transaction, state the total dollar amount of the loan charges and/or concessions that will be paid by the seller (or any other party who has a financial interest in the sale or financing of the subject property), and provide a brief description of the items on the appraisal report.

Sale and Listing History

The appraiser must research, verify, analyze, and report the following:

- Any current agreement of sale for the subject property.
- Any offering for sale of the subject property in the twelve months prior to the effective date of the appraisal.
- Any prior sales or transfers of the subject property for the three years prior to the effective date of the appraisal.
- Any prior sales or transfers of each comparable sale for the year prior to the date of sale of each comparable sale.
Contract Section

The Contract section of the appraisal report must include the following:

- Results of the appraiser's analysis of the contract for sale.
- The contract price,
- The date of the contract and to acknowledge if the property seller is the owner of record, and the data source(s) used.
- The total dollar amount and description of any financial assistance (loan charges, sales concessions, gift or down payment assistance, etc.) to be paid by any party on behalf of the borrower.

For UAD compliant appraisals, the Contract section of the appraisal must indicate the type of sale for the transaction. Valid UAD sale types include REO sale, short sale, court-ordered sale, estate sale, relocation sale, non-arm's length sale and arm's length sale.

Special Assessment Districts and Community Facilities Districts

Property values and the marketability of the subject property may be affected by assessments levied by Special Assessment or Community Facilities Districts. Therefore, special consideration to the valuation of properties located in the following districts must be given by the appraiser:

**Special Assessment Districts**

Special Assessment Districts (also known as special tax districts or municipal utility districts) provide water or other utilities in areas that are not served by existing city or municipal utility services. These districts are allowed to assess owners within its boundaries for funds that are used to cover operating costs and debt service.

If the subject property is located in a special assessment district, the appraiser must report on any special assessments affecting the subject property. If the special assessment district is experiencing financial difficulty and that difficulty has an effect on the value or marketability of the subject property, the appraiser must complete the following:

- Reflect the difficulty in the analysis and note the difficulty and impact in the appraisal report.
- Reflect market reaction to the potential liabilities that may arise within a financially troubled special assessment district.
- Consider the following within the district:
  - Current and expired listings of properties for sale
  - Pending contract sales
  - Recent closed sales

If financial difficulty of a special assessment district is so severe that its actual effect on the value and marketability of a property is not measurable because there are no comparable market data available to enable the appraiser to arrive at a reliable opinion of market value, the loan is not eligible for delivery to CMS until an active market develops allowing the appraiser to demonstrate the value and marketability of the subject property.
Appraisal Review (continued)

Special Assessment Districts and Community Facilities Districts (continued)

Community Facilities Districts (Mello-Roos)

Some states have passed legislation that create Community Facilities Districts and permits them to levy a special tax to fund the capital costs of a wide variety of public improvements, as well as the on-going operation and maintenance costs of a limited number of public services. The assessment becomes an on-going responsibility of the property owner and the assessment lien passes with title when ownership of the property is transferred.

This type of legislation generally requires full disclosure of the special assessment to any purchaser of a property located in a community facilities district. The appraiser must:

- Consider the reaction of the market, if any, to the assessment for the applicable community facilities district by analyzing similarly affected comparable sales
- Note the effect of the assessment in the appraisal report

Mello-Roos may be imposed on communities requiring new schools and infrastructures such as public parks and roads. While property tax is assessed as a percentage of the value of the home, Mello-Roos is independent and could rise or lower and is not subject to Proposition.
Neighborhood Analysis

The neighborhood in which a property is located is a critical determinant of its marketability and value. Analyze all factors presented in the appraisal’s Neighborhood section. Favorable or unfavorable factors and any changes that have occurred in the prior year that affect marketability of the properties within the neighborhood must be addressed by both the appraiser and underwriter.

The appraiser must:

- Identify neighborhood characteristics as either Urban, Suburban, or Rural
- Describe the percent built-up
- Describe growth rate
- Report on market conditions, housing trends, price and age ranges and present land uses for properties in the neighborhood

A neighborhood analysis should consider the influence of social, economic, government, and environmental forces on property values in the subject neighborhood. However, neither the racial composition nor the age of a neighborhood is an appraisal factor.

Areas are not designated as acceptable or unacceptable, in other words, “redlining”. Redlining can occur when perceived property risks are based on improper location factors such as the arbitrary granting of unfavorable loan terms based on a geographic area, or when the perceptions of risk are derived from factors that do not predict risk. Race, for example, is a factor that is not predictive of risk. Racial redlining is illegal under federal law. Other factors that serve as a proxy for race are equally impermissible. If any provision is interpreted to redline, it has been misunderstood.

Appraisal report forms require the appraiser to address several important factors that are used to analyze the neighborhood’s impact on the property’s marketability. Some of the key factors are addressed in the following sections.

- Neighborhood Characteristics
- Neighborhood Property Values
- Demand/Supply
- Marketing Time
- Price/Age Range and Predominant Value
- Present Land Use of the Neighborhood
- Neighborhood Boundaries and Description
Neighborhood Analysis (continued)

Neighborhood Characteristics

Mortgages that are secured by residential properties in urban, suburban, or rural areas are acceptable. Properties must be residential in nature, based on the characteristics of the subject property, zoning, and the present land use.

- Urban Properties
  
  Block-by-block underwriting is acceptable in neighborhoods in which rehabilitation has started in the block in which the subject property is located or in facing blocks visible to the subject property, but has not yet spread to the rest of the neighborhood. This provides for more weight being placed on the positive influences of a neighborhood in an urban area that is being rehabilitated. The appraiser must:
  
  - Demonstrate that local market conditions make block-by-block analysis appropriate
  - Analyze and use comparable sales of not only less similar property from the subject neighborhood but also from competing neighborhoods if there is a lack of comparable sales in the neighborhood, either because of the level of rehabilitation or the relatively low number of sales transactions

- Suburban Properties
  
  Since suburban areas are usually well developed and comparable sales typically are available in the subject neighborhood, the appraiser would most likely use comparable properties in the immediate vicinity of the subject property. However, if the subject property is located in an area where there is a shortage of recent comparable sales, the appraiser must adequately document his or her analysis in the appraisal report and explain why such comparable sales were used.

- Rural Properties
  
  Rural properties are generally more difficult to assess. Marketing times may be affected by its remote location. Therefore, the proximity of comparable sales is critical in determining a Rural Property’s marketability.

  Special consideration must be given to properties with outbuildings.
  
  - Minimal Outbuildings: Small barn or stable, that are of relatively insignificant value in relation to the total appraised value of the subject property, are acceptable if they are typical of other residential properties in the subject area.
  
  - Atypical Minimal Outbuildings: Small barn or stable not representing typical residential improvements for the location and property type are acceptable as long as the appraiser attributes no value to them.
  
  - Significant Outbuildings: A property that has significant outbuildings, such as a large barn, large storage area, stable, or silo, might indicate that the property is agricultural in nature. It must be determined if the improvements are residential or agricultural in nature, regardless of whether the appraiser assigns any value to the outbuildings.

See the Proximity of Comparables to the Subject section in the Sales Comparison Approach section of the document for more information.
### Trend of Neighborhood Property Values, Demand/Supply and Marketing Time

#### Indicators of Market Conditions
The appraiser must report the primary indicators of market conditions in the subject neighborhood by noting:

<table>
<thead>
<tr>
<th>Trend of Property Value</th>
<th>Supply of Properties in Subject Neighborhood</th>
<th>Marketing Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>increasing</td>
<td>shortage</td>
<td>under three months</td>
</tr>
<tr>
<td>stable</td>
<td>in-balance</td>
<td>three to six months</td>
</tr>
<tr>
<td>declining</td>
<td>over-supply</td>
<td>over six months</td>
</tr>
</tbody>
</table>

#### Neighborhood Property Values
Ideally, property values should be stable or increasing; however, there may be many areas experiencing a decline in property values. Declining values are a concern due to the potential for equity erosion.

The appraiser's role is to substantiate the stability of the market and to provide an estimated value of the subject property. In doing this, the appraiser is required to indicate on the appraisal report if property values in that market are "increasing," "stable," or "declining."

Comparable sales used to establish value that are older than six months may be an indication that the subject property is located in a market experiencing declining values. If any comparables are over six months old, the appraiser must comment on the reason for using aged comparable sales. See the Sales Comparison Approach section.

#### Market Indicator Portal
Jumbo loan primary residence transactions require submission to the CMS. If the property is located in a "C" or "D" market, the appraiser should use comparable sales that have been settled or closed within the last 12 months. The appraiser must comment on the reasons for using comparable sales that are more than six months old. If the appraiser does not have comparables that are within the last six months, the appraiser must provide two recent listings in addition to properly adjusted comparables that are older than six months.

If the appraiser states the subject property is in a declining market, yet the Market Portal Indicator indicates the subject property is in an "A" market, downgrade to a "B" market reducing the LTV/CLTV by 5 percent. However, the loan is eligible for a 5 percent market upgrade if all criteria are met. See the CMS Product Guidelines for details.

Jumbo loan second home transactions do not require submission to the Market Portal Indicator and are not eligible for a market upgrade.

#### Demand/Supply
An over-supply of housing is not desirable since it indicates that the properties are selling slowly with a lot of competition. The appraiser must comment on the reason for the over-supply and its effect on the value of the subject property.
Trend of Neighborhood Property Values, Demand/Supply and Marketing Time (continued)

Marketing Time

Marketing time is the average time that it takes for a reasonably priced property to sell in the subject neighborhood.

Marketing time of properties in the subject neighborhood should be less than six months to assure no loss of equity.

When marketing time for a particular area is greater than six months, the appraiser must comment on the reason for the extended marketing period and its effect on the subject property value.

Price/Age Range and Predominant Value

The appraiser must indicate the price range and predominant value, as well as the age range and predominant age, of properties in the subject neighborhood. These must reflect the high and low prevailing ranges for residential properties comparable to the property being appraised.

A comparison of the predominant value for the neighborhood must favorably reflect the value of the subject property. If the subject property sets the top value for the neighborhood, it may be an indication the subject property represents an over-improvement. Future purchasers may be less willing to pay for property features not common to the area and its appeal may be limited at its current value. Maximum financing may not be appropriate.

A property at the low end of the market’s value may also be cause for concern. Careful evaluation is required to determine whether the property in its current form is likely to continue to be its highest and best use.

Present Land Use of the Neighborhood

Typically, dwellings best maintain value when situated in neighborhoods consisting of similar dwellings. However, the existence of different land uses and property types within a neighborhood does not mean a property is unacceptable. When different land uses and property types are present in a neighborhood, it should be considered a neighborhood characteristic. The appraiser needs to take into consideration neighborhood characteristics when performing the neighborhood analysis and defining the neighborhood boundaries.

In addition, if there is a significant amount of vacant or undeveloped land in the neighborhood, the appraiser should include comments to ensure that he or she adequately describes the neighborhood.

The appraiser must comment whether the present land use in the neighborhood is likely to change or whether it is in the process of changing. If the subject property is in an area undergoing transition, the appraiser must describe the changes and comment about the impact on marketability and value of the subject property.

A change in the neighborhood’s land use is of concern when the change negatively affects the property’s future value.

Neighborhood Boundaries and Description

The appraiser must summarize and rate the various aspects of a neighborhood such as general appearance and market appeal by comparing the characteristics of the subject neighborhood to those of competing neighborhoods and comment on any impact to marketability and value of the subject property.

When performing the neighborhood analysis and defining the neighborhood boundaries, the appraiser must factor in the general occupancy of the homes in the neighborhood (owner occupancy or tenant occupied).
Site Analysis

A property site should be of a size, shape, and topography generally acceptable in its market area. It must have utilities, street improvements and other amenities normally expected in the area. The subject property amenities, easement, and encroachments must be reflected in the appraisal analysis and evaluation since they can either detract from or enhance the marketability of a site. If there is market resistance to a property because its site is not compatible with the neighborhood or with the requirements of the competitive market, maximum financing may not be appropriate.

**Multiple Parcels as Mortgage Security**

The subject property may consist of more than one adjoining parcel subject to the following requirements:
- Each parcel must be conveyed in its entirety
- Parcels must be adjoined to the other
- Each parcel must be zoned as residential
- Only one parcel may have a dwelling unit (limited nonresidential improvements such as a garage are acceptable)
- The mortgage must be a valid first lien on each parcel
- Two separate deeds are not permitted

**Properties with Acreage**

The appraiser must appraise the actual size of the site and not a hypothetical portion of the site (e.g., appraiser only 5 acres of an un-subdivided 40-acre parcel). The appraised value must reflect the entire parcel/site and the comparable sales must be of similar size to establish marketability.

The determination of value for acreage and the acceptable acreage limitations vary by Loan Program. See the CMS Product Guidelines for restrictions.

**Site/Land Values**

The appraiser must address site values and land-to-value ratios. The subject property land-to-value ratio must be typical and consistent with other residential properties in the area.

**Zoning**

The appraiser must report the specific zoning classification and its permitted use for the subject property. The appraiser must also include a statement indicating whether the improvements represent a legal use; a legal non-conforming (Grandfathered Use); illegal use under the zoning regulations; or whether there is no local zoning.

The use of the subject property should conform to the applicable zoning and use restrictions, however a property that does not conform to applicable zoning and use restrictions, if the property is a legal use or legal non-conforming use.

**Legal Non-Conforming One- to Four- Unit Properties**

If an appraisal indicates a property is of a legal non-conforming use, the appraiser’s analysis must reflect any adverse effect the non-conforming use has on the value and marketability of the property.

- Desktop Underwriter, Loan Prospector and Manually Underwritten Loans

  The legal non-conforming use is acceptable if the subject property is a one- to four-unit property or in a PUD project. The appraiser must comment on any adverse effect of any non-conforming use when estimating the market value and marketability of the property.
Site Analysis (continued)

Zoning (continued)

- Jumbo Loans: Must meet the requirements for Desktop Underwriter, Loan Prospector and Manually Underwritten Loans in to obtaining one of the following:
  - The appraisal or letter of addendum, must specifically state the property may be rebuilt “as is” in the event of a loss. The appraiser must also indicate the source of information used to make this determination.
  - Letter from the county stating the property may be rebuilt “as is” in the event of a loss

- Legal Non-Conforming Projects
  A condominium unit in a project with legal nonconforming use is acceptable only if the improvements can be rebuilt to current density in the event of its partial or full destruction. In such cases, one of the following must be obtained:
  - Copy of the applicable zoning regulations
  - A letter from the local zoning authority authorizing reconstruction to current density

- Illegal Zoning
  Illegal zoning is not permitted except in the case of a one- or two-unit property that includes an illegal additional unit or accessory apartment (usually referred to as a mother-in-law, mother-daughter, or granny unit). A mortgage secured by a three- or four-unit property with an illegal accessory apartment is unacceptable.

- Accessory Apartment or In-law Suites
  A one- or two-unit property that includes an accessory apartment (also referred to as a mother-in-law, mother-daughter, or granny unit) may be acceptable. The appraiser must be advised of any information regarding the suite, including its legality when ordering the report.
  If the accessory apartment represents a legal use of the property under local zoning laws, the following criteria applies:
  - The zoning or legal status must be a residential single family or two-family property. If the zoning is “two-unit” or “two-family”, the property should be approached under two- to four-family guidelines
  - The property must conform to the subject neighborhood and the market
  - The property must be appraised as a single family or two-family property
  - Comparable sales must include at least one property that has use of an accessory unit (may be legal or illegal)
  - The value assigned by the appraiser must be based on contributory value of the accessory unit, considering the quality of above grade finish work. In some cases, no value may be assigned
  - No rental income will be counted from the accessory unit
Site Analysis (continued)

Zoning (continued) If the accessory apartment represents an illegal use of the property under local zoning law, the following criteria applies:

- The illegal use conforms to the subject neighborhood and to the market
- The property must be appraised based upon its current use
- The appraisal must report that the subject property/accessory apartment represents an illegal use
- The appraisal report must demonstrate that the subject property/accessory apartment are typical for the market by providing at least three comparable sales that have the same illegal use.
- Verification that the existence of the illegal accessory unit will not jeopardize future hazard insurance claims is required
- No rental income will be counted from the accessory unit

- Agriculturally Zoned Property

Agriculturally zoned properties are eligible when all of the following exist:

- Highest and best use of the subject property is residential
- Subject property is used as a residence and is typical for the neighborhood or market area
- The appraiser adequately demonstrates that the subject neighborhood is residential in nature
- Residential use is permissible under the zoning and land use regulations
- Property adheres to the maximum acreage standards. See the CMS Product Guidelines.

The appraiser must provide detail of any outbuildings on the property:

- Size of the outbuildings
- Are the outbuildings being used for a special purpose
- Do the comparable sales have similar outbuildings
- Is the property residential in nature

Value given to any auxiliary buildings must be supported by market sales of properties with similar amenities.

- Commercially Zoned Property

Commercially zoned properties are eligible when all of the following exist:

- Subject property is be used as a residence and is typical for the neighborhood or market area
- The appraiser adequately demonstrates that the subject neighborhood is residential in nature
- Residential use is permissible under the zoning and land use regulations
- Fits the legal non-conforming property guidelines

- Land-Use Regulations

Properties subject to certain land-use regulations, such as coastal tideland or wetland laws, that create setback lines or other provisions preventing the reconstruction or maintenance of the property improvements if damaged or destroyed are unacceptable.
**Underwriting Guidelines (Conventional)**

**Mortgage Lending Division**  
**Version 1.0 – 02/01/12**

### Site Analysis (continued)

<table>
<thead>
<tr>
<th><strong>Highest and Best Use</strong></th>
<th>Properties must represent the highest and best use for the site. If current improvements do not represent the highest and best use of the property, the property is unacceptable.</th>
</tr>
</thead>
</table>
| **Utilities**            | Utilities must meet community standards, be adequate, be in service, is common to the area, and be accepted by area residents. All utilities must be turned on and in good working order.  
If public sewer and/or water are not supplied and regulated by the local government, community or private well and septic facilities must be available and used by the subject property. The owners of the subject property must have the right to access those facilities, which must be viable on an ongoing basis.  
Generally, private well or septic facilities must be located on the subject site. However, if the owners have the right to access off-site private facilities and there is an adequate, legally binding agreement for its access and maintenance, then off-site facilities are acceptable.  
The appraisal must address the effect of any market resistance due to environmental hazards may have on the marketability and value of the subject property or any other conditions that affect well, septic, or public water facilities. See the [Environmental Hazards](#) section for more information. |
| **Flood Zones**          | A property located in a Special Flood Hazard Area (SFHA) that is ineligible under the National Flood Insurance Program is unacceptable.  
The appraiser must indicate on the appraisal report whether or not the property is located in a Special Flood Hazard Area as identified by the Federal Emergency Management Agency (FEMA). The appraiser must also indicate the specific FEMA flood zone, map number, and map date. |
| **Lava Zones**           | CMS accepts properties located in lava zones if they are insurable. Properties located in Lava Zones 1 & 2 are generally not insurable with standard Hazard Insurance and therefore, would not be eligible. |
| **Off-Site Improvements**| The property should front a publicly dedicated and maintained street, which meets community standards and is accepted in the market area.  
If the property fronts a street that is not typical of those found in the community, the appraiser must address the effect of that location on the marketability and the value of the subject property. The presence of sidewalks, curbs, and gutters, street lights, and alleys depends on local custom - if they are typical in the community, they should be present on the subject site.  
If the property is on a community-owned or privately-owned and maintained street, an adequate, legally enforceable agreement or covenant for maintenance of the street is required. The agreement or covenant should include the following provisions and be recorded in the land records of the appropriate jurisdiction:  
- Responsibility for payment of repairs, including each party's representative share  
- Default remedies in the event a party to the agreement or covenant fails to comply with his or her obligations  
- The effective term of the agreement or covenant, which in most cases should be perpetual and binding on any future owners |
### Site Analysis (continued)

#### Off-Site Improvements (continued)

If the property is located within a state that has statutory provisions that define the responsibilities of property owners for the maintenance and repair of a private street, no separate agreement or covenant is required.

If a legally enforceable, recorded use and maintenance agreement is not in place, the following information will be acceptable:

- Statement from the borrower acknowledging the existence of the private road and his or her responsibility to maintain and repair the road when necessary
- Affirmative statement from the appraiser confirming the private road is common in the area and is supported by comparable properties exhibiting the same characteristics. Additionally, the appraiser must state the existence of the private road is not a detriment to marketability, accessibility, or the value of the property
- Comparable properties must be subject to the same access conditions
- Appraiser must comment on the condition of the road and indicate that the road is in good condition
- Municipality or the appraiser must confirm that the private road does not detrimentally affect the availability of public services for the property, particularly fire protection and police protection
- Legal ingress and egress must be available to the property, and no exceptions may be noted on the title report for these characteristics

#### Environmental Hazards

Any known or suspected environmental hazards on or near the subject property, e.g., landfills, toxic waste dumps, or junk yards, must be disclosed. The appraiser must note any hazardous conditions observed during the inspection of the subject property or information that he or she became aware of through the normal research involved in performing an appraisal.

If an environmental hazard is located on or near the subject property, the appraiser must comment on any influence that the hazard has on the property’s value and marketability and make appropriate adjustment in the overall analysis of the property’s value.

If any environmental hazard is suspected, CMS may require an environmental study of the subject property prior to considering any loan for purchase. In this case, a nationally recognized and reputable environmental engineering firm must be hired to perform the written report. The report must include an analysis and detailed list of cleanup costs, if any.

CMS will not approve a loan for purchase without acceptable evidence confirming any known or suspected environmental hazards will not have an adverse effect upon the marketability, livability, or appraised value of the subject property. This confirmation must be evidenced by either acceptable or documented clean-up efforts or by verification of comparable market data confirming no buyer resistance to the hazard.
Property Condition and Quality of Construction

**UAD Rating**
The appraisal report must contain an accurate description of the improvements and any factors that may affect the market value or marketability of the subject property. For appraisal reports that are required to be completed using the UAD, the appraiser must incorporate the UAD quality rating (Q1, Q2, Q3, Q4, Q5, or Q6) that best describes the overall quality of the subject property and each comparable property. Additionally, the appraiser must incorporate the UAD condition rating (C1, C2, C3, C4, C5 or C6) that best describes the overall condition of the property.

**Condition**
The appraiser must consider and describe the overall condition of the property improvements. The appraiser should be specific about needed repairs, additional features, modernization, etc., and should provide a supporting addenda, if necessary.

For UAD compliant appraisals, the property must receive a condition rating. The condition rating must reflect a holistic view of the condition of the property improvements. If a property has deficiencies or defects that are severe enough to affect the safety, soundness or structural integrity of the improvements, then the property's condition must be rated C6. The appraisal report must contain additional commentary, descriptions, and explanations as required, to understand the property condition.

Properties with a condition rating of C1, C2, C3, or C4 are acceptable in "as is" condition. Properties with a condition rating of C5 or C6 in "as is" condition or "subject to repairs" are not acceptable.

It is acceptable for an appraisal to be completed subject to repairs or alterations required for the subject property to be rated C4 (or better). If the appraisal is completed subject to repairs or alterations, the UAD condition rating must reflect the overall condition of the subject property as if the repairs or alterations have been completed (C4 or better).

Properties with a C5 or C6 condition at time of inspection should be appraised subject to all repairs and alterations necessary to bring the property into C4 (or better) condition. The condition rating on the appraisal report must show C4 (or better) as if the repairs or alterations have been completed.

A Fannie Mae Form 1004D/Freddie Mac Form 442 Appraisal Update must be completed prior to closing or loan purchase.
### Property Condition and Quality of Construction (continued)

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
</tr>
</thead>
</table>
| C1     | The improvements have been very recently constructed and have not previously been occupied. The entire structure and all components are new and the dwelling has no physical depreciation.  
Note: Newly constructed improvements that feature recycled materials and/or components can be considered new dwelling provided that the dwelling is placed on a 100% new foundation and the recycled materials and the recycled components have been rehabilitated/re-manufactured into like-new condition. Recently constructed improvements that have not been previously occupied are not considered "new" if they have any significant physical depreciation (newly constructed dwellings that have been vacant for an extended period of time without adequate maintenance or upkeep) |
| C2     | The improvements feature no deferred maintenance, little or no physical depreciation, and require no repairs. Virtually all building components are new or have been recently repaired, refinished, or rehabilitated. All outdated components and finishes have been updated and/or replaced with components that meet current standards. Dwellings in this category either are almost new or have been recently completely renovated and are similar in condition to new construction. |
| C3     | The improvements are well-maintained and feature limited physical depreciation due to normal wear and tear. Some components, but not every major building component, may be updated or recently rehabilitated. The structure has been well-maintained. |
| C4     | The improvements feature some minor deferred maintenance and physical deterioration due to normal wear and tear. The dwelling has been adequately maintained and requires only minimal repairs to building components/mechanical systems and cosmetic repairs. All major building components have been adequately maintained and are functionally adequate. |
| C5     | The improvements feature obvious deferred maintenance and are in need of some significant repairs. Some building components need repairs, rehabilitation, or updating. The functional utility and overall livability is somewhat diminished due to condition, but the dwelling remains usable and functional as a residence. |
| C6     | The improvements have substantial damage or deferred maintenance with deficiencies or defects that are severe enough to affect the safety, soundness, or structural integrity of the improvements. The improvements are in need of substantial repairs and rehabilitation, including many or most major components. |
### Property Condition and Quality of Construction (continued)

<table>
<thead>
<tr>
<th>Not Updated, Updated, and Remodeled</th>
<th>Level of Updating</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Not Updated</strong></td>
<td></td>
<td>Little or no updating or modernization. This description includes, but is not limited to, new homes. Residential property of fifteen years of age or less often reflect an original condition with no updating, if no major components have been replaced or updated. Those over fifteen years of age are also considered not updated if the appliances, fixtures, and finished are predominantly dated. An area that is Not Updated may still be well-maintained and fully functional, and this rating does not necessarily imply deferred maintenance or physical/functional deterioration.</td>
</tr>
<tr>
<td><strong>Updated</strong></td>
<td></td>
<td>An area of the home has been modified to meet current market expectations. These modifications are limited in terms of both scope and cost. An updated area of the home should have an improved look and feel, or functional utility. Changes that constitute updates include refurbishment and/or replacing components to meet existing market expectations. Updates do not included significant alterations to the existing structure.</td>
</tr>
<tr>
<td><strong>Remodeled</strong></td>
<td></td>
<td>Significant finish and/or structural changes have been made that increase utility and appeal through complete replacement and/or expansion. A remodeled area reflects fundamental changes that include multiple alterations. These alterations may include some or all of the following: replacement of a major component (cabinet(s), bathtub, or bathroom tile), relocation of plumbing/gas fixtures/appliances, significant structural alterations (relocating walls, and/or the addition of square footage). This would include a complete gutting and rebuild.</td>
</tr>
</tbody>
</table>

### Quality

CMS does not provide minimum specifications for materials and construction. The appraiser must consider and describe the overall quality of the property improvements.

For UAD compliant appraisals, the selected quality rating must reflect a holistic view of the quality of construction. A quality rating of Q6 is not acceptable. The issues that caused the Q6 rating must be cured prior to closing. Items that may be required to be cured include:

- Modifying the property to make it habitable for year-round occupancy
- Upgrading electrical, plumbing, and other mechanical systems to community standards
- Correcting substandard or nonconforming additions to the original structure
- Curing any other quality related items needed to make the subject property acceptable to typical buyers in the market area

### Desktop Underwriter, Loan Prospector Loans

CMS will close or purchase conforming loans with an appraisal report with a Q1, Q2, Q3, Q4, or Q5 quality rating in either “as is” condition or “subject to repairs.”
### Property Condition and Quality of Construction (continued)

<table>
<thead>
<tr>
<th>Quality (continued)</th>
<th>Jumbo Programs</th>
</tr>
</thead>
<tbody>
<tr>
<td>CMS will close or purchase loans with loan amounts greater than $1,000,000 with an appraisal report with a Q1, Q2, Q3, or Q4 quality rating in either &quot;as is&quot; condition or &quot;subject to repairs&quot;.</td>
<td></td>
</tr>
<tr>
<td>It is acceptable for an appraisal to be completed subject to repairs or alterations required for the subject property to be rated Q4 (or better). If the appraisal is completed subject to repairs or alterations, then the UAD condition rating must reflect the overall quality of the property improvements as if the repairs or alterations have been completed (Q4 or better).</td>
<td></td>
</tr>
<tr>
<td>Properties with a Q5 or Q6 quality rating should be appraised subject to all repairs and alterations necessary to bring the property to a Q4 quality rating. The quality rating on the appraisal report must show Q4 (or better) based on the quality of the property improvements as if the repairs and alterations are complete.</td>
<td></td>
</tr>
<tr>
<td>CMS will not close or purchase any appraisal with a Q5 or Q6 quality rating, either in &quot;as is&quot; condition or &quot;subject to repairs&quot;.</td>
<td></td>
</tr>
<tr>
<td>A Fannie Mae Form 1004D/Freddie Mac Form 442 Appraisal Update must be completed prior to closing or loan purchase for any appraisal report &quot;subject to repairs&quot; prior to closing or purchase.</td>
<td></td>
</tr>
<tr>
<td>Rating</td>
<td>Description</td>
</tr>
<tr>
<td>--------</td>
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</tr>
<tr>
<td>Q1</td>
<td>Dwellings with this quality rating are usually unique structures that are individually designed by an architect for a specified user. Such residences typically are constructed from detailed architectural plans and specifications and feature an exceptionally high level of workmanship and exceptionally high-grade materials throughout the interior and exterior of the structure. The design features exception high-quality exterior refinement and ornamentation, and exceptionally high-quality interior refinements. The workmanship, materials, and finishes throughout the dwelling are of exceptionally high quality.</td>
</tr>
<tr>
<td>Q2</td>
<td>Dwellings with this quality rating are often custom designed for construction on an individual property owner's site. However, dwellings in this quality grade are also found in high-quality tract developments featuring residences constructed from individual plans or from highly modified or upgraded plans. The design features detailed, high-quality exterior ornamentation, high-quality interior refinements, and detail. The workmanship, materials, and finishes throughout the dwelling are generally of high or very high quality.</td>
</tr>
<tr>
<td>Q3</td>
<td>Dwellings with this quality rating are residences of higher quality build from individual or readily available designer plans in above-standard residential tract developments or on an individual property owner's site. The design includes significant exterior ornamentation and interior that are well finished. The workmanship exceeds acceptable standards and many materials and finishes throughout the dwelling have been upgraded from &quot;stock&quot; standards.</td>
</tr>
<tr>
<td>Q4</td>
<td>Dwellings with this quality rating meet or exceed the requirements of applicable building codes. Standard or modified standard building plans are utilized and the design includes adequate fenestration and some exterior ornamentation and interior refinements. Materials, workmanship, finish, and equipment are of stock or builder grade and may feature some upgrades.</td>
</tr>
<tr>
<td>Q5</td>
<td>Dwellings with this quality rating feature economy of construction and basic functionality as main considerations. Such dwelling feature a plain design using readily available or basic floor plans featuring minimal fenestration* and basic finishes with minimal exterior ornamentation and limited interior detail. These dwellings meet minimum building codes and are constructed with inexpensive stock materials with limited refinements and upgrades.</td>
</tr>
<tr>
<td>Q6</td>
<td>Dwellings with this quality rating are of basic quality and lower cost; some may not be suitable for year-round occupancy. Such dwellings are often built with simple plans or without plans, often utilizing the lowest quality building materials. Such dwelling are often build or expanded by persons who are professionally unskilled or possess only minimal construction skills. Electrical, plumbing, and other mechanical systems and equipment may be minimal or nonexistent. Older dwelling may feature one or more substandard or nonconforming additions to the original structure.</td>
</tr>
</tbody>
</table>

*Fenestration – the design and disposition of windows and other exterior openings of a building.
Improvement Analysis

**Improvements**

Improvements must conform to the neighborhood in terms of age, design, and materials used for construction. Improvements for all properties must be of the quality and condition acceptable to typical purchasers in the subject market area.

The description of the improvements must include a general overall description and specific descriptions of the exterior, foundation, basement, insulation, interior surfaces, heating and cooling systems, kitchen equipment, attic, amenities, and car storage. If the subject property includes an accessory apartment, the appraiser must describe it in the comments section of the improvement analysis portion of the appraisal report.

**General Description**

**Design and Appeal**

The appraiser must assess the design and appeal of the subject property and evaluate whether similarly designed properties exist within the area. The comparable properties must demonstrate market acceptance and support a reasonable marketing time.

Uniquely Designed Properties - Dome homes, log cabins, earth berms, and underground homes are examples of properties that may require extended marketing time and have limited comparables due to its overall appeal to the marketplace. In order to be eligible, value must be supported using similarly designed comparables that exist in the area.

**Actual and Effective Age**

The relationship between the actual and effective ages of the property is a good indication of its condition. A property that has been well maintained will generally have an effective age somewhat lower than its actual age.

On the other hand, properties that have an effective age higher than its actual age probably have not been well maintained or may have a particular physical problem.

When adjustments are made to the appraisal for the effective age, the appraiser must provide an explanation for the adjustments and the condition of the property.

There is no restriction on the age of eligible dwellings. Consequently, mortgages on older dwellings that meet the general requirements are acceptable.

**Foundation**

Foundations must be in good condition and typical for the area.

Post and pier foundations are acceptable if common to the area and the property meets FEMA standards.
Improvement Analysis (continued)

**Heating**

All properties must have a permanently affixed, thermostatically controlled heating system. A property with no heating system, where the only source of heat are items such as a space heater, fireplace, wood-burning stove, solar panels, or windmill is not acceptable. In addition, a property in which only some rooms in the property are heated and some are not heated is not acceptable. If a property has an unusual heating system, it must be determined whether the system is permanently affixed, properly vented to the exterior and is in accordance with local codes. The property may be acceptable if marketability can be established. To establish marketability, the appraiser must use comparables with a similar type of heating system.

**Warm Weather Climate**

A permanent heating source may not be required if the following are met:

- Property is located in Hawaii
- Lack of permanent heat source is common to the area
- Appraiser must provide three comparables without a permanent heat source in a similar elevation
- The subject property must be suitable for year-round occupancy

**Finished Area/Square Feet Above Grade**

**Layout and Floor Plans**

Dwellings with unusual layouts, peculiar floor plans, or inadequate equipment or amenities generally have limited market appeal.

A review of the room list and floor plan for the dwelling unit may indicate an unusual layout such as bedrooms on a level with no bath, or a kitchen on a different level from the dining room.

The appraisal must include appropriate adjustments based on how the subject compares to the comparable sales. If market acceptance can be demonstrated through comparable sales based on how the subject compares to the comparable sales with the same inadequacies, no adjustments are required.

**Above-Grade Room Count/Gross Living Area**

The most common comparison for one-unit properties is the above-grade gross living area. The appraiser must be consistent when calculating and reporting the finished above-grade room count and the square footage of gross living area that is above-grade.

The following must be observed when calculating and reporting above-grade room count and square footage for the gross living area:

- Is the total finished area including any interior common areas, such as stairways and hallways of the improvements based on exterior measurements
- Must be consistently developed for the subject property and all comparables used in the appraisal
- Must include only finished above-grade areas when calculating and reporting above-grade room count and square footage for the gross living area, counting all interior common areas such as stairways, hallways, storage rooms, etc.
- Must not include garages and basements, including those that are partially above-grade
- Cannot count exterior common areas such as open stairways
Improvement Analysis (continued)

Finished Area/Square Feet Above Grade

For units in condominium projects, the appraiser should use interior perimeter unit dimensions to calculate the gross living area.

CMS will critically analyze all properties with less than 800 square feet to determine the property is typical and readily marketable for the subject area.

**Below-Grade Areas**

A level is considered below-grade if any portion of it is below-grade, regardless of the quality of its finish or the window area of any room.

A walk-out basement with finished rooms would not be included in the above-grade room count. Rooms that are not included in the above-grade room count may add substantially to the value of a property, particularly when the quality of the finish is high.

The appraiser must report the basement or other partially below-grade areas separately and make appropriate adjustment for them.

**Gross Building Area**

- Is the total finished area including any interior common areas, such as stairways and hallways based on exterior measurements
- Is the most common comparison for two- to four-unit properties
- Must be consistently developed for the subject property and all comparables used in the appraisal
- Must include all finished above-grade and below-grade living areas, counting all interior common areas such as stairways, hallways, storage rooms, etc.
- Cannot count exterior common areas such as open stairways

The use of other comparisons for two to four-family properties, such as the total above-grade and below-grade areas as discussed above are acceptable as long as the appraiser explains the reasons he or she did not use a gross building area comparison and clearly describe the comparisons used.

**Insulation and Energy Efficiency of the Improvements**

An energy-efficient property is one that uses cost-effective design, materials, equipment, and site orientation to conserve non-renewable fuel.

Special energy-saving items must be recognized in the appraisal process. The nature of these items and their contribution to value will vary throughout the country due to climate conditions and difference in utility costs.

The appraiser should list the energy-efficient features of the subject property to those of comparable properties in the Sales Comparison Analysis to ensure the overall contribution of these items is reflected in the market value of the subject property. The appraiser must be able to support any adjustments.
Improveout Analysis (continued)

<table>
<thead>
<tr>
<th>Property Condition</th>
<th>The appraiser must consider and describe the overall quality and condition of the property, in specific terms. The appraiser must report a detrimental condition of the improvements even if that condition is typical for competing properties. The appraisal must identify items that require immediate repair and items where maintenance may have been deferred, which may or may not require immediate repair. The comments section must address needed repairs and physical, functional, or external inadequacies.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>For appraisal reports that are required to be completed using the UAD, the appraiser must incorporate the UAD quality rating (Q1, Q2, Q3, Q4, Q5, or Q6) that best describes the overall quality of the subject property and each comparable property. Additionally, the appraiser must incorporate the UAD condition rating (C1, C2, C3, C4, C5 or C6) that best describes the overall condition of the property.</td>
</tr>
</tbody>
</table>

- Roof Damage
  Visible evidence of roof leaks and/or interior water damage (e.g., ceiling stains) must be addressed, even if the appraisal does not list them. If any of these conditions exist, obtain a roof certification by a qualified roofing contractor or general contractor, indicating a remaining useful and physical life of at least three years.

- As-Is Condition
  Properties are eligible based on the as-is condition of the property provided the existing conditions are minor and do not affect the livability, soundness, or structural integrity of the property and the appraiser's opinion of value reflects the existence of these conditions.
  Minor conditions or deferred maintenance are typically due to normal wear and tear from the aging process and occupancy of the property. While such conditions generally do not require repair they must be reported. A cost to cure may be required.
  Examples of minor conditions and deferred maintenance include worn floor finishes or carpet, holes in window screens, or cracked glass.

- Physical Deficiencies That Affect Soundness, Structural Integrity, and Livability
  The appraisal report must identify and describe physical deficiencies that could affect a property's soundness, structural integrity, or livability, or improvements that are incomplete. The property must be appraised subject to completion of the specific alterations or repairs.
  If the appraiser is not qualified to evaluate the alterations or repairs needed, the appraisal must identify and describe the deficiencies and the property must be appraised subject to a satisfactory inspection by a qualified professional. The appraisal may have to be revised based upon the results of the inspection. If so, the report must indicate the impact, if any, on the final value. Review the revised appraisal report to ensure that no physical deficiencies or conditions that would affect the livability, soundness, or structural integrity of the property are indicated and ensure that material conditions are repaired before loan delivery.
Improvement Analysis (continued)

Property Condition (continued)

- Appliances
  All properties must be habitable and all appliances, plumbing, electrical, etc. must be functional and in good working condition.
  The installation of any appliance is required only when required by the appraiser.

- Debris, Graffiti or Trash
  Properties showing an excessive amount of debris, graffiti, or trash may require cleanup. If cleanup is necessary, CMS requires an Appraisal Update and/or Completion Report with photos.

- Infestation, Dampness, Settlement
  If the appraiser indicates evidence of wood boring insects, dampness or settlement, the appraisal must comment on the effect on the subject property’s marketability and value.
  Provide either satisfactory evidence that the condition was corrected or a professionally prepared report, indicating that the condition does not pose any threat of structural damage.

- Unacceptable Property Conditions
  - Imminent Threat - Properties defined as imminent threat are those that pose an imminent health or safety threat
  - Inadequate Foundation - Inadequate foundations are those that do not meet current code requirements. Additionally, Cantilevered Property is not acceptable. A Cantilevered Property is a projecting structure supported at one end and carries a load at the other end or along its length
  - Inadequate Heating - Properties defined as having inadequate heating are those without permanently affixed legal heating systems (e.g., the property uses space heaters or fireplaces to heat the premises)
  - Inadequate Maintenance or Services - These are properties, which lack city or county maintenance services
  - Inadequate Utilities - These are properties without water or public electricity connections to the site. This term also includes improperly vented water heaters
  - Boarded up Properties
  - Chinese Drywall – Drywall imported from China from 2001 through 2007, which emits sulfur gases, which usually create a noxious odor, and corrodes copper and other metal surfaces, damaging air conditioning, electrical wiring, copper, plumbing, appliances and electronics. Chinese drywall can also cause adverse health effects. Note that not all drywall manufactured in China is defective.
Improvement Analysis (continued)

**Conformity to the Neighborhood**

The subject improvements must conform to the neighborhood in terms of age, type, design, and materials used for its construction. There may be market resistance to a property because its improvements are not compatible with the neighborhood or with the requirements of the competitive market due to adequacy of plumbing, heating, or electrical services; design; quality; size; condition; or any other reason directly related to market demand.

If recent comparable sales of the same design and appeal as the subject property are not available, the appraiser must determine sound adjustments for the differences between the available comparables and the subject property and demonstrate the marketability of the property. This may be based on older comparable sales, comparable sales in competing neighborhoods, similar properties in the market area, and any other reliable market data.

If the appraiser is unable to establish market acceptance and a reliable estimate of market value due to significantly different characteristics of the property, the property will not be acceptable for purchase by CMS.

- Minimum Square Footage
  
  There is no minimum size or living area requirements for properties. However, dwelling units of any type should contain sufficient living area to be acceptable to typical purchasers or tenants in the subject market area. There should be comparables of similar size to the subject property to support the general acceptability of a particular property type.

**Sales Comparison Approach**

The greatest weight and reliance is placed on the sales comparison approach. The value indicated by this approach must be supported by an analysis of recently closed sales of at least three comparables located in the subject property’s neighborhood or market. More than three comparable sales may be submitted to support the opinion of market value provided at least three are actually settled or closed sales.

Comparable sales that have settled or closed within the last 6 months should be used. Comparable sales that have settled or closed within the last 6 - 12 months old may be used if old when accompanied by an appraiser explanation for use. Older comparable sales that are the best indicator of value can be used if appropriate.

The appraiser's analysis of a property must take into consideration all factors that have an impact on value, recognizing that a well-informed or well-advised purchaser will pay no more for a property than the price he or she would pay for a similar property of equal desirability and utility if it were purchased without undue delay. To accomplish this, the appraiser must analyze the closed or settled sales, the contract sales, and the current listings of properties that are the most comparable to the subject property. This is particularly important in soft or declining markets because the competing current listings and contracts probably reflect the upper-end of value for the subject property as of the effective date of the appraisal, and we expect appraisers to accurately report and reflect market conditions as of that date.

In addition, the appraiser must report and analyze a minimum three-year sales history for the subject property. The sales history of the subject property and comparables will be used to determine if any substantial appreciation or property churning has occurred. If there has been a prior sale of the subject property within three years and there is an increase in value, the appreciation or improvements must be explained. If the value has increased by 15 percent or more in one year or 30 percent in three years from the original sales price the appraiser must analyze and explain the increase if due to a below market sale, such as a property in foreclosure. If the increase was due improvements, the appraiser must analyze, explain and the file must contain documentation such as contracts, receipts, and photographs.
### Improvement Analysis (continued)

#### Sales Comparison Approach (continued)

<table>
<thead>
<tr>
<th>Similarity of Comparables to Subject Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>The comparables used by the appraiser must represent the best market data available to support the property's estimated value. Comparable sales must be as similar to the subject property as possible in physical attributes, rights of ownership, zoning and other amenities. When similar to the subject property, comparables establish that it is typical to the area and that the need for adjustments will be minimal.</td>
</tr>
</tbody>
</table>

If the appraiser believes a foreclosure sale or a short sale is an appropriate comparable, then the appraiser must identify and consider any differences from the subject property, such as the condition of the property and whether any stigma has been associated with it. The appraiser cannot assume it is equal to the subject property. A foreclosure or short sale property may be in worse condition when compared to the subject property, especially if the subject property is new construction or was recently renovated. The appraiser must conduct the proper research in order to complete the assignment and provide an accurate opinion of market value.

#### Proximity of Comparables to the Subject

Comparable sales should be located in the same neighborhood and/or market. The description of the comparable’s proximity to the subject property must be specific (e.g., two blocks south).

The use of comparable sales that are located in competing neighborhoods are allowed, as these may be the best comparable sales available and the most appropriate for the appraiser’s analysis. However, the appraiser must not expand the neighborhood boundaries just to encompass the comparable sales selected. The appraiser must indicate the comparables sales are from a competing neighborhood and address any differences that exist. The appraiser must also provide an explanation as to why specific comparables sales were used in the appraisal report and explain how a competing neighborhood is comparable to the subject neighborhood.

Because rural properties often have large lot sizes and rural neighborhoods can be relatively undeveloped, there may be a shortage (or absence) of recent truly comparable sales in the immediate vicinity of a subject property that is in a rural location. This means that the appraiser will often need to select comparable sales that are located a considerable distance from the subject property. If available, the appraiser must also provide a minimum of one dated comparable on a closed sale located in the subject neighborhood. In such cases, the appraiser must use his or her knowledge of the area and apply good judgment in selecting comparable sales that are the best indicators of value for the subject property. The appraiser should include an explanation of why the particular comparables were selected in his or her analysis.

For UAD compliant appraisal report forms, the appraisal report form must include a rating of the location of the subject property and each comparable sale by providing a rating of either "Neutral," "Beneficial" or "Adverse." The location rating is for the location of the subject property within the neighborhood or market area, and is not a rating for the overall neighborhood or market area.

The location rating should describe the overall effect on value and marketability of the location of the property within the neighborhood.
### Improvement Analysis (continued)

<table>
<thead>
<tr>
<th>Sales Comparison Approach (continued)</th>
<th>View</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>For appraisal report forms that are required to be completed using the UAD, the overall view associated with the subject property and each comparable sale must be rated as either &quot;Neutral,&quot; &quot;Beneficial&quot; or &quot;Adverse.&quot; The UAD view rating (which will be abbreviated as N, B, or A in the appraisal) should describe the overall effect on value and marketability of the view associated with the property.</td>
</tr>
</tbody>
</table>

In all appraisals, appropriate adjustments must be made for differences in view between the subject property and each comparable property to reflect the value of the differences, if any, to the market.

**Condition and Quality**

Appropriate adjustments must be made for differences in condition and quality between the subject property and each comparable property to reflect the value, if any, of the differences to the market.

Sometimes, it may be appropriate for an appraiser to make an adjustment for differences in quality and condition between the subject property and a comparable property even though the properties have the same UAD quality or condition rating. The appraiser is expected to provide a sufficient explanation of the basis and rationale for all adjustments (or, if necessary, lack of adjustments) within the appraisal report or addenda.

**Sales price**

The sales price of each comparable sale must be within the general range of the estimate of market value for the subject property. For example, a $100,000 comparable sale for a $75,000 subject property would raise questions about the validity of the comparable.

**Data Sources**

The comparable market data must be verified, analyzed, and adjusted for differences between the comparable sales and the subject property. Because the appraiser's estimate of market value is no better than the reliability of the comparable data that is used, the appraiser must exercise due diligence to ensure the reliability of the comparable sales data that he or she uses. The appraiser must report his or her data and/or verification sources for each comparable sale on the appraisal report.

When comparable sales data is provided by parties that have a financial interest in either the sale or financing of the subject property, the appraiser must verify the data with a party that does not have a financial interests in the subject transaction.

**Comparables Inside and Outside Established Project**

For properties located in established subdivisions or for units in established condominium, or PUD projects, the appraiser should use comparable sales from within the subject property's subdivision or project if the project has resale activity.

Resale activity from within the subdivision or project is the best indicator of value for properties in the subdivision or project. If the appraiser uses sales of comparable sales that are located outside of the subject neighborhood, he or she must include an explanation with the analysis.
Improvement Analysis (continued)

Comparables Inside and Outside New Subdivisions or Projects

For properties located in new subdivisions or for units in new (or recently converted) condominiums or PUD projects, or the appraiser must compare the subject property to other properties in its general market area as well as to properties within the subject subdivision or project.

The appraiser should select at least one comparable sale from the subject subdivision or project and at least one comparable sales from outside the subject subdivision or project or subdivision that are outside the influence of the subject property developer, builder or property seller. Resales from within the subject project may be used to meet this requirement.

When appraising new construction, the appraiser may need to rely solely on the builder of the property being appraised to provide comparable sales data, as this data may not yet be available through typical data sources, such as public records or multiple listing services. In this scenario, it is acceptable for the appraiser to verify the transaction of the comparable sale by viewing a copy of the HUD-1 Settlement Statement from the builder’s file.

By using the HUD-1 Settlement Statement to verify a recent sale of new construction not yet available through other data sources, an appraiser may be better able to comply with the requirement that at least one comparable sale is from the subject’s subdivision or project. The appraiser may also provide additional recent comparable builder sales from competing projects that are not presently available through traditional data sources as long as the appraiser verified the sale through the applicable HUD-1 Settlement Statement. In selecting the comparables, the appraiser should keep in mind that a sale from within the subject subdivision or project is preferable to a sale from outside the subdivision or project, provided the developer or builder of the subject property is not involved in the transaction. Additionally, the appraisal must include discussion and analysis of sales concessions and upgrades for the subject property relative to concessions and upgrades for each builder sale.

Over-improvements

In some instances, the improvements represent an over-improvement for the neighborhood, but are still within the neighborhood price range such as a property with an in-ground swimming pool, large addition, or oversized garage in a market that does not demand these kinds of improvements. The appraiser must comment on such over-improvements and indicate its contributory value in the sales comparison analysis adjustment grid.

Adjustments to Comparable Sales

Comparable sales must be adjusted to the subject property, except for sales and financing concessions, which are adjusted to the market at the time of sale. The subject property is the standard against which the comparable sales are evaluated and adjusted.

The appraiser must describe property characteristics using specific, factual, and detailed language. The appraiser must use numerals whenever applicable (e.g., for lot size, age of improvements, etc.). Clear descriptions (such as good, average, fair, or poor) must be used to provide consistency between the property and the comparable.
Improvement Analysis (continued)

Sales Comparison Approach (continued)

If an item in the comparable property is superior to that in the subject property, a negative (-) adjustment is required to make that item equal to that in the subject property. Conversely, if an item in the comparable property is inferior to that in the subject property, a positive (+) adjustment is required to make that item equal to that in the subject property. Individual adjustments that are excessively high should be explained by the appraiser and reviewed carefully.

If the appraiser’s adjustments do not fall within the net and gross percentage adjustment guidelines, but the appraiser believes that the comparable sales used in the analysis are the best available, as well as the best indicators of value for the subject property, the appraiser must provide an appropriate explanation.

- Net and Gross Adjustments

There are established guidelines for the net and gross percentage adjustments that are relied upon to determine whether a property should be used as a comparable sale.

The dollar amount of the net adjustments for each comparable sale should not exceed 15 percent of the sales price of the comparable. When the adjustments exceed 15 percent, the appraiser must comment on the reasons for not using a more similar comparable. The amount of net adjustment is determined by adding all of the individual adjustments with consideration given to the positive or negative values.

The dollar amount of the gross adjustments for each comparable sale should not exceed 25 percent of the sales price of the comparable. The amount of the gross adjustment is determined by adding all individual adjustments without regard to the positive or negative adjustments. When the adjustments exceed 25 percent, the appraiser must comment on the reasons for not using a more similar comparable.

Individual adjustments that are higher than normal should be explained and justified by the appraiser.

- Sales or Financing Concessions

The dollar amount of the sales or financing concessions paid by the seller must be reported for the comparable sales if the information is reasonably available. Appraisers must provide the sales and financing concession information that was available and verified for the comparable sales. The appraisal should reflect sales or financing data for comparables, (e.g., the mortgage amount, loan type, interest rate, term), and any fees or concessions paid by the seller. Sales or financing data should be obtained from parties associated with the comparable transaction, such as the broker, buyer or seller, or a reliable data source. There may be some situations in which sales or financing information is not available because of legal restrictions or other disclosure-related problems. In such cases, the appraiser must explain why the information is not available.

Review the appraisal to determine if the appraiser has adequately demonstrated the effects of financing or sales concessions on the property’s value.
Improvement Analysis (continued)

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<tr>
<th>Sales Comparison Approach (continued)</th>
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<tr>
<td>Adjustments to the comparables must be made for sales concessions. No adjustments are necessary for those costs that are normally paid by sellers as a result of tradition or law in a market area, those costs are readily identifiable since the seller pays these costs in virtually all sales transactions. Special or creative financing adjustments can be made to the comparable property by comparison to financing terms offered by a third-party institutional lender that is not already involved in the property or transaction. The negative adjustment should not be calculated on a dollar-for-dollar cost of the financing or concession but the dollar amount of any adjustment should approximate the market's reaction to the financing or concession based on the appraiser's judgment. Positive adjustments for sales or financing concessions are not acceptable.</td>
</tr>
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- **Date of Sale/Time Adjustment**
  The appraiser must provide the date of the sales contract and the month and year of the settlement or closing date for each comparable sale. If the both the contract date and the settlement or closing date are not reported, the reported sale date must be identified as either the "contract date" or the "settlement or closing date." If only the contract date is reported, the appraisal must indicate whether the contract resulted in a settlement or closing. The appraiser must minimize adjustments made due to the difference in time of the comparable sale from the subject property sale. Time adjustments must reflect the difference in market conditions between the date of sale of the comparable and effective date of appraisal for the subject property.

- **Above-Grade Room Count and Gross Living Area**
  Only finished above-grade areas can be included in the calculation. Large differences between subject property and comparable sales must be addressed since they raise doubts about the validity of the comparables as good indicators of value. Adjustments for differences in square footage must be realistic for the marketplace. To assure consistency in the sales comparison analysis, the appraiser generally should compare above-grade areas to above-grade areas and below-grade areas to below-grade areas. However, if the appraiser needs to deviate from this approach because of the style of the subject property or of any of the comparables, he or she must explain the reason for the deviation and clearly describe the comparisons that are being made.

- **Below-Grade Areas**
  Rooms that are not included in the above-grade room count may add substantially to the value of a property, particularly when the quality of the finish is high. The appraiser must report the basement or other partially below-grade areas separately and make appropriate adjustments for them on the "basement and finished areas below-grade" line in the sales comparison grid.
## Improvement Analysis (continued)

### Sales Comparison Approach (continued)

- **Over-Improvements**
  
  An over-improvement is an improvement that costs more than its contributory value within the marketplace.

  The appraiser must comment on over-improvements and indicate their contributory value in the sales comparison analysis’ adjustment grid.

  Improvements can represent an over-improvement for the neighborhood, but still be within the neighborhood price range—such as a property with an in-ground swimming pool, a large addition, or an oversized garage in a market that does not demand these kinds of improvements.

  Review appraisals on properties with over-improvements that may not be acceptable to the typical purchaser to ensure that only the contribution value of the over-improvement is reflected in the appraisal analysis.

### Appraiser’s Comments & Indicated Value

The appraiser’s comments should reflect his or her reconciliation of the adjusted (or indicated) values for the comparable sales and identify the comparables that were given the most weight in arriving at the indicated value for the subject property.

### Income Approach

The Income Approach to value is based on the assumption that market value is related to the market rent or income that a property can be expected to earn. Appraisals relying on the Income Approach as a sole indicator of market value are not acceptable. Its use generally is appropriate in neighborhoods of single-family properties when there is a substantial rental market, and is required for all two- to four-unit properties and investment properties.

The Income Approach may not be the sole approach used to determine value.

### Project Information for PUDs

If the subject property is located within a PUD, the PUD information section within the appraisal must be completed. See the [Property Types and Project Standards](#) section for more information.

### Valuation Analysis and Final Reconciliation

The reconciliation process that leads to the estimate of market value is ongoing throughout the appraiser’s analysis. In the final reconciliation, the appraiser must:

- Reconcile the reasonableness and reliability of each applicable approach to value
- Reconcile the reasonableness and validity of the indicated values
- Reconcile the reasonableness of available data, and
- Select and report the approach or approaches that were given the most weight

This reconciliation is not an averaging technique; rather it is a process used by the appraiser to explain the reasonableness of each approach and its applicability to the final estimate of value.
Improvement Analysis (continued)

Valuation Analysis and Final Reconciliation (continued)

- Changes to the Appraised Value
  Appraisal reports must be complete and any changes made to the report were made by the appraiser who originally completed the report. If there are any concerns with any aspect of the appraisal that result in questions about the reliability of the value, an attempt must be made to resolve those concerns with the appraiser who originally prepared the report. If unable to resolve concerns with the appraiser, a replacement report must be obtained prior to making a final underwriting decision on the loan. Any request for a change in the appraised value must be based on material and substantive issues and must not be made solely on the basis that the market value as indicated in the appraisal report does not support the proposed loan amount.

  Pay particular attention to those loans in which the appraised value is believed to be excessive or where the value of the property has experienced significant appreciation in a short time period since the prior sale.

- Guidance on Addressing Appraisal Deficiencies
  If an appraisal is considered deficient, any of the following options are available:
  - Appropriate party contacts the appraiser to address deficiencies contained in the appraisal report
  - Obtain a field review of the original appraisal
  - Obtain a new appraisal of the subject property

  The appraisal report may be returned to the appraiser who completed the assignment, identify the deficiencies found, and provide justification for requesting correction of the deficiencies the lender believes make the report unreliable.

  If the revised appraisal report does not that adequately address all concerns, a field review of the report may be obtained and must be completed in accordance with the USPAP.

  In lieu of a field review, a new appraisal report may be obtained. The new appraisal report, at a minimum, must be based on the same level of inspection that was required for the original appraisal. For example, if the original appraisal was based on an interior and exterior inspection of the property, then the new appraisal, at a minimum, must also be based on an interior and exterior inspection of the property.

  When a review appraisal or new appraisal is obtained, the opinion of market value as stated in the review or new appraisal must be used because the original appraisal was rejected. It is not acceptable to exercise blanket discretion by arbitrarily changing the opinion of market value from a report for use in the lending process. For example, it is not acceptable to simply average the two opinions of market value in order to arrive at a final value conclusion.
Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties

Overview
Attached housing and multiple units add another level of complexity when analyzing the collateral securing the loan. In addition to the neighborhood, site, improvement, and market analysis discussed above, consider the following when appraising two- to four-unit properties, condominiums, and Leaseholds.

Two- to Four-Unit Properties
The marketability of two- to four-unit properties is tied to the level of rent commanded by the property and its compatibility with the neighborhood.

Neighborhood
The extent to which other small residential income properties are located in the area will influence the marketability of the subject property. Market rents must be stable or increasing. The appraiser’s statement of market rents will be assessed by the comparable rental properties used for comparison.

The appraiser must also consider rent controls and the amount of vacancies when assessing the appeal of the property. Excessive vacancies may reflect a lack of marketability and this must be considered when making a decision to lend on the property.

Comparable Rental Data
Market rent is an estimate of the property’s potential to generate income from its units. Rental data must be supplied from at least three other small income-producing properties that are similar in number of units, room count, and living area. Rental comparables must be readily available and in close proximity to the subject property. Going out of the immediate neighborhood to obtain rental comparables might suggest a lack of rental activity and therefore, lack of marketability.

Comparable Market Data
The adequacy of the comparable sales will be analyzed by the date of sale, proximity to the subject property and number and amount of adjustments. As in the rental comparisons, the appraiser must assess the similarity of the sales comparisons to the subject property in terms of gross building area, unit count, and room count.

Operating Income Statement
In developing the valuation for a two- to four-unit investment property, the appraiser must analyze the most current and most comparable rental properties that are available to develop an estimated market rent for the subject property. The appraiser must report and analyze at least three rental comparables (which do not have to be the same comparables used in the sales comparison analysis).

The appraiser should reconcile the comparable rental data and provide support for the estimated market rents for the individual subject units, providing information about lease dates, number of vacant units, actual rents, and estimated market rents for the subject property.

The appraisal report must address that the units and properties selected as comparables are comparable to the subject property (in terms of both the units and the overall property) and accurately represent the rental market for the subject property.
### Condominiums

<table>
<thead>
<tr>
<th>Neighborhood</th>
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<tbody>
<tr>
<td>The presence of other condominium projects in the subject property’s market area indicates the appeal and marketability of the condominium under review. Marketability of a single condominium project will be difficult to demonstrate if the neighborhood lacks competing projects.</td>
</tr>
</tbody>
</table>

### Project Improvements

Condominium units are affected by the improvements and amenities of the overall project. As amenities increase, required maintenance and related association fees increase.

- **Number of Stories**
  - The selection of comparable sales must be from projects that are similar in height to the subject property’s building.
  - High-rise condominiums (greater than 8 stories) are acceptable in areas with proven marketability. At least two comparable sales must be from two competing projects. The appraiser must select sales comparables with a similar floor location.

- **Condominium Conversions**
  - To establish marketability for condominium conversions at least one comparable sale should be from the subject project and two from similar competing conversion projects.

- **Stage of Completion**
  - Consider whether the amenities are complete. Under-funded budgets may affect the developer's ability to complete all expected improvements, which may in turn affect the project's future marketability.

- **Additional Features**
  - Properties with the following characteristics require scrutiny to identify whether the project is a Cooperative or Condo-Hotel. These features include, but are not limited to the following:
    - Central telephone system
    - Room Service
    - Units that do not contain full-sized kitchen appliances
    - Daily cleaning service
    - Advertising of rental rates
    - Registration service
    - Restriction on interior decorating
    - Franchise agreements
    - Central key systems
    - Location of the project in a resort area
    - The occupancy of the project
    - Projects converted from a hotel or motel
Additional Review Considerations for Two- to Four-Unit Properties, Condominiums, Mixed-Use Properties, and Leasehold Properties (continued)

Condominiums (continued)

- Number of Units Sold or Rented
  The appraiser must provide information on the number of units sold and rented. Analyze the percentage of units sold and rented to determine whether the project meets the warranties published in this Client Guide.

Sales Comparison

The market sales information will be analyzed in a similar manner to a single-family dwelling. Recent sales comparables, similarity of living area and number of adjustments are all considered in analyzing the appropriateness of the comparables.

See the Comparables Inside and Outside Established Project and Comparables Inside and Outside New Subdivisions or Projects sections in the Sales Comparison Approach section for more information.

Mixed-Use Property

The appraiser must provide the following information when appraising a mixed-use property:

- A detailed description of the mixed-use characteristics of the subject property
- The mixed-use of the property must represent a legal, permissible use of the property under the local zoning requirements
- The market value of the property must be primarily a function of its residential characteristics, rather than the business use or any special business-use modifications that were made.
- A discussion of any adverse impacts of the commercial use
- A statement describing any market resistance to the commercial use and adjustments for any commercial features made to the comparable sales

Loan Prospector Loans: An Interior and Exterior Inspection is required.

See the Mixed-Use Property section in Property Types and the CMS Product Guidelines for more information.

Leasehold Properties

In addition to meeting Leasehold loan eligibility requirements, the appraiser must:

- Develop a thorough, clear and detailed description of the terms, conditions, and restrictions of the ground lease
- Consider and report any effect the terms of the lease have on the value and marketability of the subject property
- When there are comparable sales available of similar properties that have the same lease terms, the appraiser should use these sales as comparable sales.
  - Use the property sales in the analysis of the market value of the leasehold estate for the subject property and
  - Report the property sales in the sales comparison analysis grid on the appraisal report
- If not available, use best comparables available
## Natural Disasters

### Federal Emergency Management Agency (FEMA)

When a natural disaster occurs (e.g., hurricane, tornado, etc.), steps must be taken to ensure that the security for loans is protected.

When a disaster is declared by FEMA, FEMA announces which counties are considered disaster areas under Designated Counties at [http://www.fema.gov/](http://www.fema.gov/).

The following guidelines apply when a property is located in a Federally Declared Major Disaster Area as defined by FEMA.

### Properties Located in Federally Declared Major Disaster Areas

In the event the subject property, for which an appraisal has been issued but the loan has not yet funded, is located in an FEMA declared disaster area, steps must be taken to ensure that the property meets the collateral requirements set forth in these guidelines.

If the property inspection was completed prior to the incident date of the natural disaster, a re-inspection or inspection will be required. These requirements apply to all loans, regardless of whether or not the transaction requires an appraisal. An inspection will be required up to, and including 90 days from the date the natural disaster occurred prior to the Note date. There may be situations where a longer timeframe may be required.

### Inspection Requirements

An appraiser must perform the property inspection and photographs of the subject property must be attached to the Disaster Inspection Certification (see the [Special Disaster Inspection Certification Alternatives](#) section below for other acceptable forms). The inspecting appraiser should review the original appraisal report to verify any disaster related damages. The appraiser's Disaster Inspection Certification must address the physical condition of the site and improvements but is not required to address value trends. If the condition of the subject property is acceptable, the value conclusion made prior to the disaster is acceptable.

### Special Disaster Inspection Certification Alternatives

The following forms may also be used for this certification along with a photograph of the subject property:

- Appraisal Update and/or Completion Report (Fannie Mae Form 1004D/Freddie Mac Form 442)
- Desktop Underwriter Property Inspection Report (Fannie Mae Form 2075)
- Uniform Residential Appraisal Reports (Fannie Mae Form 1004/Freddie Mac Form 70)
- Exterior Only Appraisal Report (Fannie Mae or Freddie Mac Form 2055)
- Individual Condominium or PUD Unit Appraisal Report (Fannie Mae Form 1073/Freddie Mac Form 465)
- Disaster Inspection Certification may take the form of a letter on the appraiser's letterhead bearing an original signature. The letter is required to contain the language indicated in the Disaster Inspection Certification Instructions

If the appraiser notes defects in the exterior inspection, a Uniform Residential Appraisal Report (Fannie Mae Form 1004/Freddie Mac Form 70) with an interior and exterior inspection with photographs is required.
Natural Disasters (continued)

| Property with Significant Damage | If significant damage is found during the inspection, a qualified home inspector or engineer must assess the damage. If the damage affects the structural integrity or livability of the subject property, as determined by the inspector, the property must be repaired before the loan is sold to CMS. |
| Property with Minor Damage | Repairs for a property with minor damage not affecting the structural integrity or livability of the property will not be required, provided an adequate escrow is arranged to guarantee the completion of repairs. Based on the engineer or home inspector's damage estimate, an accurate escrow holdback account must be established to repair the damaged property. |

End of Guidelines