

Annual Standard Underwriting Guidelines*

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Table of Contents

Industry Update	3
Qualified Mortgage	3
Underwriting Criteria Approach	3
Underwriting Guidance Summary Chart.....	5
General	5
Exceptions to QLB Underwriting Guidelines	5
Manual Underwriting.....	5
AUS Selection	6
Fair Lending	6
Eligibility	7
Eligible Borrower	7
Co-Borrowers	8
First Time Homebuyers	8
Non-Purchasing Spouse.....	9
Trust Requirements	9
Non-Occupant Co-Borrowers	9
Non-U.S. Citizen Borrowers	9
Power of Attorney	12
Occupancy	14
Multiple Loans	15
Retaining an existing property	15
Transaction Type	15
Types of Refinance Transactions	16
Cash Out.....	19
Subordinate Loans	21
Cash Out from Concurrent Secondary Financing	21
Loan Program Requirements	23
Construction to Permanent Financing	23
Loan Requirements	Error! Bookmark not defined.
LTV Determination.....	24
Land Acquisition	25
Using a General Contractor.....	26
Certificate of Occupancy	26
LTV Calculation Refinance	26
LTV Calculation for Agency Conforming and Agency Jumbo	26
Non-Contingent Second Trust Deeds	27
Purchase Property Scenarios	27
Purchase of a Short Sale Property	27
Non-Arm's Length Transactions	28
Documentation	29
Age of Documentation- Conventional.....	30
Age of Documentation- FHA & VA Loans	30
Income Documentation.....	28
Alternative Income Documentation (applies to DU/LP findings only).....	33
Funds & Assets	34
Down Payment	34
Cash Reserves	34

Source of Funds	36
Sale Proceeds	38
Retirement Accounts	38
Rent Credit with Option to Purchase	39
Down Payment Assistance and MCC Credit.....	40
Gifts	40
Evidence of Gift Funds	42
Sales Concessions/Interested Party Contributions/Finance Concessions	42
Credit Criteria	43
Credit Analysis.....	44
Bankruptcy (Chapter 7 or Chapter 11)	50
Foreclosure.....	51
Deed-in-Lieu of Foreclosure and Pre-foreclosure Sale	52
Summary — All Waiting Period Requirements.....	53
Requirements for Re-establishing Credit	54
Employment and Income.....	56
Continuity of Income.....	56
Other Sources of Income.....	58
Employment-Related Assets as Qualifying Income	59
Overtime and Bonus Income	63
Rental Income	64
Retirement, Government Annuity, and Pension Income	67
Self-Employed Borrowers.....	70
Evaluating Tax Returns	74
Evaluating Corporate Tax Returns	79
Evaluating Partnership Tax Returns.....	80
Debts and Liabilities	81
Installment Debts.....	85
Revolving Accounts	85
Undisclosed Debt	85
Ratios and Qualifying	85
Qualifying Ratios	86
Housing Payment to Income Ratio	86
Insurance/Taxes and Mortgage Insurance	87
Estimating Monthly Hazard Insurance Premium	87
Estimating Flood Insurance	88
Private Mortgage Insurance	93
Title Policy Review	92
Property Overview	94
Pre-Funding Audit Procedures	95
Exhibits	98
A. Appendix Q to Regulation Z – Part 1026 – Standards for Determining Monthly Debt and Income	
B. Visa Types and Descriptions	

***Note: Standard Underwriting Guidelines are updated annually.**

See Example of how the guidelines are updated below:

- **Retaining an existing property (Updated 7/15/15)**

Industry Update

The Consumer Financial Protection Bureau (CFPB) has adopted a rule that implements the Ability to Repay/Qualified Mortgage (ATR/QM) provision of the Dodd-Frank Act. The ATR/QM rule generally requires creditors to make a reasonable, good-faith determination of a consumer's ability to repay any consumer credit transaction secured by a dwelling and establishes certain protections to the creditor from liability under this requirement for "qualified mortgages".

The rule applies to transactions covered under this rule for which you receive an application on or after January 10, 2014. The effective date later defined as the RESPA application date or the Case Assignment Date for FHA mortgages.

Compliance with ATR requirements is established by:

- General ATR Standards;
- Refinance a non-standard mortgage into a standard mortgage (current creditor);
- Make a Qualified Mortgage (QM);

QM Mortgages have two categories General QM and Temporary GSE QM.

Qualified Mortgage

To be a Qualified Mortgage, the loan:

- Cannot have excessive upfront points and fees;
- Cannot be longer than 30 years;
- Cannot have certain risky features, such as paying only interest and not principal, or paying less than the full amount of interest so that the total debt grows each month; and
- Must be in one of three categories:
 1. The monthly loan payment, plus the borrower's other debt payments, does not exceed 43 percent of the borrower's monthly income; or
 2. The loan qualifies for purchase or guarantee by a government sponsored enterprise (Fannie Mae or Freddie Mac), or is insured or guaranteed by a federal housing agency.
 3. The loan is made by a small lender that keeps the loan in portfolio (PBM is not a small lender).

Underwriting Criteria Approach

These Standard Underwriting Guidelines provide an overview of eligibility standards and general criteria used in evaluating residential loan applications. The primary source of information contained in this guideline is based on guidance from Fannie Mae. This document provides as a reference point as they relate to eligibility standards, specific guidance to satisfy underwriting criteria for determining monthly debt and income for each category is outlined in the *General Comparison of Ability-to-Repay Requirements with Qualified Mortgages* chart below. Summarized program guidelines are available in the Quick Look Book. The program guideline will also provide additional specific investor requirements.

A reasonable, good-faith ATR evaluation must include eight ATR underwriting factors (referenced on the chart). A creditor must verify the information it relies upon making the ATR determination, using "reasonably reliable, written, third-party records, such as: tax returns (transcripts), pay stubs, credit reports, bank statements and W-2's.

General Comparison of Ability-to-Repay Requirements with Qualified Mortgages¹

	ATR Standard	General QM Definition	Agency/GSE QM Temporary
Underwriting Criteria	Approach to 8 underwriting criteria – per INVESTOR Specific Guidelines.	Appendix Q	AUS or Agency Guidelines for Manual Underwrites
Loan feature Limitations	No limitations	No negative amortization, interest-only or balloon payments	No negative amortization, interest-only, or balloon payments
Loan term limit	No limitations	30 years	30 years
Points & fees limit	No limitations	3%	3%
Payment Underwriting (3)	Greater of fully indexed or introductory rate	Max rate in first 5 years	As applicable, per GSE or agency requirements
Mortgage-related obligations (5)	Consider and verify	Included in underwriting monthly payment ² and DTI ³	As applicable, per GSE or agency requirements
Income or assets (1)	Consider and verify	Consider and verify	As applicable, per GSE or agency requirements
Employment status (2)	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements
Simultaneous loans (4)	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements
Debt, alimony, child support (6)	Consider and verify	Consider and verify	As applicable, per GSE or agency requirements
DTI or Residual Income (7)	Consider and verify	DTI ≤ 43 percent	As applicable, per GSE or agency requirements
Credit History (8)	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements

¹ This chart compares the general ATR requirements with the requirements for originating QM loans. Additional requirements may apply, particularly for small creditor and balloon- payment QM loans. This chart is not a substitute for the rule. Only the rule and its Official Interpretations can provide complete and definitive information regarding its requirements. The complete rule, including the Official Interpretations and small entity compliance guide, is available at <http://www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/>.

² “Included in underwriting monthly payment” means that the rule does not require the creditor to separately consider and verify this factor. However, a creditor must consider this factor when underwriting the consumer’s monthly payment under the rule.

³ “Included in underwriting DTI” means that the rule does not require the creditor to separately consider and verify these factors. However, a creditor considers and verifies these factors when calculating the consumer’s debt-to-income ratio.

Underwriting Guidance Summary Chart

Program Type	Category	Standards that must be used for Determining Monthly Debt and Income are provided in:
Conforming Conventional (Fannie Mae/Freddie Mac) FHA VA	Temporary QM	<ul style="list-style-type: none"> ▪ Automated Underwriting System (AUS) ▪ Agency Guidelines (Manual ONLY) ▪ QLB – Program Guideline
Non-Conforming Conventional	General QM	<ul style="list-style-type: none"> ▪ Appendix Q ▪ QLB – Program Guideline (investor overlays)
Non-Conforming Conventional with interest only or other risky feature	Standard ATR	<ul style="list-style-type: none"> ▪ ATR – 8 underwriting factors as defined specifically by Investor in QLB Program Guideline

The ATR/QM rules established by the CFPB are under the Truth-In-Lending Act/Regulation Z. Appendix Q to Part 1026-Standards for Determining Mortgage Debt and Income for general QM mortgages is provided as an exhibit to this guideline.

Agency Guidelines are published by Fannie Mae, Freddie Mac, FHA and VA. Fannie Mae and Freddie Mac guidelines are available on AllRegs. FHA Guidelines are located on line in the FHA connection 4155 handbook. VA guidelines are located on the VA website. Summaries of FHA and VA Program Guidelines are available in the QLB.

General

Exceptions to QLB Underwriting Guidelines

Provident Bank Mortgage (PBM) Program Guidelines located in the QLB are based on the most restrictive investor criteria. Unless the program is investor specific, PBM will have several investors that are available to purchase standardized agency products (such as conforming conventional, FHA and VA).

PBM will consider exceptions to posted guidelines when we have an investor that allows for less restrictive guideline. Exceptions will not be granted for requests that do not conform to Quality Mortgage eligibility standards as outlined in the AUS, Agency Guideline or Appendix Q. All exceptions must be within an investors posted guidelines.

Manual underwrites are also treated as Exceptions. Our requirement on all agency products is to obtain an approval from an AUS, a manual underwrite would be an exception to this requirement.

The underwriter is to complete the Loan Exemption Form and follow the Loan Exception Request procedures. Exceptions are tracked by PBM Underwriting management

Manual Underwriting

All transactions for agency products (Fannie Mae, Freddie Mac, FHA and VA) are underwritten by submitting the mortgage to an AUS – Desktop Underwriter or Loan Prospector.

If an AUS finding dictates a manual underwrite the loan must be underwritten outside of the AUS and will be subject to specific conditions published in Agency Guidelines. Each agency has detailed guidelines and specific limitations for loans that are manually underwritten.

All agencies are more restrictive with manually underwritten loans. Several have matrixes that limit the DTI based on credit scores or other comprehensive underwriting criteria (such as increased reserves, rental history, limited LTV, etc.)

The manual underwrite will occur at the branch; however Corporate Underwriting must ultimately approve the exception for the manual underwrite.

AUS Selection

If DU or LP have been run and received a Refer or Caution you CANNOT flip to the other AUS. The only time you can switch to the other AUS is when you have run DU and you get an "Approve/Ineligible". This is not the same as a "refer", it simply means the criteria does not fit Fannie Mae Guidelines. This is the ONLY case you can then run an LP. Not following this guideline will result in employee/branch counseling, possible termination and could result in branch fines.

Underwriting with DU

- Loans may be submitted to DU before or after the closing of the mortgage loan; however, the first submission to DU for underwriting purposes must occur before closing of the mortgage loan.
- When the mortgage loan or borrower information changes and it no longer matches the information used when the loan casefile was last underwritten with DU, the underwriter must update the data and resubmit the loan casefile to DU.

Risk Factors for Loans Where No Borrower Has a Credit Score – Fannie Mae 08/30/2016)

DU will consider the following factors when evaluating the overall credit risk of the loan when no borrower on the loan casefile has traditional credit and a credit score:

- Borrower's equity and LTV ratio
- Liquid reserves, and
- DTI ratio

Note: if a loan casefile does not receive an Approve recommendation or if the borrower is unable to meet the DU requirements related to the sources of nontraditional credit required, the underwriter may manually underwrite and document the loan according to the nontraditional credit guidelines.

Fair Lending

Provident Savings Bank (PBM) is an equal opportunity lender, and we consider all loan applications individually, regardless of the applicant's race, gender, national origin, familiar status (having children under 18), age (except that a borrower has reached the legal age at which the Note is enforceable), or handicap. We do not deny a loan because all or part of the applicant's income comes from public assistance, or because the applicant has exercised any right under the Consumer Credit Protection Act.

When evaluating home loan applications, do not consider the age or location of property, or the characteristics of the surrounding neighborhood in approving or denying a loan, except in the unusual case where it might be necessary to avoid unsafe business or unsound practice. Do not give preferences to those applicants who have previously owned real estate.

In addition, PBM has established a Second Look policy to ensure that a decision to reject a loan application is reached fairly and does not constitute a violation of anti-discrimination laws/regulations instituted to promote fair-lending.

Eligibility

Eligible Borrower

- Individuals who are citizens or legal residents of the United States.
- Revocable Living Trusts (approved by a Senior Underwriter)
- Nonpermanent resident aliens (refer to program matrices for limitation).

Ineligible Borrower

- Foreign Nationals, Individuals with Diplomatic Immunity
- Entities such as: Corporations, General Partnerships, Limited Partnerships and churches.

Definition of Continuity of Obligation

Continuity of obligation occurs on a refinance transaction when at least one of the borrower(s) on the existing mortgage is also a borrower on the new refinance transaction secured by the subject property.

Requirements for Continuity of Obligation (Fannie Mae) updated 2/23/2016 Fannie Mae has deleted this topic from their guidelines

Requirements for Continuity of Obligation (Freddie Mac) updated 6/15/2016

For all refinance mortgages, when an existing mortgage will be satisfied as a result of a refinance transaction, one of the following requirements must be met:

- At least one borrower on the refinance mortgage was a borrower on the mortgage being refinanced; or
- At least one borrower on the refinance mortgage held title to and resided in the mortgaged premises as a primary residence for the most recent 12-month period and the mortgage file contains documentation evidencing that the borrower, either:
 - Has been making timely mortgage payments, including the payments for any secondary financing, for the most recent 12-month period; or
 - Is a related person to a borrower on the mortgage being refinanced,; or
- At least one borrower on the refinance mortgage inherited or was legally awarded the mortgaged premises (for example), in the case of divorce, separation or dissolution of a domestic partnership)

All refinance transactions must

- Comply with the definition above
- Meet one of the permissible exceptions described below, or
- Comply with the limited eligibility parameters described below.

Note the following:

- Continuity of obligation requirements do not apply when there is no existing mortgage on the subject property as a result of the borrower either having purchased the subject property with cash or when any prior mortgage for which the borrower was an obligor was paid in full.

All time period references in this section are measured from the date of the event (for example, transfer of title) and end with the disbursement date of the new refinance transaction.

Delayed Financing Exception

Original transaction must have closed within the last 6 months (measured from the date on which the property was purchased to the disbursement date of the new mortgage loan) are eligible for a cash-out refinance if all of the following are met.

- The new loan amount can be no more than the actual documented amount of the borrower's initial investment in purchasing the property plus the financing of closing costs, prepaid fees, and points (subject to the maximum LTV/CLTV/HCLTV ratios for the transaction based on current appraised value).
- The purchase transaction was an arms-length transaction.
- The original purchase transaction is documented by a settlement statement, which confirms that no mortgage financing was used to obtain the subject property. (A recorded trustee's deed (or similar alternative) confirming the amount paid by the grantee to trustee may be substituted for a settlement statement if a settlement statement was not provided to the purchaser at time of sale.
- The sources of funds for the purchase transaction are documented (such as, bank statements, personal loan documents, HELOC on another property).
- All other cash-out refinance eligibility requirements are met and cash-out pricing is applied.

Note: The preliminary title report must not reflect any existing liens on the subject property. If the source of funds used to acquire the property was an unsecured loan or a HELOC (secured by another property), the settlement statement for the refinance transaction must reflect that all cash-out proceeds be used to pay off or pay down, as applicable, the loan used to purchase the property. Any payments on the balance remaining from the original loan must be included in the DTI.

Delayed Financing Cash-Out Guidelines are available on the Intranet under PBM Manual, under Quick Look Manual

Co-Borrowers

Co-borrowers are acceptable provided that all parties sign the Note and take title to the property.

Co-Signor/Guarantor

Co-Signers or Guarantors are not permitted. Co-Signers or Guarantors have income and credit that are considered in qualifying the applicant and are contractually liable for repayment of the debt. However, the co-signer has no vested interest in the subject property.

First Time Homebuyers

First Time Homebuyers are defined as borrowers who have not owned real estate property in the past three (3) years.

Provident Bank Mortgage recognizes the inherent risk of financing First Time Homebuyers (FTHB) and the need to protect the borrower from participating in a program that may have a negative impact on the borrower's credit profile over an extended period of time.

In addition to the risks associated with First Time Homebuyers, it is further recognized that certain loan programs, by the nature of their specific program criteria, will layer the risk to the First Time Homebuyer. Full/Alt Doc Transactions are eligible without restriction.

Trust Requirements

Eligible Borrowers:

- Individuals who are citizens or lawful residents of the United States.
- Living or Inter Vivos Revocable Trust:
 - Prior approval needed by a Sr. Underwriter or Corporate Administrator
 - Owner-Occupied, Second Home and Investment Property allowed.
 - Trust certification is allowed. Trust Certification must be prepared by Borrower, notarized and approved by title. Trust certification must answer all questions contained on PBM Trust Checklist. If not, complete, executed, notarized Trust Agreement must be supplied.
 - U/W must fully complete pages 2 & 3 of Trust Approval documentation (found in P/P > Forms)
 - Trust Certification is good for 90 days. After 90 days, updated Trust Certification is required.
 - POAs not allowed when property is in a trust.

Ineligible Borrowers

- Corporations
- Foreign Nationals (including diplomatic immunity)
- Partnerships

Non-Purchasing Spouse

A non-purchasing spouse is permitted provided he/she executes the security instrument or any other documentation required to evidence that the spouse is relinquishing all rights to the property if so required to perfect the lien under governing law. Refer to Vesting specifics for Non-Titled Spouse and Titled Spouse Requirements are located in Provident Bank Mortgage's Procedure Manual.

Non-Occupant Co-Borrower

Non-occupant co-borrowers are eligible with Full/Alternative Documentation. Follow DU/LP findings.

Fannie Mae Guidelines

- You must have an Approved/Eligible DU. The non-occupant co-borrower does not need to be related to the occupant borrower; but must have a relationship history.
- DU analyzes the risk factors in the loan casefile for all borrowers on the mortgage loan. Regardless of whether an individual borrower will be occupying the property as his or her principal residence, DU will consider the income, assets, liabilities, and credit of that borrower.
- For DU loan casefiles, if the income of a co-borrower is used for qualifying purposes, and that co-borrower will not occupy the subject property, the maximum LTV, CLTV, and HCLTV ratio may not exceed 95% (unless a Community Seconds is part of the transaction, in which case the CLTV ratio may not exceed 105% or the maximum stated in the Eligibility Matrix).

Freddie Mac Guidelines (07/11/16)

- For Accept Mortgages, the underwriter is not required to calculate or evaluate the occupant borrower's monthly housing expense-to-income ratio or the occupant borrower's monthly debt payment-to-income ratio.
- Borrower funds and reserves may come from the occupant and/or the non-occupant borrower.

Non-U.S. Citizen Borrowers

Social Security Number

A valid Social Security Number (SSN) is required for all non-U.S. citizen borrowers whose income and/or assets are being used to qualify for a loan – **No Exceptions.**

Although there are other documents that are issued for tax (ITIN) or identification (Matricula Consular Card) purposes, they are not acceptable in lieu of a valid Social Security Number.

Additional underwriting and documentation requirements apply. Please refer to individual program guidelines for requirements or restrictions in addition to the standard requirements noted below.

The underwriter is required to obtain certification that the Permanent or Non-Permanent Resident Alien is a legal resident of this country. In order to satisfy this requirement a Certification of Permanent or Non-Permanent Resident Alien Status must be completed for each applicant/borrower that indicates an alien status in the loan file or in the declaration section of the Uniform Residential Loan Application. Certification may be completed by any Provident Bank Mortgage employee, approved broker representative or escrow officer.

Non-U.S. Citizen Borrower Eligibility Requirements

- A non-U.S. citizen who is lawfully residing in the U.S. as a permanent or nonpermanent resident alien is eligible for a mortgage on the same terms as a U.S. citizen.
- A mortgage to a non-U.S. citizen who has no lawful residency status in the United States is not eligible.

Green Cards

A copy of the Green Card is required for all permanent resident aliens whose income and/or assets are being used to qualify for a loan. A copy of the front and back of the card is required and must be included in the loan file. Or, any of the following USCIS documents are acceptable:

1. A Permanent Resident Card/Alien Registration Receipt Card (USCIS Form I-551) with an original term of ten years. The document is acceptable even if it is due to expire.
2. Permanent Resident Card (USCIS Form I-551) that is valid for two years, accompanied by the applicable INS receipts.
3. A USCIS receipt for a petition to remove conditions on residence (USCIS Form I-751), filed by the non-citizen spouse.
4. A USCIS receipt for a petition to change immigration status, filed by the citizen spouse.
5. Unexpired foreign passport that contains an unexpired stamp reading "*Processed for I-551. Temporary Evidence of Lawful Admission for Permanent Residence. Valid Until (mm-dd-yy). Employment authorized.*"
6. *I-551. Temporary Evidence of Lawful Admission for Permanent Residence. Valid Until (mm-dd-yy). Employment authorized.*
7. Any other evidence of permanent residency issued by the INS.

Other requirements:

- Employment: Minimum 2 years employment history with a U.S. Based employer. Income used for qualifying purposes must be from acceptable income sources generated from within the U.S.
- Credit: Two (2) years U. S. credit history.
- Funds: Funds from outside the U. S. are not acceptable. The borrower must have an established asset base in the U. S.

Non-Permanent Resident Aliens

Non-Permanent Resident Aliens are permitted as long as they meet the credit, income and asset requirements

Required Visas

All non-permanent resident aliens must provide evidence of a valid, acceptable visa. A copy of the unexpired visa must be included in the loan file evidencing one of the following visa classes:

1. A Series (A-1, A-2, A-3): these visas are given to officials of foreign governments, immediate family members and support staff. Only those without diplomatic immunity, as verified on the visa, are allowed.
2. E-1, Treaty Trader: this visa is essentially the same as H-1 or L-1; the title refers to the foreign country's status with the United States.
3. G Series (G-1, G-2, G-3, G-4, G-5): these visas are given to employees of international organizations that are located in the United States. Verification that the applicant does not have diplomatic immunity must be obtained from the applicant's employer and/or by the viewing of the applicant's passport.
4. H-1, Temporary Worker: this is the most common visa given to foreign citizens who are temporarily working in the United States.
5. L-1, Intra-Company Transferee: an L-1 visa is given to professional employees whose company's main office is a foreign country.
6. TN, NAFTA visa: used by Canadian or Mexican citizens for professional or business purposes.
7. TC, NAFTA visa: used by Canadian citizens for professional or business purposes.

See visa type and descriptions

- A. All standards for determining stable monthly income, adequate credit history and sufficient liquid assets must be applied in the same manner to each borrower including borrowers who are non-permanent resident aliens. For more information about visas, visit the USCIS website:
<http://www.uscis.gov/portal/site/uscis>.
- B. A chart of Visa Types and Descriptions is provided as Exhibit B.

Foreign Nationals

Foreign nationals who have no lawful residency status in the U.S. and have neither full nor partial diplomatic immunity are not considered to be non-permanent resident aliens and are not eligible for financing, except as noted below.

Note: Foreign nationals from Canada and Mexico who are working in the U.S. under the terms of NAFTA are eligible. They must be treated as non-permanent resident aliens when determining their eligibility. They must meet the standard requirements established for non-permanent resident aliens. NAFTA workers must provide a NAFTA Worker's visa. Refer to North American Free Trade Agreement (NAFTA) visa above.

Foreign Nationals with Diplomatic Immunity

Due to the inability to compel payment or seek judgment, transactions with individuals who are not subject to United States jurisdiction are not eligible. Verification the borrower does not have diplomatic immunity can be determined by reviewing the visa, passport or the U.S. Department of State's Diplomatic List at <http://www.state.gov/s/cpr/rls/dpl/>

Documentation Type

Full documentation and alternative documentation per AUS findings

Identification

A work visa, student visa, or other permit to be in the U. S. that is renewable. Acceptable visas are B-1, B-2, E-1, H-1, H-2, H-3, L-1, G series and O-1;

Employment

Minimum two years employment history with a U. S. employer and income used for qualifying purposes must be from income sources generated from within the U. S. If such employment in the U. S. cannot be verified, the loan is not eligible;

Credit

Applicant must have an established two years credit history in the U. S. A credit history that indicates only recently opened accounts in the U. S. is not sufficient to establish a credit reputation. A shorter credit history is permissible, provided that the U. S. credit history can be supplemented with a credit history from a foreign country. Credit reports from foreign countries must meet FNMA/FHLMC foreign documentation guidelines.

Power of Attorney

Provident Bank Mortgage (PBM) will accept a "specific" Power of Attorney (POA) that contains a complete legal description or address of the subject property, and authorizes the attorney in fact to enter into a real estate transaction to mortgage the property. In addition, the Power of Attorney must be:

- Signed and dated by the borrower
- Stated with the correct corresponding property address
- Previously recorded or recorded concurrently with the deed of trust.
- The POA must be signed and notarized at least one day prior to drawing loan documents
- Current and irrevocable during its period.
- To a close relative or spouse of the borrower.
- The POA cannot have a financial interest in the transaction (i.e., realtor, mortgage broker, seller, and builder).

Allowable Attorneys-in-Fact or Agents Acting Under a Power of Attorney

Except as otherwise required by applicable law, or unless they are the borrower's relative, none of the following persons connected to the transaction shall sign the security instrument or note as the attorney-in-fact or agent under a power of attorney:

- The lender (PBM);
- Any affiliate of PBM;
- Any employee of PBM or any other affiliate of PBM;
- The loan originator/broker;
- The employer of the loan originator/broker;
- Any employee of the employer of the loan originator/broker;
- The title insurance company providing the title insurance policy or any affiliate of such title insurance company (including, but not limited to, the title agency closing the loan), or any employee of either such title insurance company or any such affiliate; or
- Any real estate agent with a financial interest in the transaction or any person affiliated with such real estate agent.

As used herein, the borrower's relative includes any person defined as a relative, or a person who is a fiancé, fiancée, or domestic partner of the borrower.

For refinance transactions, an individual who would otherwise be prohibited from serving as an attorney-in-fact or agent under the restriction above may execute the required loan documents on behalf of the borrower(s), provided all of the following conditions are met:

- The attorney-in-fact or agent is not an employee of PBM
- The power of attorney expressly states an intention to secure a loan not to exceed a stated amount from a named lender on a specific property.
- The power of attorney expressly authorizes the attorney-in-fact or agent to execute the required loan documents on behalf of a borrower only if the borrower has, to the satisfaction of the attorney-in-fact or agent in a recorded, interactive session conducted via the Internet, both
 - Confirmed his or her identity; and
 - Reaffirmed, after an opportunity to review the required loan documents, his or her agreement to the terms and conditions of the required loan documents evidencing such transaction and to the execution of such required loan by such attorney-in-fact or agent.
- PBM must produce at Fannie Mae's request at any time during the term of the related loan, within a commercially reasonable time following such request and without additional expense to Fannie Mae, a recording and other documentary media memorializing the entirety of the interactive session.

Restrictions on the Use of a Power of Attorney

Except as required by applicable law, a power of attorney may not be utilized to sign a security instrument or note if;

- No other borrower executes such loan document in person in the presence of a notary public.
 - **Exception:** a power of attorney may be utilized to sign such loan document, as long as the attorney-in-fact or agent under the power of attorney is either the borrower's attorney-at-law or the borrower's relative; or
- The transaction is a cash-out refinance

Additional Requirements

If a power of attorney is used because the lender determines such use is required by applicable law, PBM must include in the mortgage loan file a written statement that explains the circumstances. Such statement must be provided to the document custodian with the power of attorney.

NOTE: A Power of Attorney cannot be used if vesting will be taken in a trust.

In addition the use of a POA for any loan transaction requires:

- Approval by a Senior Underwriter
- Approval by the Title Officer
- A Certified copy of the executed POA retained in the loan file
- A letter from the borrower stating why he/she is unable to sign documents and that he/she is fully aware of the transaction or proof from a court order as to why a POA is needed, such as a conservatorship.

Loan documents executed using a Power of Attorney may be signed using either of the following signature blocks:

Joe Borrower by John Doe, as Attorney-in-fact (signature)

Joe Borrower by John Doe as attorney-in-fact

or

Jane Borrower by John Doe, as her attorney-in-fact (signature)

Jane Borrower by John Doe as her attorney-in-fact

The agent's capacity (attorney-in-fact) must be written out in its entirety. No abbreviations allowed such as (AIF, POA, ATTY, etc.)

The vesting of the Power of Attorney (John S. Smith) must execute the documents exactly as typed not as John Smith. If this occurs the only remedy is a notarized AKA for the Power of Attorney with all variations of the POA's name referenced.

Notify Escrow Officer or Signing Service of signature block requirements. Provident Bank Mortgage cannot accept POA executed documents that are not executed exactly as indicated above.

Occupancy

Owner Occupied Principal Residence

Borrowers stated intention to occupy;

Property location is relatively convenient to borrower's place of employment;

If refinance, tax returns, W-2's etc., indicate property as residence;

Property possesses the physical characteristics to accommodate the borrower's immediate dependent family.

Second Homes

1 unit – single family residence, eligible Condo or PUD;

Owned and occupied by the borrower for some portion of the year, in addition to their primary residence;

Property must be suitable for year-round occupancy;

Property must not be subject to any rental pools or agreements, which require the rental of the property or to give control of the occupancy to a management firm;

Borrower may have more than one Second Home if in resort area;

Purchase, rate and term refinance and cash out transactions;

No subordinate financing.

Investment Property (Non-Owner Occupied)

Property is a 1-4 unit residential dwelling; eligible Condo or PUD owned by an individual and leased as a principal year-round residence and the borrower does not occupy the property.

- 1007 is required if the property is a one-unit investment property and the borrower is using rental income to qualify.
- If the borrower is not using any rental income from the subject property to qualify, gross monthly rent must be documented only for Provident Bank Mortgage reporting purposes. The borrower can provide one of the following below to satisfy this requirement:
 - If the property is not currently rented, the Underwriter can use the opinion of the market rents provided by the appraiser; or
 - If form 1007 is not required for the transaction, the Underwriter may rely upon either a signed lease from the borrower or may obtain a statement from the borrower of the gross monthly rent being charged (or to be charged) for the property. The monthly rental amounts must be stated separately for each unit in a two- to four-unit property. The disclosure from the borrower must be in the form of one of the following:
 - a written statement from the borrower, or
 - an addition to the Transmittal Summary (Form 1008)

Limits on the Number of Financed Properties

If the mortgage loan is secured by the borrower's principal residence, there are no limitations on the number of other properties that the borrower will have financed.

Multiple Financed Property Policy - Fannie Mae (03/29/2016)

If the borrower is financing a second home or investment property that is underwritten through DU, the maximum number of financed properties the borrower can have is ten. If the borrower will have one to six financed properties, Fannie Mae's standard eligibility policies apply. If the borrower will have seven to ten financed properties, the mortgage loan must have a minimum representative credit score of 720; all other standard eligibility policies apply.

Multiple Financed Property Policy – Freddie Mac (03/02/2016)

Each borrower individually and all borrowers collectively must not own and/or be obligated on more than six 1- to 4-unit financed properties, including the subject property and the borrower's primary residence.

Multiple Loans

Number of Loans to One Borrower – topic deleted (11/09/2016)

Retaining an existing property

Freddie Mac (updated 3/2/2016)

- if the borrower's current primary residence is a pending sale and the sale will not close before the note date of the mortgage, the monthly payment amount for the property pending sale may be excluded from the DTI ratio if the file contains:
 - An executed sales contract for the pending sale showing all contingencies removed; OR
 - An executed buyout agreement that is part of an employer relocation **plan**.

Fannie Mae

When the borrower owns mortgaged real estate, the status of the property determines how the existing property's PITIA must be considered in qualifying for the new mortgage transaction. If the mortgage property owned by the borrower is

- An existing investment property or a current principal residence converting to investment use, the borrower must be qualified in accordance with, but not limited to, the policies in topics B3-3.1, Rental Income. B3-4.1-01, Minimum Reserve Requirements, and if applicable B2-2-03, Multiple Financed Properties for the Same Borrower;
- An existing second home or a current principal residence converting to a second home, the PITIA of the second home must also be counted as part of the borrower's recurring monthly debt obligations; or
- The borrower's current principal residence that is pending sale but will not close (with title transfer to the new owner) prior to the subject transaction, the current PITIA and the proposed PITIA must be used in qualifying the borrower for the new mortgage loan. However, Fannie Mae will not require the current principal residence's PITIA to be used in qualifying the borrower as long as the flowing documentation is provided:
 - The executed sales contract for the current residence, and
 - Confirmation that any financing contingencies have been cleared.

Transaction Type

Purchase Transaction

- Per Fannie Mae/Freddie Mac and all Government Agencies
 - ALL Purchase Transactions require a copy of the fully executed sales contract and all addenda which must be reviewed by the Underwriter and included in the Mortgage file.
- Transfer Disclosure Statement per CA state law.
- Applies to only Government Loans (i.e. FHA, VA, USDA)

Requirements for Purchase Transactions with 95.01 – 97% LTV Ratios (Fannie Mae) (08/30/2016)

Fannie Mae permits LTV, CLTV, and HCLTV ratios to exceed 95% if certain requirements are met. The table below describes the requirements for non-HomeReady mortgage loan transactions with LTV ratios of 95.01-97%.

Criteria	Requirements
CLTV Ratio	<ul style="list-style-type: none">95.01 to 97% if the subordinate lien is not a Community Seconds Loan105% if the subordinate lien is a Community Seconds loan.
HCLTV Ratio	<ul style="list-style-type: none">95.01 to 97%
Loan Type	<ul style="list-style-type: none">Fixed-rate loans with terms up to 30 years <p>Note: High Balance, adjustable-rate, and HomeStyle Renovation loans are not permitted.</p>
Property	<ul style="list-style-type: none">One-unit principal residence. Manufactured housing is not permitted.
Borrower Eligibility	<ul style="list-style-type: none">At least one borrower must be a first-time home buyer, as indicated on the <i>Uniform Residential Loan Application</i> (Form 1003) in Section VIII., when at least one borrower responds “No” to Declaration M: Have you had an ownership interest in a property in the last three years?At least one borrow on the loan must have a credit score
Underwriting Method	<ul style="list-style-type: none">DU only
Reserves	<ul style="list-style-type: none">Reserves requirements will be determined by DU

Note: The above requirements do not apply to HomeReady mortgage loans.

Exceptions may be approved provided there is an adequate reason and they can be documented.

Seasoning and LTV/CLTV Calculation

There may be a seasoning requirement to consider when determining whether or not the LTV/CLTV for a refinance transaction should be based on the property’s appraised value or acquisition cost. Refer to specific product matrices for restrictions and acceptable seasoning terms.

Types of Refinance Transactions (updated 6/28/2016)

Refinance Transactions

A refinance transaction is defined as the repayment of an existing debt from the proceeds of a new mortgage loan that has as borrowers the current legal owners of the property securing the loan

OR

A new mortgage that is obtained on a property that does not already have an existing mortgage lien against it (this would be considered cash out).

OR

To create a new mortgage by modifying an interim construction loan or term note into permanent financing

Properties Listed for Sale

Properties currently listed for sale are not permitted. A property that was previously listed must be off the market prior to the application date for a Rate and Term Refinance. Cash out transactions have a minimum of 6 months seasoning prior to the new loan application date. A copy of the cancelled listing must be placed in the file along with a current Multiple Listing Service search to verify that the property is not currently listed by a different agency.

Limited Cash Out/Rate and Term

DU/LP maximum cash back to borrower is 2% or \$2,000, whichever is less. Or, the maximum allowed in the specific program guideline. FHA max cash back is \$500

❖ *Limited cash-out refinance transactions must meet the following requirements:*

- The transaction is being used to pay off an existing first mortgage loan (including an existing HELOC in first-lien position) by obtaining a new first mortgage loan secured by the same property; or for single-closing construction-to-permanent loans to pay for construction costs to build the home, which may include paying off an existing lot lien.
- Only subordinate liens used to purchase the property may be paid off and included in the new mortgage: Exceptions are allowed for paying off a Property Assessed Clean Energy (PACE) loan or other debt (secured or unsecured) that was used solely for energy improvements.
- The subject property must not be currently listed for sale. It must be taken off the market on or before the disbursement date of the new mortgage loan, and the borrowers must confirm their intent to occupy the subject property (for principal residence transactions).
 - Verification of listing cancellation is required.

Note: If the requirements above are met, appraised value may be used to determine the LTV/CLTV. If not, you must use the lower of the original sales price or appraised value.

❖ *Ineligible Transactions: When the following conditions exist, the transaction is ineligible as a limited cash-out refinance and must be treated as cash-out refinance.*

- No outstanding first lien on the subject property (except for single-closing construction-to-permanent transactions, which are eligible as a limited cash-out refinance even though there is not an outstanding lien on the subject property);
- The proceeds are used to pay off a subordinate lien that was not used to purchase the property (other than the exceptions for paying off PACE loans and other debt used for energy-related improvements)
- The borrower finances the payment of real estate taxes for subject property in the loan amount, but does not establish an escrow account;
- The borrower finances the payment of real estate taxes that are more than 60 days delinquent for the subject property in the loan amount; and
- A short-term refinance mortgage loan that combines a first mortgage and a non-purchase-money subordinate mortgage into a new first mortgage or any refinance of that loan within six months.

The transaction is not eligible when the subject property is listed for sale at the time of disbursement of the new mortgage loan.

*When paying off a subordinate lien, regardless of age, it is considered cash-out, unless the junior lien was purchase money second. Obtain a copy of the final HUD-1 or Settlement Statement from the purchase to prove the second was a direct result of the purchase,

The inclusion of any delinquent property taxes or HOA dues in the loan amount is not allowed on a limited cash out/rate and term refinance.

Agency Conforming & High Balance	Standard Jumbo
Unpaid principal balance of an existing first lien And/or Junior liens (closed-end seconds, HELOCs that were used for the original purchase of the home) Other than payment of the first and second liens and closing costs, incidental cash back may not exceed the lesser of 2% of the principal amount of the new mortgage or \$2000. (DU Refi Plus and Open Access are maxed at \$250 cash back)	Refer to specific Jumbo Program Guidelines

Requirements for Limited Cash-Out Refinance Transactions with 95.01-97% LTV Ratios (Fannie Mae) (updated 8/30/2016)

Fannie Mae permits LTV, CLTV, and HCLTV ratios to exceed 95% if certain requirements are met. The table below describes the requirements for limited cash-out refinance transactions with LTV ratios of 95.01-97%.

Criteria	Requirements
Existing Loan	The underwriter must document that the existing loan being refinanced is owned (or securitized) by Fannie Mae. Documentation may come from <ul style="list-style-type: none"> • PBM's servicing system or the current services (if PMB is not the servicer) • Fannie Mae's Loan Lookup tool, or • Any other source as confirmed by PBM Note: PBM must inform DU that Fannie Mae owns the existing mortgage using the Owner of Existing Mortgage field in the online loan application before submitting the loan to DU
CLTV Ratio	<ul style="list-style-type: none"> • 95.01 to 97% if the subordinate lien is not a Community Seconds loan • 105% if the subordinate lien is a Community Seconds loan
HCLTV Ratio	.95.01 to 97%
Loan Type	Fixed-rate loans with terms up to 30 years High-balance, adjustable-rate, HomeReady mortgage loans, HomeStyle Energy mortgage loans and HomeStyle Renovation mortgage loans are not permitted
Property and Occupancy	One-unit principal residence Manufactured housing is not permitted
Borrower Eligibility	At least one borrower on the loan must have a credit score
Underwriting Method	DU only
Other	All other standard limited cash-out refinance policies apply

Note: The above requirements do not apply to DU Refi Plus or Refi Plus transactions.

Loan Program Requirements

Rate and term refinance transactions are subject to the following loan program requirements:

Purpose of Refinance	Agency Conforming / Agency Jumbo	Standard Jumbo
Pay off a first mortgage regardless of age	Allowed	Refer to specific Jumbo Program Guidelines.
Purpose of Refinance	Agency Conforming / Agency Jumbo	Standard Jumbo
Pay off a junior lien	<p>Allowed only if the proceeds were used to acquire the subject property.</p> <p>If the junior lien is a home equity line of credit (HELOC), the current balance may not exceed the initial draw amount; otherwise it is considered cash-out refinance.</p> <p>Required Documentation: A copy of the final HUD-1 from the purchase</p>	Refer to specific Jumbo Program Guidelines
The “buy out” of the interest of one owner or beneficiary, such as in a divorce or inheritance settlement	<p>Allowed. The borrower who will be acquiring sole ownership must receive no cash out from the transaction.</p> <p>Required Documentation: A copy of the divorce decree, property separation, agreement, will, probate court approval, deed, or other documentation substantiating the transfer must be in the loan file.</p>	
The “buy out” of the interest of a domestic partner, fiancée or fiancé	<p>Allowed with the following restrictions:</p> <p>The borrower who is “buying out” the other borrower’s interest must be able to qualify for the mortgage under standard underwriting guidelines</p> <p>The borrower who will be acquiring sole ownership must receive no cash out from the transaction</p>	
Pay off a lien secured by a leasehold estate and convert the title to fee simple	<p>Allowed. The payoff of the leasehold estate must occur directly at closing by the escrow officer.</p> <p>Required Documentation: A copy of the documentation substantiating the purchase of the fee simple interest and its cost The payoff must be reflected on the HUD-1</p>	

Cash Out (updated 6/28/2016)

Borrower is receiving cash back that exceeds the limits for limited cash out/rate and term. This includes transactions that will payoff existing second trust deed liens, which were not purchase money or any other outside of transaction debt or Free and Clear Properties.

❖ **Cash out refinance transactions must meet the following requirements:**

- The transaction must be used to pay off existing mortgages by obtaining a new first mortgage secured by the same property or be a new mortgage on a property that does not have a mortgage lien against it.
- Financing the payment of closing costs, points, and prepaid items. The borrower can include prepaid real estate taxes in the new loan amount if those taxes are due within the 60 days prior to or 60 days following the closing date of the new loan. Delinquent real estate taxes (taxes pas due by more than 60 days) can also be included in the new loan amount, but if they are, an escrow account must be established, subject to applicable law or regulation;
- Properties listed for sale in the 6 months preceding the application date of the new mortgage loan are limited to 70% LTV/CLTV/HCLTV ratios (or less, if mandated by the specific product, occupancy, or property type).

Note: Properties that were listed for sale must have been taken off the market on or before the application date of the new mortgage loan and borrower must address their intentions to continue to occupy the property.

- The property must have been purchased by the borrower at least six months prior to the disbursement date of the new mortgage loan except if delayed financing guidelines are met. See delayed financing guidelines for details.
- A statement from the borrowers disclosing the purpose for the cash out is required.
- Cash-Out available on Investment Properties 3-4 units (see Fixed Rate product matrix for details).
 - Not available on ARM Product
 - High Balance (cash-out available on Primary 1 Unit Only)
- The property must have been purchased by the borrower at least 6 months prior to the loan application for new financing, except if delayed financing guidelines are met.
 - See Delayed Financing Cash Out Guidelines A-1F

Note: For Cash-Out transaction, borrowers must have been on title for 6 months to use the current appraised value to determine LTV/CLTV.

❖ *The following are acceptable uses for cash-out refinance transactions:*

- Paying off the unpaid principal balance of the existing first mortgage.
- Financing the payment of closing cost, prepaid items, and points.
- Paying off any outstanding subordinate mortgage liens of any age.
- Taking equity out of the subject property that may be used for any purpose.
- Financing a short-term refinance mortgage loan that combines a first mortgage or a refinance of the short-term refinance loan within 6 months.

❖ *The following transaction types are not eligible as cash out refinances:*

- The mortgage is subject to a temporary interest rate buydown.
- The subject property was purchased by the borrower within the 6 months preceding the disbursement date of the new mortgage, except if delayed financing guidelines are met.
- The subject property is currently listed for sale at the time of the new mortgage loan.
- Transactions in which a portion of the proceeds of the refinance is used to pay off the outstanding balance on an installment land contract, regardless of the date of the installment land contract was executed.

The transaction is not eligible for delivery when the subject property is listed for sale at the time of disbursement of the new mortgage loan.

Subordinate Loans

When subordinate liens remain outstanding, they must be clearly subordinate to the new refinance loan. Additionally, the new refinance loan must meet the subordinate financing criteria.

A loan's classification as a limited cash out/rate and term transaction will not be affected when there is existing secondary financing that will be subordinated.

When calculating CLTV/HCLTV on a transaction with a subordinate equity line, the CLTV is calculated based on the current balance and HCLTV is based on the maximum loan limit.

On any subordinating lien *which is secured by the subject property of our loan* where the maximum line amount has been reduced by the borrower or the lender we now must require a copy of the recorded modification agreement which reflects the reduction. We can no longer just accept the letter notifying the Borrower of the reduction to the maximum line OR a credit report supplement reflecting the reduced line amount. Our investors now require the copy of the recorded modification to support the change and allow use of the reduced line amount for calculating the CLTV. Please make sure that any loans you currently may have in your pipeline have been formally modified so that the subordination agreement reflects the lesser amount as the subordinate lien. As a reminder, any subordinate financing cannot have any reference to the possibility of negative amortization. Any questions, please do not hesitate to contact Corporate Underwriting.

NOTE: Copy of Note and/or Contract for subordinate financing is ALWAYS required to be in the loan file as well as a copy of the executed subordination agreement.

Home Equity Line of Credit (HELOC) that provides for a monthly payment of principal and interest or interest only, the payment on the HELOC must be considered as part of the monthly debt obligations. If the HELOC does not require a payment, there is no recurring monthly debt obligation, underwriter does not need to develop an equivalent payment amount.

Acceptable Subordinate Financing Types

Fannie Mae

- Variable payment mortgages that comply with the details below.
- Mortgages with regular payments that cover at least the interest due so that negative amortization does not occur.
- Mortgages with deferred payments in connection with Employer subordinated financing
- Mortgage terms that require interest at market rate.

If financing provided by the property seller is more than 2% below current standard rates for second mortgages, the subordinate financing must be considered a sales concession and the subordinate financing amount must be deducted from the sale price.

Unacceptable Subordinate Financing (updated 6-28-2016)

- Mortgage with negative amortization
- Subordinate financing that does not fully amortize under a level monthly payment plan where the maturity or balloon payment date is less than 5 years.
- HERO/PACE assessments

NOTE: Fannie Mae will accept the first two subordinate financing terms when the amount of the subordinate debt is minimal relative to the borrower's financial assets and/or credit profile. HERO/PACE assessments must be paid off prior to loan closing.

Eligible Variable Payment Terms for Subordinate Financing

Fannie Mae permits variable payments for subordinate financing if the following provisions are met:

- With the exception of HELOCs, when the repayment terms provide for a variable interest rate, the monthly payment must remain constant for each 12 month period over the term of the subordinate lien mortgage. (For HELOCs, the monthly payment does not have to remain constant.)
- The monthly payments for all subordinate liens must cover at least the interest due so that negative amortization does not occur (with the exception of employer subordinate financing and that has deferred payments).

Eligible Repayment Terms for Employer Subordinate Financing-Fannie Mae

If the subordinate financing is from the borrower's employer, it does not have to require regular payments of either principal and interest or interest only. Employer subordinate financing may be structured in any of the following ways:

- Fully amortizing level monthly payments,
- Deferred payments for some period before changing to fully amortizing level payments,
- Deferred payments over the entire term, or
- Forgiveness of the debt over time.

The financing terms may provide for the employer to require full repayment of the debt if the borrower's employment is terminated (either voluntarily or involuntarily) before the maturity date of the subordinate financing.

Freddie Mac - Mortgages with secondary financing

General requirements

Secondary financing is all financing that is subordinate in lien priority to the First Lien Mortgage. Freddie Mac will purchase First Lien Mortgages with secondary financing under the terms of the Purchase documents in this section.

Terms of any secondary financing must be disclosed to the appraiser and to the MI. The terms of the secondary financing that must be disclosed include, but are not limited to, the Note Rate and the institution or individual providing the financing. The underwriter may not indicate a value needed to support the transaction, or provide any information to the appraiser about an expected loan-to-value (LTV) ratio.

Secondary financing is not eligible for sale to Freddie Mac.

Special requirements for new secondary financing

Secondary financing originated concurrently with the First Lien Mortgage (i.e., the First Lien Mortgage and the lien are originated on the same day) must meet the following requirements:

Maturity Date

The maturity date or amortization basis of the junior lien must not be less than five years after the Note Date of the First Lien Mortgage delivered to Freddie Mac, unless the junior lien is fully amortizing or a Home Equity Line of Credit (HELOC). In addition, the junior lien must not contain a call provision within five-year period, unless the junior lien is a HELOC.

Documentation requirements

The underwriter must include a copy of the following documentation in the Mortgage file:

- Note or other evidence of subordinate lien terms
- Settlement/Closing Disclosure Statement that evidences the fees and costs paid by the Borrower at closing in connection with the secondary financing
- For HELOCs, the HELOC agreement indicating all fees and costs paid by the Borrower at closing, and the maximum permitted credit advance

Special requirements for existing secondary financing

Freddie Mac will purchase First Lien refinance Mortgages with existing junior liens (including HELOCs) that are not paid off from the proceeds of the refinance Mortgage provided that:

- Evidence of subordination of outstanding secondary financing is retained in the Mortgage file
- The junior lien has scheduled payments sufficient to meet the interest due

Refinance/Churn Policy (Retail Only)

- Loan Officers who refinance a Provident Bank Mortgage loan within 121 days of the original transaction will not be eligible to receive a commission.
- The effective dates will be based off of the Investor purchase date.
- In cases where we cannot delay the refinance funding, due to competition, we may allow the refinance to proceed with a non-producing manager or the use of the Provident Bank Mortgage Call Center as the Originator.
- Provident Bank Mortgage Secondary must be notified via e mail prior to origination of any loan that falls into the above category.

Cash Out from Concurrent Secondary Financing

The borrower may receive cash out from the proceeds of the concurrent lien as long as the CLTV is within loan program guidelines and the first lien meets seasoning requirements outlined in Limited Cash Out/Rate and Term Refinance.

If the first lien is a limited cash out/rate and term and cash out is received from concurrent secondary financing, the first lien may remain classified as a rate and term refinance.

Loan Program Requirements

Cash out refinance transactions are subject to the following loan program requirements.

Purpose of the Refinance	Agency Conforming / Agency Jumbo	Standard Jumbo
Pay off the first mortgage regardless of age	Allowed	SEE PROGRAM GUIDELINES FOR SPECIFICS
Pay off a junior lien regardless of age and if the junior lien is a HELOC, regardless of any draws	Allowed	
Disburse cash to the borrower or other payee	Allowed. No limitations on the amount of the cash out	
Purpose of the Refinance	Conforming	
Pay off a bank, credit card or any other debt, such as tax liens, garnishment judgment, delinquent HOA dues that may not be secured by the subject property	Allowed	

Construction to Permanent Financing (updated 5/31/2016)

The term construction to permanent financing is used for the granting of long-term mortgage to a borrower to replace interim construction financing used for the construction of a new home.

Purchase versus Refinance

Transactions must be treated as a purchase or refinance subject to the following criteria:

Purchase – When a purchase transaction is used, the borrower is not the owner of the lot prior to the loan application, and the borrower is using the proceeds from the interim construction financing to purchase the lot and finance the construction of the property.

Refinance –When a limited cash-out refinance transaction is used, the borrower must have held legal title to the lot before he or she applied for the interim construction financing. The borrower is using the proceeds from the construction financing to pay off any existing liens on the lot and finance the construction of the property. This type of transaction is not a “true” limited cash-out refinance, whereby the borrower refinances a loan(s) that was used to purchase a completed property, however, all other requirements for limited cash-out refinances apply.

Note: For the borrower to be eligible for a cash-out refinance transaction, the borrower must have held legal title to the lot for at least six months prior to the closing of the permanent mortgage. All other standard cash-out refinance eligibility and underwriting requirements apply.

Loan Requirements

All construction-to-permanent loans must adhere to these requirements:

- The maximum term is 30 years from the date the first monthly installment of principal and interest is due
- The property must be completed at the time of the permanent financing funding
- A final Certification of Completion must be obtained
- Photographs of the completed property are required

Credit documents may not be more than 90 days old on the Note date.

Terms of Construction Loan Period – Single-Closing Construction to Permanent Mortgages

The construction loan must be structured as a temporary loan exempt from ability to repay requirements under Reg Z. The construction loan period may have no single period of more than 12 months and the total period may not exceed 18 months.

Down Payment

Minimum 5% down payment is required. The borrower must use his or her own funds to make the minimum contribution unless

- The LTV, CLTV, or HCLTV is less than or equal to 80%; or
- The borrower is purchasing a one-unit principal residence and meets the requirements for gifts and/or grants to pay for some or all of the borrower’s minimum contribution.

NOTE: The borrower may use the cash investment in the land, provided it was acquired in the 12 months or more before the date of the application for construction financing. Acceptable documentation include the final HUD-1, a copy of the warranty deed showing no liens, or a copy of a release of the lien

Cash Proceeds

No loan proceeds may be disbursed to the borrower unless the proceeds are used to reimburse the borrower for documented costs paid outside of closing.

LTV Determination (updated 5/31/2016)

The LTV ratio calculation differs depending on whether the transaction is a purchase or a limited cash-out refinance, as shown in the table below:

Transaction Type	Lot Ownership Requirement	LTV Ratio Calculation
Purchase	The borrower is not the owner of record of the lot at the time of loan application.	Divide the loan amount of the construction-to-permanent financing by the lesser of: <ul style="list-style-type: none"> • The purchase price (sum of the cost of construction and the sales price of the lot), or • The “as completed” appraised value of the property (the lot and improvements).
Limited Cash-out Refinance	The borrower is the owner of record of the lot at the time of loan application	Divide the loan amount of the construction-to-permanent financing by the “as completed” appraised value of the property (the lot and improvements).

Land Acquisition

The cost of the land acquisition is determined by a certified copy of the closing statement (HUD-1) from the purchase of the land

- If the land was purchased more than 2 years *prior* to the loan, the current land value may be used if substantiated by a separate land appraisal
- If the land was a gift and the value has appreciated, the value based on a current land appraisal may be used as the borrower’s down payment

Calculation of Acquisition Cost

The total acquisition cost is based on:

- With Sales Contract: Appraised value of the land, if not included in the contract price and paid receipts and cancelled checks for costs that exceed that contract price.
- Without a Sales Contract: Current appraised value of the land, and Contractor’s construction cost breakdown, and Paid receipts and cancelled checks for costs that exceed interim financing.

NOTE: If the borrower is also the builder, or an employee, relative, domestic partner fiancé/fiancée of the builder, the builder’s profit is not considered an allowable cost, and may not be included in the acquisition cost.

Sweat Equity (updated 7/11/16)

Generally, sweat equity is not an acceptable source of funds for the down payment, closing costs, and reserves, since it is difficult to accurately assess the contributory value of sweat equity work. Only for specific transactions and if all eligibility requirements are met do the Agencies consider sweat equity to be an acceptable source of funds. i.e. HomeReady and Home Possible Mortgages.

Note: Credit will not be given for sweat equity unless there is at least a 5% down payment from borrower personal funds.

Using a General Contractor

If the borrowers employ a general contractor, the following documentation is required to verify the cost of construction:

- Signed construction contract
- Sealed copy of the improvement plans and complete breakdown of construction costs and specifications
- Copies of canceled checks and receipts of bills for payment of any supplies, material, labor, or funds paid directly to subcontractors by the borrower

General Contractor is Not Used

If a general contractor is not used to construct the building, the construction costs must be documented with copies of receipts or invoices and cancelled checks for materials, supplies and/or labor.

Certificate of Occupancy

A Certificate of Occupancy is always required for newly constructed dwellings unless the borrower or contractor/developer submits a letter from the appropriate governmental authority stating it is not required."

Conversion to Permanent Loan

There is no time limitation. If the transaction occurs more than 180 days after the completion of the construction, it must be considered a refinance.

LTV Calculation Refinance

LTV Calculation for Agency Conforming Loans

Conforming loan refinance transactions are subject to the requirements in the following table when determining the LTV.

LTV Calculation for Agency Conforming and Agency Jumbo

Calculation of the LTV Ratio (03/29/2016)

The maximum allowable LTV ratio for a first mortgage is based on a number of factors including, the representative credit score, the type of mortgage product, the number of dwelling units, and the occupancy status of the property. The following table describes the requirements for calculating LTV ratios for a first mortgage transaction:

Underwriting Method	Type of Transaction	Calculation of the LTV Ratio
AUS	Purchase money transactions	Divide the original loan amount by the property value. (The property value is the lower of the sales price or the current appraised value.)
AUS	Refinance transactions	Divide the original loan amount by the property value. (The property value is the current appraised value).
AUS	Mortgages with financed mortgage insurance	Divide the original loan amount plus the financed mortgage insurance by the property value. (The property value is the lower of the sales price or the current appraised value).

Calculation of the CLTV Ratio (02/23/2016)

For first mortgage loans that are subject to subordinate financing, the underwriter must calculate the LTV ratio and the CLTV ratio. The CLTV ratio is determined by dividing the sum of the items listed below by the lesser of the sales price or the appraised value of the property.

- The original loan amount of the first mortgage
- The drawn portion (outstanding principal balance) of a HELOC, and
- The unpaid principal balance of all closed-end subordinate financing. (With a closed-end loan, a borrower draws down all funds on day one and may not make any payment plan changes or access any paid-down principal once the loan is closed.)

Note: for each subordinate liability, in order for the underwriter to accurately calculate the CLTV ratio for eligibility and underwriting purposes, the underwriter must determine the drawn portion of all HELOCs, if applicable, and the unpaid principal balance for all closed-end subordinate financing. If any subordinate financing is not shown on a credit report, the underwriter must obtain documentation from the borrower or creditor.

If the borrower discloses, or the underwriter discovers, new (or increased) subordinate financing after the underwriting decision has been made, up to and concurrent with closing, the underwriter must re-underwrite the mortgage loan.

Non-Contingent Second Trust Deeds

A non-contingent second trust deed occurs when you have a first trust deed application that will not close concurrently with a new second trust deed. The applicants are “pre-approved” for a stand-alone second, non-contingent to the new first. This concept could apply to a purchase or a refinance.

It is imperative that this second is treated as a stand-alone second. This will require a separate loan application, dated after the recording of the new first trust deed.

Application for the first trust deed is completely processed, underwritten and closed before the application for the second is created

The following credit package documents from the first loan file can be used for the new second (as long as the documents are less than 90 days old).

- Credit Report (soft-pull if > 45 days at funding)
- Verification of Income and Assets
- Appraisal

The following items from the first CANNOT be used in the new second and must be dated after the closing and recording of the first.

- The initial application.
- The Escrow Instructions.
- Flag policy or title order (must reflect the new first).

If this procedure is not followed correctly the title policy for the new first will reflect both loans, resulting in a loan that cannot be sold.

Purchase Property Scenarios

Purchase of a Short Sale Property

Borrower may pay additional fees and payments in connection with purchasing a short sale property that are typically the responsibility of the seller. Examples of short sale fees and payments include, but are not limited to the following:

- Short sale processing fee (i.e., short sale negotiation fees, buyer discount fees, short sale buyer fees).
 - **NOTE:** the short sale processing fee is not a common and customary charge and must be treated as a sales concession if any portion is reimbursed by an interest party to the transaction.
- Negotiated short payoff to a subordinate lien holder, and
- Payment of delinquent taxes or delinquent homeowners association (HOA) dues

NOTE: The above referenced fees are non-GFE fees

These fees and payments cannot be financed into the loan amount and must be included on the settlement statement. Borrowers must fund the cost of additional fees and payments with their own funds. The additional funds to complete the transaction must be documented.

- Sales contract will identify if the property being purchased is a short sale property
- The transaction must be an arm's length transaction (i.e. all parties are unaffiliated and unrelated).
- Underwriter must diligently review these purchase transactions for unusual fees, payments, and other possible red flags that could indicate fraudulent activity related to the short sale.
- Maximum allowable short sale fees that can be paid by borrower are 3% of the sales price.

Document Requirements

- Sales contract executed by all parties with details of the additional fees and payments.
- The HUD-1 Settlement Statement that includes all borrower paid short sale fees, assessments, and payments, and
- Source of borrower(s) funds used to cover the short sale fees and payments.

Non-Arm's Length Transactions

A non-arm's length transaction occurs when a personal or business relationship exists between the borrower and the builder or seller. These transactions include:

- Family sales or transfers
- Corporate sales or transfers
- Mortgagors employed in the real estate or construction trades who are involved in the construction, financing or sale of the subject property
- Transactions involving principals or a seller or other vendor (such as an appraiser, settlement agent, title company, and so on) who is involved in the lending process of the subject property

NOTE: Non-arm's length transactions may require additional documentation depending on the underwriter's assessment of risk.

Ineligible Loan Programs

Non-arm's length transactions must be a Full or Alternate Documentation transaction only.

Purchasing from a builder

If borrowers are purchasing a property from a builder who is purchasing the borrowers' existing residence, it is considered a non-arm's length transaction and is not permitted by Provident Bank Mortgage. If the borrower has a relationship or business affiliation with the builder, developer or seller, only principal residence transactions are eligible.

Transaction with Non-Family Members

Non-arm's length transactions with non-family members will be considered only if they are bona fide sales transactions and the borrowers will occupy the property as their primary residence.

Transaction with Family Members

Non-arm's length transactions with a family member are generally acceptable if:

- The family member or relative is the borrowers' spouse, child, parent or any other individual related to the borrowers by blood, adoption, or legal guardianship
 - An executed purchase or sales agreement between the purchaser and the family member is in the loan file
 - The source and ownership of funds for the down payment, closing costs and reserves are well documented in the loan file
 - The appraised value of the property is well supported, particularly for gifts of equity or gifts of more than 20% of the LTV
 - Gifts are not allowed for second home and investment properties
 - Gifts are allowed for owner-occupied transactions if they meet the normal gifting guidelines as follows:
 - The borrowers must have 5% of their own funds as a down payment; however, if the LTV/CLTV is less than or equal to 80% then the entire loan payment may be a gift
- Gifts of equity are acceptable if verified by an appraisal and gift letter
A signed gift letter and verification of the receipt of the funds are provided

Borrower is Interested Party

This type of transaction is not allowed if the builder and/or property seller is a company owned by the borrower or where the borrower is a registered agent, sales agent or partner for the builder or property seller.

A borrower may act as an interested party to a sales transaction for the subject property; however, the borrower may not use any payment for services rendered for the sales transaction of the subject party towards the down payment, closing costs or reserves requirements.

Payment for services rendered means payment for, but is not limited to:

- Realtor commissions
- Broker commissions
- Sales associate commissions

Freddie Mac

Freddie Mac allows 12 months Homeowner's dues be included as an interested party contributions.

Documentation

For all mortgage loan documentation types, Provident Bank Mortgage does not accept documentation containing evidence of ink eradicator ("white out") or other alterations, such as "blacking out". Certified copies of documentation are required and blanket certifications are acceptable.

Age of Documentation- Conventional

Type	Age of Documentation
Assets	Within 90 days of the note date or follow DU
Income	Within 90 days of the note date or follow DU
Credit	Within 45 days of funding or (soft pull required) Credit report cannot be over 90 days old as of the date of the note.
Appraisal	Within 90 days of funding or (re certification required)
Prelim	Within 90 days of funding
CPL	Within 30 days of funding
CPM	Good for 1 year from issue date
Trust Certification	Within 90 days of funding
Termite & Clearance	Within 90 days of funding

Age of Documentation- FHA & VA Loans

Type	Age of Documentation
Assets	Within 120 days of funding
Income	Within 120 days of funding
Credit	Within 45 days of funding or (soft pull required)
Appraisal FHA	120 days (effective date of appraisal)
Appraisal VA	180 days (effective date of appraisal)
Prelim	Within 120 days of funding
CPL	Within 30 days of funding
CPM	Good for 1 year from issue date
Trust Certification	Within 120 days of funding
Termite & Clearance	Within 120 days of funding

Income Documentation

Provident Bank Mortgage offers a variety loans programs with basic forms of income documentation, which have been generally defined below. The loan parameters for “Full Income” documentation and “Alternative Income” documentation are per agency guidelines.

Full Income Documentation

All income calculations are required to be itemized on the Income and Debt Worksheet.

Wage Earner

When a borrower is employed and not a business owner they may be classified as a 'wage earner' or W-2 borrower. This borrower must demonstrate 2 full years of employment history, with income documentation as determined by AUS findings, which may require the following:

- Verification of Employment(s) completed by an authorized agent of the employer dated within 60 days at time of underwriting plus Verbal VOE done by Processor or Funder.
- Paycheck stubs dated no earlier than 30 days prior to the initial loan application date and include all year-to-date earnings. The paystub must include sufficient information to appropriately calculate income, otherwise, additional documentation must be obtained.
- Most recent one- to two years W2's evidencing taxes withheld and year to date earnings.
- Verbal Verification of Employment within 10 days of funding date, including the day of funding.
- Processed 4506-T for the two most current consecutive years. (If AUS is only requiring one year 1040's or W-2 then only that year must be processed. However a 4506T for the two most recent years must be executed up front and with docs.)

Unreimbursed Employee Business Expense/2106-Fannie Mae

The following changes and clarifications have been made to the Fannie Mae Selling Guide related to unreimbursed employee business expenses.

- For a borrower who is qualified using base pay, bonus, overtime, or commission income less than 25% of the borrower's annual employment income:
 - Unreimbursed employee business expenses are not required to be analyzed or deducted from the borrower's qualifying income, or added to monthly liabilities. This applies regardless of whether unreimbursed employee business expenses are identified on tax returns (IRS for 2106) or tax transcripts received from the IRS.
 - Union dues and other voluntary deductions identified on the borrower's paystub do not need to be deducted from the borrower's income or treated as a liability.
- For borrower earning commission income that is 25% or more of annual employment income, unreimbursed employee business expenses must be deducted from gross commission income regardless of the length of time that the borrower has filed that expense with the IRS.
 - The exception to this is if the expense is an actual automobile lease or loan payment. If borrowers report an automobile allowance as part of their monthly qualifying income, the underwriter must determine if the automobile expenses reported on IRS Form 2106 should be deducted from income or treated as a liability. (See Automobile Allowance that describes how to make this determination)

Unreimbursed Employee Business Expense/2106-Freddie Mac

Employee paid business expenses reflected on the borrower's tax returns must be deducted from the borrower's commission income when calculating income, even if commissions represent less than 25% of the borrower's total qualifying income.

- (Updated 01/26/2015) W-2 Only transcripts for an Hourly or Salaried Employee must be sold as Investor Specific, Fannie Mae and/or Freddie Mac.

Incentive Pay

When a borrower receives incentive pay such as bonus income or commission earnings additional documentation may be necessary to confirm whether business related expenses should be deducted. When commission income is greater than 25% of the total income used and/or any commission income is used the following is required in addition to the above:

- Last two years Federal Tax returns (1040).
- Deduct any business-related expenses from the qualifying income.
- Process a signed 4506T to authenticate the 1040's submitted by the borrower.
- Corporate Management must review any deviations from the 4506T results and the 1040's submitted.

Self-Employed

When a borrower is a business owner they are considered to be self-employed. The following documentation is required to calculate qualifying income.

- Balance Sheet
- Year to date profit and loss statement at underwriter's discretion (see Analyzing Profit and Loss Statements)
- Past two years complete 1040's and schedules.
- Past two years completed 1065's & K-1's when applicable.;
- Past two years 1120's when applicable.
 - Process a signed 4506T to authenticate the 1040's submitted by the borrower.
 - Corporate Underwriting must review any deviations from the 4506T results and the 1040's submitted.
 - Provident Bank MortgageBM requires the underwriter to complete and sign a Self-Employed Analysis Worksheet to substantiate the income used to qualify the loan must be used.
 - 4506-T Form must be signed and dated at application and again with loan documents for all Tax returns in the loan file.
 - Example: If you have 1040's and 1120's in the loan file, a separate 4506-T form is required for the 1040's and the 1120's.
 - 4506-T form signed and dated MUST be processed (transcripts) for all tax returns in the loan file that are being used for income qualifying only. i.e. 1040's, 1120'S and 1065's.

Unearned/Passive Income in Full/Alt Doc Submission

Income received from non-employment sources is considered Unearned or Passive Income:

- Disability
- Alimony (Maintenance) Income
- Child Support
- VA Benefits
- Trust Income
- Note Income
- Workers Compensation
- Capital Gains and Losses
- Dividends and Interest (minimum 1 year history)
- Dependent Care Income
- Survivor Benefits for Minor Children
- Annuity Income
- Rental Income
- Foster Care

Unearned income must be documented by means of contract, agreement, award letter or the equivalent and must be expected to continue for at least 3 years. When Unearned/Passive Income exceeds 50% of the total qualifying income two years of Federal Tax Returns are required and authenticated by a processed 4506T.

Nontaxable income may be grossed up to 125% if you have 1040's verifying it is not taxed. Income may not be grossed up if 1040's reflect it as taxable.

Use of Verification Forms

Verification forms, mailed directly to and received directly from the borrower's employer, bank, mortgage company or landlord, may be used to document the borrower's income, employment, available funds and mortgage or rent payment history. When this type of verification is used, it is up to the underwriter's discretion if any additional, supporting documentation will be required.

These forms must be sent directly by the Originating Branch to the borrower's employer, depository, mortgage services or landlord for verification. These documents cannot be hand-carried to or from their destination by the borrower or any individual who is a party to or has an active part of the transaction, including, but not limited to the buyer, seller, realtor, builder, loan originator, account executive, processor, underwriter, funder, etc.

The sophistication of xerographic, desktop publishing and scanning technology have significantly increased the risk of mortgage misrepresentation. Using this new technology, misrepresented verifications of employment, deposit statements, and so on, can be easily created that are virtually indistinguishable from valid forms. Therefore, underwriters must thoroughly verify all information used to evaluate and establish the borrower's credit worthiness.

Alternative Income Documentation (applies to DU/LP findings only)

Wage Earner

When a borrower is employed and not a business owner they may be classified as a 'wage earner'. This borrower must demonstrate 2 full years of income documentation through the following means:

- Verbal verification of employment providing the following information:
 - Date of Employment
 - Title / Position
 - Earnings (optional)
 - Probability of continued employment (optional)
 - Name/Title/Phone of authorized employer who verified
 - Name/Title/Date of Provident employee who verified
- Paycheck stubs evidencing the borrower's base pay, tax withholding and year to date earnings covering the most recent 30 days.
- Most recent two years W2's evidencing taxes withheld and year to date earnings.
- Self-employed borrowers are not eligible for Alternative Documentation

Foreign Documentation

Documents obtained from a foreign country must meet FNMA/FHLMC document requirements and standards. All documents of foreign origin must:

- Be completed in English, or contain an English translation with an attached affidavit that warrants that the translation is complete and accurate.
- All foreign currency amounts must be converted to U.S. dollars at the time of translation.
 - Foreign documents that cannot be re-verified either in writing or verbally are not acceptable.

Funds & Assets

Any indications of borrowed funds - such as a recently opened account, a recently received large deposit, or an account balance that is considerably greater than the average balance over the previous few months must be investigated. Bank statements used for verifying assets must also be reviewed for monthly reoccurring payments, such as student loans, time shares, etc., that would be required to be included in debt ratios.

Down Payment

For Purchase Money Loans, sufficient funds to cover the down payment and closing costs must be verified. The borrower must contribute a minimum of 5% towards the down payment from his or her own cash funds unless stated otherwise in the program matrices.

To determine the amount of money a purchaser needs to close a mortgage transaction, use this calculation:

Total Closing Costs + down payment/funds from borrower – initial deposit to escrow – seller and/or lender credits = estimated cash to close.

Business Assets

When a borrower intends to use business assets as funds for the down payment, closing costs, and/or financial reserves, the underwriter must perform a business cash flow analysis to confirm that the withdrawal of funds for this transaction will not have a negative impact on the business. In order to assess the impact, the underwriter may require a level of documentation greater than what is required to evaluate the borrower's business income (for example, several months of recent business asset statements in order to see cash flow needs and trends over time, or a current balance sheet). This may be due to the amount of time that has elapsed since the most recent tax return filing, or the lender's need for information to perform its analysis. The file must contain the underwriter's written cash flow analysis and conclusions.

Cash Reserves

Refer to program matrices or AUS findings to determine specific reserve requirements. AUS will determine the reserve requirement based on the overall risk assessment of the loan, the minimum reserve requirement that may be required for the transaction, and whether the borrower has multiple financed properties. The standard reserve requirements for conventional, conforming loans are:

Subject Property	Required Reserves
Primary Residence – 1-unit	None
Primary Residence – 2- to 4-unit	Six months for the subject property
Second Home	Two months for the subject property
Investment Property	Six months for the subject property

Fannie Mae Multiple-Financed Properties Required Reserves: (updated 3/29/2016)

If a borrower has multiple financed properties and is financing a second home or investment property, DU will base the reserve calculations for the other financed properties on the number of financed properties determined by DU. Refer to the Calculation of Reserves for Multiple Financed Properties for additional details.

Freddie Mac: Multiple-Financed Properties Required Reserves (updated 7/11/16)

Second home and Investment Property mortgages require reserves in addition to the required reserves in the table above:

Subject property	Additional required reserves
Second home or Investment Property	Two months for each additional second home and/or 1- to 4-unit Investment Property: <ul style="list-style-type: none">• In which the borrower has an ownership interest or on which the borrower is obligated, and• That is financed

The underwriter must determine and verify the additional required reserves stated above in addition to the amount of reserves required to be verified by LP.

Examples of liquid financial assets that can be used for reserves include readily available funds in

- checking or savings accounts;
- investments in stocks, bonds, mutual funds, certificates of deposit, money market funds, and trust accounts;
- the amount vested in a retirement savings account; and
- the cash value of a vested life insurance policy.

Stocks, Stock Options, Bonds, and Mutual Funds

Vested assets in the form of stocks, government bonds, and mutual funds are acceptable sources of reserves provided their value can be verified. The underwriter must verify the borrower's ownership of the account or asset. When used for reserves, 100% of the value of the assets may be considered, and liquidation is not required.

Retirement Accounts

Vested funds from individual retirement accounts (IRA/SEP/Keogh accounts) and tax-favored retirement savings accounts (401(k) accounts) are acceptable sources of funds for reserves. The underwriter must verify the ownership of the account and confirm that the account is vested and allows for withdrawals regardless of current employment status. When funds from retirement accounts are used for reserves, the funds do not have to be withdrawn from the account(s).

Trust Accounts

Funds disbursed from a borrower's trust account are an acceptable source for reserves provided the borrower has immediate access to the funds. To document trust account funds, the underwriter must:

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

Source of Funds

All sources for funds must be determined that are used to pay closing costs. Typical sources include the following:

- Funds on deposit in the borrower's checking, savings, money market or certificate of deposit;
- Stocks, bonds, mutual funds, United States government securities and other securities;
- Vested stock options;
- United States savings bonds;
- IRA and (SEP)-Ira accounts;
- 401(k), KEOGH, 403(b) and other IRS-qualified employer retirement plan accounts;
- Proceeds of a loan fully secured by the borrower's assets
- Proceeds from the sale of the borrower's assets
- Funds from a trust
- Individual Development Account (IDA)- borrower contribution and Agency matching funds not subject to recapture
- Community Savings System accounts – borrower contributions
- Pooled funds
- Cash value of a life insurance policy
- Rent credits
- Trade equity
- Gift or a gift of equity from a related person
- Gift or grant from an Agency
- Proceeds from an unsecured loan that is an Employer Assisted Homeownership (EAH) benefit

Verification of Deposits and Assets

Asset verification, including Verification of Deposit (VOD), bank statements and retirement account statements must contain the following:

- Clearly identify the borrower as the account holder
- Include the account number
- Include the time period covered by the statement
- Include all deposits and withdrawal transactions (for depository accounts)
- Include all purchase and sale transactions (for financial portfolio accounts), and
- Include the ending account balance.

Checking and Savings Accounts

If there is a recently opened account or a large increase in an existing account, the source of funds must be verified and explained by the borrower. Unverified funds are not acceptable for down payment or closing costs unless they meet the requirements for borrowed funds.

Verification of Deposit

When a Verification of Deposit (Form 1006 or Form 1006 (S) (VOD) is used and depository activity is not included, the underwriter must obtain a written explanation of the source of funds from the borrower, and must verify the source of funds for;

- Accounts opened within the last 90 days of the application date, and
- Account balances that are considerably greater than the average balance reflected on the VOD.
- This information must be requested directly from the depository institution, and the completed, signed, and date documents must be sent directly from the depository to PBM branch office.

Community Seconds Terms/Proceeds-Fannie Mae (updated 3/29/2016)

A Community seconds mortgage may be funded by a federal agency, municipality, state, country, state or local housing finance agency, nonprofit organization, a regional Federal Home Loan Bank under one of its affordable housing programs, or an employer Assisted Program. It may not be funded by the property seller or any other interested party to the transaction; however, a lender may fund a Community Seconds mortgage that an employer guarantees as part of its affordable housing program.

The Community Seconds financing must be subordinate to the mortgage purchased by Fannie Mae.

A borrower of a mortgage loan secured by a principal residence may use funds received from a Community Seconds mortgage to fund all or part of the down payment or closing costs, renovations to the property, or to fund a permanent interest rate buydown. Community Seconds are not allowed for second homes or investment properties.

Cash Deposit on Sales Contract (Earnest Money)

If the earnest money check has not cleared the borrower's bank account, the amount can be included in a depository account, such as a checking or savings account. If the earnest money check has cleared the borrower's bank account, the amount can be entered as Other Credits in Section VII of the 1003, where it is assumed to be verified. Care should be taken to make sure that the earnest money deposit is not counted twice in the evaluation of the assets.

Single Deposits

For purchase transactions, the underwriter must document the source of funds for any single deposit exceeding 50% of the totally monthly qualifying income for the mortgage if the deposit is needed to meet the requirements for borrower funds and/or reserves. The underwriter must document the source of a deposit of any amount regardless of the transaction type if he or she has any indication that the funds are borrowed or are not from an eligible source.

Necessary Documentation for Large Deposits

- Borrower provides a letter of explanation for large deposit. Borrower(s) to provide the letter of explanation regardless if the large deposit is sourced or backed out to verify if this is an acceptable source. If funds in question are being used for down payment, closing cost, earnest money deposit, or reserves, additional supporting documentation is required in order to adequately verify the source of funds is an acceptable source.
- If a checking, savings or certificate of deposit (CD) account was opened within 90 days of the loan application date, documentation of the source of the funds indicating that they are from an acceptable source must be documented.
- Account balances that are greater than the average balance over the previous two months must be addressed to ensure funds are from an acceptable source
- Large deposit may need to be sourced for up to six months, if multiple account statements are in the file.
- If funds in question are not being used for down payment, closing costs, earnest money deposit or reserves, and due diligence has been performed to ensure the funds are not from an unacceptable source, the underwriter may deduct the large deposit from the balance of the account and allow remaining funds to be used for qualifying. If the asset balance is reduced by the amount of the deposit, the reason for the change in the asset amount must be documented and explained. The AUS must be updated with adjusted asset balance and rerun to update the decision.
- Underwriter Certification – required when an underwriter determines that a large deposit may be deducted, to document the underwriter's thought process.

When bank statements are provided, borrower must include ALL pages even if the last page is blank (i.e. If the statement says 1 of 5, all 5 pages are needed)

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

Examples of an unacceptable Source-

- Personal Unsecured loan
- Cash on hand
- Credit card advances

Sale Proceeds

If the proceeds from the sale of a currently owned home are needed for the down payment and closing costs on the new house, the underwriter must verify the source of funds by obtaining a copy of the settlement statement on the existing home before, or simultaneously with, the settlement on the new home, showing sufficient net cash proceeds to consummate the purchase of the new home.

Anticipated Sales Proceeds (updated 2/23/2016)

If the borrower's currently owned home is listed for sale – but has not been sold, the borrower may be qualified on the basis of his or her anticipated equity. Use of “anticipated equity” does not eliminate the responsibility for verifying the actual equity received by the borrower for loan closing. The following table describes how to determine the amount of net proceeds based on a borrower's anticipated equity.

Sales Established?	Price	Net Proceeds Calculation
Yes		Sales Price – (Sales Costs + All Liens) = Estimated Proceeds
No		90% of Listing Price – All Liens = Estimated Proceeds Note: the 10% adjustment factor that is applied to the listing price must be changed depending on market conditions.

Bridge Loans

Bridge (or swing) loans are a form of second trust deed secured by the borrower's present home, which is usually for sale. By using funds from a bridge loan, the borrower can close on a new house before selling his or her existing house. This type of financing is acceptable if:

- The purchaser has the ability to carry the payment on the new home;
- The payment on other obligations;
- The payment on the current home with the additional payment for the bridge loan.

If the repayment schedule for the bridge loan is not monthly, it must be converted to a monthly amount for qualifying purposes. Finally, the new home cannot be used as additional collateral for the bridge loan.

Retirement Accounts-Fannie Mae

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

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

Cash-on-Hand

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

Trade Equity

The property seller may take a borrower's existing property in trade as part of the down payment as long as:

- The borrower has made minimum of a 5% cash down payment and his or her equity contribution is a true-value consideration. This is determined by subtracting the outstanding loan balance of the property that is being traded, plus any transfer costs, from the lesser of its appraised value or trade-in value (as agreed to by both parties);
- A separate written appraisal for the property that is being taken in trade must be provided;
- A preliminary title report is required to verify the ownership of the property and to determine if there are any existing liens on the property.
- A 1031 Exchange is only acceptable if used in conjunction with a non-owner occupied equity trade transaction. All trade equity requirements apply for 1031 Exchanges. The loan file must contain a certified copy of the escrow account must be obtained from the accommodator and must clearly show the amount of the equity for each property in the trade.

Rent Credit with 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 towards 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 underwriter must obtain the following documentation:

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

Sweat Equity

Sweat equity is not an acceptable source of funds.

Borrowed Funds Secured by an Asset

Borrowed funds that are secured by an asset represent a return of equity. Because of this, they may be used for down payment and closing costs. Assets that may be used to secure funds include certificates of deposit, stocks, bonds, automobiles, real estate, and life insurance policies.

Verification is required of both the terms of the loan and the fact that it is a secured loan. Monthly payments for the loan must be considered as debt when qualifying the borrower. When the loan does not require monthly payments, an equivalent amount must be calculated and considered a debt.

Sale of Personal Assets

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

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

NOTE: Depending on the significance of the funds in question, the lender may accept alternatives to this required documentation, particularly when the proceeds of the sale represent a minor percentage of the borrower's overall financial contribution.

Down Payment Assistance and MCC Credit

DPA Approval Process

When requesting approval for a Down Payment Assistance Program, it is the responsibility of the branch to e-mail the following information to Specialty Product Administrator at PBMScenario&GuidelineQuestions@myprovident.com

- Copy of the most current Note and Deed.
- Name, number and e-mail address for the contact person in charge of the program.

Once this information is received it will be reviewed for PBM Approval on FHA & Conventional 1st mortgages.

MCC Approval Process

When requesting MCC Approval, it is the responsibility of the branch to provide the following information;

- Branch to provide the Lender Participation Agreement from the specific county or city and e-mail it to PBMScenario&GuidelineQuestions@myprovident.com
- Corporate to review and execute agreement
- If a check is needed to go along with the Lender Participation Agreement to the county or city, a check request will be sent to accounting.
- Once the county or city has approved our executed Lender Participant Agreement, the branch personnel may be required to participate in an education course to become certified for the MCC Program.

If you have any questions, please contact Specialty Product Administrator @ Ext. 16142.

Unacceptable Funds

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

Gifts

Gift funds may be used to fund all or part of the down payment and closing costs subject to minimum borrower contribution requirements. Gifts are not allowed on an investment property.

Acceptable Donors

- A relative, defined as the borrower's spouse, child, or other dependent, or by any other individual who is related to the borrower by blood, marriage, adoption, or legal guardianship, or
- A fiancé, fiancée, or domestic partner

The donor may not be, or have any affiliation with, the builder, the developer, the real estate agent, or any other interested party to the transaction.

Minimum Borrower Contribution Requirements

The following table describes the minimum borrower contribution requirements for transactions that contain gifts:

LTV, CLTV, or HCLTV Ratio	Minimum Borrower Contribution Requirement From Borrower's Own Funds	
80% or less	One- to four-unit principal residence Second Home	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from a gift.
Greater than 80%	One-unit principal residence (does not apply to High Balance loans)	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from a gift.
	Two-to four-unit principal residence Second Home	The borrower must make a 5% minimum borrower contribution from his or her own funds. After the minimum borrower contribution has been met, gifts can be used to supplement the down payment and closing costs.

NOTE: If borrower receives a gift from a relative or domestic partner who has lived with the borrower for the last 12 months, or from a fiancé or fiancée, 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 principal residence.

Gift Funds/Freddie Specific

- Immediate Family Member
- 5% from borrower's own funds
- LTV of <=80% all gift O.K.
- Gifts not allowed on Investment properties

Gift Funds/Fannie Specific (when down payment is all gift)

- Loan must be locked investor specific
- Available with MI Approval only
- Fixed Rate only (no ARMs)

FHA and VA gift requirements are in the QLB – Program Summary

Gifts from a Relative

A borrower can use funds obtained as a gift from a relative to satisfy part of the cash requirement for closing, although the borrower generally must use his or her own funds to cover the required minimum cash down payment (typically 5% of the sales price) FHLMC.

Pooling Gift Funds

When a relative's gift is being pooled with the borrower's funds to make up the required 5% minimum cash down payment, the "gift" letter should also include the donor's certification that he or she has lived with the borrower for the last 12 months and will continue to do so in the new residence. The donor should also provide appropriate documentation to demonstrate a history of share residency, such as a copy of a driver's license, bill, bank statement, etc. that shows the donor's address as being the same as the borrower's address.

Gift of Equity

A “gift of equity” refers to a gift provided by the seller of a property to the buyer. The gift represents a portion of the seller’s equity in the property, and is transferred to the buyer as a credit in the transaction. A gift of equity is permitted for principal residence and second homes purchase transactions. The acceptable donor and minimum borrower contribution requirements for gifts also apply to gifts of equity. (Refer to Fannie Guide Section B3-4.3-04, Personal Gifts)

- Documentation Requirements;
 - A executed/signed gift letter, and
 - The settlement statement listing the gift of equity

Evidence of Gift Funds

A gift from a relative must be evidenced by a letter that is signed by the donor. The letter must include the following:

- Specify the dollar amount of the gift and the date the funds were transferred;
- Indicate the donor’s name, address, telephone number, relationship to the borrower, and the specific purpose of the gift, and;
- Include the donor’s statement that no repayment is expected.

Verifying Donor Ability of Funds and Transfer of Gift Funds

The underwriter must verify that the donor had sufficient funds to cover the gift and verify the borrower has received the gift funds. Acceptable documentation includes:

- A copy of the donor’s check and the borrower’s deposit slip
- A copy of the donor’ withdrawal slip and the borrower’s deposit slip
- A copy of the donor’s check to the closing agent
- A settlement statement showing receipt of the donors check

When the funds are not transferred prior to settlement, the donor may give the closing agent a certified check for the amount of the gift. A copy of that check or a settlement statement showing receipt of that check will be sufficient documentation for the lender’s records. The above documentation refers to conventional lending. FHA would require evidence the donor had the ability to gift the funds by supplying evidence of the source of the gift funds, such as a bank statement.

Sales Concessions/Interested Party Contributions/Finance Concessions

Some closing costs and prepaid settlement costs generally are paid by the property purchaser, while other costs are the responsibility of the property seller. Other costs may be paid by either the property purchaser or the property seller. When any costs that are normally paid by the property purchaser are paid (indirectly or directly) by someone else, they are considered to be interested party contributions (IPCs). All IPCs may be paid by any interested party to the property sale transaction, although we may impose limitations on the amount of the contributions. In addition, listing and selling agent’s commissions and other related costs (i.e. Auction fee and Negotiator fee) are limited to a total combined 8%.

An interested party is anyone (other than the property purchaser) who has a financial interest in, or can influence the terms and the sale or transfer of, the subject property. This includes the property seller, the builder/developer (or an affiliate who may benefit from the sale of the property), and the real estate agent or broker. When the property purchaser receives financial assistance from a relative, domestic partner, fiancé, fiancée, municipality, Non-profit organization, or employer, we do not consider the provider of the assistance to be an interested party to the sales transaction unless the person or entity is the property seller (or is affiliated with the property seller).

Interested Party Contributions

Interested party contributions (IPCs) are costs that are normally the responsibility of the property purchaser that are paid directly or indirectly by someone else who has financial interest in, or can influence the terms and the sale or transfer of, the subject property.

The maximum allowable contributions that interested parties may make for a conventional mortgage are limited to:

Occupancy Type	LTV/CLTV Ratio	Maximum IPC
Principal residence or second home	Greater than 90%	3%
	75.01% - 90%	6%
	75% or less	9%
Investment Property	All CLTV ratios	2%

NOTE: IPCs are not permitted to be used for borrower's down payment, reserve requirements or to meet minimum borrower contribution requirements.

For underwriting purposes, the lender must make a downward adjustment to the sales price of the property to reflect the amount of any contributions that exceed the limitations. In addition, the cost of any contributions that are in the form of personal property (such as furniture, decorator items, automobiles, club memberships, or other "giveaways") always must be deducted from the sales price of the property. The maximum LTV ratio (or CLTV) must then be calculated based on the lesser of the reduced sales price or the appraised value.

Some seller contributions—such as moving expenses, payment of various fees on the borrower's behalf, "silent" second mortgages held by the property seller, P&I abatements, and other contributions not disclosed on the settlement statement—often are given to home buyers outside of loan closing. These undisclosed contributions tend to reduce the effective sales price of a property; therefore, they may compromise the loan-to-value ratio for a mortgage. Consequently, a mortgage with undisclosed seller contributions is not eligible.

Freddie Mac allows 12 months Homeowner's dues be included as an interested party contributions.

Credit Criteria

Any credit that is being added but is not listed on the Credit Report, or that is being omitted from qualifying ratios must be itemized on the Income and Debt Worksheet. The date of the credit report used in qualifying (associated with the DU/LP) must be listed on the same Worksheet.

Credit Report

A Residential Mortgage Credit Report (RMCR) from an independent consumer-reporting agency is required. However, the use of "three file merged" credit report for certain mortgages is acceptable. All information in the applicant's credit report must be obtained from or verified by, sources other than the applicant. The consumer reporting agency must contact at least two national repositories of accumulated credit records for each locality in which the borrower has lived during the most recent two-year period. When co-borrowers have individually obtained credit, separate repository inquiries are necessary. The results of both reports may be combined in one residential mortgage credit report if the report clearly indicates that this has been done. If a credit report is over 45 days old at funding, a soft-pull credit report must be pulled (no FICOs needed) to determine any changes. If there are no changes on soft-pull report compared to original credit report, the original credit report can be used to fund the loan, but CANNOT be older than 90 days at funding.

NOTE: A copy of the soft-pull is to be placed under Branch Documents in the loan package.

The consumer-reporting agency must verify either in writing or by telephone the borrower's current employment and his or her income if it can be obtained. If the borrower has changed jobs in the past two years, the credit report must also describe his or her previous employment and income.

The credit report must indicate the dates that 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.

Each credit report must include all available public records information and must disclose whether any judgments, foreclosures, tax liens, or bankruptcies were discovered. Adverse items should be reported in accordance with Fair Credit Reporting Act.

Public record information must be obtained from two sources. Any combination of the following sources will satisfy this requirement: national repositories of accumulated credit records, direct searches of court records by the consumer reporting agency's employees, or record searches made by other public records search firms.

The credit report must give all inquiries within the last 120 days. Explanation of the inquiries must be supplied by borrowers and the underwriter must be certain no new debt has been established.

- Provident Savings Bank (PBM) inquiry may be noted on the credit report by the Processor or Underwriter

Non Traditional Mortgage Credit Report

Non-Traditional credit is not acceptable.

Frozen Credit Reports

When a transaction has a frozen credit report, the following procedures should be followed:

California State law allows consumers whose primary residence is in California to request a security freeze on their credit bureau report.

Retail transactions: The loan agent must notify the borrower that the credit must be unfrozen within 10 days of the date of the application or the loan will be denied as an incomplete application.

Wholesale/Correspondent transactions: The broker may not submit a loan application with a credit report that has been frozen. If the broker does submit a loan application that has a frozen record the file will be recommended for denial.

- Contact the borrower/broker to inform him or her that the loan will be declined within 10 days unless the credit record is temporarily unfrozen. The report should be unfrozen for the length of time PBM requires for processing.
- Document the notepad in Empower regarding the conversation with the borrower/broker. When the credit report has been unfrozen, a new credit report will be requested. If no proper credit is received within 10 days, the underwriter will decline the loan for an incomplete application.
- The reason for the declination on the Adverse Action should be both "Application Incomplete" and "Other, Credit Application Incomplete due to frozen credit bureau report".

Credit Analysis

Reviewing the Credit Report

The following items should be considered when reviewing the credit report:

- Payment history on previous mortgage should cover activity for the previous 12 months or longer;
- Undisclosed debt. If the credit report reveals significant debt that the borrower did not disclose on the application, he or she may have been attempting to conceal liabilities in order to qualify for the mortgage. The borrower must provide a written explanation for the omission
- Revolving accounts. When revolving accounts with outstanding balances do not have stated minimum required payments, payments should be calculated at 5% of the outstanding balance.
- Authorized users (DU & LP) guidance

DU Guidance for Authorized User Accounts

DU takes credit report tradelines designated as authorized user tradelines into consideration as part of the DU credit risk assessment. However, the underwriter must review credit report tradelines in which the applicant has been designated as an authorized user in order to ensure the tradelines are an accurate reflection of the borrower's credit history. If the underwriter believes the authorized user tradelines are not accurate reflection of the borrower's credit history, the underwriter should evaluate the borrower's credit history without the benefit of these tradelines and use prudent underwriting judgment when making its final underwriting decision. In order to assist the underwriter in the review of authorized user tradelines, DU issues a message providing the name of the creditor and account number for each authorized user tradeline identified.

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, the underwriter should establish:

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

If the authorized user tradeline belongs to another borrower on the mortgage loan, no additional investigation is needed. On the other hand, if the borrow has several tradelines in good standing and only a minor number of authorized user accounts, the underwriter could make the determination that:

- The authorized user accounts had minimal, if any, impact on the borrower's overall credit profile; and
- The information reported on the credit report is an accurate reflection of the borrower's credit history.

The underwriter is not required to review an authorized user tradelines that belongs to the borrower's spouse when the spouse is not on the mortgage transaction.

LP Guidance for Authorized User Accounts

When the decision repository file used to create the Selected Borrower's credit report contains any authorized user accounts, the Loan Prospector decision is considered valid if Provident Bank Mortgage (PBM) obtains and retains in the Mortgage file documentation that evidences at least one of the following for each authorized user account:

- Another Borrower on the Mortgage owns the Tradeline in question,
- The Tradeline is owned by the Borrower's spouse, or
- The Borrower has been making the payments on the account for the last 12 months

If PBM is unable to document one of the above three requirements for each authorized user account, PBM may consider the Loan Prospector decision valid and underwrite the Mortgage as a Loan Prospector Mortgage if the Lender determines that the authorized user accounts have an insignificant impact on the Borrower's overall credit history and the information on the credit report is representative of the Borrower's own credit reputation. PBM should base its determination on the number of the Borrower's own Tradelines, as well as their age, type, size and the payment history, as compared to the authorized user accounts. Underwriter must document its determination on Form 1008, Uniform Underwriting and Transmittal Summary, or another document in the Mortgage file.

Collections, Charge-offs of Non-Mortgage Accounts, Judgments, and Liens (updated 10-24-2016)

Fannie Mae:

Delinquent credit – including taxes, judgments, charge-offs of non-mortgage accounts, tax liens, mechanics' or materialmen's liens, and liens that have the potential to affect lien position or diminish the borrower's equity must be paid off prior to closing. DU will list the collections and whether or not they are required to be paid off. Accounts that are reported as past due (not reported as collection accounts) must be brought current.

Garnishments - All garnishments with more than ten months remaining must be included in the borrower's recurring monthly debt obligations for qualifying purposes.

- For one-unit, principal residence properties, borrowers are not required to pay off outstanding collections or non-mortgage charge-offs-regardless of the amount.

Note: If the underwriter marks the collection account Paid By Close in Empower, DU will issue a message in the DU Underwriting Findings report stating that the collection must be paid.

- For two-to four-unit owner occupied and second home properties, collections and non-mortgage charge-offs totaling more than \$5,000 must be paid in full prior to or at closing.
- For investment properties, individual collection and non-mortgage charge-off accounts equal to or greater than \$250 and accounts that total more than \$1000 must be paid in full prior to or at closing.

Disputed Credit Report Tradelines – Fannie Mae

DU will issue the disputed tradeline message when a disputed tradeline is identified and that tradeline contains derogatory payment information (a 30-day or more delinquency) reported within two years prior to the credit report date. When DU issues this message, the message will list the disputed tradeline with a reported derogatory payment within the last two years, and state that the underwriter must confirm the accuracy and completeness of the information reported on the borrower's credit report for the disputed tradeline. If it is determined that the disputed tradeline information is accurate and complete, the Provident Bank Mortgage (PBM) must ensure the disputed tradelines are considered in the credit risk assessment by either obtaining a new credit report with the tradeline no longer reported as disputed and resubmitting the loan casefile to DU, or manually underwriting the loan.

If DU does not issue the disputed tradeline message, PBM is not required to:

- Further investigate the disputed tradeline on the credit report,
- Obtain an updated credit report (with the undisputed tradeline), or
- Manually underwrite the loan.

However, the underwriter is required to ensure that the payment for the tradeline, if any, is included in the debt-to-income ratio if the account does belong to the borrower.

Note: Tradelines reported as medical debt (Account Type Code of MD or Remarks Code of E0166) are not shown in the disputed tradeline message if also reported as disputed, and PBM is not required to investigate the disputed medical tradeline.

When DU issues a message stating the DU identified a disputed tradeline and that tradeline was not included in the credit risk assessment, PBM must confirm the accuracy of disputed tradelines reported on the borrower's credit report. If it is determined that the disputed tradeline information is accurate, PBM must ensure the disputed tradelines are considered in the credit risk assessment by either obtaining a new credit report with the tradeline no longer reported as disputed and resubmitting the loan to DU, or manually underwriting the loan. If DU does not issue the disputed tradeline message, PBM is not required to:

- Further investigate the disputed tradeline on the credit report,

- Obtain an updated credit report (with the undisputed tradeline), or
- Manually underwrite the loan

Accuracy of Credit Information in a Credit Report – Fannie Mae

If a borrower indicates that any significant information in the credit file is inaccurate- such as reported accounts that do not belong to the borrower or derogatory information that is reported in *error- the underwriter should carefully review the credit information with the borrower, then request the credit reporting company that provided the information to confirm its accuracy.*

If the credit reporting company confirms that the disputed information is incorrect or incomplete and underwriting of the application needs to be completed before the credit files can be corrected, the underwriter cannot use the credit score(s) in the underwriting of the application. Instead, the credit risk assessment must be based on a review of the borrower's traditional credit history.

However, PBM is required to ensure that the payment for the tradeline, if any, is included in the total expense ratios if the account does belong to the borrower. The underwriter is also responsible for determining whether the borrower's explanation is reasonable and/or whether additional documentation is necessary to disprove the adverse information (e.g. canceled checks).

Freddie Mac Adverse Credit (updated 3/2/16)

Adverse credit information in and of itself does not mean the Borrower's credit reputation is unacceptable. When there is adverse or derogatory information in the Borrower's credit history, PBM must determine whether the derogatory information is significant. For Accept Mortgage, the significance of the derogatory information has already been considered by Loan Prospector and the Borrower's credit reputation has been deemed acceptable.

Freddie Mac considers a 30 day late housing payment to have more weight than a 30 day late non-housing payment, and a collection account to have more weight than a 30 day late payment on a revolving account. Although there may be many situations involving derogatory credit information that are less clear, especially when disputes about obligations are involved, the derogatory credit information is not significant when it consist only of isolated late payments, even if several accounts show sporadic late payments, provided all of the following exist:

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

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

- There are several accounts showing recent late payments
- There are multiple 60-90 day late payments.
- There is more than one 30-day late housing payment in the last 12 months
- There are more than two 30-day or more than one 60- day late housing payments within the most recent two years.
- The number and size of the delinquent accounts are large in relation to the overall credit.
- There are multiple episodes of late payments extending over a period of time.
- The credit history shows derogatory credit information within the two most recent years combined with multiple revolving accounts with high balances-to-limits
- The public record information reveals several occurrences of derogatory credit information, including judgments, tax liens and/or collection accounts.
- There is a bankruptcy, foreclosure, deed-in-lieu of foreclosure, or short sale within the last seven years and is disclosed on the credit report, disclosed by the Borrower on the loan application, or is evidenced by other documentation contain in the Mortgage file.

If the underwriter decides that the derogatory information is not significant, he or she must provide documentation supporting the conclusion in the mortgage file. If the underwriter decides that the derogatory information is significant, he or she must determine whether the problems were due to extenuating circumstances or to financial mismanagement.

Fannie Mae DU Mortgage Delinquencies

DU applies the following guidelines to the processing of loans with mortgage delinquencies:

- If any borrower's credit report contains a mortgage tradeline that is 60 or more days past due when the account was last reported by the creditor and the account was reported within the 12 months prior to the credit report date, the loan casefile will receive a Refer with Caution Recommendation, and will be ineligible for delivery to Fannie Mae.
- If there is a mortgage that is disclosed on the loan application but not reported on the credit report, DU will issue a message requiring PBM to confirm that the account is not two or more payments past due as of the date of the application and that it has not been past due by two or more payments in the last 12 months. If the underwriter determines that the borrower does have a mortgage that is past due by two or more payments or has been past due by two or more payments in the last 12 months, then the loan casefile is not eligible for delivery.
- Borrowers may not bring past-due mortgage accounts current prior to closing in order to circumvent Fannie Mae's policy regarding past-due mortgages. However, the lender may apply some discretion with regard to the application of this policy if it determines and documents that the past-due account status was not the fault of the borrower—for example, if the servicer misapplied or lost the borrower's payment.

Loan casefiles will receive an Ineligible recommendation due to excessive prior mortgage delinquency if the borrower has a mortgage tradeline on his or her credit report that has one or more 60-, 90-, 120-, or 150-day delinquency reported within the 12 months prior to the credit report date.

Note: The above policies will apply to all mortgage tradelines, including first liens, second liens, home improvement loans, HELOCs, and manufactured home loans.

IRS/State Tax Liens

- Must be reviewed on an EXCEPTION basis ONLY and
- Tax liens must have never been reflected on the borrower's credit report and
- Payment plans for Federal and/or State tax liens must not exceed 1 year of 1040;s, i.e. tax lien Federal or State payment plan for 2015 is acceptable as long as the borrower does not have any other active tax lien payment plans for the previous tax years.
- If the borrower has a payment plan(s) already set up for a State/Federal Tax lien this payment must be included in the Debt-To-Income Ratio for qualifying.
- If the borrower has sufficient assets to cover the current year tax liability a payment plan does not need to be set up and payment does not have to be included in the Debt-To-Income Ratio.

Credit History

The borrower's credit history should demonstrate his or her past willingness and ability to meet credit obligations in a way that will enable the underwriter to draw a logical conclusion about the borrower's commitment to making payments on the new mortgage obligation that he or she is taking on.

The borrower's credit history over the past seven years should be reviewed to determine whether there are any major indications of derogatory credit.

Refer to the program matrices for program specifics.

Strong compensating factors must also be present before a borrower who continually increases liabilities to the point that he or she is unable to maintain accounts in a current status and periodically bails out from the resulting delinquencies through refinancing and debt consolidation can receive favorable consideration.

Credit Inquiries

The borrower must satisfactorily explain credit inquiries within the past (120) days of the credit report date. As deemed necessary, the borrower should provide documentation for proof of no new accounts.

Credit Scores

FICO Bureau Credit Scores provide an indication of the relative likelihood of credit risk and can direct the underwriter to an appropriate level of credit review. Each loan product may include program specific credit scoring requirements and guidelines. For such requirements and guidelines, refer to the program matrices/summaries.

Loans can be approved or declined based on credit scores. Credit scores are one indication of a borrower's willingness to repay the debt. All Borrowers must have a credit score.

Adverse / Derogatory Credit

A history that consists of a minor, isolated instance of poor credit or a late payment is acceptable as long as the lapse is satisfactorily explained and the borrower has other credit accounts that have excellent payment records.

However, if the credit history reflects a consistent pattern of slow payments, undisclosed debts, collections, judgments for nonpayment of obligations, bankruptcies, etc., these must be clearly defined and addressed as to how they impact the risk of the file. See Credit Analysis/Reviewing the Credit Report.

Significant Derogatory Credit Events- Waiting Periods & Re-establishing Credit

When the credit report is used to identify a significant derogatory event, DU uses the credit report date to measure whether or not the applicable waiting period has been met after a significant derogatory event.

If DU determines that the waiting period has not been met based on the credit report used on the initial submission to DU, PBM may obtain an updated credit report and resubmit the loan casefile to DU after the required time has elapsed. When Fannie Mae data is used to identify a significant derogatory event, DU measures whether or not the applicable waiting period has been met after a significant derogatory event using the submission date.

General Information

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

NOTE: the terms "pre-foreclosures sale" and "short sale" are used interchangeably.

PBM must determine the cause and significance of the derogatory information, verify that sufficient time has elapsed since the date of the last derogatory information, and confirm that the borrower has re-established an acceptable credit history. The underwriter must make the final decision about the acceptability of a borrower's credit history when significant derogatory credit information exists.

This topic describes the amount of time that must elapse (the "waiting period") after a significant derogatory credit event before the borrower is eligible for a new loan salable to Fannie Mae. The waiting period commences on the completion, discharge, or dismissal date (as applicable) of the derogatory credit event and ends on the disbursement date of the credit report date for DU loan casefiles. See Fannie Guide

Section B3-5.3-09, DU Credit Report Analysis. Also refer to B3-5.3-08, Extenuating Circumstances for Derogatory Credit, for additional information.

NOTE: The requirements pertaining to significant derogatory credit are not applicable on DURefi Plus mortgage Loans.

Identification of Significant Derogatory Credit Events in the Credit Report

PBM must review the credit report and Section VIII, Declarations, of the loan application to identify instances of significant derogatory credit events. PBM must also review the public records section of the credit report and all tradelines, including mortgage accounts (first liens, second liens, home improvement loans, HELOCs, and mobile home loans), to identify previous foreclosures, deeds-in-lieu or Pre-foreclosure sales, and bankruptcies. PBM must carefully review the current status of each tradeline, manner of payment codes, and remarks (descriptive text or codes such as “Foreclosure,” “forfeit deed in lieu of foreclosure,” “settled for less than full balance”) to identify these types of significant derogatory credit events.

Significant derogatory credit events may not be accurately reported or consistently reported in the same manner by all creditors or credit reporting agencies. If not clearly identified in the credit report, the lender must obtain copies of appropriate documentation. The documentation must establish the completion date of a previous foreclosure, deed-in-lieu or Pre-foreclosure sale; confirm bankruptcy discharge or dismissal date; and identify debts that were not satisfied by the bankruptcy. Debts that were not satisfied by a bankruptcy must be paid off or have an acceptable, established repayment schedule.

Bankruptcy (Chapter 7 or Chapter 11)

A four-year waiting period is required, measured from the discharge or dismissal date of the bankruptcy action.

Exceptions for Extenuating Circumstances

A two-year waiting period is permitted if extenuating circumstances can be documented, and is measured from the discharge or dismissal date of the bankruptcy action.

Bankruptcy (Chapter 13)

A distinction is made between Chapter 13 bankruptcies that were discharged and those that were dismissed. The waiting period required for Chapter 13 bankruptcy actions is measured as follows:

- two years from the discharge date, or
- four years from the dismissal date.

The shorter waiting period based on the discharge date recognizes that borrowers have already met a portion of the waiting period within the time needed for the successful completion of a Chapter 13 plan and subsequent discharge.

A borrower who was unable to complete the Chapter 13 plan and received a dismissal will be held to a four-year waiting period.

Exceptions for Extenuating Circumstances

A two-year waiting period is permitted after a Chapter 13 dismissal, if extenuating circumstances can be documented. There are no exceptions permitted to the two-year waiting period after a Chapter 13 discharge.

If a Chapter 13 bankruptcy was discharged within the last two years, dismissed within the last four years, or filed but neither discharged nor dismissed within the last four years, the loan casefile will received a Refer with Caution recommendation and will be ineligible for delivery to Fannie Mae.

Note: DU will not take tradeline accounts that are reported with a bankruptcy status code or manner of payment (MOP) code of “7” into account if there is at least one bankruptcy reported in a public record within seven years of the credit report date. In this scenario, DU assumes the date filed and the date

discharged in the public record are more accurate than the dates in the tradeline; i.e., specific filed and discharged dates do not exist in the tradeline.

Note: DU will use tradeline accounts that are reported with a bankruptcy status code or MOP code of “7” if there is not a bankruptcy reported in a public record within seven years of the credit report date. In this scenario, the underwriter will need to verify the actual filed and discharged dates to determine that the bankruptcy meets the DU bankruptcy policy.

Multiple Bankruptcy Filings

For a borrower with more than one bankruptcy filing within the past seven years, a five-year waiting period is required, measured from the most recent dismissal or discharge date.

Note: The presence of multiple bankruptcies in the borrower’s credit history is evidence of significant derogatory credit and increases the likelihood of future default. Two or more borrowers with individual bankruptcies are not cumulative, and do not constitute multiple bankruptcies. For example, if the borrower has one bankruptcy and the co-borrower has one bankruptcy this is not considered a multiple bankruptcy.

Exceptions for Extenuating Circumstances

A three-year waiting period is permitted if extenuating circumstances can be documented, and is measured from the most recent bankruptcy discharge or dismissal date. The most recent bankruptcy filing must have been the result of extenuating circumstances.

Foreclosure

A seven-year waiting period is required, and is measured from the completion date of the foreclosure action as reported on the credit report or other foreclosure documents provided by the borrower.

Exceptions for Extenuating Circumstances

A three-year waiting period is permitted if extenuating circumstances can be documented, and is measured from the completion date of the foreclosure action. Additional requirements apply between three and seven years, which include:

- Maximum LTV, CLTV, or HCLTV ratios of the lesser of 90% or the maximum LTV, CLTV, or HCLTV ratios for the transaction per the Eligibility Matrix.
- The purchase of a principal residence is permitted.
- Limited cash-out refinances are permitted for all occupancy types pursuant to the eligibility requirements in effect at that time.

Note: The purchase of second homes or investment properties and cash-out refinances (any occupancy type) are not permitted until a seven-year waiting period has elapsed.

Using Credit Report Data

- Mortgage accounts, including first liens, second liens, home improvement loans, HELOCs, and mobile home loans, will be identified as a foreclosure if there is an MOP code of “8”, a maximum delinquency MOP of “8”, an MOP in the MOP history grid of “8”, or a Remarks Code that indicates a foreclosure is present in the credit report data and associated to the tradeline.
- Mortgage accounts, including first liens, second liens, home improvement loans, HELOCs, and mobile home loans, will also be identified as a foreclosure if there is a current MOP code of “9” (collection or Non Mortgage charge-off) and there are no deed-in-lieu of foreclosure (DIL) or pre-foreclosure sale (PFS) Remarks Codes associated to the tradeline.
- If a foreclosure was reported within the seven-year period prior to the credit report date, the loan casefile will receive a Refer with Caution recommendation and will be ineligible for delivery to Fannie Mae.

Underwriting when Conflicting or Inaccurate Foreclosure Information on a DIL or PFS Tradeline

- When DU identifies a foreclosure on a credit report tradeline that appears to be one that was subject to a DIL or PFS, the lender may instruct DU to disregard the foreclosure information on the credit report by entering “Confirmed CR DIL” or “Confirmed CR PFS” in the Explanation field for question c. In the Declarations section of the online loan application and resubmitting the loan casefile to DU. When DU sees this indication, the foreclosure information on the credit report tradeline that also has a DIL or PFS Remarks Code will not be used.
- If the lender enters “Confirmed CR DIL” or “Confirmed CR PFS” it must then document that the account was subject to a DIL or PFS, that the event was completed two or more years from the credit report date, and the loan casefile complies with all other requirements specific to a DIL or PFS, as stated in B3-5.3-07, Significant Derogatory Credit Events – Waiting Periods and Re-establishing Credit.

Using Fannie Mae Data

- DU uses information Fannie Mae has on loans that have been liquidated due to a foreclosure. If the Fannie Mae data shows a foreclosure occurred in the seven years prior to the submission date, the loan casefile will receive a Refer with Caution recommendation.
- When the Fannie Mae data includes information associated with a foreclosure that the underwriter confirms is inaccurate, the underwriter may instruct DU to disregard the information by entering “Confirmed FM FC Incorrect” in the Explanation field for question c. in the Declarations section of the online loan application and resubmitting the loan casefile to DU.
- When DU sees this indication, the information associated with the event will not be used. The lender must then document why the Fannie Mae data should be disregarded.

Deed-in-Lieu of Foreclosure and Pre-foreclosure Sale

These transaction types are completed as alternatives to foreclosure. A deed-in-lieu of foreclosure is a transaction in which the deed to the real property is transferred back to the servicer. A pre-foreclosure sale or short sale is the sale of a property in lieu of a foreclosure resulting in a payoff of less than the total amount owed, which was pre-approved by the servicer.

The following waiting period requirements apply:

Primary Residence

Waiting Period	Waiting period with Extenuating Circumstances
4 Years	2 Years

Exceptions for Extenuating Circumstances

A two-year waiting period is permitted if extenuating circumstances can be documented.

Using Credit Report Data

- DU will determine if a mortgage tradeline is a DIL or PFS by using specific Remarks Codes that are present in the credit report data and associated to the tradeline.
- When DU identifies a DIL or PFS, the lender must confirm the accuracy of the information. The lender must also document that the event was completed two or more years from the credit report date and the loan casefile must comply with all other requirements specific to a DIL or PFS, as stated in B3-5.3-07, Significant Derogatory Credit Events – Waiting Periods and Re-establishing Credit.

Using Fannie Mae Data

- DU uses information Fannie Mae has on loans that have been liquidated due to a DIL or PFS. If the Fannie Mae data shows a DIL or PFS occurred in the two years prior to the submission date, the loan casefile will receive a Refer with Caution recommendation.
- When the Fannie Mae data includes information associated with the DIL or PFS that the lender confirms is inaccurate, the lender may instruct DU to disregard the information by entering “Confirmed FM DIL Incorrect” or “Confirmed FM PFS Incorrect” in the Explanation field for question c. in the Declarations section of the online loan application and resubmitting the loan casefile to DU. When DU sees this indication, the information associated with the event will not be used. The lender must then document why the Fannie Mae data should be disregarded.

Summary — All Waiting Period Requirements

The following table summarizes the requirements for all significant derogatory credit events:

Derogatory Event	Waiting Period Requirements	Waiting Period with Extenuating Circumstances
Bankruptcy Chapter 7 or 11	— 4 years	2 years
Bankruptcy Chapter 13	— <ul style="list-style-type: none"> • 2 years from discharge date • 4 years from dismissal date 	<ul style="list-style-type: none"> • 2 years from discharge date • 2 years from dismissal date
Multiple Bankruptcy Filings	5 years if more than one filing within the past 7 years	3 years from the most recent discharge or dismissal date
Foreclosure ^a	7 years	3 years - Additional requirements after 3 years up to 7 years: <ul style="list-style-type: none"> • 90% maximum LTV ratios^b • Purchase, principal residence • Limited cash-out refinance, all occupancy types
Deed-in-Lieu of Foreclosure and Pre-foreclosure Sale	<ul style="list-style-type: none"> • 4 Years 	2 years

^a When both a bankruptcy and foreclosure are disclosed on the loan application, or when both appear on the credit report, the Underwriter may apply the bankruptcy waiting period if the Underwriter obtains the appropriate documentation to verify that the mortgage loan in question was discharged in the bankruptcy. Otherwise, the greater of the applicable bankruptcy or foreclosure waiting period must be applied.

^b **References** to LTV ratios include LTV, CLTV, and HCLTV ratios. The maximum LTV ratios permitted are the lesser of the LTV ratios in the table or the maximum LTV ratios for the transaction per the Eligibility Matrix.

Foreclosure and Bankruptcy on the Same Mortgage

If a mortgage debt was discharged through a bankruptcy, the bankruptcy waiting periods may be applied if the Underwriter(s) obtains the appropriate documentation to verify that the mortgage obligation was discharged in the bankruptcy. Otherwise, the greater of the applicable bankruptcy or foreclosure waiting periods must be applied.

Requirements for Re-establishing Credit

After a bankruptcy, foreclosure, deed-in-lieu of foreclosure, or pre-foreclosure sale, the borrower's credit will be considered re-established if all of the following are met:

- The waiting period and the related additional requirements are met.
- The loan receives a recommendation from DU that is acceptable for delivery to Fannie Mae or, if manually underwritten, meets the minimum credit score requirements based on the parameters of the loan and the established eligibility requirements.
- The borrower must have traditional credit.

Disputed Credit Report Trade Lines

When DU issues a message stating the DU identified a disputed trade line and that trade line was not included in the credit risk assessment, PBM must confirm the accuracy of disputed trade lines reported on the borrower's credit report. If it is determined that the disputed trade line information is accurate, lenders must ensure the disputed trade lines are considered in the credit risk assessment by either obtaining a new credit report with the trade line no longer reported as disputed and resubmitting the loan case file to DU, or manually underwriting the loan.

If DU does not issue the disputed trade line message, the lender is not required to

- Further investigate the disputed trade line on the credit report,
- Obtain an updated credit report (with the undisputed tradeline), or
- Manually underwrite the loan

However, PBM is required to ensure that the payment for the tradeline, if any, is included in the total expense ratios if the account does belong to the borrower.

Restructured Mortgage Loans/Loan Modification (updated 6/28/16)

A restructured loan is a mortgage loan in which the terms of the original transaction have been changed, resulting in 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, or
- Conversion of any portion of the original mortgage debt from secured to unsecured.

With respect to restructured mortgages, PBM can rely upon existing policy when determining whether the loan is eligible for delivery under a refinance transaction or as a modified mortgage loan. Both Fannie Mae and Freddie Mac have eliminated any restrictions on refinancing a modified or restructured mortgage loan.

Revolving Debts to be paid off to qualify

Payoff or Pay down of Debt for Qualification For FNMA D/U only

Payoff 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. Generally

- Installment loans that are being paid off or paid down to 10 or fewer remaining monthly payments do not need to be included in the borrower's long-term debt.
- If a revolving account balance is to be paid off at or prior to closing, a monthly payment on the current outstanding balance does not need to be included in the borrower's long-term debt, i.e., not included in the debt-to-income (DTI) ratio. Such accounts do not need to be closed as a condition of excluding the payment from the DTI ratio.

Payoff or Pay down of Debt for Qualification For Freddie Mac LP only:

If the borrower pays off or pays down existing debts in order to qualify for the mortgage, the underwriter must document the payoff or pay down of the debts and the source of the funds used in the mortgage file.

- If all or any portion of the proceeds of the Mortgage are being used to payoff or pay down existing debts in order to qualify for the Mortgage, Underwriter must document such payoff in the Mortgage file. Canceled checks, paid receipts and/or a copy of the HUD-1 form or other closing statement may be used to document the repayment.
- A Borrower who increases debt and then periodically uses refinance or debt consolidation to reduce payments to a manageable level presents a higher risk and the qualifying ratios should be close to guidelines. The Underwriter should consider the Borrower's short-term and long-term ability to repay the Mortgage

Age of Credit Report

Unless otherwise stipulated in the product summary, the age of the credit report may be no older than:

- Construction 45 days at close.
- New Construction 45 days at close.

Employment and Income

Employment Stability

Many components make up income potential, the borrower's occupation, employment tenure, and opportunities for future advancement, educational background, and occupational training.

The borrower's employment must be verified for the two full years that precede the mortgage application. (If the borrower has an employment history of less than two years and was previously in school or the military, a copy of his or her diploma or discharge papers will be required). The underwriter must determine the probable stability and continuance of employment. The potential for future income can have a positive influence for borrowers who have recently entered the job market. These borrowers should be considered favorably if adequate future income can be anticipated because their education and training will expand their job opportunities. In addition, borrowers who are in a line of work in which advancement is possible because there is a continuing demand for that kind of service, and who have demonstrated an ability to maintain full employment and advance in standing, may be given favorable consideration.

A borrower who changes jobs frequently to advance within the same line of work and is successful in that work should receive favorable consideration. Job-hopping without advancement, or from one line of work to another, may indicate an inability to master a job and could lead to unstable income. Many low and moderate-income borrowers change jobs frequently because that is the nature of the employment that is available. Such borrowers should not be penalized for frequent changes in jobs if they have maintained income continuity despite the changes.

Borrowers with questionable employment histories must have offsetting financial strengths to be considered for maximum financing.

Income Trending: (UPDATED 10-24-2016)

- If the trend in the amount of income is stable or increasing, the income amount should be averaged.
- If the trend was declining, but has since stabilized and there is no reason to believe that the borrower will not continue to be employed at the current level, the current, lower amount of variable income must be used.
- If the trend is declining, the income may not be stable. Additional analysis must be conducted to determine if any variable income should be used, but in no instance may it be averaged over the period when the declination occurred.

Continuity of Income

A key driver of successful homeownership is confidence that all income used in qualifying the borrower will continue to be received by the borrower for the foreseeable future. Unless PBM has knowledge to the contrary, if the income does not have a defined expiration date and the applicable history of receipt of the income is documented (per the specific income type), PBM may conclude that the income is stable, predictable and likely to continue. It's the Underwriters discretion to request additional documentation.

If the income source does have a defined expiration date or is dependent on the depletions of an asset account or other limited benefit, the lender must document the likelihood of continued receipt of the income for at least 3 years.

The following table contains examples of income types with and without defined expiration dates. This information is provided to assist in determining whether additional income documentation may be necessary to support a three-year continuance. Note: the underwriter remains responsible for making the final determination of whether the borrower's specific income source has a defined expiration date.

Expiration date Not Defined	Defined Expiration Date*
<p><u>PBM does not need to document a 3-year continuance</u></p> <ul style="list-style-type: none"> • Automobile allowance • Base salary • bonus, overtime, commission, or tip income • capital gains income • corporate retirement or pension • disability income- long-term • foster-care income • interest and dividend income (unless other evidence that asset will be depleted) • military income • mortgage credit certificates • part-time job, second job, or seasonal income • rental income • self-employment income • social security, VA or other government retirement or annuity 	<p><u>PBM must document 3-year continuance</u></p> <ul style="list-style-type: none"> • alimony or child support • distributions from a retirement account (example 104K, IRA, SEP, Keogh) • mortgage differential payments • notes receivable • public assistance • royalty payment income • Social Security (not including retirement or long-term disability) • Trust Income • VA Benefits (not including retirement or long term disability)

*Because these income sources have defined expiration date or allow the depletion of an asset, care must be taken when this is the sole source or majority of qualifying income. PBM must consider the borrower's continued capacity to repay the mortgage loan when the income source expires or the distributions will deplete the asset prior to maturation of the mortgage loan.

Income sources that are not listed above will require the underwriter judgment to determine if documentation of continuance must be obtained.

Employment Gaps

The borrower must explain any employment gaps that extend beyond one month.

Employed by a Relative

When a relative employs a borrower or closely held family business, we will require him or her to submit signed federal income tax returns for two years, in addition to the Verification of Employment.

Verification of Employment

The Verification of Employment must indicate the number of hours worked per week if the borrower is paid on an hourly basis.

If it does not or if it gives a range of hours, the borrower's actual earnings for the past year and his or her year-to-date earnings should be averaged to determine the monthly gross income. (Also see Full/Alt Doc Verification information for specific requirements and restrictions)

Other Sources of Income

Alimony or Child Support

When using alimony, child support to qualify the borrowers, the following documentation must be provided:

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

- A copy of a divorce decree or legal separation agreement (if the divorce is not final) that indicates payment of alimony or child support and states the amount of the award and the period of time over which it will be received.
NOTE: if a borrower who is separated does not have a legal separation agreement that specifies alimony or child support payments, the lender should not consider any proposed or voluntary payments as income.
- Any other type of written legal agreement or court decree describing the payment terms for the alimony or child support.
- Documentation that verifies any applicable state law that mandates alimony, child support, or separate maintenance payments, which must specify the conditions under which the payments must be made.
- Check for limitation on the continuance of payments, such as the age of the children for whom the support is being paid or the duration over which alimony is required to be paid.
- Document no less than six months of the borrower's most recent regular receipt of the full payment
- Review the payment history to determine its suitability as stable qualifying income. To be considered stable income, full, regular and timely payments must have been received for six months or longer. Income received for less than six months is considered unstable and may not be used to qualify the borrower for the mortgage. In addition, if full or partial payments are made on an inconsistent or sporadic basis, the income is not acceptable for the purpose of qualifying the borrower.

Automobile Allowance – Fannie Mae

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

There are two methods for calculating the income associated with an automobile allowance:

Actual cash flow approach: If the borrower reports automobile allowances on Employee Business Expenses (IRS Form 2106 or IRS Form 1040, Schedule C

- funds in excess of the borrower's monthly expenditures are added to the borrower's monthly income, or
- expenses in excess of the monthly allowance are included in the borrower's total monthly obligations.

If the borrower used IRS Form 2106 and recognized "actual expense" instead of the "standard mileage rate," the Underwriter MUST look at the "actual expenses" section to identify the borrower's actual lease payments and make appropriate adjustments.

- Income and debt approach: If the borrower does not report the allowance either Form 2106 or Schedule C, the full amount of the allowance is added to the borrower's monthly income, and the full amount of the lease or financing expenditure for the automobile is added to the borrower's total monthly obligations.

Automobile Allowance – Freddie Mac

Written VOE Covering two full years and a verbal VOE obtained either no more than 10 Business Days prior to the Note Date or all of the following:

- YTD paystub or salary voucher documenting at least 30 days of income
- W-2 forms for the most recent two years
- Verbal VOE obtained either no more than 10 Business Days prior to the Note Date.

Boarder Income

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

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

The following table provides verification requirements for income from boarders.

✓	Verification of Income from Boarders
	Obtain documentation of the boarder’s history of shared residency (such as a copy of driver’s license, bills, bank statements, or W-2 forms) that shows the boarder’s address as being the same as the borrower’s address.
	Obtain documentation of the boarder’s rental payments for the most recent 12 months.

Commission Income

An average of the last two years income must be used in evaluating the borrower’s income qualifications. Commission income must be supported by signed federal income tax returns for the past two years.

It is also important to establish an earnings trend for commission income. Annual earnings that are level or increasing from one year to the next are acceptable. However, if the earnings show a decline toward the current year, there must be strong offsetting factors for the commission income to be acceptable.

Employment-Related Assets as Qualifying Income

The following table provides the requirements for employment-related assets that may be used as qualifying income:

Asset Requirements	
	Assets used for the calculation of the monthly income stream must be owned individually by the borrower, or the co-owner of the assets must be a co-borrower of the mortgage loan. Note: documentation of asset ownership must be in compliance with Allowable Age of Credit Documents Policy (B1-1-03 Allowable Age of Credit Documents and Federal Income Tax Returns, for additional information).
	Assets must be liquid and available to the borrower with no penalty and must be sourced as one of the following: <ul style="list-style-type: none"> • A non-self-employed severance package or non-self-employed lump sum retirement package (a lump sum distribution) must be documented with a distribution letter from the employer (form 1099-R) and deposited to a verified asset account. • For 401(k) or IRA, SEP, Keogh retirement accounts- the borrower must have unrestricted access without penalty to the accounts and can only use the accounts if distribution is not already set up or the distribution amount is not enough to qualify. The account must be documented with the most recent monthly, quarterly, or annual statement.
	If the employment-related assets are in the form of stocks, bonds, and mutual funds, 70% of the value (remaining after costs for the transaction) must be used to determine the income stream to account for the volatile nature of these assets.
	“Net documented assets” are equal to the sum of eligible assets minus: <ol style="list-style-type: none"> (a) The amount of the penalty that would apply if the account was completely distributed at the time of calculation; (b) The amount of funds used for down payment, closing costs, and required reserves; (c) 30% of the remaining value of any stocks, bonds, or mutual funds assets (after the calculation in (b)).
Example: Calculation of Net Documented Assets	
Checking and savings accounts (for illustration purposes only- not an eligible employment-related asset)	\$40,000
IRA (made up of stocks and mutual funds)	+\$500,000
Total eligible documented assets	\$540,000
Funds required for closing (down payment, closing costs, reserves)	(\$100,000)
(a) Remaining IRA Assets (\$500,000 - \$60,000 used at closing)	\$440,000
(b) Minus 30% of \$440,000 (\$440,000 x .30)	(\$132,000)
Net Documented Assets	\$308,000

	Monthly income calculation (\$308,000/360 months)	\$856/monthly
	See income calculation/Payout Stream in table below	
	Ineligible assets are non-employment-related assets (for example, stock options, non-vested restricted stock, lawsuits, lottery winnings, sale of real estate, inheritance, and divorce proceeds). Checking and savings accounts are generally not eligible as employment-related assets, unless the source of the balance in a checking or savings account was from an eligible employment-related asset (for example, a severance package or lump sum retirement distribution)	

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

Parameter	Fannie Mae Requirement
Maximum LTV/CLTV/HCLTV	70%
Minimum Credit Score	DU: 620 Standard: Higher of 620 or minimum credit score per Fannie Mae's eligibility matrix
Loan Purpose	Purchase and limited cash-out refinance only
Occupancy	Principal residence and second home only
Number of units	One-to four-unit properties
Income Calculation/Payout Stream	Divide "Net documented assets" by 360 months (A 30-year term must be used regardless of borrower age or amortization term of the mortgage loan)

Note: if the mortgage loan does not meet the above parameters, employment-related assets may be eligible under other standard income guidelines, such as "Interest and Dividend Income," or "Retirement, Government Annuity, and Pension Income."

Farm Income

Underwriter to determine based on the appraisal review and review of Borrower's Tax Returns as to whether the property is considered a working farm.

- Hobby Farms/Gentlemen's Farms may be considered.
 - The underwriter needs to include comments in the file as to the reasoning behind accepting these types of farms.
 - Income from these types of farms must be nominal compared to the overall qualifying income of the loan file.
- The underwriter must take into account the affect this income or loss has on the loan and the property qualifications.

Foreign Income

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

✓	Verification of Foreign Income
	Copies of his or her signed federal income tax returns for the most recent two years that include foreign income
	The underwriter must satisfy the standard documentation requirements based on the source and type of income.

Note: all income must be translated to U.S. dollars.

Foster-Care Income

Income received from a state-or county-sponsored organization for providing temporary care for one or more children may be considered acceptable stable income if the following requirements are met.

✓	Verification of Foster-Care Income
	Verify the foster-care income with letters of verification from the organizations providing the income
	Document that the borrower has a two years history of providing foster-care services. If the borrower has not been receiving this type of income for two full years, the income may still be counted as stable income if; <ul style="list-style-type: none">• The borrower has at least a 12-month history of providing foster-care services, and• The income does not represent more than 30% of the total gross income that is used to qualify for the mortgage loan (Fannie Mae only)• Foster care income must be likely to continue for at least the next three years.

Interest and Dividends

Interest and dividend income may be used if it is properly documented and has been received for the past two years and the funds are expected to continue to generate the same or more income after closing. An average of the income for the last two years is required in evaluating the borrower's income qualifications. Tax returns or account statements may be used to verify this income. Any funds used for down payment or closing costs must be subtracted before the qualifying interest income is calculated.

Military Income

Military personnel may be entitled to different types of pay in addition to their base pay. Flight or hazards pay, rations, clothing allowance, quarter's allowance, and proficiency pay may be considered as part of the borrower's stable income as long as its future continuance can be established.

Mortgage Differential Payments

An employer may subsidize an employee's mortgage payments by paying all or part of the interest differential between the employee's present and proposed mortgage payments. When calculating the qualifying ratio, the differential payments should be added to the borrower's gross income. The payments may not be used to directly offset the mortgage payment, even if the employer pays them to the mortgage lender rather than to the borrower. The following table provides verification for mortgage differential payment income:

✓	Verification of Income From Mortgage Differential Payments
	Obtain written verification from the borrower's employer confirming the subsidy and stating the amount and duration of the payments
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application.

If this income is used on a purchase transaction, current receipt is not required to be documented except as verified in the employer letter. For refinance transactions where the income is continuing with the new loan, the recent receipt must be in compliance with the Allowable Age of Credit Documents policy. .

Mortgage Credit Certificates

States and municipalities can issue mortgage credit certificates (MCCs) in place of, or as part of, their authority to issue mortgage revenue bonds. MCCs enable an eligible first-time home buyer to obtain a mortgage secured by his or her principal residence and to claim a federal tax credit for a specified percentage (usually 20% to 25%) of the mortgage interest payments.

When calculating the borrower's DTI ratio, treat the maximum possible MCC income as an addition to the borrower's income, rather than as a reduction to the amount of the borrower's mortgage payment. Use the following calculation when determining the available income:

- ❖ $(\text{Mortgage Amount}) \times (\text{Note Rate}) \times (\text{MCC \%}) \text{ divided by } 12 = \text{Amount to be added to borrower's monthly income}$

For example, if a borrower obtains a \$100,000 mortgage that has a note rate of 7.5% and he or she is eligible for a 20% MCC program, the amount that should be added to his or her monthly income would be \$125 ($\$100,000 \times 7.5\% \times 20\% = \1500 divided by 12 = \$125).

PBM must obtain a copy of the MCC and the lender's documented calculation of the adjustment to the borrower's income and include them in the mortgage loan file.

For refinance transactions, the PBM may allow the MCC to remain in place as long as it obtains confirmation prior to loan closing from the MCC provider that the MCC remains in effect for the new mortgage loan. Copies of the MCC documents, including the reissue certification, must be maintained in the new mortgage loan file.

NOTE: because the MCC is transaction specific, it does not have to comply with the Allowable Age of Credit Documents policy.

Nontaxable Income

Special consideration may be given to regular sources of income that are nontaxable, such as child support payments, disability retirement payments, workers compensation benefits, certain types of public assistance payments, food stamps, etc.

The amount of tax savings attributable to the nontaxable income must be determined and added to the borrower's "adjusted gross income". This adjusted gross income should be used in the calculations for the income and debt ratios. The adjustments must be supported and documented in the loan file.

Notes Receivable

A copy of the note to establish the amount and length of payment is required.

- Payments must continue for at least three years from the date of the mortgage application;
- Borrowers must provide evidence that they have received the funds for the most recent 12 months. Acceptable evidence includes deposit slips, tax returns, or copies of the borrower's bank statements.
- Payments on a note executed within the past 12 months, regardless of the duration, may not be used as stable income.

Overtime and Bonus Income

Overtime and bonus income can be used to qualify the applicant if the employer verifies that the applicant has received it for the last two years and indicates that the overtime or bonus income will in all probability continue. An average of the last two years overtime and bonus income must be developed to determine the amount of income that can be considered in evaluating the borrower's qualifications.

It is also important to establish an earnings trend for overtime and bonus income. Annual earnings that are level or increasing from one year to the next are acceptable. However, if the earning shows a decline toward the current year, there must be strong compensating factors for the overtime or bonus income to be acceptable.

Part-time Income or Second-Job Income

Part-time or second-job income may be used if it can be verified as having been uninterrupted for the previous two years and if it has a strong likelihood of continuation. Seasonal part-time or second-job income, such as that received by a person who works part-time at a department store during the Christmas shopping period can be considered as uninterrupted if the borrower has worked in the same job "in season" for the past two years and expects to be rehired for the next "season".

Rental Income

Rental from boarders in a single-family property that is also the borrower's primary residence or second home generally will not be considered as acceptable income.

Rents received for other properties are acceptable income, even when the borrower occupies one of the units of a multiple-unit property. Copies of the borrower's federal income tax return (Schedule E, Supplemental Income Schedule) are required as evidence of the receipt of rental income. However, if a property is not listed on Schedule E, a copy of the lease as evidence of the rental income will be acceptable. Rental income may be calculated by deducting expenses from income, with no additional add-backs or deductions (such as depreciation or loss carry over).

Documenting Rental History from Subject Property

PBM must obtain documentation that is used to calculate the monthly rental income for qualifying purposes. The documentation may vary depending on whether the borrower has a history of renting the property, and whether the prior year tax return includes the income.

Rental income from the Security Property		
Does the borrower have history of receiving rental income from Property?	Transaction Type	Documentation Requirements
YES	REFINANCE	Form 1007 or Form 1025, as applicable, and either <ul style="list-style-type: none"> • The borrower's most recent year of signed federal income tax returns, including Schedule E, OR • Copies of the current lease agreement(s) if the borrower can document a qualifying exception (see partial or No Rental History on Tax Returns below).
NO	PURCHASE	Form 1007 or Form 1025, as applicable, and <ul style="list-style-type: none"> • Copies of the current lease agreement(s) If the property is not currently rented, lease agreements are not required. Lenders may use market rent supported by Form 1007 or Form 1025, as applicable. If there is a lease on the property that is being transferred to the borrower, the lender must verify that it does not contain any provisions that could affect Fannie Mae's first lien position on the property. See section B7-2-05, Title Exception and Impediments, for additional Information.
NO	REFINANCE	Form 1007 or Form 1025, as applicable, and <ul style="list-style-type: none"> • Copies of the current lease

		agreement(s).
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If the borrower is not using any rental income from security property to qualify, the gross monthly rent must still be documented for lender reporting purposes.

Documenting Rental Income from property other than Subject Property – Fannie Mae

When the borrower owns property- other than the subject property – that is rented, PBM must document the monthly gross (and net) rental income with the borrower’s most recent signed federal income tax return that includes Schedule E. Copies of the current lease agreement(s) may be substituted if the borrower can document a qualifying exception. See Partial or No Rental History on Tax Returns below.

Partial or No Rental History on Tax Returns

In order for the underwriter to determine qualifying rental income, the underwriter must determine whether or not the rental property was in service for the entire tax year or only a portion of the year. In some situations, the underwriter’s analysis may determine that using alternative rental income calculations or using lease agreements to calculate income are more appropriate methods for calculating the qualifying income from rental properties. This policy may be applied to refinances of a subject rental property or to other rental properties owned by the borrower.

If the borrower is able to document (per the table below) that the rental property was not in service the previous tax year, or was in service for only a portion of the previous tax year, the lender may determine qualifying rental income by using

- Schedule E income and expenses, and annualizing the income (or loss) calculation; or
- Lease agreement(s) to determine the gross rental income to be used in the net rental income (or loss) calculation.

If....	Then...
The property was acquired during or subsequent to the most recent tax filing year,	<p>PBM must confirm the purchase date using the settlement statement or other documentation.</p> <ul style="list-style-type: none"> • If acquired during the year, Schedule E (Fair Rental Days) must confirm a partial year rental income and expenses (depending on when the unit was in service as a rental). • If acquired after the last tax filing year, Schedule E will not reflect rental income or expenses for this property.
The rental property was out of service for an extended period,	<ul style="list-style-type: none"> • Schedule E will reflect the costs for renovation or rehabilitation as repair expenses. Additional documentation may be required to ensure that the expenses support a significant renovation that supports the amount of time that the rental property was out of service. • Schedule E (Fair Rental Days) will confirm the number of days that the rental unit was in service, which must support the unit being out of service for all or a portion of the year
PBM determines that some other situation warrants an exception to use a lease agreement,	The underwriter must provide an explanation and justification in the loan file.

If the borrower is converting a principal residence to an investment property, see [B3-6-06, Qualifying Impact of Other Real Estate Owned](#), for guidance in using that rental income to qualify the borrower.

Calculating Monthly Qualifying Rental Income (or Loss)

If the property was in service

- For the entire tax year, the rental income must be averaged over 12 months; or
- For less than the full year, the rental income must be averaged over the number of months that the borrower used the property as a rental unit.

Lease agreements: when current lease agreements are used, PBM must calculate the rental income by multiplying the gross rent(s) by 75%. The remaining 25% of the gross rent will be absorbed by vacancy losses and ongoing maintenance expenses.

Treatment of the Income (or Loss)

The amount of monthly qualifying rental income (or loss) that is considered as part of the borrower's total monthly income (or loss) – and its treatment in the calculation of the borrower's total debt-to-income ratio – varies depending on whether the borrower occupied the rental property as his or her principal residence.

If the rental income relates to the borrower's principal residence:

- The monthly qualifying rental income must be added to the borrower's total income (the income is not netted against the PITIA of the property.)
- The full amount of the mortgage payment (PITIA) must be included in the borrower's total monthly obligations when calculating the debt-to-income ratio.

If the rental income (or loss) relates to a property other than the borrower's principal residence:

- If the monthly qualifying rental income minus the full PITIA is positive, it must be added to the borrower's total monthly income.
- If the monthly qualifying rental income minus PITIA is negative, the monthly net rental loss must be added to the borrower's total monthly obligations
- The full PITIA for the rental property is factored into the amount of the net rental income (or loss); therefore, it should not be counted as a monthly obligation.

Note: for DU loan casefiles, the term "subject net cash flow" applies to net rental income from the subject property, and the term "net rental income" applies to rental income from properties other than the subject property.

Entering Subject Net Cash Flow in DU

Subject net cash flow applies to one- to four-unit investment properties and two- to four-unit principal residences secured by the subject property. DU does not calculate the subject net cash flow. The underwriter must calculate and enter the income in the Subject Net Cash in Section V of the online loan application.

Note: Although negative subject net cash flow values appear to reduce the gross monthly income in Section V, DU actually treats the negative value as a liability and includes it in the debt-to-income ratio.

Investment properties

Calculate the subject net cash flow. If the subject net cash flow is a positive, enter the amount in Section V. It will be included in the total qualifying income. If the cash flow is negative, enter the amount in Section V as a negative value. DU will include it in the debt-to-income ratio calculation as a liability. If income from the subject property is not included in the qualifying ratios, the underwriter should enter the entire proposed PITIA as a negative amount in the Subject Net Cash field in Section V.

Rental Income – Freddie Mac updated 03/02/2016

Minimum documentation requirements:

- An executed lease agreement or
- The most recent complete individual federal tax returns

Whenever rental income is to be used, reasonable adjustments to gross rental income must be made to compensate for vacancies, operating and maintenance expenses and rental income received for furniture.

If the borrower owned a rental property during the previous tax year, the borrower's federal individual income tax returns must be obtained to determine the net rental income or loss for qualifying. In some instances, the income reported on the borrower's federal individual income tax returns may not reflect the property's current rental value (i.e., the tax returns show large one-time expenses or the property was under renovation). In these instances, federal individual income tax returns must be obtained; however, Form 998, Operating Income Statement, may be used to determine rental income. PBM must explain the reasons for not using the income or loss from the federal individual income tax returns to determine rental income, in the mortgage file.

Documentation required to verify Rental Income:

Analysis of the following required documentation is necessary to verify all consumer rental income.

A. IRS Form 1040 Schedule E.

B. Current Lease/Rental Agreements.

C. Subject/Non Subject properties.

Rental Income Calculation Worksheets

Fannie Mae publishes three worksheets that underwriters may use to calculate rental income. Use of these worksheets is optional.

See Fannie Mae website Forms link below:

visit <https://www.fanniemae.com/singlefamily/selling-servicing-guide-forms>

Forms 1037,1038 and 1039

Retained Earnings

Retained earnings in a company are not an acceptable source of income.

Retirement, Government Annuity, and Pension Income

The following provides verification requirements for retirement and pension income:

For existing and established sources of retirement, annuity and pension income:

- Document income type, source, payment frequency and pre-determined payment amount with a benefit verification letter, award letter, pay statement, 1099 or other equivalent documentation. Age of documentation requirements do not have to be met.
- Document current receipt with a bank statement, pay statement, benefit verification letter, award letter or other equivalent documentation. Age of documentation requirements must be met.

or

For newly established sources of retirement, annuity, and pension income:

- Document the finalized terms of the newly established income including, but not limited to, the source, type, effective date of income commencement, payment frequency and pre-determined payment amount with the benefit verification letter, notice of award letter or other equivalent documentation from the payor that provides and establishes these terms. The income must commence prior to or on the first mortgage payment due date. The documentation must be dated no more than 120 days prior to the note date. Verification of current receipt is not required.

If retirement income is paid in the form of a distribution from a 401K , IRA, or Keogh retirement account, determine whether the income is expected to continue for at least three years after the date of the mortgage application. In addition:

- The borrower must have unrestricted access without penalty to the accounts; and
- If the assets are in the form of stocks, bonds, or mutual funds, 70% of the value (remaining after any applicable costs for the subject transaction) must be used to determine the number of distributions remaining to account for the volatile nature of these assets.

In the event a borrower has been receiving monthly distributions from their IRA Account and need to increase their monthly income to qualify, the following documentation will be needed for the loan file prior to closing:

- Letter from the company showing the increase of monthly IRA Distribution, and
- Proof of (1) month receipt of increased monthly distribution into borrower's account.

Note: Investor Specific (contact PBM-Secondary Locks)

Documentation of asset ownership must be in compliance with the Allowable age of Credit Documentation.

Social Security Income

The following provides verification requirements for Social Security income:

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

Documentation Requirements		
Type of Social Security Benefit	Borrower is drawing Social Security benefits from own account/work record	Borrower is drawing Social Security benefits from another person's account/work record
<u>Retirement</u> <u>Disability</u>	<ul style="list-style-type: none"> • Social Security Administrator's (SSA) award letter, OR • Proof of current receipt 	<ul style="list-style-type: none"> • SSA Award letter, • Proof of current receipt, AND • Three year continuance (e.g., verification of beneficiary's age

Survivor Benefits	N/A	<ul style="list-style-type: none"> • SSA Award letter, • Proof of current receipt, AND • Three year continuance (e.g., verification of beneficiary's age)
Supplement Security Income (SSI)	<ul style="list-style-type: none"> • SSA Award letter, AND • Proof of current receipt 	N/A
<p>Examples of how a borrower might draw Social Security benefits from another person's account/work record and use the income to qualify:</p> <ul style="list-style-type: none"> • A borrower may be eligible for benefits from a spouse, ex-spouse, or dependent parents (the benefit is paid to the borrower on behalf of the spouse, etc.) or • A borrower may use Social Security income received by a dependent (a minor or disabled dependent). 		

Trust Income

The following provides verification requirements for trust income.

- Confirm the trust income by obtaining a copy of the trust agreement or the trustee's statement confirming the amount, frequency, and duration of payments.
- Verify that the trust income will continue for at least three years from the date of the mortgage application.
- Unless this income is received monthly, documentation of current receipt of the income is not required to comply with the Allowable Age of Credit Documents policy.

VA Benefits

Most VA benefits are acceptable income if they are documented by a letter or distribution form from the Department of Veterans Affairs and will continue for at least three years from the date of the mortgage application.

Education benefits are not acceptable income as they are offset by education expenses.

Unemployment and Public Assistance Benefits

Unemployment and Public Assistance benefits MAY be considered as acceptable income if they are properly documented by letters or exhibits from the paying agency. The amount, frequency, and duration of the payments must be stated in the verifying letters or exhibits. If an individual receives unemployment benefits as a regular part of his or her income, proof of receipt must be evidenced by copies of tax returns for the past two years to establish a history of receipt is required. Unemployment compensation cannot be used to qualify the borrower unless it is clearly associated with seasonal employment that is reported on the borrower's signed federal income tax returns. Verify that the seasonal income is likely to continue.

Unemployment

- Verify that the borrower has worked in the same job (or the same line of seasonal work) for the past two years
- Confirm with the borrower's employer that there is a reasonable expectation that the borrower will be rehired for the next season
- For seasonal unemployment compensation, verify that it is appropriately documented, clearly associated with seasonal layoffs, expected to recur, and reported on the borrower's signed federal income tax returns. Otherwise, unemployment compensation cannot be used to qualify the borrower.

Public Assistance Income

- Document the borrower's receipt of public assistance income with letters or exhibits from the paying agency that state the amount, frequency, and duration of the benefit payments.
- Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application.

Section 8 income

The Housing Choice Voucher Program (more commonly known as Section 8) is also an acceptable source of qualifying income. There is no requirement for the Section 8 voucher payments to have been received for any period of time prior to the date of the mortgage application or for the payments to continue for any period of time from the date of the mortgage application.

Temporary Leave Income

Temporary leave from work is generally short in duration and for reasons of maternity or parental leave, short-term medical disability, or other temporary leave types that are acceptable by law and/or the employer. If PBM is made aware that a borrower will be on temporary leave at the time of closing the mortgage loan and the borrower's income is needed to qualify for the loan, the underwriter must determine allowable income and confirm employment as described below:

- The borrower's employment & income history must meet standard eligibility requirements.
 - Two years of documentation for borrower(s) employment and income history
 - Likelihood of continued receipt of income for at least 3 years.
- Borrower(s) must provide written confirmation of his or her intent to return to work and the agreed upon date of return as evidenced by documentation provided by the borrower or directly from the employer (or a designee of employer when the employer is using the services of a third party to administer employee leave), documentation evidencing such date that has been produced by the employer or by a designee of the employer.
 - Examples of the documentation may include, but are not limited to, previous correspondence from the employer or designee that specifies the duration of leave or expected return date or a computer printout from an employer or designee's system of record.
- PBM must receive no evidence or information from the borrower's employer indicating that the borrower does not have the right to return to work after the leave period.
- Obtain a verbal verification of Employment based on the requirements below.
 - Independently obtain a phone number & address for the borrower's employer. (i.e. telephone book, internet, directory assistance or by contacting the applicable licensing bureau).
 - Contact the employer verbally and confirm the borrower's current employment status within 10 days of funding. Day of funding is also acceptable.
 - Conversation must be documented and include name & title of person who confirmed the employment, the date of call, and source of the phone number.
- Document amount and duration of the borrower's "temporary leave income" which may require multiple documents or sources depending on the type and duration of the leave period, and
- The amount of the "regular employment income" the borrower received prior to the temporary leave. Regular employment income includes, but is not limited to, the income the borrower receives from employment on a regular basis that is eligible for qualifying purposes (i.e. base pay, commissions, and bonus).
- Income verification may be provided by the borrower, by the borrower's employer or by a third-party employment verification vendor.

NOTE: If the employer confirms the borrower is currently on temporary leave, the lender must consider the borrower "employed."

Requirements for Calculating Temporary Leave Income used for qualifying

- If borrower will return to work as of the first mortgage payment date, the lender can consider the borrower's regular employment income in qualifying.
- If the borrower will not return to work as of the first mortgage payment date, the lender must use the lesser of the borrower's temporary leave income (if any) or regular employment income. If the borrower's temporary leave income is less than his or her regular employment income, the lender may supplement the temporary leave income with available liquid financial reserves. (see B3-4.1-01, Minimum Reserve Requirements).

- For instructions on how to calculate “supplemental income” see section B3-3.1-09 under “Requirements for Calculating income used to qualify.
- Requirements for Calculating income used to qualify located below:

Supplemental income amount = available liquid reserves divided by the number of months of supplemental income.

- Available liquid reserves: subtract any funds needed to complete the transaction (down payment, closing cost, other required debt payoff, escrows, and minimum required reserves) from the total verified liquid asset amount.
- Number of months of supplemental income: the number of months from the first mortgage payment date the borrower will begin receiving his or her regular employment income, rounded up to the next whole number.
- After determining the supplemental income, the Underwriter must calculate the total qualifying income.

Total qualifying income = supplemental income plus the temporary leave income

The total qualifying income that results may not exceed the borrower’s regular employment income.

Note: These requirements apply if the Underwriter becomes aware through the employment and income verification process that the borrower is on temporary leave. If a borrower is not currently on temporary leave, the Underwriter must not ask if he or she intends to take leave in the future.

Disability Income- Long Term

The following information provides verification requirements for long-term disability income. It does not apply to disability income that is received from the Social Security Administration. See Section below regarding Social Security Income.

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

Generally, long-term disability will not have a defined expiration date and must be expected to continue. The requirement for re-evaluation of benefits is not considered a defined expiration dated.

If a borrower is currently receiving short-term disability payment that will decrease to a lesser amount within the next three years because they are being converted to long-term benefits, the amount of the long-term benefits must be used as income to qualify the borrower. For additional information on short-term disability, see Temporary Leave Income above.

Unacceptable Income

Monthly income derived from the following sources is Not Acceptable:

- Projected income
- Retained earnings
- Expense account advances or reimbursements
- Unverifiable income
- VA education benefits
- Room rent from subject property
- Draw income
- Illegal income

Self-Employed Borrowers

Any individual who has a 25% or greater ownership interest in a business is considered to be self-employed.

The following factors must be analyzed before approving a mortgage for a self-employed borrower:

- The stability of the borrower's income,
- The location and nature of the borrower's business,
- The demand for the product or service offered by the business,
- The financial strength of the business, and
- The ability of the business to continue generating and distributing sufficient income to enable the borrower to make the payments on the requested mortgage

Verification of Income updated 6/28/2016

PBM must verify the existence of the borrower's business within 120 calendar days for Fannie Mae/DU loans (or 30 days for Freddie Mac/LP loans) prior to the note date from a third party, such as a CPA, regulatory agency, or the applicable licensing bureau, if possible; or by verifying a phone listing and address for the borrower's business using a telephone book, the Internet or directory assistance. PBM must document the source of the information obtained and the name and title of the PBM employee who obtained the information.

The underwriter may verify a self-employed borrower's employment and income by obtaining from the borrower copies of his or her signed federal income tax returns (both individual returns and in some cases, business returns) that were filed with the IRS for the past two years (with all applicable schedules attached).

Alternatively, the underwriter may use IRS issued transcripts of the borrower's individual returns business federal income tax returns that were filed with the IRS for the most recent two years as long as the information provided is complete and legible and the transcripts include the information from all of the applicable schedules.

The underwriter may waive the requirement for business tax returns if:

- The borrower is using his or her own personal funds to pay the down payment and closing costs,
- The borrower has been self-employed in the same business for at least five years, and
- The borrower's individual tax returns show an increase in the self-employment income over the past two years.

Length of Self-Employment

Fannie Mae and Freddie Mac generally require underwriters to obtain a two-year history of the borrower's prior earnings as a means of demonstrating the likelihood that the income will continue to be received.

However, a person who has a shorter history of self-employment- 12 to 24 months, may be considered, as long as the borrower's most recent signed federal income tax returns reflect the receipt of such income as the same (or greater) level in a file that provides the same products or services as the current business or in an occupation in which he or she had similar responsibilities to those undertaken in connection with the current business. In such cases, the underwriter must give careful consideration to the nature of the borrower's level of experience, and the amount of debt the business has acquired

Analysis of Self-Employed Borrower – updated 6/29/16

When determining the appropriate qualifying income for a self-employed borrower, it is important to note that business income (specifically from a partnership or S corporation) reported on an individual IRS Form 1040 may not necessarily represent income that has actually been distributed to the borrower. The fundamental exercise, when conducting a self-employment income cash flow analysis, is to determine the amount of income that can be relied on by the borrower in qualifying for their personal mortgage obligation. When underwriting these borrowers, it is important to review business income distributions that have been made or could be made to these borrowers while maintaining the viability of the underlying business. This analysis includes assessing the stability of business income and the ability of the business to continue to generate sufficient income to enable these borrowers to meet their financial obligations.

When a borrower is relying upon self-employed income to qualify for a mortgage and the requirements that permit the underwriter to waive business tax returns are not met, the underwriter must prepare a written evaluation of its analysis of the borrower's business income. The underwriter must evaluate the borrower's business through its knowledge of other businesses in the same industry to confirm the stability of the borrower's business's income and estimate the potential for loan-term earnings.

The purpose of this analysis is to:

- Consider the recurring nature of the business income, including identification of pass-through income that may require additional evaluation;
- Measure year-to-year trends for gross income, expenses, and taxable income for the business;
- Determine (on a yearly or interim basis) the percentage of gross income attributed to expenses and taxable income; and
- Determine a trend for the business based on the change in these percentages over time.

The underwriter may use Fannie Mae's Comparative Income Analysis (Form 1088) or any other method of trend analysis that enable it to determine a business's viability, as long as the method used fairly presents the viability of the business and results in a degree of accuracy and conclusion that is comparable to that which would be reached by use of Form 1088.

The underwriter must consider whether the borrower's self-employed income has increased or decreased over the previous two years. If the analysis reflects that the income has significantly increased or decreased, the underwriter must provide sufficient documentation and justification to support the determination that the income used to qualify the borrower is stable and likely to continue for the next three years. If the borrower is self-employed and the self-employment income is not used to qualify, PBM must obtain the borrower's federal individual income tax returns to determine if there is a business loss that may have an impact on the stable monthly income used for qualifying.

Declining Income

A continuing large decline in gross income over two or three years may require the application be denied; even if the borrower's current income and debt ratios meet the guidelines. The actual income source, not just the total income must be analyzed. For example, adjusted gross income could be increasing yearly because of items not related to the business (such as by capital gains from the sale of real estate), but the actual business income could be declining yearly. The underwriter should also evaluate the individual business to estimate the potential for long-term earnings.

Verification of Self-Employed Co-Borrowers – Fannie Mae (updated 10-24-2016)

When co-borrower income that is derived from self-employment is not being used for qualifying purposes, the underwriter is not required to document or evaluate the co-borrower's self-employment income (or loss). Any business debt on which the borrower is personally obligated must be included in the total monthly obligations when calculating the debt-to-income ratio.

Business Structures

There are five principal business structures – sole proprietorships, partnerships, Limited Liability (LLC's), S Corporations, and Corporations. Knowledge of the structure of a self-employed borrower's business will assist the underwriter in analyzing and evaluating the stability of the business and the degree of the borrower's involvement

Sole Proprietorships

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

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

The income expenses and taxable profits of a sole proprietorship are reported on the owner's IRS Form 1040, Schedule C, and are taxed at the tax rates that apply to individuals.

When evaluating a sole proprietorship, the underwriter must:

- Review the owner's most recent signed federal income tax returns to ensure that there is sufficient and stable cash flow to support both the business and the payments for the requested mortgage, and
- Determine whether the business can accommodate the withdrawal of assets or revenues should the borrower need them to pay the mortgage payment and/or other personal expenses.

Partnerships

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

General Partnership

Under a general partnership, each partner has responsibility for running the business, is responsible for the actions of every other partner (unless otherwise specified in the partnership agreement).

A general partnership is dissolved immediately on the death, withdrawal, or insolvency of any of the partners, although the personal liability to partnership creditors exists even after the partnership is dissolved. However, the partnership's assets will first be applied to the creditors of the business and the partners' individual assets will be first applied to their personal creditors, with any surplus in a partner's personal assets then being applied to the remaining business creditors.

Limited Partnership

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

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

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

To quantify the level of the borrower's financial risk, the underwriter must:

- Determine whether the borrower has guaranteed any loans obtained by the partnership (other than loans that are considered as nonrecourse debt or qualified nonrecourse debt),
- Determine if the borrower received a distribution from the partnership, and
- Determine the borrower's share of non-cash expenses that can be added back to the cash flow of the partnership business.

Limited Liability Companies

A limited liability company (LLC) is a hybrid business structure that is designed to offer its member-owners the tax efficiencies of a partnership and the limited liability advantage of a corporation. The member-owners of the LLC (or their assigned managers) can sign contracts, sell assets, and make other important business decisions. The LLC operating agreement may set out specific divisions of power among the member-owners (or manager).

Although the member-owners generally have limited liability, there may be some instances in which they are required to personally guarantee some of the loans that the LLC obtains. Profits from the operation of the LLC may be distributed beyond the pool of member-owners, such as by offering profit distributions to managers.

The LLC may report its profit or loss on IRS Form 1065 or IRS Form 1120S with each member-owner's share of the profit or loss on Schedule K-1, IRS Form 1065 or IRS Form 1120S; however, the LLC pays no tax on its income. Each member-owner uses the information from Schedule K-1 to report his or her share of the LLC's net profit or loss (and special deductions and credits) on his or her individual IRS Form 1040, whether or not the member-owner receives a cash distribution from the LLC. Individual member-owners pay taxes on their proportionate share of the LLC's net income at their individual tax rates.

The underwriter must evaluate the LLC using IRS Form 1065 or IRS Form 1120S along with the Schedule K-1, as applicable, to determine the following:

- Whether the borrower actually received a cash distribution from the LLC, since profits may or may not be distributed to the individual member-owners; and
- Whether the borrower has guaranteed any loans obtained by the LLC (other than loans that are considered as nonrecourse debt or qualified nonrecourse debt).

S Corporations

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

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

Because the income from the distribution of corporate earnings may or may not be distributed to the individual shareholders, the lender must determine if the borrower received a cash distribution from the S corporation. The cash flow of an S corporation is otherwise evaluated similarly to that of a regular corporation.

Corporations

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

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

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

Evaluating Tax Returns

The underwriter must prepare a written evaluation of its analysis of a self-employed borrower's personal income, including the business income or loss, reported on the borrower's individual income tax returns. The purpose of this written analysis is to determine the amount of stable and continuous income that will be available to the borrower. This is not required when a borrower is qualified using only salaried income (not derived from self-employment) and self-employment is a secondary and separate sources of income (or loss).

The underwriter may use Fannie Mae's Cash Flow Analysis (Form 1084) or any other type of cash flow analysis that applies the same principles as Fannie Mae's form.

A copy of the written analysis must be included as part of any loan application package that the underwriter submits to Fannie Mae for a mortgage that is selected for a post-purchase quality control review.

Individual Tax Returns (IRS Form 1040)

The two methods of analyzing individual income tax returns are as follows:

Schedule Analysis Method

The schedule analysis method for determining a self-employed borrower's income evaluates only the income from self-employment and ignores other income that is documented on the borrower's individual tax return (such as dividends, interest, and social security income). This "other" income may be considered when it is properly documented and summarized separately on the loan application. The following schedules to the U. S. Income Tax Return (IRS Form 1040) or supplemental forms are used to analyze a self-employed borrower's income under the schedule analysis method:

Schedule C - Business income from a sole proprietorship

Certain adjustments to the net profit or loss shown on this form can be made to arrive at the income available to the borrower. Depletion and depreciation can be added back, while the meals and entertainment exclusion must be deducted.

Schedule D – Capital Gains and Losses

Income received from capital gains is generally a one-time transaction; therefore, it should not be considered as part of the borrower's stable monthly income. However, if the borrower needs to rely on income from capital gains to qualify, the income must be verified in accordance with the following requirements.

Verification of Capital Gains Income

- Document a two-year history of capital gains income by obtaining copies of the borrower's signed federal income tax returns that were filed with the IRS for the past two years, including IRS Form 1040, Schedule D.
- Develop an average income from the last two years (according to the Variable Income Section of B3-3.1-01 General Income Information located in Fannie Guide), and use the averaged amount as part of the borrower's qualifying income 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 loan payments.

NOTE: W-2 income with Capital losses identified on IRS Form 1040, Schedule D, do not have to be considered when calculating income or liabilities, even if the losses are recurring.

NOTE: if borrower is 100% Schedule C Business owner, and Schedule D losses are related to Schedule C income being used to qualify, then you would count the Schedule D loss against the borrower.

NOTE: Due to the nature of this income, current receipt of the income is not required to comply with the Allowable age of Credit Documents policy. However, documentation of the asset ownership must be in compliance with the Allowable Age of Credit Documents policy.

Schedule E – Supplemental Income and Loss

The income or loss is taken from Schedule K-1 of the US Partnership Return of Income (IRS Form 1065). If the business is a partnership, the income or loss is the sum of ordinary income (or loss) and guaranteed payments. If the business is an S corporation, the income or loss is the sum of ordinary income (or loss) and other income (or loss).

Schedule F – Farm Income and Expenses

This form is used to determine any business income from farming. Depreciation can be added back to the net profit or loss.

Employee Business Expenses (IRS Form 2106)

This form is used when a borrower who receives wages from a corporation has business expenses. Actual business expenses paid by the borrower should be deducted from the income available to the borrower. If the corporation reimbursed the borrower for his or her expenses, the amount reimbursed would have been reported as part of his or her W-2 income.

Wage and Tax Statement (IRS Form W-2)

A self-employed borrower receives a W-2 form if he or she is paid a salary by the corporation each year.

Adjusted Gross Income Method

The adjusted gross income method for determining a self-employed borrower's income relies on the "adjusted gross income" reported on his or her individual tax returns.

Wages, Salaries, Tips

If an amount for wages, salaries, or tips is reported for a self-employed borrower it could mean that the self-employed borrower operates as a corporation and pays himself or herself a salary. It could also mean that the borrower's spouse is employed. If this is the case, the spouse's income should be subtracted from the adjusted gross income. If the spouse's income is needed to qualify the borrower, verification of the spouse's employment is required.

Taxable Interest Income (from Schedule B)

This income may be included only if it has been received for the past two years. It cannot be counted as income if the interest-bearing asset will be used as the source of the down payment or closing costs.

Tax Exempt Interest Income

This income may be included only if it has been received for the past two years and is expected to continue. It must be added back to adjusted gross income to include it as income.

Dividend Income (from Schedule B)

This income may be included only if it has been received for the past two years. It cannot be counted as income if the dividend-producing asset will be used as the source of the down payment or closing costs.

Taxable Refunds of State and Local Income Taxes

This income must be deducted from the adjusted gross income since it is not a recurring income.

Business Income or Loss (Schedule C)

The sole proprietorship income (or loss) calculated on Schedule C is business income or loss. Depreciation and depletion from Schedule C must be added back to the adjusted gross income. The exclusion for meals and entertainment expenses must be deducted from the adjusted gross income.

Capital Gain or Loss (from Schedule D)

A capital gain or loss is generally a one-time transaction. Therefore, it should not usually be considered as either a gain or loss in determining income. However, if the borrower's business has a constant turnover of assets that produces regular gains or losses, the capital gain or loss may be considered. (An example of this is the person who buys old houses, remodels them, and sells them for profit). If the borrower has operated in this manner over a period of time, the lender may develop an average of the past two years gains or losses for consideration in the income calculation. If this source represents a substantial portion of the borrower's income, the tax returns should be reviewed for at least the last three years to obtain average earning from this source.

Operating Loss Calculations

- **If loss related to a previous business (no longer operating) this loss does not have to be considered for income qualifying. Proof that the business has been dissolved/no longer in operation must be provided for U/W review.**
- **If loss related to current business, then 2 years tax returns required and loss must be considered for income calculations.**

IRA Distributions

The income may be included if it will continue for at least three years. The nontaxable portion must be added back to the adjusted gross income.

Pension and Annuities

This income may be included if it will continue for at least three years. The nontaxable portion must be added back to the adjusted gross income. Refer to "Verification of Retirement, Government Annuity and Pension Income for details.

Rents, Royalties, Partnerships, Estates, Trust, Etc. (from Schedule E)

This income falls into three general categories.

1. Rental income is calculated from the Schedule E by taking the rental income less expenses before depreciation. Add back the interest, taxes, and insurance from the schedule E, and then deduct the full PITIA payment from your total. Use Rental Income Calculation Worksheet to properly document the rental income being used for qualifying.
2. Income (or loss) from partnerships and S must also be analyzed for "un-allowed" losses.
3. Income from estates and trusts may be included, provided such income is documented with evidence of the amount, frequency of receipt, and continuity for the past three years. Losses from estates and trusts must be analyzed for "un-allowed" losses. An "un-allowed" loss is an actual cash loss that could not be deducted from income for tax purposes. An "un-allowed loss carryover" is an "un-allowed" loss from previous years that may reduce the income figure for tax purposes in the current tax year. When total net losses exceed the allowed losses, the "un-allowed" loss must be deducted from the adjusted gross income. When the total net losses are less than the allowed losses, the "un-allowed loss carryover" should be added to the adjusted gross income.
4. If the subject is N/O/O and the borrower does not have a two year history of landlord experience the rent on the subject cannot be used. Borrower must qualify with the payment.

Farm Income or Loss (from Schedule F)

This is the profit and loss from farming. Any depreciation shown on Schedule F must be added back to the adjusted gross income.

Social Security Benefits

This income may be included if it will continue to be received for at least three years. The nontaxable portion of these benefits must be added back to the adjusted gross income.

Adjustments to Income

Most of the income adjustments shown on IRS Form 1040 must be added back to adjusted gross income. These adjustments include IRA deductions, the self-employed health insurance deduction, Keogh retirement plans, penalties on early withdrawal of savings, and alimony paid. The adjustment for reimbursed employee business expenses represents an actual expense so it should not be added back to the adjusted gross income. Any alimony paid (although added back to adjusted gross income) must also be included as a monthly debt.

Employee Business Expenses (IRS Form 2106)

These are actual out-of-pocket expenses that should be deducted from the borrower's adjusted gross income.

Depreciation and amortization (IRS Form 4562)

Amortization can be added back to adjusted gross income, but depreciation should not since the adjustment would already have been made based on Schedule E or F of IRS Form 1040.

Evaluating Corporate Tax Returns

Self-Employed Income Analysis Form

The Self-Employed Income Analysis (FNMA Form 1084A or 1084B) should be used to determine the borrower's share of a corporation's after-tax income and non-cash expenses after obligations that are payable in less than one year have been deducted from the corporate tax returns. The borrower's percentage of ownership can usually be determined from the "compensation of officer" section of the corporate tax return. If this information is not provided, the other evidence of the borrower's ownership must be obtained before this income can be considered. (A statement from the corporation's accountant will be considered as acceptable evidence).

Corporation Income

Before using the borrower's share of a corporation's funds to qualify the borrower for the mortgage, the borrower's right to the funds must be verified by obtaining a corporate resolution or other comparable document that establishes that right.

If the corporation operates on a fiscal year that is different from the calendar year, time adjustments must be made to relate the corporate income to the individual tax return (which is on a calendar year basis).

Particular attention to the following items is crucial when evaluating income from U.S. Corporation Income Tax Returns (IRS Form 1120) to make sure they develop the correct "adjusted" business income:

Taxable Income

This is the corporation's net profit. It must be reduced by the corporation's total taxes to determine after-tax income.

Depreciation

This non-cash expense must be added back to the corporation's after-tax income.

Depletion

This non-cash expense must be added back to the corporation's after-tax income.

Mortgage, Notes, Bonds Payable in Less Than One Year

This figure, which is found on the corporation's balance sheet, must be deducted from the corporation's after-tax income since it is not available for distribution because the funds must be used to meet the next year's obligations.

Once the adjusted business income has been developed, it should be multiplied by the borrower's percentage of ownership in the business.

Subtract any dividend income from the business that the borrower reported on his or her individual tax return to arrive at the total income available to the borrower for qualifying purposes.

After the income available to the borrower for qualifying purposes has been determined, the underwriter should reevaluate the corporation's overall financial position, using the Comparative Income Analysis. A borrower's withdrawal of cash may have a severe negative impact on the corporation any may lead to negative cash flow.

Evaluating Partnership Tax Returns

Income Analysis

The Self-Employed Income Analysis (Form 1084A or 1084B) should be used to determine the borrower's share of the partnership's adjusted business income that will be available for qualifying the borrower for the mortgage (if the borrower is able to provide evidence that he or she has access to the funds).

Partnership Tax Returns

Both general and limited partnerships use the U.S. Partnership Return of Income (IRS Form 1065) and the Partner's Share of Income, Credits, Deductions, etc. (Schedule K-1) for filing federal income tax returns for the partnership. The partner's share of income is carried over to Schedule E of his or her U.S. Income Tax Return (IRS Form 1040).

The borrower's proportionate share of depreciation and depletion can be added back to the borrower's income since they are non-cash expenses. However, they must first be reduced by the borrower's proportionate share of the partnership's total obligations that are payable in less than one year. (This will help determine whether the business will be able to meet its short-term obligations).

Once the income available to the borrower for qualifying purposes has been determined, the lender should reevaluate the partnership's overall financial position, using the Comparative Income Analysis. A borrower's withdrawal of cash may have a severe negative impact on the business and may lead to a negative cash flow.

Analyzing Profit and Loss Statements

The underwriter may use a profit and loss statement, audited or unaudited, for a self-employed borrower's business to support its determination of the stability or continuance of the borrower's income. A typical profit and loss statement has a format similar to IRS Form 1040, Schedule C;

- A Year-to-date profit and loss statement is not required for most businesses', but if the borrower's loan application is dated more than 120 days after the end of the business's tax year, the underwriter may choose to require this document if it believes that it is needed to support its determination of the stability or continuance of the borrower's income.
- If the underwriter did not count the borrower's year-to-date salary or draws in determining the borrower's qualifying income, he/she may add them to the net profit shown on the profit and loss statement as well as adding any of the allowable adjustments it used in analyzing the tax returns for the business, such as nonrecurring income and expenses, depreciation, and depletion. However, only the borrower's proportionate share of these items may be considered in determining the amount of income from the business that the borrower can use for qualifying purposes.

IRS Form 4506-T

Each borrower (regardless of income source) must complete and sign separate IRS Form 4506-T at application and again with loan documents.

4506-T requirements (follow D/U requirements); Process 4506-T based on AUS findings. If most recent year has an extension a 4506-T must be processed and;

- state "no record",
- a copy of the extension must be obtained and evidence of any monies owed must be documented paid to the IRS or evidence of refund.
- In cases of W-2 borrowers with extensions a 4506-T for the W-2 should be processed for the extension year.

If 4506-T results reflect income/loss information that we did not have documented in our file we must require two years 1040's that match the 4506-T results. **AT NO TIME CAN THE W2 RESULTS REPLACE THE REQUIRED 4506T RESULTS.**

For High Balance, Jumbo, VA and FHA

4506-T Form must be signed and date at application and again with loan documents for all Tax returns in the loan file.

- Example: If you have 1040's and 1120's in the loan file, a separate 4506-T form is required for the 1040's and the 1120's.

4506-T form signed and dated MUST be processed (transcripts) for all tax returns in the loan file that are being used for income qualifying only, i.e. 1040's, 1120's and 1065's.

Note: Conventional Conforming loan products require business transcripts, even if income is not used to qualify

2015 Income Qualification

When 2015 income is used to qualify the borrower, below are the minimum documentation requirements. This guideline is effective through 4/15/2016; thereafter the verified tax return or extension with evidence of payment for each is required.

Self Employed Borrower

- Copy of the 1040's stamped by the IRS as "Received"
- Cancelled check for the tax payment or evidence of receipt of refund
- IRS Transcripts for 2013; 2014 and 2015 (2015 will reflect "no record found"). Use worst case scenario with minimum of 24 mos. average if 2015 is increasing and 12 mos. average if decreasing.
- Audited P&L if the 2015 tax returns are not available and the income has increased and used to qualify. An unaudited P&L may be used to support previous year's income. If the P&L indicates a significant decline, the 2015 income must be taken into consideration when qualifying
- CPA letter addressing any significant decline if the tax returns/unaudited P&L cannot be verified

W2 Employee Updated (Any 2 of the below to be met)

- Borrowers final pay stub for 2015 (unless 2015 W2 available) OR
- IRS Transcripts for 2013 & 2014 OR 2015 if available OR follow the AUS findings
- IRS verified 2015 W2's (when income cannot be verified by tax transcripts) OR
- Written VOE confirming and explaining increase in income if the 2015 W2's cannot be verified

Retired Borrowers

- In cases where the borrower is not required to file tax returns, 4506T transcripts are still required.
- If "No Results" feedback is received, provide a copy of the feedback in the file with supporting documentation.

As always, the decision to use 2015 income is at the discretion of the Underwriter.

The decision to use the income largely depends on the industry and/or company the borrower owns or by which he/she is employed.

The Underwriter must provide an explanation of their thought process in using income that cannot be adequately verified with IRS Tax Transcripts. If there is a question as to whether to use the income contact Corporate Underwriting.

2015 Tax Transcripts required for loans closed on and after June 15, 2016

If a borrower has filed an extension, we require:

1. Evidence in the file that the extension was filed on or before April 15, 2016.
2. A 2015 Tax Transcript showing "No Record of return filed," and
 - For salaried borrowers: a 2014 Transcript, a current paycheck stub, and 2015 W-2.
 - For self-employed borrowers: A 2014 transcript and Profit and Loss Statement for 2015.
 - For retired borrowers: In cases where the borrower is not required to file, transcripts are still required.

If "No Results" feedback is received, provide a copy of the feedback in the Loan file with supporting income documentation.

Note: Loans that do not require income (non-credit qualifying FHA Streamlines and VA IRRRLs) are exempt.

Use of IRS Form 4506-T to Validate Borrower Income Documentation

PBM requires each borrower (regardless of income source) completed and sign a separate IRS Form 4506-T at application and at closing. It may be necessary to have the borrower complete and sign multiple IRS 4506-T forms depending on the transcripts required to validate the information used in documenting income.

- Underwriter's discretion if personal tax returns and if, applicable (the borrower is 100% owner of the business), business returns are used to document the borrower's income, those transcripts must be obtained from the IRS.

Debts and Liabilities

The borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, negative income from rental properties, stock pledges, alimony, child support, and all other debts of a continuing nature.

- Monthly payments that extend beyond ten months must be included in the total obligations-to-income ratio.
- Verification is required for any other liability that is not shown on the credit report.
- Verification forms must pass directly between the lender and the creditor, without being handled by other parties.

Alimony/Child Support Payments

Monthly payments that extend beyond ten months must be included in the total obligations-to-income ratio. A copy of the complete divorce decree and dissolution of marriage must be provided and included in the loan file.

Contingent Liabilities – Freddie Mac

If the Borrower is a cosigner/guarantor on a debt (which includes Mortgage debt) for another person, the underwriter must determine who actually makes the payments on the debt when deciding whether the contingent liability needs to be included in debts submitted to Loan Prospector or considered by the underwriter when manually qualifying the Borrower.

The underwriter must obtain evidence that timely payments are being made by someone other than the Borrower and document that someone other than the Borrower makes the payments by obtaining copies of canceled checks or a statement from the lender. The underwriter may document that timely payments are being made through a reference on the Borrower's credit report or by obtaining a payment reference from the lender. If someone other than the Borrower has been making the payments for the most recent 12 months and the payments have been timely for the most recent 12 months, the contingent liability may be excluded.

If the payments on the contingent liability have not been timely over the most recent 12 months or if the underwriter is unable to document that someone other than the Borrower made the payments for the most recent 12, the liability must be included in the data submitted to Loan Prospector or, when manually underwriting, included in the monthly payment-to-income ratio.

If the Borrower is listed as the Borrower on a Mortgage that has been assumed by another, the underwriter must obtain a copy of the documents transferring the property and any assumption agreement executed by the transferee. As long as the Borrower no longer owns the property, the contingent liability may be disregarded, without having to document the most recent 12 months' payment history.

The contingent liability (on a secured debt or Mortgage) may also be disregarded and the documentation of the most recent 12 months' payment history is not required, if the obligation to make the payments on a debt of the Borrower:

- Has been assigned to another by court order, such as a divorce decree, and
- The underwriter documents the order (provides appropriate pages from the separation agreement or divorce decree) and documents the transfer of title.

Court-Ordered Assignment of Debt – Fannie Mae

When a borrower has outstanding debt that was assigned to another party by court order (such as under divorce decree or separation agreement) and the creditor does not release the borrower from liability, the borrower has a contingent liability. The Underwriter is not required to count his contingent liability as part of the borrower's recurring monthly debt obligations.

The Underwriter is not required to evaluate the payment history for the assigned debt after the effective date of the assignment. The underwriter cannot disregard the borrower's payment before its assignment.

Co-Signed Loans

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

The liability does not need to be considered as part of the borrower's recurring monthly debt obligations if the underwriter can verify a history of documented payments on the co-signed debt by the primary obligor and ascertain that there is not a history of delinquent payments for the debt (since this could be an indication that the co-signer might have to assume the obligation at some point in the future).

Generally, the primary obligor should have been making payments on the debt for at least 12 months (although shorter payment histories may be considered on a case by case basis).

The liability does need to be considered as part of the borrower's recurring monthly debt obligations if:

- Payment by the primary obligor cannot be sufficiently documented,
- A sufficient payment history has not been established for the debt, or
- The primary obligor has a history of delinquent in making payments on the debt.

Installment Debts

Payments on installment debts that extend beyond ten months must be included in the total obligations-to-income ratio. The required monthly payment reflected on the most recent statement may be used instead of the payment that is reflected on the credit report.

Lines of Credit

Payment on lines of credit will be considered on that portion of any credit line that is currently being used or accessed. The monthly payment on a Home Equity Line of Credit (HELOC)

401K Loans

Are considered a secured asset and not included in the qualifying ratios.

Mortgage Payments

Mortgage payments reflected on the credit report must cover at least the previous 12 months of activity. If it does not, a payment history must be obtained directly from the mortgage servicer.

Non Income Producing Real Estate

Monthly mortgage payments on any non-income producing real estate (including those related to a second home that secures a mortgage) must be considered.

Revolving Accounts

For DU loan casefiles,

- if a revolving debt is provided on the loan application without a monthly payment amount, DU will use the greater of \$10 or 5% of the outstanding balance as the monthly payment when calculating the total debt-to-income ratio.

For LP casefiles,

- a monthly payment must be included in the total liabilities on revolving or open-end accounts, regardless of balance. In the absence of a stated payment, the payment must be calculated by multiplying the balance by 3%.

Undisclosed Debt

If the credit report reveals significant debt that the borrower did not disclose on the application, he or she may have been attempting to conceal liabilities in order to qualify for the mortgage. The borrower must provide a written explanation for the omission.

Fannie Mae DU Debt Comparison

Du compares the balances and payments of the debts on the credit report with the debts on the loan application. If material differences are found, the underwriter must confirm that all debts from the credit report are included on the loan application and provide documentation to support the use of payments and balances lower than those on the credit report. If the debt affects the debt-to-income ratio by more than the allowable tolerances, the underwriter must add the debt to the loan application and resubmit the loan. Otherwise, the underwriter is expected to provide documentation that supports the omission from the loan application.

Ratios and Qualifying

Qualifying ratios are based upon DU findings on all loans except Jumbo.

Refer to the program matrices for specific qualifying ratio guidelines if applicable.

Conforming Fixed and ARMs, and High Balance Fixed and ARMs have been set to a maximum DTI of 50% in Empower.

Compensating factors may justify ratios higher than those stated in individual product guidelines. All compensating factors used for this justification must be documented and deemed reasonable by Corporate Underwriting.

Qualifying Interest Rate Requirements	
Transaction Type	DU and Manual Underwriting
Fixed-Rate mortgages	Note Rate
ARMs with initial fixed-rate period of 5 years or less	Greater of the note rate plus 2% or the fully indexed rate
ARMs with an initial fixed-rate period of greater than 5 years.	Greater of the note rate or the fully indexed rate

Additional Information about ARM Qualifying for DU Loan Casefiles

For DU loan casefiles, the fully indexed rate is defined as the index plus the margin as entered in the online loan application. The index and margin are required for all ARM loans submitted to DU.

If “Lender ARM Plan” is used in DU, DU uses the interest rate entered in the ARM Qualifying Rate Field. If no interest rate is entered in that field, DU uses the note rate plus 2% to qualify the borrower.

Qualifying Ratios

Fannie Mae: For loan casefiles underwritten through DU, DU determines the maximum allowable DTI ratio based on the overall risk assessment of the loan casefile. DU will apply a maximum allowable DTI of 45%, with flexibilities offered up to 50% for certain loan casefiles with strong compensating factors.

Freddie Mac – Loan Prospector calculates and evaluates the borrower’s qualifying ratios. For Accept mortgages, LP has determined that the borrower’s qualifying ratios are acceptable.

Housing Payment to Income Ratio

The monthly housing expense is the sum of the following charges divided by the applicant’s monthly income:

1. Monthly principal and interest payment on the applicant’s primary residence.
2. 1/12th of the annual hazard insurance.
3. 1/12th of the annual real estate taxes
4. 1/12th of the annual flood insurance premium, if applicable.
5. Monthly leasehold payments, if applicable.
6. Monthly homeownership association dues, condominium maintenance fees, monthly assessments, if applicable.
7. Monthly payment for other financing, if applicable.

Secondary Financing

Loans that are subject to secondary financing must comply with the following:

- Terms of the second trust deed must provide for a minimum 5 year term;
- Repayment terms must provide for regular monthly payment that cover at least the interest due;
- No negative amortization;
- Terms of note should provide for an interest rate that is market rate, and allows for prepayment without a penalty.
- Borrower must qualify with the monthly payment included in the housing ratio;
- Lien must be recorded and clearly subordinated to the first lien;
- Terms of the loan and a copy of the executed note must be included in the loan file.

Equity Line

- CLTV must be based on the maximum available balance;
- The credit line must be subordinated to the first lien;
- **Fannie Mae:** For Home Equity Line of Credit (HELOC) loans, when there is a monthly payment of principal and interest or interest only, the payment on the HELOC must be considered as part of the borrower's recurring monthly debt obligations. If the HELOC does not require a payment, there is no recurring monthly debt obligation so the underwriter does not need to develop an equivalent payment amount.
- **Freddie Mac:** The monthly payment on a Home Equity Line of Credit (HELOC) is the payment reported on the credit report. If the HELOC has a balance but no monthly payment is reported, the underwriter must obtain documentation verifying the payment amount, or use a minimum of 1% of the balance.

Insurance/Taxes and Mortgage Insurance

Estimating Monthly Hazard Insurance Premium

California: Loan Amount x .0035 divided by 12 = monthly figure

Estimating Monthly Property Taxes

Purchases and Construction to Permanent Financing in California

All jurisdictions of California have various assessments and bond fees according to that jurisdiction. Processor/Underwriter must complete the "Tax Calculation Worksheet" (located in PBM-Policies and Procedures-Forms) for the calculation of estimated monthly property taxes.

- Form must be placed on top of the preliminary title report in the loan file.

Refinances in California

Property taxes from Preliminary Title Report divided by 12 = monthly figure + any assessments

Estimating Mello-Roos

If the exact figure is not available calculate monthly figure as follows:

Sales Price x .0150 divided by 12 = monthly figure

PBM must base its calculation of real estate taxes for borrower qualification on no less than the current assessed value. (Taxes are listed on the title commitment.) However, PBM may (or must in some circumstances) project the real estate taxes if it can document one of the following:

- The amount of taxes will be reduced based on federal, state, or local jurisdictional requirements. However, the taxes may not be reduced if an appeal to reduce them is only pending and has not been approved.
- If the transaction is new construction, the lender must use a reasonable estimate of the real estate taxes based on the value of the land and completed improvements.
- There is tax abatement on the subject property that will last for no less than 5 years from note date. For example:
 - For a municipality with a 10-year abatement, the lender may qualify the borrower with the reduced tax amount;
 - For a municipality with 10-year abatement and with annual real estate tax increases in years 1 through 10, PBM must qualify the borrower with the annual taxes that will be required at the end of the 5th year after the first mortgage payment date.

Estimating Flood Insurance

California: Loan amount x .0035 divided by 12 = monthly figure; or if available use amount from policy

Flood Insurance Coverage Requirements

General Requirements

PBM must ensure that any flood insurance required for the security property is in place. PBM requires flood insurance for any property that has a residential building, dwelling, structure, or improvement situated in a Special Flood Hazard Area (SFHA) that;

- Has federally mandated flood insurance purchase requirements, or
- Is located in the Coastal Barrier Resources System or Otherwise Protected Area.

Flood insurance coverage is required for all residential buildings on the mortgaged premises if any part of the structure is located within an SFHA. If two or more residential structures are located on a security property (for example, a principal structure and a guest house), all structures with any part in the SFHA must be covered by adequate flood insurance. (For the purpose of Fannie Mae's flood insurance requirements, the "principal structure" is the primary residential structure on the security property.)

The following table describes when flood insurance is required:

If...	Then flood insurance...
Any part of the principal structure on a property securing the mortgage loan is located in an SFHA,	Is required on the principal structure.
A non-residential detached structure attached to the land on a property securing the mortgage loan has any part located in an SFHA,	Is not required on the non-residential detached structure.
A residential detached structure on a property securing the mortgage loan has any part located in an SFHA,	Is required on the residential detached structure.

The underwriter must determine whether or not the structures on the security property are located in an SFHA by using the Standard Flood Hazard Determination form endorsed by FEMA as mandated by federal flood insurance purchase requirements. SFHAs are shaded on a Flood Hazard Boundary Map and designated on a Flood Insurance Rate Map (FIRM). All flood zones beginning with the letter "A" or "V" are considered SFHAs.

If the underwriter determines that a principal and/or residential detached structure is located in an SFHA but the community does not participate in the National Flood Insurance Program (NFIP) the mortgage is not eligible.

For communities that participate in the Emergency Program of the NFIP, mortgage loans secured by properties in those communities are eligible provided that the flood insurance coverage meets higher NFIP Regular Program limits (available on FEMA's website). Because the NFIP Emergency Program provides only limited coverage, the borrower must obtain private insurance or a supplemental private policy in conjunction with the NFIP Emergency Program policy that fully meets PBM's flood insurance coverage requirements (described below).

PBM will not require flood insurance on a principal or residential detached structure if the borrower obtains a letter from FEMA stating that its maps have been amended so that the structure is no longer in an SFHA.

Acceptable Flood Insurance Policies

Flood insurance should be in the form of the standard policy issued under the NFIP or by a private insurer. The terms and conditions of the flood insurance coverage must be at least equivalent to the terms and conditions of coverage provided under the standard policy of the NFIP for the appropriate property type. The Policy Declaration page of a policy is acceptable evidence of coverage.

The amount of flood insurance provided by the NFIP or by a private insurer must meet Fannie Mae's minimum coverage requirements for the appropriate property type. In addition, private carriers must meet Fannie Mae's minimum rating requirements for insurance underwriters.

Coverages for First Mortgages

The minimum amount of flood insurance required for most first mortgages secured by one-to four-unit properties, individual PUD units, and certain individual condo units (such as those in detached condos, townhouses, or row houses) is the lowest of :

- 100% of the replacement cost of the insurable value of the improvements;
- The maximum insurance available from the NFIP, which is currently \$250,000 per dwelling; or
- The unpaid principal balance of the mortgage

Coverage for Second Mortgages

When originating a second lien mortgage eligible, the underwriter must include all property liens when determining the appropriate flood insurance coverage for the subject loan. All other requirements applicable to first mortgages must also be met.

Requirements for Project Developments

If a first mortgage is secured by a unit in an attached condo or PUD project and any part of the improvements are in an SFHA, the underwriter must verify that the HOA maintains a master or blanket policy of flood insurance and provides for premiums to be paid as a common expense.

Project Type	Coverage Requirements
<p>Condo</p>	<p>Individual condo units:</p> <p>Stand-alone flood insurance dwelling policies for an attached individual condo unit are not acceptable. A master condo flood insurance policy must be maintained by the HOA, subject to the coverage requirements below. (For detached units, refer to the requirements described in Coverage for First Mortgages above.)</p> <p>Condo Projects:</p> <p>The HOA must obtain a Residential Condominium Building Association Policy or equivalent private flood insurance coverage for each building that is located in an SFHA. The policy must cover all of the common elements and property (including machinery and equipment that are part of the building), as well as each of the individual units in the building.</p> <p>The master flood insurance policy must be at least equal to the lower of</p> <ul style="list-style-type: none"> • 80% of the replacement cost, or <p>The maximum insurance available from NFIP per unit (which is currently \$250,000). If the condo project master policy meets the minimum coverage requirements above but does not meet the one-to four-unit coverage requirements (described in Coverage for First Mortgages), a supplemental policy may be maintained by the unit owner for the difference.</p> <p>The contents coverage should equal 100% of the insurable value of all contents (including machinery and equipment that are not part of the building), owned in common by association members.</p> <p>If condo project has no master flood insurance policy or if the master flood insurance policy does not meet the requirements above, the loan securing the units in that project are not eligible.</p> <p>NOTE: DU Refi Plus and Refi Plus loans secured by units in a condo project are not required to meet the flood insurance requirements for master flood insurance policies stated in this section. Rather, if no master policy is in place, a stand-alone dwelling policy may be maintained by the unit owner to meet the full one-to four-unit requirements. If the master policy is deficient (by any amount), a supplemental policy may be maintained by the unit owner for the difference between the master policy and the one-to four-unit requirements.</p>
<p>PUD</p>	<p>Individual PUD Units:</p> <p>PBM requires the same flood insurance for individual PUD units that is required for other one- to four-unit properties (described in Coverage for First Mortgages above). A stand-alone dwelling policy may be maintained to meet these requirements.</p> <p>PUD project:</p> <p>If a master policy is maintained, it must cover any common element buildings and any other common property located in an SFHA.</p>

Maximum Allowable Deductibles

Deductible for master project and individual dwelling flood insurance policies must meet NFIP requirements for the type of improvements insurance unless state law requires a higher maximum deductible amount. This requirement applies to both NFIP and private policies.

Hazard Insurance (updated 12/7/2016)

- Insurer must be acceptable to FNMA/FHLMC.
- Coverage must be equal to the lesser of loan amount or the amount reflected on the appraisal as "total estimated cost new". Guaranteed Replacement Cost Coverage is acceptable.
- The maximum allowable deductible for insurance covering a property (including common elements in a PUD or condo) securing a first mortgage loan is 5% of the face amount of the policy. When a policy provides for a separate wind-loss deductible (either in the policy itself or in a separate endorsement), that deductible must be no greater than 5% of the face amount of the policy (Fannie Mae/Freddie Mac/FHA).
- Lender's Loss Payable endorsement (CA BFU438). Always verify insurance company will issue the 438. For example, Topa Insurance has the rating, but will not issue a 438. Form 370 is not acceptable.
- Condos and PUD's must maintain blanket insurance policy that provides for public liability and fidelity bond coverage that meets investor requirement. Walls in coverage must be obtained (HO6).
- Six months remaining coverage for refinance transactions, 12 months for purchase transactions.

Fannie Mae: Properties with Solar Panels (updated 2/23/2016)

If the solar property owner is the owner of the solar panels, standard eligibility requirements apply (for example, appraisal, insurance and title)

If the solar panels are leased from or owned by a third party under a power purchase agreement or other similar arrangement, the following requirements apply:

If the solar property owner is the owner of the solar panels, standard eligibility requirements apply (for example, appraisal, insurance and title).

If the solar panels are leased from or owned by a third party under a power purchase agreement or other similar arrangement,

The following requirements on the table on the next page apply:

Requirements for Properties with Solar Panels that are Leased or Covered by a Power Purchase Agreement
The solar panels may not be included in the appraised value of the property.
The property must maintain access to traditional electric utilities. For example, properties with lease solar panels must have traditional electrical utilities in addition to the electricity provided by the solar energy, to ensure consistent access to electricity in the event the solar panels become non-functioning or are removed.
<p>The lease payment must be included in the debt-to-income (DTI) ratio calculation unless the lease is structured to</p> <ul style="list-style-type: none"> • Provide delivery of a specific amount of energy at a fixed payment during a given period, and • Have a production guarantee that compensates the borrow on a prorated basis in the even the solar panels fail to meet the energy output required for in the lease for that period. <p>Payments under power purchase agreements where the payment is calculated solely based on the energy produced may be excluded from the DTI ratio.</p>
The owner of the solar panels must have a general liability insurance policy that covers damage to the mortgaged property caused by faulty installation, malfunction, or other manufacturing defects, whether or not covered by the warranty.
<p>The owner of the solar panels agrees:</p> <ul style="list-style-type: none"> • Not to be named loss payee (or named insured) on the property owner's property insurance policy. • As an alternative the underwriter may verify that the owner of the solar panels is not named a loss payee
<p>The lease or power purchase agreement must indicate that</p> <ul style="list-style-type: none"> • Any damage that occurs as a result of the installation, malfunction, manufacturing defect, or the removal of the solar panels is the responsibility of the owner of the equipment and the owner must be obligated to repair the damage and return the improvements to their original or prior condition (for example, sound and watertight conditions that are architecturally consistent wit the home). .
<p>In the event of foreclosure, either:</p> <ul style="list-style-type: none"> ○ PBM may terminate the lease/agreement and require the third-party owner to remove the equipment; ○ PBM has the right to become the beneficiary of the borrower's lease/agreement with third party without charge; or ○ PBM has the right, but not the obligation, to enter into a new lease/agreement with the third party, under terms no less favorable than the prior owner. <p>Note: Any lease/agreement in which PBM is a party in connection with a foreclosure (whether as beneficiary or direct party), must also be assignable to a subsequent purchaser of the realty from the PBM. In addition, PBM must also have the right to terminate the lease/agreement and require removal of the equipment (for example if the third party places restrictions on the assignment to a purchaser).</p>
Title exceptions with respect to the solar panels (for example, easements, notice of contract) may be present on the title provided the interest is not superior to Fannie Mae's first lien position.
The title cannot reflect any liens related to the ownership or maintenance of the solar panels that will result in a lien superior to PBM's first lien position.

Private Mortgage Insurance

- Mortgage Insurance coverage – Refer to approved MI Company for specific guidelines.
- Approved Mortgage Insurance Companies –

RADIAN: www.radian.biz

ESSENT: www.essent.us

NATIONAL MI: www.nationalmi.com

MGIC: www.MGIC.com

GENWORTH: <http://mortgageinsurance.genworth.com>

PMI: www.pmi-us.com

RMIC: www.rmic.com

- Loan applications dated on or after October 1, 2014 must be insured under one of the Fannie Mae-approved Forms.

Underwriter(s) are required to make sure the Mortgage Insurance Companies are using the correct forms when obtaining the Mortgage Insurance Certification. List of correct forms on link below: <https://www.fanniemae.com/content/tool/approved-mortgage-insurance-forms.pdf>

- Transferred Mortgage Insurance is allowed as long as the following steps are taken to determine the type of Mortgage Insurance is acceptable to Provident Bank Mortgage.
 - Underwriter to condition for satisfactory transferable Mortgage Insurance.
 - If you are unable to determine if the transferred mortgage is acceptable, send it to Corporate Underwriting for final approval.
 - It is the responsibility of the Branch to make sure a copy of the final MI Certification is in the loan file prior to shipping to the loan vault.
- Step by step instructions for entering Mortgage Insurance into Empower can be found in Announcement 2012-28a dated 8/23/2012

PBM offers the following MI products:

- Zero Option Monthly BPMI – You pay a MI premium in addition to your monthly payment. The first premium will be collected with the first or second loan payment.
- Single Premium Cash BPMI – You pay on MI premium in cash at closing
- Split Premium Insurance BPMI – A portion of the insurance is paid upfront and then a smaller amount on the monthly premium.
- Lender Paid Mortgage Insurance LPMI - The loan has a higher interest rate and the lender pays for the Mortgage Insurance.
 - LPMI can only be done thru Radian, MGIC, Essent and Genworth at this time.

NOTE: All loans that require Mortgage Insurance are subject to MI Approval. Contact one of the approved MI Companies above for guidance.

- Loan applications date on or after October 1, 2014 must be insured under one of the Fannie Mae-approved Forms.
- Underwriter(s) are required to make sure the Mortgage Insurance Companies are using the correct forms when obtaining the Mortgage Insurance Certification.

Title Policy Review

Underwriting the Preliminary Title Report

Underwriters are responsible for underwriting the preliminary title report. The underwriting process includes marking each item on the Schedule B in ink, either “in or out”. Underwriters are responsible for giving instructions to the closing department. These instructions must be clear and consistent. The underwriter must add required endorsements as specifically addressed in “Underwriting the Preliminary Title Report” located in Provident Bank Mortgage’s Procedure Manual.

Closing Protection Letter (CPL)

Closing Protection Letter dated within 30 days of funding is required on all loans.

Vesting Requirements

Vesting specifics for Non-Titled Spouse and Titled Spouse Requirements are defined in separate matrices located in Provident Bank Mortgage’s Procedure Manual. Underwriters are required to refer to these matrices whenever special vesting circumstances exist.

Private Transfer Fees

Private transfer fee covenants may be attached to real property by the owner or another private party, or the property developer and provide for a transfer fee to be paid to an identified third party, such as the developer or its trustee, upon each resale of the property. The fee typically is stated as a fixed amount or as a percentage, such as one percent of the property’s sales price, and often exists for an extended period of time.

Fannie Mae, Freddie Mac and Government Loan Agencies will not purchase or securitize mortgages on properties encumbered by private transfer fee covenants if those covenants were created on or after February 8, 2011, unless permitted by the Regulation. Acceptable exclusions include private transfer fees paid to homeowner associations, condominiums, cooperatives, and certain tax-exempt organizations that use private transfer fee proceeds to benefit the property.

Underwriters are required to ensure that properties approved under Fannie Mae, Freddie Mac and Government Agency Guidelines are not secured by properties encumbered with a private transfer fee that are unacceptable.

Property Overview

Provident Bank Mortgage’s Appraisal Underwriting Guidelines for Residential Units is published as our uniformed guide to the evaluation process. The following list represents property valuation guides that are available in Provident Bank Mortgage’s Policy and Procedure Manual:

- Appraisal Underwriting Checklist
- Condo / PUD Guidelines
- Condo / PUD Warranty Certification
- Condo / PUD Matrix
- LAPP Review Procedures
- SAR Review Form

Note: The Appraisal Review Policy is included in the Appraisal Underwriting Guidelines. All appraisal underwriting must be documented on an appraisal underwriting worksheet.

Pre-Funding Audit Procedures

The following pre-funding quality control reviews are required on all closed loans:

1. Run Data Verify with Property Verify may be required per specifications below.
2. Appraisal Review if deemed necessary by the underwriter or program guidelines.
3. Appraisal Check List completed by the underwriter.
4. 4506T to be processed on all loans.
5. Social Security Verification Review on all FHA and on any conventional that has any kind of SS# Alert found in the credit report or on the Data Verify or any other place in the file.
6. MERS to be run twice on all loans at processing/underwriting and funding
7. Verbal VOE's to be done by processor or funder within 10 days of funding or at time of funding.
8. Credit report to be no more than 45 days old at time of funding. If credit is aged a soft-pull updated report (do not need FICOs) must be run.
9. LDP/GSA must be run on all FHA loans and all conventional loans with applications dated on or after June 1, 2010. Names and/or parties MUST be spelled correctly when run through LDP/GSA.
10. Verify Initial and Final loan application is signed by the borrower and Mortgage Loan Officer. NMLS Number for the Mortgage Loan Officer must be reflected on both initial and final loan application

The above requirements have been standardized to apply to all loan transactions. Wholesale transactions previously requiring pre audits will now be satisfied with the above requirements. Wholesale transaction requiring audits due to broker being on the watch list will require an Audit Form to be completed.

Data Verify – An audit tool to be run on all loans prior to closing. The ID Verify, App Verify and Property Verify scores must be equal to or greater than 700. All findings in the “High Caution” range must be cleared by the underwriter with appropriate documentation or comments placed in the loan file. All findings in the Medium and Low Caution ranges must be reviewed for red flags and possible clearance.

NOTE: Medium and Low range findings deemed insignificant may have to be cleared to bring the score to 700+.

Appraisal Review – Field or Desk Appraisal Reviews are at the discretion of the Underwriter unless the required by specific program guidelines.

Appraisal Check List – is a tool for the underwriter to use to make sure the appraisal is thoroughly analyzed at underwriting and specific declining market requirements are met. There is one for both FHA and Conventional.

4506T – must be processed on all loans. The results must match/support the income documentation in the file. If the results reflect additional earnings/loss this income/loss must be documented, addressed and taken into consideration in qualifying.

Social Security Number Verification - A third party verification through the Social Security Administration is required for all FHA borrowers. Conventional loans only require this when there is any discrepancy or variation in the credit report or the Data Verify or any other place in the loan file. Social Security Number must be consistent throughout the file (1040s, W-2's, check stubs, credit report, etc.).

MERS – is used to determine what if any open mortgages the borrowers may have. The SS# of the borrowers is used for the search. Any additional open mortgages found must be documented, addressed and considered in qualifying.

Verbal VOE

A verbal VOE must be performed at underwriting/processing and again at funding. The verbal VOE at underwriting must include the borrower's dates of employment and position. If the employer mentions future layoff or deferments, loan may not fund and the file must go back to the underwriter for further review.

Verbal VOE Fannie Mae (06/28/2016)

The verbal verification must be obtained within 10 business days prior to the note date for employment income, and within 120 calendar days prior to the note date for self-employment income.

Verbal VOE Freddie Mac

Obtained either no more than 10 business days prior to the note date or after the note date but prior to the delivery date for employment income, and verification of existence of the business through a third-party source obtained either no more than 30 calendar days prior to the note date or after the note date but prior to the delivery date for self-employment income.

NOTE: Any change in the borrower's employment status could have significant impact on the borrower's capacity to repay the mortgage loan and must be fully reevaluated

Credit Report Age – The credit report used to qualify the borrower may not be older than 45 days at funding. The purpose of this is to determine that no new financing has occurred which could affect the qualification of the specific transaction and that there has been no new derogatory credit established. If a soft-pull update is needed, ficos are not required unless there are significant changes found on the soft-pull report. Any significant changes such as newly opened accounts, increase in accounts that would affect ratios, derogatory credit etc. would require re running of DU with updated credit and FICO's. The loan would then need to be re-qualified and changes made in Empower. If there are no changes on the soft-pull compared to the existing credit report, the existing credit report can be used to fund the loan, but CANNOT be more than 90 days old. Major changes could possibly result in a need to restructure or decline the loan.

LDP/GSA - Fannie Mae requires lenders to confirm that companies or individuals involved in the origination, underwriting, or servicing of the mortgage transaction are not on the General Services Administration (GSA) Excluded Party List or the HUD Limited Denial of Participation List ("LDP List") prior to delivery of the loan. Regardless of the reason for the party being excluded, any party to the transaction included on either list will result in the loan being ineligible for delivery.

Companies or individuals involved in a mortgage transaction include a person with management or supervisory responsibilities within a seller's or servicer's company and any person or entity with critical influence on or substantive control over the origination or servicing of a mortgage or any function related to the origination or servicing of a mortgage. The individuals we should be checking are Borrowers, Loan Officers, Underwriter, Appraiser, Listing Agent, Listing Agent's company, Selling Agent, Selling Agent's company, Escrow Officer, Escrow company, Title Officer and Title Company. Names and/or parties MUST be spelled correctly when run through GSA.

Early Check (DU)/Loan Quality Advisor* (LP) - A verification of the files AUS Findings matching the final accurate information in the Empower System must be run prior to close.

*Loan Quality Advisor for LP is not available at this time. However the accuracy of the LP compared to the information in Empower must be manually reviewed.

Should any of the above pre closing QC procedures reflect inconsistencies or misrepresentation, the file and its findings must be sent to Corporate QA Underwriting for further QC review. A cover letter explaining the concerns must accompany the file. Corporate QA Underwriting will review the findings and if applicable will issue a Suspicious Activity Report (SAR) and notification to the appropriate agencies.

Risk Advisory

Risk is a characteristic that denotes a potential negative impact to the salability and/or performance of a loan. The layering of risk characteristics increases the probability of a negative impact on the salability and/or performance of a loan. Risk characteristics are attributes of each loan that impact the borrower's motivation or capacity to repay the mortgage loan.

When a number of risk factors are present without sufficient compensating factors, their cumulative effect can dramatically increase the likelihood of default. This is referred to as layered risk. Loans with layered risk characteristics can be measured through early payment default, common risk and quality errors, unsalable loans, and repurchase requests. Loans with risk and quality errors historically correlate to higher defaults.

The following information provides guidance in the form of observations and recommendations specific to how loan scores, along with common risk and quality errors are related to layered risk.

Loan Scores: The relationship between loan scores and other layered risk factors

Observation: Loan scores are one predictive measure of credit risk for loans; however, loan scores are less of a driving factor when additional risk is layered on the transaction. For example, loans with high loan-to-values *and* loan scores less than 740 exhibit layered risk.

Recommendations:

- Minimize the risk for any loans where the housing ratio exceeds 34%. We recommend that these loans have compelling compensating factors such as substantial reserves, or a long history of maintaining a higher housing ratio with unchanged circumstances.
- Document the comprehensive risk decision; provide a written statement for the underwriting rationale used to approve higher risk loans.
- Consider other contributory risk factors such as financial reserves, mortgage term, and property type, presence of co-borrowers, mortgage delinquency, bankruptcy and foreclosure.
- Carefully consider other risk characteristics to the transaction such as an ARM feature; or a cash-out option.

Unique factors specific to self-employed borrowers

Observation: Self-employed borrowers are more likely to be affected by layered risk and high DTI ratios. Self-employed income is more volatile and uncertain. Most self-employed borrowers with curtailed income also have high debt ratios. Post-closing liquidity (reserve) requirements are not a risk offset. Under stress, assets are more likely diverted to the failing business than to repay the mortgage. CLTV appears to have some off-setting effect on higher debt-to-income ratios; loan score does not.

Recommendations:

Carefully consider the number and combination of the total risk factors in order to minimize the likelihood of default for self-employed borrowers.

- Debt-to-income ratio greater than or equal to 38%
- Loan scores less than 740
- CLTV greater than 75%
- Low post-closing liquidity assets
- Non primary residences

Unique factors specific to cash-out refinance transactions

Observation: Increasing numbers of homeowners are taking on additional risk by leveraging the value of their home through a cash-out refinance transaction. Historically, borrowers who pursue a cash-out refinance subsequently are more likely to default than borrowers who don't. Cash-out can be used for various reasons; however, in some cases it can be a sign of financial distress. Cash-out refinances allow consumers to borrow against the value of their homes. This is financial leverage and it adds an additional layer of risk to cash-out refinance transactions.

Recommendations:

- Carefully consider the borrower's circumstances and reasonableness of the transaction.
- Understand why the borrower is seeking cash out by borrowing against their home.
- Understand the borrower's credit situation including recent accumulation of debt, excessive use of revolving debt, and number of trade lines.
- Assess the borrower's employment stability, including things like time as self-employed, seasonal work or industries susceptible to downsizing.
- Assess the borrower's history of saving and whether or not it is proportionate to their income.
- Conduct additional review or due diligence for cash-out transactions on second homes or investment properties. Make sure the property is supported by the appraisal.

Common risk and quality errors

Observation: Common risk and quality errors reduce the ability to complete a comprehensive and accurate risk evaluation. Recent risk and quality errors observed, but are not limited to:

- missing or inaccurate documentation,
- income validation,
- income calculation,
- occupancy (reasonableness of),
- debt exclusion (undisclosed mortgage debt and missing explanations),
- transaction structure (identity of interest), and
- missing an underwriting written analysis to support the underwriting rationale

Recommendations:

- Provide a written analysis to justify the determination of income, assets and credit that are used to qualify the borrower. This will give clarity regarding the underwriter's rationale and approach in the overall loan decision. Tell the whole story on every loan.
- Have conversations with borrowers to ensure complete and accurate information on the 1003.
- Establish a process and take steps to ensure underwriters identify and weigh the risk factors and offsets: - Consider whether or not the borrower can afford the payments and other housing obligations in addition to their current debt load.
- Consider the borrower's ability to save cash to close.
- Consider the borrower's willingness to repay based on their payment history.

Document the comprehensive risk decision; provide a written statement for the underwriting rationale used to approve higher risk loans.

Completing a comprehensive risk assessment, along with addressing common risk and quality errors is important to originating well underwritten loans. Implementing and promoting responsible lending practices is critical to protecting borrowers, lenders and investors in the mortgage industry.

Exhibits

- A. Appendix Q to Regulation Z – Part 1026 – Standards for Determining Monthly Debt and Income**
- B. Visa Types and Descriptions**