



# **Community DSCR Program Guidelines**

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# I INTRODUCTION

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

## I.1 LOAN UNDERWRITING PHILOSOPHY

Many aspects of the loan are evaluated but primarily relies on evaluation of the borrower's ability to repay the loan to predict loan performance. Additional characteristics of the loan are also examined including credit history, asset position, and the property being used for collateral.

There is no-tolerance policy as it relates to fraud. Loans containing fraudulent documentation or information will immediately be declined.

## I.2 FAIR LENDING STATEMENT

Community Wholesale Lending operates in accordance with the provisions of the Fair Housing Act and Equal Credit Opportunity Act. The Fair Housing Act makes it unlawful to discriminate in housing-related activities against any person because of race, color, religion, national origin, sex, handicap, or familial status. The Equal Credit Opportunity Act prohibits discrimination with respect to any aspect of a credit transaction on the basis of sex, race, color, religion, national origin, marital status, age (provided the borrower has the capacity to enter into a binding contract), receipt of public assistance, or because the borrower has in good faith exercised any right under the Consumer Credit Protection Act. Community Wholesale Lending fully supports the letter and spirit of both of these laws and will not condone discrimination in any mortgage transaction.

## I.3 RESPONSIBLE LENDING STATEMENT

The primary focus of this lending program is the borrower's ability to repay the mortgage obligation. Loans should be affordable to the borrower in his or her pursuit of homeownership.

Under the general Ability-to-Repay (ATR) standard, lenders must make a reasonable, good-faith determination that the consumer has a reasonable ability to repay the loan. Lenders must verify information using third-party records that provide reasonably reliable evidence of income or assets.

If a loan is subject to the ATR rules under the Federal Truth in Lending Act ("TILA"), lenders must consider eight underwriting factors to be in compliance:

- Current or reasonably expected income or assets (other than the value of the property that secures the loan) that the consumer will rely on to repay the loan
- Current employment status (if you rely on employment income when assessing the consumer's ability to repay)
- Monthly mortgage payment for this loan. You calculate this using the introductory or fully indexed rate, whichever is higher, and monthly, fully amortizing payments that are substantially equal
- Monthly payment on any simultaneous loans secured by the same property
- Monthly payments for property taxes and insurance that you require the consumer to buy, and certain



- other costs related to the property such as homeowner's association fees or ground rent
- Debts, alimony, and child support obligations
- Monthly debt-to-income ratio or residual income, that you calculated using the total of all of the mortgage and non-mortgage obligations listed above, as a ratio of gross monthly income
- Credit history

## **2 GENERAL PROGRAM INFORMATION**

The DSCR Program is designed for investment or non-owner-occupied loans that are designated for business purposes only. Section 14 outlines requirements specific to the DSCR Program.

For the DSCR Program, the following forms are required:

- Business Purpose & Occupancy Affidavit (all Borrowers, Borrowing Entities, and/or Personal Guarantors are required to sign prior to submission and at closing to declare that the property is, or will be, for commercial business or investment purpose only)
- I-4 Family Rider/Assignment of Rents (FNMA Form 3170)
- Guaranty Form (if applicable)

### **2.1 LOAN AMOUNTS AND LOAN-TO-VALUES**

Refer to DSCR Matrix

### **2.2 STATE RESTRICTIONS**

Refer to DSCR Matrix

### **2.3 PREPAYMENT PENALTIES, POINTS, AND FEES**

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

Prepayment penalties may be required on investment property transactions as indicated via rate lock confirmation and where permitted by applicable law. Buydown options are available to reduce or remove prepayment penalties. Prepayment penalties on primary residence and second home transactions are prohibited.

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

# 3 TRANSACTIONS

## 3.1 OCCUPANCY

The DSCR Program allows for financing of investment properties only.

### 3.1.1 PURCHASE

A copy of the fully executed purchase contract and all attachments or addenda is required for purchase transactions. The lesser of the purchase price or appraised value of the subject property is used to calculate the loan-to-value.

### 3.1.2 GENERAL REFINANCE REQUIREMENTS

#### 3.1.2.1 DETERMINING LOAN-TO-VALUE

The following standards apply to refinance transactions under DSCR:

- If the property was acquired  $\geq 6$  months from application date, the appraised value may be used to determine loan-to-value.
- If the property was acquired  $< 6$  months from application date, the lesser of the current appraised value or the previous purchase price plus documented improvements (if any) must be used. The purchase settlement statement and any invoices for materials/labor will be required.

#### 3.1.2.2 LEASE REQUIREMENTS

For refinance transactions, an executed lease with no less than 3 months remaining at time of close is required for all units in the subject property. Month-to-month tenancy is not subject to this requirement with sufficient evidence (such as a signed extension letter). Purchase transactions may be vacant.

The following requirements apply to refinance transactions:

- Monthly lease payments must be consistent with market rents
- The Property must not and cannot be occupied by a borrower, guarantor, any member of the borrower's LLC, or any family member.
- If subject property is not leased, see the DSCR Matrix for LTV restrictions.

#### 3.1.2.3 PROPERTIES LISTED FOR SALE

To be eligible for either a rate/term or a cash-out refinance, the subject property must be taken off the market on or before application date. The borrower or guarantor must also confirm in writing the reason for the prior listing.

For cash-out transactions, if the subject property was listed for sale in the 6 months prior to application date, a 10% LTV reduction from the maximum available for the specific transaction is required.

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

### **3.1.3 RATE/TERM REFINANCE**

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

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

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

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

On rate/term transactions, the borrower may only receive cash back in an amount that is the lesser of 2% of the new mortgage balance or \$2,000.

### **3.1.4 CASH-OUT REFINANCE**

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

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

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

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

- Additional cash in hand reflected on the settlement statement

Cash-out proceeds may only be utilized for business purposes as prescribed on the Business Purpose & Occupancy Affidavit.

### **3.1.5 FLIP TRANSACTIONS**

When the subject property is being resold within 365 days of its acquisition by the seller and the sales price has increased more than 10%, the transaction is considered a “flip”. To determine the 365-day period, the acquisition date (the day the seller became the legal owner of the property) and the purchase date (the day both parties executed the purchase agreement) should be used.

Flip transactions are subject to the following requirements:

- All transactions must be arm’s length, with no identity of interest between the buyer and property seller or other parties participating in the sales transaction.
- No pattern of previous flipping activity may exist in the last 12 months. Exceptions to ownership transfers may include newly constructed properties, sales by government agencies, properties inherited or acquired through divorce, and sales by the holder of a defaulted loan.
- The property was marketed openly and fairly, through a multiple listing service, auction, for sale by owner offering (documented) or developer marketing.
- No assignments of the contract to another buyer.
- If the property is being purchased for more than 5% above the appraised value, a signed letter of acknowledgement from the borrower or guarantor must be obtained.

A second appraisal is required in the following circumstances:

- Greater than 10% increase in sales price if seller acquired the property in the past 90 days
- Greater than 20% increase in sales price if seller acquired the property in the past 91-180 days

### **3.1.6 INHERITED PROPERTIES AND PROPERTY BUYOUTS**

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

These transactions are subject to the following:

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

### **3.1.7 PERMANENT FINANCING FOR NEW CONSTRUCTION**

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

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

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

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

### **3.1.8 INELIGIBLE TRANSACTIONS**

The following transactions are ineligible under the DSCR Program:

- Non-arm's length transactions
- Land contract or contract for deed
- Lease with purchase option

## **4 BORROWERS**

### **4.1.1 U.S. CITIZENS**

U.S. citizens are eligible for financing.

### **4.1.2 PERMANENT RESIDENT ALIENS**

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

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

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

Employment Authorized.”

### **4.1.3 NON-PERMANENT RESIDENT ALIENS**

A Non-Permanent Resident Alien is a non-U.S. citizen authorized to live and work in the U.S. on a temporary basis. Non-Permanent Resident Alien borrowers are eligible for the DSCR Program.

#### **4.1.3.1 VERIFICATION OF RESIDENCY STATUS**

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

- E-1, E-2, E-3
- G-1 through G-5
- H-1B & C, H-2 through H-4
- L-1B, L-2
- NATO 1 through 6
- O-1
- R-1
- TN-1 & 2 (NAFTA)

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

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

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

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

Citizens of Venezuela are ineligible.

#### **4.1.3.2 CREDIT REQUIREMENTS**

A U.S. credit report is required for each borrower on the loan using a valid Social Security number. A 12-month housing history is also required.

#### **4.1.3.3 ASSETS**

All funds required for down payment and closing costs on Non-Permanent Resident Alien transactions must be seasoned for 60 days.

### **4.1.4 FOREIGN NATIONALS**

A Foreign National is a non-U.S. citizen authorized to live in the U.S. on a temporary basis but does not meet the definition of a Non-Permanent Resident Alien. Foreign National borrowers are eligible for the DSCR Program.

#### **4.1.4.1 VERIFICATION OF RESIDENCY STATUS**

The following visa types are allowed as Foreign Nationals:

- B-1 and B-2
- H-2 and H-3
- I
- J-1 and J-2
- O-2
- P-1 and P-2

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

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

Canadian citizens are not required to provide a valid visa. An unexpired passport is acceptable.

Borrowers who are residents of countries which participate in the State Department's Visa Waiver Program (VWP) will not be required to provide a valid visa. Participating countries can be verified through the U.S. Department of State website at <https://travel.state.gov/content/travel/en/us-visas/tourism-visit/visa-waiver-program.html>. An unexpired passport is acceptable.

Citizens of Venezuela are ineligible.

#### **4.1.4.2 CREDIT REQUIREMENTS**

A U.S. credit report should be obtained for each Foreign National borrower with a valid Social Security Number. The credit report should provide merged credit information from the 3 major national credit repositories.

For borrowers without a valid Social Security Number, an Individual Taxpayer Identification Number (ITIN) is also allowed. An ITIN is acceptable if the borrower has the ITIN for purposes of reporting taxes from passive income sources only and is not employed in the U.S. A traditional U.S. credit report is not required for borrowers without a valid SSN.

Foreign National borrowers who do not have a SSN or ITIN may still proceed under the Foreign National Program. All other program requirements still apply.

#### **4.1.4.3 TRADELINES**

A U.S. credit borrower has a valid Social Security Number and are subject to the requirements found in.

A foreign credit borrower may or may not have a U.S. credit report with no credit score, a single score, or a score with insufficient tradelines. Foreign credit borrowers must establish an acceptable credit history subject to the following requirements:

- Three open accounts with a 2-year history must be documented for each borrower reflecting no late payments
- A 2-year housing history can be used as tradeline
- U.S. credit accounts can be combined with letters of reference from verifiable financial institutions in a foreign country to establish the 3 open accounts and an acceptable credit reputation. If letters of reference are obtained, they must:
  - State the type and length of the relationship, how the accounts are held, and status of the account;
  - Contact information must be provided for the person signing the letter; and
  - Any translation must be signed and dated by a certified translator.

#### **4.1.4.4 MORTGAGE AND RENTAL PAYMENT VERIFICATION**

A 12-month housing history is required for Foreign National transactions.

#### **4.1.4.5 DEBT-SERVICE COVERAGE RATIO**

The minimum DSCR required for Foreign National transactions is 1.00.

#### **4.1.4.6 ASSETS**

All funds required for down payment and closing costs on Foreign National transactions must be seasoned for 60 days. See the DSCR Matrix for complete reserve requirements.



#### **4.1.5 BORROWING ENTITIES**

Borrowing Entities in the form of Limited Liability Companies (hereafter referred to as Borrowing Entity or borrower) are allowed under the DSCR Program. A Personal Guarantor is also required. See Personal Guarantor for complete requirements.

Both the Borrowing Entity and the Personal Guarantor must complete a loan application. Borrowing Entities and Guarantors must also receive notice of the loan and its terms prior to closing.

The business purpose and activities of the Borrowing Entity are limited to ownership and management of real estate, and ownership is limited to a maximum of 4 owners (aka members, partners, or shareholders).

The following documentation is required for each Borrowing Entity:

- Articles Of Organization/Certificate of Formation
- Secretary of State Search
- Operating Agreement (or equivalent)
- Certificate of Good Standing
- Executed W-9 and/or Employer Identification Number (EIN)
- Evidence of signing authority for Guarantor(s) signing on behalf of the entity

Series or Layered LLCs with multiple members/managers are eligible. See Series or Layered LLCs.

##### **4.1.5.1 ARTICLES OF ORGANIZATION/CERTIFICATE OF FORMATION**

The following requirements apply to the Articles of Organization/Certificate of Formation:

- The Articles identify the state in which the LLC was organized.
- The Articles is the document to be used to determine the exact name of the LLC.
- In some states, the Articles identify the Manager or Managing Member.

##### **4.1.5.2 SECRETARY OF STATE SEARCH**

The following requirements apply to the Secretary of State search:

- After the state in which the LLC was formed has been identified, search for the LLC on the web site of the Secretary of State for the applicable state.
- The web site will:
  - confirm the state in which the LLC was organized;
  - confirm whether the LLC is in good standing with the state (not all state websites will confirm good standing); and
  - contain the most recent Filings filed with the Secretary of State by the LLC. These filings may be labelled “Annual Reports,” “Statement of Information,” or “Filings.”
- Open the most recent Statement of Information/Filing to determine the person or entity that manages the LLC.
  - The LLC will be managed by either a Manager or a Managing Member.

- If the managing person or managing entity in the Statement of Information does not match the managing person or managing entity in the Operating Agreement, the discrepancy must be resolved.

#### **4.1.5.3 OPERATING AGREEMENT**

The following requirements apply to the Operating Agreement (or equivalent):

- Review the management section of the Operating Agreement.
  - This section identifies whether the LLC is managed by (i) one or more Managers, or (ii) the Members of the LLC. The Section should also provide the name(s) of the initial Manager(s).
  - Review the section to ensure that the Manager or Managing Member has the authority to sign the loan document or agreement.
- The signature page of the Operating Agreement will identify the Managers and Members.
- Confirm if there are any amendments to the Operating Agreement or Resolutions/Consents changing the identity of the Managers or Members.
- If the identity of the Manager(s) or Member(s) in the Operating Agreement differ from the Articles/Certificate or the Statement of Information/Filing on the Secretary of State's website, the discrepancy must be resolved.

#### **4.1.5.4 CERTIFICATE OF GOOD STANDING**

To ensure that the LLC remains in good standing with the state, a Certificate of Good Standing from the Secretary of State of the state or organization should be ordered.

- If the LLC is obtaining a loan secured by real property in a state that is different from the LLC's state of organization, a Certificate of Good Standing in that additional state is required as well.
- For example, if a Delaware LLC is obtaining a loan to buy a rental property in the state of Florida, a Lender should obtain a Certificate of Good Standing from the state of Florida to ensure that the LLC registered as a foreign company with the Florida Secretary of State.
- Ensure that the Certificate of Good Standing is dated no more than 30 days prior to closing.

#### **4.1.5.5 SERIES OR LAYERED LLCs**

Series or Layered LLCs with multiple members/managers are eligible as Borrowing Entities when the following requirements are met:

- Personal Guarantor for transaction must own at least 25% of the Borrowing Entity LLC and all subsequent ascending LLCs making up the overall ownership structure.
- Personal Guarantor must have signing rights for Borrowing Entity LLC and all subsequent ascending LLCs making up the overall ownership structure.

- LLC documentation listed in Borrowing Entities must be received for all ascending LLCs making up the overall ownership structure.

<b>SERIES OR LAYERED LLC EXAMPLE #1</b>		
	<b>EXAMPLE 1</b>	<b>PERSONAL GUARANTOR OWNERSHIP %</b>
<b>PARENT LLC</b>	TDR HOLDINGS LLC	25%
<b>SUBORDINATE LLC 1</b>	TDR LLC	25%
<b>SUBORDINATE LLC 2 BORROWING ENTITY LLC</b>	123 MAIN STREET LLC	25%
		<b>PASS**</b>
<b>**Personal Guarantor must have a minimum of 25% ownership stake in each LLC.</b>		

<b>SERIES OR LAYERED LLC EXAMPLE #2</b>		
	<b>EXAMPLE 1</b>	<b>PERSONAL GUARANTOR OWNERSHIP %</b>
<b>PARENT LLC</b>	TDR HOLDINGS LLC	50%
<b>SUBORDINATE LLC 1</b>	TDR LLC	10%
<b>SUBORDINATE LLC 2 BORROWING ENTITY LLC</b>	123 MAIN STREET LLC	25%
		<b>FAIL**</b>
<b>**Personal Guarantor must have a minimum of 25% ownership stake in each LLC.</b>		

#### **4.1.5.6 PERSONAL GUARANTORS**

At least one Personal Guarantor is required. A Personal Guarantor must be a beneficial owner of the Borrowing Entity with 25% or greater ownership interest in the Borrowing Entity.

Personal Guarantors must meet the credit requirements outlined in Credit Analysis . The credit report for the Personal Guarantor will be used to determine qualification. Each Personal Guarantor must sign the Guaranty Form and complete the loan application.

References to “borrowers” in Asset Analysis apply to Personal Guarantors when the borrower is a Borrowing Entity.

##### **4.1.5.6.1 ELIGIBLE GUARANTORS**

U.S. Citizens, Permanent Resident Aliens, and Non-Permanent Resident Aliens are eligible to act as Personal Guarantors under the DSCR Program.

##### **4.1.5.6.2 PERMANENT RESIDENT ALIEN**

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

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

##### **4.1.5.6.3 NON-PERMANENT RESIDENT ALIENS**

A Non-Permanent Resident Alien is a non-U.S. citizen authorized to live and work in the U.S. on a temporary basis. The following visa classifications are allowed as Non-Permanent Resident Aliens:

- E-1, E-2, E-3
- G-1 through G-5
- H-1B & C, H-2 through H-4
- L-1B, L-2
- NATO 1 through 6
- O-1
- R-1
- TN-1 & 2 (NAFTA)

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

Individuals who are residents of countries which participate in the State Department's Visa Waiver Program (VWP) will not be required to provide a valid visa. Participating countries can be verified through the U.S. Department of State website at [Visa Waiver Program \(state.gov\)](https://state.gov/visa-waiver-program)

Citizens of Venezuela are ineligible for programs.

#### **4.1.5.6.4 INELIGIBLE GUARANTORS**

The following individuals are not eligible to be Personal Guarantors:

- Foreign Nationals
- Individuals with diplomatic immunity or otherwise excluded from U.S. jurisdiction
- Residents of any country not permitted to transact business with US companies are ineligible (as determined by any U.S. government authority)
- Trusts or Land Trusts
- Individuals less than 18 years old

#### **4.1.6 CUSTOMER IDENTIFICATION PROGRAM (CIP)**

The USA Patriot Act requires banks and financial institutions to verify the name, date of birth, address, and identification number of all borrowers or guarantors. The published CIP procedures must be followed for each borrower or guarantor to ensure the true identity of all borrowers or guarantors has been documented. Settlement agents are required to verify identity at the time of closing on all loans.

#### **4.1.7 FRAUD REPORT AND BACKGROUND CHECK**

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

#### **4.1.8 EXCLUSIONARY LIST/OFAC/DIPLOMATIC IMMUNITY**

All parties involved on each transaction must be screened through any exclusionary list used by Community Wholesale Lending.

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

Borrowers or guarantors from OFAC sanctioned countries are ineligible. A list of sanctioned countries is

available at <https://home.treasury.gov/policy-issues/financial-sanctions/sanctions-programs-and-country-information>.

Individuals with diplomatic immunity are not eligible due to the inability to compel payment or seek judgment. Verification the borrower or guarantor does not have diplomatic immunity can be determined by reviewing the visa, passport, and/or the U.S. Department of State's Diplomatic List at <https://www.state.gov/resources-for-foreign-embassies/deans-of-the-diplomatic-corps/>.

#### **4.1.9 FIRST-TIME INVESTOR**

A First-Time Investor is a borrower who has not owned at least one investment property for at least 12 months anytime during the most recent 12-month period.

#### **4.1.10 LIMITED POWER OF ATTORNEY**

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

- POA is specific to the transaction
- Recorded with the mortgage/deed of trust
- Contains an expiration date
- Used only to execute the final loan documents
- Borrower who executed the POA signed the initial 1003
- No interested party to the transaction (such as property seller, broker, loan officer, realtor, etc.) may act as Power of Attorney
- Not permitted on cash-out or Borrowing Entity transactions

#### **4.1.11 VESTING AND OWNERSHIP**

Ownership must be fee simple. Acceptable forms of vesting are:

- Individuals
- Joint tenants
- Tenants in Common
- Inter Vivos Revocable Trust
- Business Entity
  - Limited Liability Company (LLC)
  - Limited and General Partnerships
  - Corporations
  - S Corporations

#### **4.1.11.1 INTER VIVOS REVOCABLE TRUST VESTING**

Inter Vivos Revocable Trusts are allowed as vested or titled owners of the subject property (but not as borrowers). The trust must be established by one or more natural persons, solely or jointly. The primary beneficiary of the trust must be the individual(s) who establishing the trust. The trust must become effective during the lifetime of the person establishing the trust.

If the trust is established jointly, there may be more than one primary beneficiary as long as the income or assets of at least one of the individuals establishing the trust will be used to apply and qualify for the mortgage.

The trustee must include either:

- The individual establishing the trust (or at least one of the individuals, if 2 or more); or
- An institutional trustee that customarily performs trust functions in and is authorized to act as trustee under the laws of the applicable state.

The trustee must have the power to hold the title and mortgage the property. This must be specified in the trust. One or more of the individual parties establishing the trust must use personal income or assets to apply and qualify for the mortgage.

A copy of the trust is required, or a signed attorney's opinion may be obtained in lieu of the trust documents. The opinion letter must indicate that the trust meets all published requirements and must also include the following:

- Name of the trust
- Date executed
- Settler(s) of the trust
- Whether it is revocable or irrevocable
- Whether the trust has multiple trustees
- Name of trustees
- Manner in which vesting will be held

The attorney needs to also verify that the trust has not been revoked, modified, or amended in any manner that would cause the representations to be incorrect.

The deed of trust/mortgage and all attached riders must be completed by the authorized trustee(s) of the trust that is the vested owner of the subject property.

#### **4.1.11.2 BUSINESS ENTITY VESTING**

Ownership or title vesting in the name of an LLC, partnership, or corporation (collectively 'Entity') is acceptable on investment property transactions only. For Borrowing Entity Requirements, Borrowing Entities.

To vest ownership in an Entity but close in the name of a natural person, the following requirements

must be met:

- Business purpose and activities are limited to ownership and management of real estate.
- Entity limited to a maximum of 4 owners (aka members, partners, or shareholders).
- A minimum of 50% of the Entity ownership must be represented as borrowers on the loan, each completing a I003 as applicants.
- The loan application, credit report, income (if applicable), and assets for each Entity owner will be used to determine qualification and pricing.
- Each Entity owner must receive notice of the loan and its terms prior to closing.

The following Entity documentation must be provided:

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

Documents must be completed and signed by each individual applicant (in their capacity as an individual only) that is an owner of the vesting Entity, as follows:

- Business Purpose & Occupancy Affidavit – signed by each Entity owner represented (both submission and closing) and guarantors, when applicable.
- Loan Application (I003) – Completed and signed by each Entity owner represented and guarantors, when applicable. I003 section labeled “Title will be held in what Name(s)” should be completed with only the Entity name.
- Disclosures (GFE, TIL, Notice of Intent to Proceed, Servicing Disclosure, etc.) – completed and signed by each Entity owner represented and guarantors, when applicable.
- Closing Disclosure – completed and signed by each Entity owner represented and guarantors, when applicable.
- Other Closing Documents (Final TIL, Business Purpose & Occupancy Affidavit, etc.) – completed by Entity owner represented and guarantors, when applicable.
- Note – signed by each Entity owner represented and guarantors, when applicable.
- Deed of Trust/Mortgage and all attached Riders – must be completed by the authorized owner(s) of the Entity who can legally sign and bind the Entity that is the vested owner of the subject property.

#### **4.1.12 MULTIPLE FINANCED PROPERTIES AND EXPOSURE**

There is no limit on the number of other properties borrowers may currently have financed. Community Wholesale Lending exposure may not exceed \$10M aggregate with a maximum of 10 loans for each



individual borrower. Exceptions to this policy will be reviewed on a case-by-case basis.

#### **4.1.13 INELIGIBLE BORROWERS**

The following borrowers are not eligible:

- Borrowers with diplomatic immunity or otherwise excluded from U.S. jurisdiction
- Residents of any country not permitted to transact business with US companies are ineligible (as determined by any U.S. government authority)
- Trusts or Land Trusts (trusts may qualify for ownership vesting only)
- Borrowers less than 18 years old
- Loans to employees
- First-Time Home Buyers

## **5 CREDIT ANALYSIS**

### **5.1.1 CREDIT REPORT**

A credit report is required for every borrower or guarantor. The credit report should provide merged credit information from the 3 major national credit repositories. A valid Social Security number (SSN) is required for all borrowers or guarantors on the loan.

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

#### **5.1.1.1 AGE OF CREDIT REPORT/CREDIT DOCUMENTATION**

All credit documentation, including the credit report, may not be more than 90 days old at the time of closing.

#### **5.1.1.2 FRAUD ALERTS**

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

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

All Fraud Alerts must be properly addressed and resolved prior to submitting the loan to underwriting. The actions must be reasonable and compliant with applicable laws. An underwriting decision cannot be made without full resolution of the alert.

### 5.1.1.3 CREDIT REPORT SECURITY FREEZE

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

### 5.1.1.4 GAP CREDIT REPORT

A gap credit report is not required on DSCR loans.

## 5.1.2 CREDIT SCORE REQUIREMENTS

Each borrower or guarantor must have a valid score from at least 2 of the following 3 agencies: Experian (FICO), Trans Union (Empirica), and Equifax (Beacon). Only scores from these agencies are acceptable.

The applicable credit score is the middle of three scores provided for any borrower or guarantor. If only two credit scores are obtained, the lesser of two will be used. When there are multiple borrowers, the lowest applicable score from the group of borrowers is the representative credit score for qualifying.

## 5.1.3 TRADELINE REQUIREMENTS

DSCR MINIMUM TRADELINES			
	OCCUPANCY	TRADELINE HISTORY	MINIMUM STANDARDS
<b>STANDARD TRADELINES</b>	Investment	3 tradelines reporting for 12+ months with activity in last 12 months or 2 tradelines reporting for 24+ months with activity in last 12 months or **1 tradeline with 36+ months with activity in the last 12 months	*0X60 for most recent 12 months
<p><i>*Applies only to tradelines being used to meet minimum number of trades</i>  <i>** Tradeline must be a mortgage account or installment account</i></p>			

All borrowers or guarantors must meet the minimum tradeline requirements under the DSCR Program. To qualify as a valid tradeline, the following requirements apply:

- The credit line must be reflected on the borrower’s credit report.
- The account must have activity in the past 12 months and may be open or closed.
- Tradelines used to qualify may not exceed 0x60 in the most recent 12 months.
- An acceptable 12- or 24-month housing history not reporting on credit may also be used as a tradeline.

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

#### **5.1.4 EVIDENCE OF PRIMARY RESIDENCE**

All borrowers or guarantors must presently maintain a primary residence. Evidence of primary occupancy is required.

Borrowers or guarantors who own a primary residence must provide:

- Proof of ownership of a primary home superior in value and/or appeal to subject.
- Sufficient evidence of ownership must be obtained for borrowers residing in a marital home owned solely by the non-borrowing spouse (i.e. fraud report, property report).

Borrowers or guarantors who rent a primary residence must provide:

- Evidence of an active lease in place.
  - Borrowers living rent free may be considered on a case-by-case basis with compelling evidence of continued occupancy.
- Primary residence should be supported by one of the following characteristics:
  - Geographically consistent with borrower's place of employment; or
  - General appeal and location of primary is superior to subject property.

#### **5.1.5 MORTGAGE AND RENTAL PAYMENT VERIFICATION**

The following requirements apply for mortgage and rental verifications: See the DSCR Matrix for max allowable housing payment lates:

The mortgage/rental history on both the borrower's or guarantor's primary residence and the subject property are required (if applicable, i.e., refinance).

- The mortgage/rental history for the primary and/or subject property must be current at time of application and closing.
- Any derogatory mortgage history reporting on the credit report and/or provided within the loan file will be factored into the overall housing history rating and must be brought current.
- Mortgage histories for other REOs not reporting on credit are not required.
- Minimum application requirements include the disclosure of all borrower-owned or guarantor-owned REO and associated mortgages reporting on credit. PITIA from the subject property must be documented; however, PITIA from additional REO is not required to be verified.

Mortgage and rental payments that are required to be verified but not reflected on the original credit report must be documented via an institutional Verification of Rent or Verification of Mortgage (VOR/VOM). A combined total of all late mortgage and rental payments in the past 12 months must be used to determine

the housing history. If the borrower or guarantor is making payments to an individual or interested party, 12 months of cancelled checks or bank statements must be obtained. A VOR/VOM is not required but may be requested for clarification.

#### **5.1.6 ROLLING LATE PAYMENTS**

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

#### **5.1.7 PAST DUE ACCOUNTS**

Past due consumer debts can be no more than 30 days past due at time of closing.

#### **5.1.8 DELINQUENT CREDIT BELONGING TO EX-SPOUSE**

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

- Borrower or guarantor provides a copy of the divorce decree or separation agreement which shows the derogatory accounts belong solely to the ex-spouse
- Late payments occurred after the date of the divorce or separation
- Evidence of title transfer prior to any delinquent debt must be provided if debt is a mortgage, and evidence of buyout as part of court proceedings

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

#### **5.1.9 LAWSUIT/PENDING LITIGATION**

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

#### **5.1.10 CONSUMER CREDIT COUNSELING SERVICE (CCCS)**

Consumer Credit Counseling must be completed for a minimum of 24 months from closing date.

#### **5.1.11 COLLECTIONS AND CHARGE-OFFS**

The following accounts may remain open:

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

- All medical collections

Collection and charge-off balances exceeding the amounts listed above must be paid in full.

### **5.1.12 JUDGMENTS AND TAX LIENS**

All judgments or liens affecting title must be paid as title must insure our lien position without exception. Court-ordered judgments may remain open when one of the following options is met:

- The amount is the lessor of \$5,000 per occurrence or 2% of the loan amount
- The borrower or guarantor is currently in a repayment agreement with the creditor (if currently in a repayment plan, the following requirements apply):
  - A minimum of 3 months has elapsed on the plan and evidence of timely payments for the most recent 3 months is provided; and
  - The maximum payment required under the plan is included in the debt-to-income ratio.
- Judgment or lien has passed beyond the statute of limitations for that state (supporting documentation required)

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

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

### **5.1.13 HOUSING EVENTS**

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

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

Housing Events must be seasoned for a minimum of 36 months from loan closing.

Seasoning of a foreclosure, deed-in-lieu, or short sale is measured from the date of completed sale or final property transfer. The Housing Event must be completed prior to loan closing with no outstanding deficiency balance remaining.

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

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

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

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

#### **5.1.14 BANKRUPTCY**

All bankruptcies must be discharged or dismissed for a minimum of 36 months from closing date.

## **6 EMPLOYMENT/INCOME ANALYSIS**

There is no employment verification or income analysis under the DSCR Program.

### **6.1 RATIOS AND QUALIFYING**

A Debt-Service Coverage Ratio (DSCR) must be calculated for the subject property. Market rent must be documented with FNMA Form 1007 or Form 1025, as applicable. See the DSCR Matrix for the minimum Debt-Service Coverage Ratio.

For interest-only loans, the DSCR calculation allows for the use of the interest-only payment including escrows.

#### **6.1.1 DSCR (USING NON-SHORT-TERM RENTAL INCOME)**

The DSCR calculation using non-short-term rental income is as follows:

$$\text{Debt-Service Coverage Ratio} = \text{Gross Income} / \text{Proposed [P]ITIA}^*$$

To calculate Gross Income, use the lower of the (a) executed lease agreement or (b) market rent from FNMA Form 1007 or Form 1025, as applicable. If the executed lease agreement reflects a higher monthly rent, it may be used in the calculation when evidence of receipt of the higher amount for the 3 most recent, consecutive months is provided.

#### **6.1.2 DSCR (USING SHORT TERM RENTAL INCOME)**

The DSCR calculation using short-term rental income is as follows:

$$\text{Debt-Service Coverage Ratio} = \text{Average Monthly Gross Income} * 80 / \text{Proposed [P]ITIA}^*$$

To calculate Average Monthly Gross Income, use the lower of the (a) 12-month average of short-term

rental income (see the following section Rental Income from Short-Term Rentals) or (b) market rent from FNMA Form 1007 or Form 1025, as applicable.

#### **6.1.2.1 RENTAL INCOME FROM SHORT-TERM RENTALS**

Short-term term rentals are properties which are leased on a nightly, weekly, monthly, or seasonal basis. Short-term rental income received directly from a home-sharing service (such as Airbnb or VRBO) or property management services may be used for qualification when any of the following requirements are met:

- 12 months evidence of receipt via the home-sharing service or property management company.
  - Receipt must identify the subject property/unit and all rents collected for the previous 12 months. Rental income used will be net of any management or vendor fees.
  - Property ownership report obtained and proof of property listing on service provider website.
- Bank statement deposits clearly evidencing short-term rental deposits.
  - Bank statement deposits must be supported by rental records for subject property/unit to support the monthly rental activity for the previous 12 months.
  - Property ownership report obtained and proof of property listing on service provider website.
- Appraisal Form 1007 or Form 1025, or a short-term rental narrative reflecting short-term market rents, prepared by the appraiser.
  - Short-term rental market data must include multiple sources such as Air B&B, VRBO, Air DNA, etc. (Air DNA is acceptable when accompanied by additional sources listed above).

A 20% expense factor will be applied to gross rents (after management/vendor fees) to account for operational costs associated with managing short-term rental properties such as marketing, cleaning, furnishing, vacancy, etc.

#### **6.1.3 ADJUSTABLE-RATE QUALIFYING**

For all ARM loans, the note rate is used to determine the qualifying PITIA. For I/O ARM loans, guidelines in Interest-Only Qualifying should be followed.

#### **6.1.4 INTEREST-ONLY QUALIFYING**

Interest-only loans qualify using the interest-only payment, including escrows, to determine qualifying ITIA.

## **7 DOWN PAYMENT**

See applicable DSCR matrix for specific LTV and down payment requirements.

## **8 ASSET ANALYSIS**

Verification of assets is required for purchase or refinance transactions to evidence sufficient funds to close and reserves.

### **8.1.1 RESERVES**

The DSCR Program requires reserves for the subject property PITIA (or ITIA, if applicable). See matrix for minimum reserve requirements for the DSCR Program. Reserves are not required for additional real estate owned.

### **8.1.2 VERIFICATION OF ASSETS**

Assets must be seasoned for 60 days or sourced, and verified with one of the following:

- Most recent 2 months' account statements, or most recent quarterly account statement, indicating opening and closing balances, and reflecting a consecutive 60 days of asset verification
- If account summary page provides the required information, additional pages are not required.
- Written Verification of Deposit (VOD), completed by the financial institution
  - Must include the current and average balances for the most recent 2 months
  - Large disparities between the current balance and the opening balances will require additional verification or supporting documentation
- Account statements must provide all of the following information:
  - Borrower or guarantor as the account holder
  - Account number
  - Statement date and time period covered
  - Current balance in US dollars

Note: Large and/or unusual deposits may require additional documentation including letter of explanation, third party documentation, etc.

### **8.1.3 GIFT FUNDS**

Gift funds can be used for down payment, closing costs, and reserves on the DSCR Program after the borrower or guarantor has documented a 10% minimum borrower contribution.

A gift can be provided by:

- a relative, defined as the borrower's or guarantor's spouse, child, or other dependent, or by any other individual who is related to the borrower or guarantor by blood, marriage, adoption, or legal guardianship
- a non-relative that shares a familial relationship with the borrower or guarantor defined as a domestic partner (or relative of the domestic partner), individual engaged to marry the borrower,



guarantor, former relative, or godparent

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

- Donor's name, address, phone, and relationship to borrower or guarantor; and
- Dollar amount of gift; and
- Date funds were transferred; and
- Donor's statement that no repayment is expected.

Sufficient funds to cover the gift must be verified as either currently in the donor's account or evidence of transfer into the borrower's or guarantor's account. Acceptable documentation includes any of the following:

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

When the funds are not transferred prior to closing, it must be documented that the donor gave the closing agent the gift funds in the form of a certified check, a cashier's check, money order, or wire transfer.

#### **8.1.4 BUSINESS ASSETS**

Business assets are an acceptable source of funds for down payment, closing costs, and reserves. Business assets may come from either the Borrowing Entity or a secondary business owned by one or more of the borrowers or guarantors.

If the assets being used are from a secondary business, the borrowers or guarantors on the loan must have a minimum of 25% ownership of the business and must be owners on the business account. Ownership percentage must be documented via CPA letter, Operating Agreement, or equivalent. All non-borrowing owners of the business must provide a signed and dated letter acknowledging the transaction and confirming the borrower's access to funds in the account. The balance of the business assets must be multiplied by the ownership percentage to determine the owner's portion of business assets allowed for the transaction.

#### **8.1.5 BORROWED FUNDS SECURED BY AN ASSET**

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

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

The monthly payments for the loan secured by non-financial assets must be counted in the debt-to-income ratio. However, when the loan is secured by the borrower's financial assets and there are sufficient assets

to pay off the loan currently verified, the monthly payment for the loan does not have to be considered as a long-term debt when qualifying the borrower (as in the case of a 401(k) loan).

If the same financial asset is also used as part of the borrower's financial reserves, adequacy of the borrower's reserves must be determined after taking into consideration the net value of the asset after it has been reduced by the proceeds from the secured loan (and any related fees).

### **8.1.6 DEPOSITORY ACCOUNTS**

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

Indications of borrowed funds must be investigated, including recently opened accounts, recent large deposits, or account balances that are considerably greater than the average balance over the previous few months. A signed, written explanation of the source of funds should be obtained from the borrower and the source of funds verified. Unverified funds are not acceptable.

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

### **8.1.7 EARNEST MONEY/CASH DEPOSIT ON SALES CONTRACT**

If earnest money is needed to meet the borrower's minimum contribution requirement, it must be verified that the funds are from an acceptable source. Virtual currency may not be used for earnest money.

Satisfactory documentation includes any of the following:

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

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

### **8.1.8 FOREIGN ASSETS**

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

Funds required for closing (down payment and closing costs) must be documented as currently available for withdraw from a U.S. depository institution or seasoned in a U.S. depository institution for 30 days prior to closing, whichever comes first.

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

### 8.1.9 INTERESTED PARTY CONTRIBUTIONS

MAXIMUM CONTRIBUTIONS		
OCCUPANCY	LTV	MAX PERCENTAGE
Primary and 2 <sup>nd</sup> Homes	ALL	6%
Investment	ALL	3%

*Note: Percentage is based on of the lesser of the property's sales price or appraised value and may be applied towards the buyer's closing costs, prepaid expenses, discount points, and other financing concessions.*

Sales concessions include:

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

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

### 8.1.10 LIFE INSURANCE

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

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

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

### **8.1.11 LIKE-KIND EXCHANGE (1031 EXCHANGE)**

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

### **8.1.12 MINIMUM BORROWER CONTRIBUTION**

Borrowers must document a minimum of 5% (of the sales price) of their own funds on purchase transactions.

A minimum borrower contribution of 10% must be documented on the following transactions:

- Primary residence with unverifiable housing history
- Second home
- Investment property

Note: Business Assets may be used to meet the borrower’s minimum contribution. See also Business Assets for documentation requirements.

### **8.1.13 NET PROCEEDS FROM SALE OF REAL ESTATE**

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

### **8.1.14 RENT CREDIT FOR LEASE WITH PURCHASE OPTION**

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

The following documentation must be obtained:

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

### **8.1.15 RETIREMENT ACCOUNTS**

Vested funds from individual retirement accounts (IRA/SEP/Keogh accounts) and tax-favored retirement savings accounts (401(k) accounts) are acceptable sources of funds for the down payment, closing costs, and reserves. Ownership of the account must be verified and the account must be vested and allow withdrawals regardless of current employment status.

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

account.

If the borrower intends to use the retirement account to also satisfy income requirements, see Proof of Continuance

### **8.1.16 SALE OF PERSONAL ASSETS**

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

The following must be documented:

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

### **8.1.17 SECONDARY/SUBORDINATE FINANCING**

Secondary or subordinate financing is allowed with a maximum CLTV equaling maximum LTV per matrix. Existing secondary financing is not permitted for investor-occupied properties.

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

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

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

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

The following requirements apply to all subordinate liens:

- Seller-held subordinate liens are not permitted.
- Subordinate financing must be recorded and clearly subordinate to the new mortgage.
- Payment on the subordinate financing must be included the borrower's DTI. If a payment is unable to be determined, 1.5% of the original loan balance can be used.
- If the debt is an equity line of credit, the CLTV ratio is calculated by adding the total HELOC credit line limit (rather than the amount of the HELOC in use) to the first mortgage amount, plus any other subordinate financing, and dividing that sum by the value of the property.

- Negative amortization is not allowed, and the scheduled payments must be sufficient to cover at least the interest due.
- Subordinate financing from the borrower's employer may not include a provision requiring payment upon termination.

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

### **8.1.18 SPOUSAL ACCOUNTS**

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

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

### **8.1.19 STOCK OPTIONS**

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

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

### **8.1.20 STOCKS, BONDS, AND MUTUAL FUNDS**

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

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

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

### **8.1.21 TRUST ACCOUNTS**

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

To document trust account funds, both of the following must be obtained:

- Written documentation of the value of the trust account from either the trust manager or the trustee; and

- 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.

### 8.1.22 VIRTUAL CURRENCY

Virtual currency that has been exchanged into U.S. dollars is acceptable for the down payment, closing costs, and reserves provided the following requirements are met:

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

A large deposit may be from virtual currency that was exchanged into U.S. dollars. Sufficient documentation must be obtained to verify the funds originated from the borrower’s virtual currency account. Virtual currency may not be used for earnest money for the purchase of the subject property.

Note: Payment on any debt secured by virtual currency must be included when calculating the debt-to-income ratio.

### 8.1.23 UNACCEPTABLE FUNDS

- Cash-on-hand
- Sweat equity
- Gift or grant funds which must be repaid
- Down payment assistance programs
- Unsecured loans or cash advances
- Section 8 Voucher Assistance
- Proceeds of SBA/PPP loans or any other government assistance

## 9 PROPERTY

### 9.1.1 ELIGIBLE PROPERTY TYPES

PROPERTY ELIGIBILITY	
PROPERTY TYPE	ELIGIBLE
Single-Family Residence	Yes
Planned Unit Development (PUD)	Yes
Townhomes	Yes
2-4 Unit Multi-Family Properties*	Yes
Condominium (low-rise and high-rise)	Yes

Site Condominium	Yes
Non-Warrantable Condominiums	Yes
Assisted Living/Continuing Care Facilities	No
Boarding Houses	No
Condotels or Condo Hotels	No
Co-operative Units	No
Farms or Hobby Farms	No
Log Homes	No
Manufactured Homes	No
Mixed-Use Properties	No
Modular Homes	No
Properties Subject to Rent Control Regulations	No
Unique Properties (Earth Homes, Berm Homes, Dome Homes, Barndominiums, Shouses, etc.)	No
<i>*See the applicable matrix for LTV restrictions.</i>	

### 9.1.2 AGE OF APPRAISAL AND APPRAISAL UPDATES

For loans under the DSCR Program, appraisals are valid for 120 days and are not eligible for appraisal updates.

### 9.1.3 APPRAISAL REVIEW PROCESS

All transactions under the DSCR Program require either a Clear Capital CDA (or like product), field review, or FNMA Collateral Underwriter review with a score of 2.5 or less (must include a copy of the Submission Summary Report).

The following transactions require a 2<sup>nd</sup> full appraisal in lieu of an appraisal review product listed above:

- Approved loan amount exceptions (when exceeding max loan amount available per matrix)

### 9.1.4 APPRAISAL REVIEW TOLERANCE

A 10% tolerance is permitted for all secondary review products. If the review product does not provide a value, an additional review product of a higher-level must be ordered.

If the review product value is more than 10% below the appraised value, the lower of the two values must be used. If the tolerance is exceeded, an additional review product of a higher-level review may be ordered. The original appraised value may then be used if the additional review product value is within 10% of the appraised value. If the variance is greater than 10%, a second full appraisal is required.

If two appraisals are required, the lower of the two values or the purchase price must be used. If there is a variance greater than 10% between both appraisals, the property is considered ineligible.

## 9.2 GENERAL PROPERTY REQUIREMENTS

A completed appraisal report is required on all loan transactions to assess the adequacy of the property as



collateral for the mortgage requested.

The following will be reviewed and assessed:

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

### **9.3 UNIFORM RESIDENTIAL APPRAISAL REPORT (URAR)**

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

- Uniform Residential Appraisal Form (FNMA Form 1004)
- Small Residential Income Property Appraisal Report (FNMA Form 1025)
- Individual Condominium Unit Appraisal Report (FNMA Form 1073)
- Appraisal Update and/or Completion Report (FNMA Form 1004D)
- Single Family Comparable Rent Schedule for all 1-unit investment properties (FNMA Form 1007)
- 1-4 Family Rider (Assignment of Rents) for all investment properties (FNMA Form 3170)

#### **9.3.1 APPRAISAL REPORT REQUIREMENTS**

The following items must be contained in the appraisal report:

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

### **9.3.2 APPRAISER QUALIFICATIONS**

Real estate appraisers are to be state-certified or state-licensed in accordance with the provisions of Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989. They must have the requisite knowledge required to perform a professional quality appraisal for the specific geographic location and property type as well as have access to the necessary and appropriate data sources for the appropriate area of the appraisal assignment.

An unlicensed or uncertified appraiser who works as an employee or subcontractor of a licensed appraiser may perform a significant amount of the appraisal as long as the appraisal report is signed by a licensed or certified appraiser and is acceptable under state law. A supervisory appraiser or any appraiser signing on the left-hand side of the appraisal report as the "Appraiser" must have performed the level of inspection of the subject property required by the assignment.

### **9.3.3 ELECTRONIC SUBMISSION OF APPRAISAL REPORT**

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

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

### **9.3.4 TRANSFERRED APPRAISALS**

Transferred appraisals are only allowed and must meet all AIR policy & procedure.

## **9.4 MINIMUM PROPERTY STANDARDS**

All properties must:

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

## **9.5 PROPERTY LOCATION**

Subject property must be subject to the laws of the state in which the loan is made.

## **9.6 MARKET ANALYSIS**

### **9.6.1 NEIGHBORHOOD REVIEW**

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

- Degree of development
- Demand and supply

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

### **9.6.2 COMPATIBILITY OF SUBJECT PROPERTY AND NEIGHBORHOOD**

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

### **9.6.3 PROXIMITY OF COMPARABLES TO SUBJECT PROPERTY**

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

For properties in established subdivisions, condo projects or PUDs, comparable sales from within the same subdivision or project as the subject property must be used if the subdivision or project has resale activity. Use of comparable properties located outside of the established subject neighborhood must be explained in the appraisal analysis.

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

### **9.6.4 AGE OF COMPARABLES**

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

### **9.6.5 PROPERTY VALUES WITHIN MARKET AREA**

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

- the trend of property values

- the supply of properties in the subject neighborhood
- marketing time for properties

The appraiser must provide their conclusions for the reasons a market is experiencing declining property values, an over-supply of properties, or marketing times over 6 months. If the appraisal indicates the property is located within a declining market, a 5% LTV reduction is required.

### **9.6.6 REDLINING PROHIBITION**

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

### **9.6.7 OVER-IMPROVEMENTS**

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

## **9.7 VALUATION ANALYSIS**

### **9.7.1 SALES COMPARISON APPROACH**

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

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

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

Comparable sales utilized in the market approach should:

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

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

### **9.7.2 COST APPROACH**

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

### **9.7.3 INCOME APPROACH**

When the income approach to value is used, the appraisal report must include the supporting comparable rental and sales data and the calculations used to determine the gross rent multiplier. Appraisals that rely solely on the income approach as an indicator of market value are not acceptable.

### **9.7.4 VALUATION ANALYSIS AND FINAL RECONCILIATION**

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

## **9.8 PROPERTY CONSIDERATIONS**

### **9.8.1 ACCESSORY DWELLING UNITS**

Properties with an accessory unit (ADU) are acceptable if all of the following are met:

- Property is typical, readily acceptable, and common in the subject's market area.

- Property must conform to all zoning laws and/or regulations.
- Appraisal contains 1 comparable with similar additional accessory unit.
- Accessory unit is substantially smaller than the primary dwelling.
- Legal non-conforming use is acceptable provided its current use does not adversely affect value and marketability.
- Existence of the unit must not jeopardize any future hazard insurance claim that may need to be filed for the property.

Rental income received from the ADU may be used for qualifying if zoning permits an accessory unit (current or grandfathered). Use of rental income is allowed, subject to the following:

- Appraisal report reflects the accessory dwelling unit is legal.
- Appraiser to confirm ADU is typical to the area with at least one comparable with an ADU.
- Maximum one ADU per property.
- The market rent for the accessory unit is documented on FNMA Form 1007.
- Copy of the current lease and 2 months proof of current receipt are provided.
- See Rental Income for additional guidance on rental income calculation.

Note: Rental income from an ADU may not be used on the Equity Advantage Program for qualifying purposes.

### **9.8.2 DAMPNES**

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

### **9.8.3 DEED RESTRICTIONS**

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

- Age Restricted Communities

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

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

any delinquency or default

#### **9.8.4 DEFERRED MAINTENANCE**

Property must be in average or better condition. Properties in C5 or C6 condition are not acceptable. Deferred maintenance is allowed provided the neglected item is not structural in nature (as noted by the appraiser). Deferred items may be left “as is” if the aggregate cost to cure the deficiency does not exceed \$2,000 or impact the safety or habitability of the property.

#### **9.8.5 DISASTER AREAS**

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

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

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

Damage to the subject property must meet requirements in 11.8.4 Deferred Maintenance.

##### **9.8.5.1 PROPERTY APPRAISED PRIOR TO DISASTER INCIDENT**

If the appraisal effective date is prior to the disaster incident, the following documentation is required:

- Clear Capital Post Disaster Inspection Report (PDI or equivalent); or
- An exterior inspection completed by licensed third-party professional:
- Exterior inspection must certify the condition of the subject property and identify any impact to habitability or marketability
  - Inspection report must include photographs of the front, street view, and any damage to subject property
  - Inspection report and evidence of inspector licensing must be retained in loan file

If the appraisal was complete at the time of the disaster but ‘subject to completion’ or ‘subject to repairs’, an Appraisal Update and/or Completion Report (FNMA Form 1004D) is required in addition to the inspections listed above.

##### **9.8.5.2 PROPERTY APPRAISED AFTER DISASTER INCIDENT**

When the appraisal effective date is after the disaster incident, no additional documentation is required.

##### **9.8.5.3 DISASTER INCIDENT OCCURS AFTER CLOSING OR PRIOR TO FUNDING**

If the disaster incident occurred after closing, the loan is ineligible for purchase or funding until one of



the following is received certifying no damage to the subject property:

- Clear Capital Post Disaster Inspection Report (PDI or equivalent); or
- Appraisal Update and/or Completion Report (FNMA Form 1004D)

#### **9.8.5.4 TIME PERIOD**

Guidelines for disaster areas should be followed for 60 days from the incident period ending date or the date the adverse event occurred, whichever is later.

#### **9.8.5.5 VERBAL VERIFICATION OF EMPLOYMENT RE-VERIFICATION**

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

### **9.8.6 ELECTRICAL SYSTEMS**

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

### **9.8.7 ENVIRONMENTAL HAZARDS**

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

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

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

### **9.8.8 ESCROWS FOR WORK COMPLETION**

Not allowed

### **9.8.9 FLOOD ZONE**

The appraisal should indicate if the property is located in a flood zone. Refer to Flood Insurance for additional information on flood certifications and flood insurance.

### **9.8.10 FOUNDATION SETTLEMENT**

If the appraisal report notes evidence of excessive settlement, the appraiser must clearly define the effect on value and marketability of the subject property. Settlement problems which denote structural deficiencies and/or significant negative impact on value and marketability must be corrected prior to closing. Generally, a structural engineer's report is required prior to making a loan decision.

Properties with evidence of sinkhole activity are ineligible for financing.

### **9.8.11 HEATING SYSTEMS**

A central heat source with ductwork or baseboard in all rooms is required on all properties. If subject does not have central heat, the appraiser must provide similar comparable properties and an addendum indicating:

- the heat source is typical for the area
- the heat source is permanently attached
- the heat source is adequate for the dwelling
- the heat source is externally vented

### **9.8.12 LAVA ZONES**

Community Wholesale Lending allows mortgage loans secured by properties that are located within lava zones 3 through 9 in the state of Hawaii. Properties in lava zones 1 and 2 are not eligible due to the increased risk of property destruction from lava flows within these areas.

Hawaiian lava flow maps and other information are available online at the U.S. Geological Survey Hawaiian Volcano Observatory website: <https://www.usgs.gov/observatories/hvo>

### **9.8.13 LEASEHOLD APPRAISAL REQUIREMENTS**

A mortgage that is secured by a leasehold estate or is subject to the payment of “ground rent” gives the borrower the right to use and occupy the real property under the provisions of a lease agreement or ground lease, for a stipulated period of time, as long as the conditions of the lease are met.

When the lease holder is a community land trust, there may be significant restrictions on both the purchase and resale of the property. See also Community Land Trust Appraisal Requirements

#### **9.8.13.1 APPRAISAL REQUIREMENTS FOR LEASEHOLD INTERESTS**

The appraisal requirements for leasehold interest properties are as follows:

- Appraisers must develop a thorough, clear, and detailed narrative that identifies the terms, restrictions, and conditions regarding lease agreements or ground leases and include this information as an addendum to the appraisal report.
- Appraisers must discuss what effect, if any, the terms, restrictions, and conditions of the lease agreement or ground lease have on the value and marketability of the subject property.

#### **9.8.13.2 COMPARABLE REQUIREMENTS FOR LEASEHOLD INTERESTS**

When there are a sufficient number of closed comparable property sales with similar leasehold interests available, the appraiser must use the property sales in the analysis of market value of the leasehold estate for the subject property.

However, if not enough comparable sales with the same lease terms and restrictions are available, appraisers may use sales of similar properties with different lease terms or, if necessary, sales of similar properties that were sold as fee simple estates. The appraiser must explain why the use of these sales is appropriate and must make appropriate adjustments in the Sales Comparison Approach adjustment

grid to reflect the market reaction to the different lease terms or property rights appraised.

### **9.8.13.3 COMMUNITY LAND TRUST APPRAISAL REQUIREMENTS**

#### **9.8.13.3.1 Appraiser Qualifications for Properties in a Community Land Trust**

The appraiser must be knowledgeable and experienced in the appraisal techniques, namely the direct capitalization and the market derivation of capitalization rates that are necessary to appraise a property subject to a leasehold estate held by a community land trust. Policies and procedures should be established to ensure that qualified individuals are being selected in accordance with the Appraiser Independence Requirements.

#### **9.8.13.3.2 Appraisal Requirements for Properties in a Community Land Trust**

The appraisal requirements for community land trust properties are as follows:

- The appraiser must analyze the property subject to the ground lease when a leasehold interest is held by a community land trust. Because the community land trust typically subsidizes the sales price to the borrower, that price may be significantly less than the market value of the leasehold interest in the property.
- The appraised value of the leasehold interest in the property must be well supported and correctly developed by the appraiser because the resale restrictions, as well as other restrictions that may be included in the ground lease, can also affect the value of the property.
- The lender and the borrower must execute the Community Land Trust Ground Lease Rider (FNMA Form 2100) to remove such restrictions from the community land trust's ground lease.
- The land records for the subject property must include adoption of the terms and conditions that are incorporated in that ground lease rider. The appraiser must develop the opinion of value for the leasehold interest under the hypothetical condition that the property rights being appraised are the leasehold interest without the resale and other restrictions that the ground lease rider removes when a property is disposed of through foreclosure.
- The appraiser must use a three-step process to develop an opinion of value (when this appraisal technique is used, there is no need to document the actual land value of the security property).
  - The appraiser must determine:
    - Step 1: the fee simple value of the property by using the sales comparison analysis approach to value,
    - Step 2: the applicable capitalization rate and convert the income from the ground lease into a leased fee value by using the market-derived capitalization rate, and
    - Step 3: the leasehold value by reducing the fee simple value by the lease fee

value

- On the actual appraisal report form, the appraiser must:
  - indicate “leasehold” as the property rights appraised,
  - provide the applicable ground rent paid to the community land trust,
  - show the estimated fee simple value for the property in the Sales Comparison Approach adjustment grid,
  - report the “leasehold value” as the indicated value conclusion, and
  - check the box “as is” and include in the addendum the development of the capitalization rate and an expanded discussion of the comparable sales used and considered.

#### **9.8.13.3.3 Comparable Requirements for Determining Fee Simple Value**

In determining the fee simple value of the subject property, the appraiser must use comparable sales of similar properties that are owned as fee simple estates. If this is not possible, the appraiser may use sales of properties that are subject to other types of leasehold estates as long as he or she makes appropriate adjustments, based on the terms of their leases, to reflect a fee simple interest.

When the community or neighborhood has sales activity for other leasehold estates held by a community land trust, the appraiser must discuss them in the appraisal report, but must not use them as comparable sales because, in all likelihood, the sales prices will have been limited by restrictions in the ground lease. Therefore, these sales transactions would not be comparable to the hypothetical condition that the property rights being appraised are the leasehold interest without the resale and other restrictions on which the appraisal of the subject property must be based.

#### **9.8.13.3.4 Determining the Capitalization Rate**

When the community has an active real estate market that includes sales of properties owned as fee simple estates and sales of properties subject to leasehold estates other than those held by community land trusts, the appraiser can use the most direct method for determining the capitalization rate, extracting it from the market activity. To extract the capitalization rate, the appraiser must divide the annual ground rent for the properties subject to leasehold estates by the difference in the sales prices for the comparable sales of properties owned as fee simple estates and the comparable sales of properties subject to leasehold estates.

If there are no available comparable sales of properties subject to leasehold estates other than those held by a community land trust, the appraiser must develop a capitalization rate by comparing alternative low-risk investment rates, such as the rates for long-term bonds, and selecting a rate that best reflects a “riskless” (safe) rate.

#### **9.8.13.3.5 Determining the Leasehold Value**

To determine the leasehold value of the subject property, the appraiser must first convert the annual income from the community land trust’s ground lease into a leased fee value by dividing the income by the market-derived capitalization rate. The appraiser must then reduce the estimated fee simple value of the subject property by this leased fee value to arrive at his or her opinion of the leasehold value of

the subject property. For example, assume that the annual ground rent from the community land trust's ground lease is \$300, the market-derived capitalization rate is 5.75%, and the estimated fee simple value of the subject property is \$100,000:

- $\$300 \text{ annual rent} / 5.75\% \text{ capitalization rate} = \$5,217.39$  (rounded to \$5,200)
- $\$100,000 \text{ fee simple value} - \$5,200 \text{ leased fee value} = \$94,800$  (leasehold value)

#### **9.8.13.3.6 Addendum to the Appraisal Report**

Because appraisal report forms do not include space to provide all of the details required for appraising a property subject to a leasehold held by a community land trust, the appraiser must attach an addendum to the appraisal report to provide any information that cannot otherwise be presented on the appraisal report form. As previously mentioned, the appraiser must check the box "as is" and include in the addendum the development of the capitalization rate and an expanded discussion of the comparable sales used and considered.

The addendum must also include the following statement: "This appraisal is made on the basis of the hypothetical condition that the property rights being appraised are the leasehold interest without resale and other restrictions that are removed by the Community Land Trust Ground Lease Rider."

#### **9.8.14 MULTIPLE DWELLINGS ON ONE LOT**

Properties with 2 or more detached single-family homes on a single lot are generally ineligible for financing. Single-family properties containing additional residential dwellings (guesthouse, carriage house, etc.) must comply with local zoning regulations. They must be typical and common within the subject's neighborhood. Typically, the additional dwelling is smaller than the main dwelling and will not be rented. The subject property should be appraised as a single-family residence. Any value for additional dwellings should be supported by comparable sales. See also Accessory Dwelling Units

#### **9.8.15 MULTIPLE PARCELS**

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

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

example, a home built across both parcels where the lot line runs under the home is acceptable.

- The mortgage must be a valid first lien that covers each parcel.

### **9.8.16 NEW CONSTRUCTION**

The following are required for all new construction properties:

- Appraisal Update and/or Completion Report (FNMA Form 1004D) with complete interior and exterior photos reflecting completion, if applicable. Proposed improvements are not allowed.
- Property taxes for new construction are calculated at 1.5% of the sales price for qualification. 1.25% should be used for properties located in CA.

### **9.8.17 PEST INFESTATION**

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

### **9.8.18 PLUMBING**

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

### **9.8.19 PRIVATE ROADS**

Properties on private roads are acceptable subject to the following:

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

### **9.8.20 PUD (PLANNED UNIT DEVELOPMENT)**

A Planned Unit Development (PUD) is a project or subdivision that consists of common property and improvements that are owned and maintained by an HOA for the benefit and use of the individual PUD

units. In order for a project to qualify as a PUD, all of the following requirements must be met:

- Each unit owner's membership in the owners' association must be automatic and non-severable
- The payment of assessments related to the unit must be mandatory
- Common property and improvements must be owned and maintained by an HOA for the benefit and use of the unit owners
- The subject unit must not be part of a condo or co-op project

Zoning is not a basis for classifying a project or subdivision as a PUD. The PUD project must be analyzed to ensure that an individual unit in the project will be acceptable security for the mortgage.

### **9.8.21 REPAIRS**

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

### **9.8.22 SEPTIC SYSTEM/SEWAGE DISPOSAL SYSTEM**

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

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

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

### **9.8.23 SOLAR PANELS**

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

- The solar panels may not be included in the appraised value of the property.
- The property must maintain access to an alternate source of electric power that meets community standards.
- The monthly lease payment must be included in the debt-to-income (DTI) ratio calculation unless the lease is structured to:

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

#### **9.8.24 UNCONVENTIONAL FLOOR PLANS**

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

#### **9.8.25 WATER SUPPLY**

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

- The water supply system is in proper working order and pumping an adequate supply of water for the subject property; and
- The water supply is potable and complies with local and/or state health authority standards (in the absence of a local health authority, a reputable chemical testing agency must certify that the water is fit for human consumption). The water certification(s) for existing properties can be no more



than 60 days old on the date of closing. If new construction, the report may be 1-year old as of the date of closing.

### **9.8.26 ZONING AND LAND-USE REGULATIONS**

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

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

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

## **9.9 CONDOMINIUMS**

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

### **9.9.1 DEFINITIONS OF ESTABLISHED AND NEW CONDOMINIUMS**

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

Established condominium projects meet the following criteria:

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

New condominium projects meet the following criteria:

- Fewer than 90% of the total units in the project have been conveyed to the unit purchasers
- The project is not fully completed, such as proposed construction, new construction, or the proposed or incomplete conversion of an existing building to a condo

- The project is newly converted
- The project is subject to additional phasing or annexation

### **9.9.2 GENERAL CONDOMINIUM REQUIREMENTS**

All condominium projects must meet the following requirements:

- All common areas and amenities within the project or subject phase must be complete.
- Subject unit must have at least 600 square feet of living space.
- The sustainability, marketability and financial stability of the project must be supported.
- Project must be located in an area where acceptability of condominium ownership is demonstrated.
- The project must be in compliance with all applicable state or local laws. The homeowners' association must be incorporated in the state where the project is located.
- Condo projects must have acceptable insurance coverage.
- An environmental hazard assessment is required for condo projects if an environmental problem is identified through performance underwriting or due diligence. The solution must be deemed acceptable by Community Wholesale Lending.
- Projects with pending or threatened litigation are typically ineligible.
- The project must be located on one contiguous parcel of land. The project may be divided by a public street.
- The structures within the project must be within a reasonable distance from each other. Common elements and facilities, such as recreational facilities and parking, must be consistent with the nature of the project and competitive in the marketplace.
- All programs are limited to a maximum number of units within one project of 20% or 20 loans, whichever is less.
- The maximum loan concentration by an individual borrower in a single condo development is 10%.

### **9.9.3 CONDOMINIUM PROJECT REVIEWS**

A valid project review is required for all condominium transactions, along with a completed Condominium Project Questionnaire (or equivalent form). The Condominium Project Questionnaire may not be greater than 120 days old at the time of closing.

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

#### **9.9.3.1 PERS (PROJECT ELIGIBILITY REVIEW SERVICE)**

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

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

New projects are acceptable only with a PERS approval. New projects without a PERS approval are subject to non-warrantable condominium requirements. See Non-Warrantable Condominiums.

### **9.9.3.2 FHA APPROVED CONDOMINIUMS**

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

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

### **9.9.3.3 CONDOMINIUM PROJECT QUESTIONNAIRE REVIEW**

For all established condominium projects without valid PERS or FHA approvals, or for projects that do not meet all the requirements of the various project review methods, a Condominium Project Questionnaire Review is required. The completed Condominium Project Questionnaire (or equivalent form) must reflect compliance with the following requirements:

- Project must meet the definition of an established condo.
- For investment property transactions only, at least 50% of the total units in the project must be conveyed to purchasers as primary or second homes.
- No more than 15% of the total units in a project may be 60 days or more past due on their HOA dues.
- No single entity, the same individual, investor group, partnership, or corporation may own more than 20% of the total units in the project. For projects with 1-4 total units, single entity ownership may not exceed 1 unit. For 5–20-unit projects, single entity ownership may not exceed 2 units.
- No more than 35% of the total square footage of the project may be used for commercial purposes.
- Mortgagee may not be responsible for more than the greater of 6 months or the maximum amount permitted under applicable state law of delinquent HOA dues. For condos in Florida, the first mortgagee's liability for dues assessed prior to its acquisition of title is limited to the lesser of 12 months' assessments or 1% of the original mortgage debt.
- All facilities related to the project must be owned by the unit owners or the HOA cannot be subject to a lease between the unit owners or HOA and another party.

### **9.9.4 NON-WARRANTABLE CONDOMINIUMS**

Non-warrantable condominiums are allowed. A completed Condominium Project Questionnaire is required. Refer to the matrix for specific LTV restrictions.

## **NON-WARRANTABLE CONDOS**

<b>CHARACTERISTIC</b>	<b>CONSIDERATIONS</b>
<b>COMMERCIAL SPACE</b>	Commercial space in project up to 50%.
<b>COMPLETION STATUS</b>	The project, or the subject's legal phase along with other phases, must be complete. All common elements in the project or legal phase must be 100% completed. At least 50% must be sold or under a bona-fide contract.  If the LTV is $\leq 80\%$ and credit score is $\geq 680$ , a minimum of 30% presale is allowed.
<b>CONDOTELS</b>	Vacation rental projects will be considered on a case-by-case basis. See Non-Warrantable Vacation Rental Projects for requirements.  True Condotels operating as hotels are prohibited.
<b>DELINQUENT HOA DUES</b>	No more than 20% of the total units in the project may be 60 days or more past due on the payment of condominium/association fees.
<b>INVESTOR CONCENTRATION</b>	Investor concentration in project up to 100%.
<b>HOA CONTROL</b>	The developer may be in control of the condominium association provided the Master Agreement provides for the homeowners to take control upon either a predetermined percentage of unit sales or within a defined time period.
<b>LITIGATION</b>	Projects involved in litigation are acceptable as long as the pending lawsuit(s) are not structural in nature, do not affect the marketability of the units and: - Potential damages do not exceed 25% of the HOA reserves, OR - Documentation must be provided by the insurance carrier or the attorney representing the insurance carrier that the insurance carrier has agreed to provide the defense and the association's insurance policy is sufficient to cover the litigation.
<b>MASTER CONDO INSURANCE POLICY DEDUCTIBLE</b>	Master condo insurance policy deductible up to 10%.
<b>SINGLE ENTITY OWNERSHIP</b>	Single entity ownership in project up to 30%.

### **9.9.5 NON-WARRANTABLE VACATION RENTAL PROJECTS**

Vacation rental projects will be considered as a non-warrantable condominium project on a case-by-case basis. The following requirements apply:

- Minimum square footage for unit is 600 square feet.
- Unit must contain a full-size kitchen including a minimum of a sink, refrigerator, stove, and dishwasher.
- Bedroom(s) are separate from the main living area.
- Project may include a welcome desk, concierge service, daily cleaning services, and allow rentals of units on a daily or short-term basis.

Any project with one or more of the following characteristics is ineligible:

- Projects marketed, operated, or managed as a hotel, motel, or similar hospitality entity.
- Project has a legal or common name that contains hotel, or motel.
- Project is a conversion of a hotel.
- Project is subject to rental-pooling.
- Project allows fractional ownership.
- Project is primarily transient in nature.

### **9.9.6 CONDOMINIUM CONVERSIONS**

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

### **9.9.7 SITE CONDOMINIUMS**

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

Appraisals for site condos may be documented on either FNMA Form 1004 or FNMA Form 1073. The appraiser should include an adequate description of the project, information about the homeowners' association fees, and note the quality of the project maintenance.

### **9.9.8 INELIGIBLE PROJECTS**

- Projects comprised of manufactured homes
- Projects with units used for 'live-work'
- Projects managed and operated as a hotel or motel
- Projects containing the word hotel or motel in the name
- Projects that restrict the owner's ability to occupy the unit

- Projects with mandatory rental pooling agreements that require unit owners to either rent their units or give a management firm control over unit occupancy
- Projects with non-incident business operations owned or operated by the homeowners' association (such as a restaurant, spa, health club, etc.)
- Common interest apartments
- Fractional ownership projects
- Timeshare or segmented ownership projects
- Continuing Care Retirement Communities or Life Care Facilities
- Multi-unit dwelling condos that permit an owner to hold title to more than one dwelling unit, with ownership of all of his or her owned units evidenced by a single deed and financed by a single mortgage

### **9.9.9 LAND VALUE AND ACREAGE**

Maximum acreage under the DSCR Program is 5 acres. Acreage and land value must be typical and common for the subject's market. See also Rural Properties.

### **9.9.10 RURAL PROPERTIES**

A property indicated by the appraisal as rural, or containing any of the following characteristics, is typically considered a rural property:

- Neighborhood is less than 25% built-up.
- Area around the subject is zoned agricultural.
- Photographs of the subject show a dirt road.
- Comparables are more than 5 miles away from the subject.
- Subject is located in a community with a population of less than 25,000.
- Distance to schools and/or amenities are greater than 25 miles.
- Subject property and or comparables have lot sizes greater than 10 acres.
- Subject property and or comparables have outbuilding or large storage sheds.

Rural properties must comply with all of the following criteria:

- Residential use only.
- Maximum acreage 5, including road frontage and subject property.
- Property must be located in a market where rental properties are prevalent. Locations may include but are not limited to mountain towns, beach communities, waterfront properties, or other tourist/recreational destinations.
- Single Family Residences and condominiums only.
- At least two comparable recent sales and rentals must be located within 5 miles of subject property.

- Property must not be agricultural or provide an agricultural source of income to the borrower.
- Lot size and acreage must be typical for the area and similar to surrounding properties.
- Property cannot be subject to idle acreage tax benefit or other tax incentive program.
- Present use as per the appraisal must be the “highest and best use” for the property.
- Condition, quality, and use of outbuildings should be considered in determining the market value of the subject property when the appraiser clearly supports the adjustments with similar comparable information.
- Refer to the matrix for LTV restrictions.

# 10 PROPERTY INSURANCE

## 10.1 HAZARD INSURANCE

### 10.1.1 MINIMUM HAZARD INSURANCE COVERAGE

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

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

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

Hazard insurance coverage should be in the amount corresponding to:

- 100% of the insurable value of improvements, as established by the property insurer (Replacement Cost Estimator or equivalent); or
- The unpaid principal balance of the mortgage, as long as it equals the minimum amount (80% of the insurable value of the improvements) required to compensate for damage or loss on a replacement cost basis. If it does not, then coverage that does provide the minimum required amount must be obtained; or
- 100% Replacement Cost Coverage as stated on the policy declaration page; or
- Total dwelling coverage equal to the final loan amount.

If the policy does not have 100% replacement cost or a replacement cost estimate is not provided, an Account Manager’s Certification verifying the insurer’s replacement cost estimate is acceptable. The

certification must include the insurance company’s complete information, subject property details, confirm the replacement cost amount determined by the insurer, and be signed and dated by the Account Manager.

### 10.1.2 DETERMINING THE AMOUNT OF REQUIRED HAZARD COVERAGE

The following tables describes how to calculate the amount of required hazard insurance coverage when the policy does not explicitly guarantee 100% replacement cost coverage:

<b>DETERMINING HAZARD COVERAGE</b>	
<b>STEP</b>	<b>DESCRIPTION</b>
<b>1</b>	Compare the insurable value of the improvements as established by the property insurer to the unpaid principal balance of the mortgage loan.
<b>1A</b>	If the insurable value of the improvements is less than the unpaid principal balance, the insurable value is the amount of coverage required.
<b>1B</b>	If the unpaid principal balance of the mortgage loan is less than the insurable value of the improvements, go to Step 2.
<b>2</b>	Calculate 80% of the insurable value of the improvements.
<b>2A</b>	If the result of this calculation is equal to or less than the unpaid principal balance of the mortgage, the unpaid principal balance is the amount of coverage required.
<b>2B</b>	If the result of this calculation is greater than the unpaid principal balance of the mortgage, this calculated figure is the amount of coverage required.

<b>EXAMPLES</b>			
<b>CATEGORY</b>	<b>PROPERTY A</b>	<b>PROPERTY B</b>	<b>PROPERTY C</b>
<b>INSURABLE VALUE</b>	\$90,000	\$100,000	\$100,000
<b>UNPAID BALANCE</b>	\$95,000	\$ 90,000	\$ 75,000
<b>80% INSURABLE VALUE</b>	—	\$ 80,000	\$ 80,000
<b>REQUIRED COVERAGE</b>	\$90,000	\$ 90,000	\$ 80,000
<b>CALCULATION METHOD</b>	Step 1A	Step 2A	Step 2B



### **10.1.3 DEDUCTIBLE AMOUNT**

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

### **10.1.4 EVIDENCE OF HAZARD INSURANCE**

Policy must be effective for at least 60 days after the date of funding (does not apply to condominium project insurance policies). Evidence of Insurance may be provided in one of the following forms:

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

Evidence of Insurance must provide the following information:

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

### **10.1.5 OPTIONAL COVERAGE**

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

### **10.1.6 RATING REQUIREMENTS**

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

- Carriers rated by A.M. Best Company, Inc. must have:
  - a “B” or better Financial Strength Rating in Best’s Insurance Reports, or
  - an “A” or better Financial Strength Rating and a Financial Size Category of “VIII” or greater

in Best's Insurance Reports Non-US Edition

- Carriers rated by Demotech, Inc. must have an "A" or better rating in Demotech's Hazard Insurance Financial Stability Ratings
- Carriers rated by Kroll's Bond Rating Agency must have a "BBB" or better rating in Kroll Bond Rating Agency's Insurance Financial Strength Rating (IRSR)
- Carriers rated by Standard and Poor's must have a "BBB" or better Insurer Financial Strength Rating in the Standard and Poor's Ratings Direct Insurance Service

The following types of property insurance policies are acceptable if they are the only coverage the borrower can obtain:

- policies underwritten by a state's Fair Access to Insurance Requirements (FAIR) plan; and
- policies obtained through state or territory insurance plans, such as the Hawaii Property Insurance Association (HPIA), Florida's Citizens Property Insurance Corporation, or other state-mandated windstorm and beach erosion insurance pools.

### **10.1.7 RENT LOSS INSURANCE**

Rent Loss Insurance for the subject property is required and must equal at least 6 months PITIA for the subject property. Blanket policies covering the subject property are permitted.

- If Rent Loss coverage is less than 6 months, the deficiency balance may be comprised of additional subject property PITIA reserves.
  - Example: if the required reserves for the transaction are 3 months and the required Rent Loss coverage is 6 months, the total PITIA requirement for the transaction is 9 months. If the Rent Loss coverage for the property is insufficient at 4 months, the borrower can provide evidence of 5 months PITIA reserves to complete the 9 months PITIA requirement.

## **10.2 CONDOMINIUM AND PUD PROJECT INSURANCE REQUIREMENTS**

### **10.2.1 MINIMUM HAZARD INSURANCE COVERAGE**

Insurance must cover 100% of the insurable replacement cost of the project improvements, including the individual units in the project. An insurance policy that includes any of the following coverage, either in the policy language or in a specific endorsement to the policy, is acceptable:

- Guaranteed Replacement Cost – the insurer agrees to replace the insurable property regardless of the cost,
- Extended Replacement Cost – the insurer agrees to pay more than the property's insurable replacement cost, or
- Replacement Cost – the insurer agrees to pay up to 100% of the property's insurable replacement cost.

Acceptable policies must provide coverage for either an individual project or multiple affiliated projects. The insurance policy must at a minimum protect against fire and all other hazards that are normally covered by the standard extended coverage endorsement, and all other perils customarily covered for similar types of projects, including those covered by the standard “all risk” or “special form” endorsement. If the policy does not include an “all risk” or “special form” endorsement, a policy that includes the “broad form” covered causes of loss is acceptable.

**PUD Requirements:** The HOA must maintain a property insurance policy, with premiums being paid as a common expense. The policy must cover all of the common elements except for those that are normally excluded from coverage, such as land, foundation, and excavations. Fixtures and building service equipment that are considered part of the common elements, as well as common personal property and supplies, should be covered.

Individual insurance policies are also required for each unit mortgage in the PUD project. If the project’s legal documents allow for blanket insurance policies to cover both the individual units and the common elements, blanket policies are acceptable to satisfy insurance requirements for the units.

**Condo Requirements:** The entire condo project insurance policy must be reviewed to ensure the HOA maintains a master or blanket type of insurance policy, with premiums being paid as a common expense.

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

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

### **10.2.2 DEDUCTIBLE AMOUNT**

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

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

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

If the deductible exceeds 5% on a master condo policy, see Non-Warrantable Condominiums for additional considerations.

### **10.2.3 GENERAL LIABILITY COVERAGE**

Project liability insurance requirements are as follows:

- The homeowners’ association must maintain a commercial general liability insurance policy for

condo projects or Type F PUD projects, including all common areas and elements, public ways, and any other areas that are under its supervision.

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

#### **10.2.4 FIDELITY BOND COVERAGE**

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

### **10.3 FLOOD INSURANCE**

Flood insurance is required for any property located within any area designated by the Federal Emergency Management Agency (FEMA) as a Special Flood Hazard Area (SFHA). A SFHA is typically denoted as Flood Zone A or Zone V (coastal areas). Properties in Flood Zone A or V must be located in a community which participates in the FEMA program to be eligible for financing.

#### **10.3.1 FLOOD CERTIFICATE**

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

The flood insurance requirement can be waived if:

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

#### **10.3.2 MINIMUM FLOOD INSURANCE COVERAGE**

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

- 100% of the replacement cost of the insurable value of the improvements;
- the maximum insurance available from the National Flood Insurance Program (NFIP), which is

- currently \$250,000 per dwelling; or
- the unpaid principal balance of the mortgage

### **10.3.3 PROJECT FLOOD INSURANCE REQUIREMENTS**

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

### **10.3.4 DEDUCTIBLE AMOUNT**

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

### **10.3.5 EVIDENCE OF FLOOD INSURANCE**

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

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

Evidence of Insurance must provide the following information:

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

### **10.3.6 SURVEY REQUIREMENTS**

The following states required a survey:

- Florida
- Kansas
- New Mexico
- Texas

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

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

## **11 TITLE INSURANCE**

### **11.1 TITLE POLICY REQUIREMENTS**

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

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

The title insurer must be qualified to do business in the state where the subject property is located. The title insurer and policy must conform to Fannie Mae/Freddie Mac requirements. Evidence of errors and omissions insurance covering the title company is also required.

#### **11.1.1 BORROWER INFORMATION**

All borrower names must be indicated on the title commitment. If the borrower's marital status appears to be different than on 1003, the discrepancy must be addressed. The property seller's name must be cross-referenced to the purchase agreement and valuation chain of title.

#### **11.1.2 COVERAGE AMOUNT**

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

#### **11.1.3 INSURED NAME**

Title policy must insure Community Wholesale Lending as Community Wholesale Lending appears in the security instrument. It must also include the language "its successors and assigns as their interest may appear."

#### **11.1.4 AGE OF REPORT**

The preliminary title report/title commitment should be dated no later than 120 days prior to closing. Any requirements by title, such as Statements of Information or copies of trust agreements, must be cleared prior to closing.

## **11.2 TITLE COMMITMENT REVIEW**

### **11.2.1 CHAIN OF TITLE**

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

### **11.2.2 TITLE EXCEPTIONS**

The following items are allowable title exceptions:

- Customary public utility subsurface easements; the location of which are fixed and can be verified. The exercise of rights of easement will not interfere with use and enjoyment of any improvement of the subject property or proposed improvements upon which the appraisal or loan is based.
- Above-surface public utility easements that extend along one or more property lines for distribution purposes, or along the rear property line for drainage, provided they do not extend more than 12 feet from the subject property lines and do not interfere with any of the buildings or improvements, or with the use of the subject property; and public utility restrictions, provided their violation will not result in the forfeiture or reversion of title or a lien of any kind for damages, or have an adverse effect on the fair market value of the subject property.
- Mutual easement agreements that establish joint driveways or party walls constructed on the subject property and on an adjoining property, provided all future owners have unlimited and unrestricted use of them.
- Encroachments on one foot or less on adjoining property by eaves or other overhanging projections or by driveways provided there is at least a 10-foot clearance between the buildings on the subject property and the property line affected by the encroachments.
- Encroachments on the subject property by improvements on adjoining property provided these encroachments extend one foot or less over the property line of the subject property, have a total area of 50 square feet or less, do not touch any buildings, and do not interfere with the use of any improvements on the subject property or the use of the subject property not occupied by improvements.
- Encroachments on adjoining properties by hedges or removable fences.
- Liens for real estate or ad valorem taxes and assessments not yet due and payable.
- Outstanding oil, water, or mineral rights as long as they do not materially alter the contour of the property or impair its value or usefulness for its intended purpose