CMS Conventional Guidelines—FNMA

DOCUMENT OVERVIEW

Purpose

The following document describes the responsibilities and requirements of the Carrington Mortgage Services, LLC (CMS) Mortgage Lending Division Underwriter (Underwriter) when reviewing and underwriting mortgage loan applications. The purpose of credit and property underwriting is to ensure that each loan meets high quality standards that make the loans acceptable to CMS and Fannie Mae.

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Revision Summary

Refer to Revision Summary for details.

ELIGIBILITY

Purpose

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

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

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

Loan Application

Requirements

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

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

In addition to the requirements listed above, the final application for closing must include the complete and accurate financial information for all borrowers and be signed and dated by all borrowers. The final loan application must include all debt incurred during the application process and through loan closing.

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

Any documents within the loan file that are applicable to the underwriting process must be reviewed for any alterations or fabrications. If any conflicting information exists between or within documents the potential borrowers must provide an adequate explanation and this information must documented and included in the loan file. Borrower(s) must write, sign, and date all letters of explanation themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter’s content.

Loan Application (continued)

Requirements for the Loan Application Package

The table below provides the requirements for the loan application package.

✓	The loan application package must include …
	A copy of the ratified sales agreement, if applicable.
	Escrow/closing or settlement instructions, if applicable.
	Any other information or documentation needed to verify, clarify, or substantiate information in the borrower's application.
	Any other documentation that is needed to make a prudent underwriting decision.

Document Images

CMS permits the use of any available technology to produce copies of the documents in the mortgage loan file, such as a photocopier, facsimile machine, document scanner, or camera. Copies of documents provided by the borrower may be photos or scanned versions of the original documents and can be delivered to CMS in hardcopy or via email or other electronic means.

Document images must be typical of what the actual document would look like and must have good image quality, be legible, and not have borders showing phone/mobile background content.

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

Requirements

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

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

Preliminary Review of Borrower's Application

Requirements

CMS should perform a preliminary review of the borrower's application to determine that the requested mortgage loan satisfies Fannie Mae mortgage eligibility criteria. CMS level of review should be the same for each mortgage. This eligibility review should take place before underwriting begins and be based on predictive risk factors that are incorporated into the *Eligibility Matrix*, specifically:

- loan-to-value/combined loan-to-value ratios,
- representative credit score,
- product type,
- purpose,
- occupancy, and
- number of units.

Blanket Authorization Form

Requirements

CMS obtains the borrower's signature on the following Blanket Authorization form to obtain the documentation needed to evaluate the borrower's creditworthiness.

> This borrower-signed document gives CMS blanket authorization to request the information needed to document the borrower's creditworthiness. I hereby authorize _______________ ("CMS") to verify my past and present employment earnings records, bank accounts, stock holdings, and any other asset balances that are needed to process my mortgage loan application. I further authorize __________________ ("CMS") to order a consumer credit report and verify other credit Information, including past and present mortgage and landlord references. It is understood that a photocopy of this form also will serve as authorization. The information the lender obtains is only to be used in the processing of my application for a mortgage loan.

CMS attaches a copy of the Blanket Authorization form to each Form 1005/Form 1005(S) or Form 1006/Form 1006(S) sent to a verifying institution. The information must be requested directly from the institution. The completed form(s) must be signed and dated, and must be sent directly from the verifying institution.

Identity Verification

Requirements

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

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

Social Security Number Validation

Acceptable Documentation

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

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

Social Security Number Validation (continued)

Acceptable Documentation, continued

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

Note: Any use of a Social Security or Individual Taxpayer Identification Number for purposes of filing taxes that was not issued legally to an applicant is considered fraud. As such, the applicant will not be eligible for a loan through Carrington and evidence of such fraud will be reported as required under Carrington policy.

Fannie Mae requires that each borrower has a valid Social Security number or Individual Taxpayer Identification Number (ITIN) (in addition to meeting existing legal residency and documentation requirements).

DU may identify data integrity issues pertaining to the borrower's Social Security number. CMS must take steps to resolve any issues, including numbers not issued, borrower age/issue date discrepancies, or Social Security numbers associated with deceased individuals. If CMS cannot resolve any Social Security number inconsistencies:

- CMS must validate the Social Security number with the Social Security Administration (SSA). Direct validation with SSA by a third party is acceptable. SSA–89 (Authorization for the Social Security Administration to Release Social Security Number [SSN] Verification) must be used for this purpose. If using a third-party vendor, CMS must ensure that the vendor goes directly to the SSA to validate the Social Security numbers. It is important to note that most standard vendor reports are not direct SSA validations and, therefore, do not satisfy Fannie Mae's requirements.
- Upon positive validation of the Social Security number with the SSA, CMS must deliver the loan with SFC 162. SFC 162 should only be used if there is a discrepancy identified with the Social Security number (for example, identified via Loan Delivery edits), and the Social Security number was validated through the SSA.
- If the Social Security number cannot be validated with the SSA, the loan is not eligible for delivery to Fannie Mae.

If the borrower's Social Security number format is invalid and the borrower cannot provide a valid Social Security number, the loan is not eligible for delivery to Fannie Mae.

Allowable Age of Credit Documents

Requirements

Credit documents include credit reports and employment, income, and asset documentation. For all mortgage loans (existing and new construction), the credit documents must be no more than four (4) months old on the note date. When consecutive credit documents are in the loan file, the most recent document is used to determine whether it meets the age requirement. For example, when two (2) consecutive monthly bank statements are used to verify a depository asset, the date of the most recent statement must be no more than four (4) months old on the note date. If the credit documents are older than allowed, CMS must update them. For age requirements related to appraisals.

Soft Pull Credit Reports

CMS Underwriters review a “soft” credit report (also known as a credit refresh) on ALL Conventional loans, prior to the Clear-to-Close milestone. A “soft pull” credit report must be provided on every Conventional loan prior to documents being drawn and the report is good for 14 calendar days to closing.

The “soft pull” credit report provides an updated record of the original credit report used to underwrite the loan, and helps identify any changes to the borrower's credit standing. The Underwriter must review the results of the “soft-pull” credit report and compare all debts, new inquiries, alerts and borrower data to the original credit report for any changes that could potentially impact the loan approval. Any discrepancies or variances must be addressed, and if applicable, the loan may need to be re-analyzed and re-qualified.

Occupancy Types

Principal Residence Properties

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

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

A primary residence is a property that:

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

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

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

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

Occupancy Types (continued)

Principal Residence Properties (continued)

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

The following restrictions apply to primary residence transactions:

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

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

  The following table describes conditions under which Fannie Mae considers a residence to be a principal residence even though the borrower will not be occupying the property.

Borrower Types	Requirements for Owner-Occupancy
Multiple borrowers	Only one borrower needs to occupy and take title to the property, except as otherwise required for mortgages that have guarantors or co-signers.
Parents or legal guardian wanting to provide housing for their physically handicapped or developmentally disabled adult child	If the child is unable to work or does not have sufficient income to qualify for a mortgage on his or her own, the parent or legal guardian is considered the owner/occupant.
Children wanting to provide housing for parents	If the parent is unable to work or does not have sufficient income to qualify for a mortgage on his or her own, the child is considered the owner/ occupant.

Occupancy Types (continued)

Second Home

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

The following requirements must be followed for second home properties:

- Second home properties must be suitable for year-round occupancy and must not be located in the same market area as the borrower's primary residence.
- Must be occupied by the borrower for some portion of the year
- Second homes may be located in a major metropolitan area that the borrower visits on a regular basis.
- The borrower must have exclusive control over the property and the property must not be subject to any kind of time sharing agreement, rental pools, or agreements that require the borrower to rent, share or give management firm control over occupancy.
- Rental income must not be used to qualify the borrower. Reporting rental income on the borrower's personal tax returns does not contradict second home status, but must be minimal. The hazard insurance policy may not contain any coverage for loss of rent.
- Is restricted to one-unit dwellings

If CMS identifies rental income from the property, the loan is still eligible as a second home as long as the income is not used for qualifying purposes, and all other requirements for second homes are met (including the occupancy requirement above).

Notes: Occasional season rental is permitted. See the Employment and Income Analysis and Documentation section for more information. If a property is being purchased for an individual other than the borrower, the transaction should be considered an investment property purchase. See the Investment Property section below for more information.

Investment Properties

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

The following requirements must be followed for investment properties:

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

Borrower Types

Borrowers

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

The following are requirements for a borrower:

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

U.S. Citizen

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

Non-U.S. Citizen

Non-U.S. citizens lawfully residing in the U.S. as a permanent or non-permanent resident alien are eligible with supporting documentation. Foreign Nationals, borrowers with Diplomatic Immunity and Non-U.S. citizens who have no lawful residency status in the United States are not eligible.

Permanent Resident

A permanent resident is a non-U.S. citizen who is legally eligible to maintain permanent residency in the U.S. and holds a Permanent Resident card. Legal residency must be documented with one of the following:

- A valid and current Permanent Resident card (form I-551)
- A passport stamped "processed for I-551, Temporary evidence of lawful admission for permanent residence. Valid until_______. Employment authorized". This evidence that the holder has been approved for, but not issued, a Permanent Resident card.

The "Valid Until" expiration date need not be taken into consideration.

See the U.S. Citizenship and Immigration Services website for more information.

Non-Permanent Resident

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

Borrower Types, continued

Non-U.S. Citizen (continued)

- Non-Permanent Resident Aliens – Required Visas

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

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

All standards for determining stable monthly income, adequate credit history, and sufficient liquid assets must be applied in the same manner to each borrower including borrowers who are non-permanent resident aliens.

- A valid Social Security number is required for all borrowers signing the Note.
- Individuals classified under Diplomatic Immunity, Temporary Protected Status, Deferred Enforced Departure, or Humanitarian Parole are not eligible.
- Deferred Action for Childhood Arrivals (DACA) is not considered a "legal" residency status (it is deferred action from deportation), and the specific FNMA requirement is for Borrowers to have legal residency. Therefore, DACA Employment Authorization Documents are not eligible for FNMA financing.

Borrowers must meet all other program requirements. See the CMS Product Matrices for LTV/CLTV/HCLTV limitations.

Guarantors, Co-Signers, or Non-Occupant Borrowers

Requirements

Guarantors and co-signers are credit applicants who

- Do not have ownership interest in the subject property as indicated on the title;
- Sign the mortgage or deed of trust note;
- Have joint liability for the note with the borrower; and
- Do not have an interest in the property sales transaction, such as the property seller, the builder, or the real estate broker.

Non-occupant borrowers are credit applicants on a principal residence transaction who

- Do not occupy the subject property;
- May or may not have an ownership interest in the subject property as indicated on the title;
- Sign the mortgage or deed of trust note;
- Have joint liability for the note with the borrower(s); and
- Do not have an interest in the property sales transaction, such as the property seller, the builder, or the real estate broker.

Homeownership Education and Housing Counseling

Overview

Fannie Mae believes that credit and underwriting guidelines alone are not always enough to assess a borrower's readiness for homeownership. High-quality homeownership education and housing counseling can provide the borrower with the additional information and resources to make informed decisions that support long-term homeownership sustainability. Fannie Mae requires programs that are aligned with the National Industry Standards (NIS) for Homeownership Education and Counseling or the U.S. Department of Housing and Urban Development (HUD) Counseling Program, or provided by a HUD-approved counseling agency.

Compliance with Law

All education, collection, and counseling efforts must comply with the requirements of applicable federal and state laws, including the Equal Credit Opportunity Act, the Fair Debt Collections Practices Act, and the Fair Credit Reporting Act.

Homeownership Education and Housing Counseling, continued

Definitions

The following definitions apply to these requirements:

- **Homeownership Education:** Education with an established curriculum and instructional goals, provided in a group, classroom setting, or via other formats, that covers homeownership topics such as the home-buying process, how to maintain a home, budgeting, and the importance of good credit.
- **Housing Counseling:** One-on-one assistance that addresses unique financial circumstances and housing issues, and focuses on overcoming specific obstacles to achieve housing goals. Counseling includes topics such as repairing credit, locating cash for a down payment, recognizing predatory lending practices, understanding fair lending and fair housing requirements, avoiding foreclosure, and resolving a financial crisis. All housing counseling involves the creation of a budget and a written action plan, and includes a homeownership education component.

Transactions that Require Homeownership Education

For the following transactions, at least one borrower on the mortgage loan must complete homeownership education prior to loan closing:

- if all borrowers on the loan are relying solely on nontraditional credit to qualify, regardless of the loan product or whether the borrowers are first-time home buyers; or
- for HomeReady purchase transactions when all occupying borrowers are first-time homebuyers, regardless of LTV ratio, or
- Purchase transactions with LTV, CLTV, or HCLTV ratios greater than 95% when all borrowers are first-time homebuyers.

Meeting the Homeownership Education Requirements

To satisfy the homeownership education requirement, Fannie Mae permits any qualified third-party provider, independent of the lender, to administer homeownership education. The provider’s content must be aligned with NIS or HUD standards. The education may be delivered in various formats (in-person, Internet, telephone, or a hybrid format). In lieu of homeownership education, the borrower may receive housing counseling.

CMS must confirm the course content is aligned with NIS or HUD standards and must retain a copy of the certificate of course completion in the loan file.

Homeownership Education and Housing Counseling, continued

Housing Counseling

Housing counseling must be provided by a HUD-approved agency and meet HUD standards for the delivery of this service. The following requirements apply when counseling is obtained to satisfy the homeowner education requirement:

- If a borrower opts to work with a housing counselor, completion of housing counseling prior to closing will satisfy Fannie Mae's homeownership education requirement. CMS must retain a copy of the certificate of course completion in the loan file.
- HomeReady borrowers who complete housing counseling prior to the execution of the sales contract may be eligible for a loan-level price adjustment credit. The requirements of the counseling are described in the Certificate of Completion of Housing Counseling (Form 1017). This form must be signed by the counseling recipient (the borrower) and the HUD counselor if the counseling is obtained prior to the sales contract. CMS must retain a copy of the form in the loan file. See HomeReady Mortgage Underwriting Methods and Requirements, for additional information.

Note: References to the use of a HUD-approved agency include affiliated agencies (as defined in the HUD Housing Counseling Program Handbook) participating in a HUD program through a HUD-approved intermediary or State Housing Finance Agency

Additional Resources

Fannie Mae provides additional resources to lenders, borrowers, and nonprofit agencies in support of homeownership education and housing counseling on its website.

Summary of Homeownership Education and Housing Counseling Options

	Homeownership Education	**Housing Counseling**
Eligible Provider	• Any qualified third-party provider, independent of the lender; which can include a mortgage insurance company (without regard to whether they provide mortgage insurance coverage for the particular transaction) • Education course provided by a Community Seconds or other down payment assistance program provider, where the program requires homeownership education or counseling provided by a HUD-approved agency	HUD-approved Agency
Course Content	Course content must align with NIS or HUD standards	Course content must align with HUD standards

Homeownership Education and Housing Counseling, continued

Summary of Homeownership Education and Housing Counseling Options, continued

	Homeownership Education	Housing Counseling
Method of Delivery	Any method offered by an eligible provider	Any method offered per HUD standards
Date Required for Completion	Prior to loan closing	Prior to loan closing **Note:** There may be an additional incentive for HomeReady loans when housing counseling is completed prior to the execution of the sales contract.
Required Documentation	Certificate of course completion from the provider.	If after execution of the sales contract but prior to closing, certificate of course completion from the provider. If prior to execution of the sales contract (HomeReady loans) Form 1017 signed by both the counseling recipient (borrower) and the HUD counselor.

Ineligible Borrower and Vesting Types

Ineligible Borrowers

The following are ineligible borrowers:

- Trusts
- Limited Liability Company (LLC)

Ineligible Vesting Types

The following are ineligible vesting types:

- Trusts
- Limited Liability Company (LLC)

Previous Financial Crimes

Policy

CMS will not make a loan to any individual who has ever been convicted of a felony or within the past five (5) years if convicted of a misdemeanor where money or property was taken or used in an illicit manner. Guilty or No Contest pleas are included in this restriction.

Examples of such crimes include but are not limited to fraud, embezzlement, forgery or identity theft.

TRANSACTIONS

Multiple Properties Financed

Multiple Properties

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

Properties Financed

If the mortgage loan being delivered to Fannie Mae is secured by the borrower's principal residence, there are no limitations on the number of other properties that the borrower will have financed. If the mortgage is secured by a second home or an investment property, the multiple financed properties policy applies. The maximum number of financed properties that are permitted is based on the underwriting method.

Note: there is a maximum limit of two financed properties (including the subject property) for HomeReady mortgage loans.

The financed property limit

- Applies to the number of one- to four-unit residential properties where the borrower is personally obligated on the mortgage(s), even if the monthly housing expense is excluded from the borrower's DTI in accordance with Monthly Debt Obligations;
- Applies to the total number of properties financed, not to the number of mortgages on the property or the number of mortgages sold to Fannie Mae;
- Includes the borrower's principal residence if it is financed; and
- Is cumulative for all borrowers (though jointly financed properties are only counted once).

The following property types are not subject to these limitations, even if the borrower is personally obligated on a mortgage on the property:

- Commercial real estate,
- Multifamily property consisting of more than four units,
- Ownership in a timeshare,
- Ownership of a vacant lot (residential or commercial).

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

Multiple Properties Financed, continued

Properties Financed (continued)

DU will determine the number of financed properties for the loan casefile based on the following approach:

- If the Number of Financed Properties field is completed, DU will use that as the number of financed properties. CMS must complete this field with the number of financed one- to four-unit residential properties (including the subject transaction) for which the borrower(s) are personally obligated.
- If the Number of Financed Properties field is not provided, DU will use the number of residential properties in the Real Estate Owned (REO) section that include a mortgage payment, or that are associated with a mortgage or HELOC in the liabilities section of the loan application, as the number of financed properties.
- If the Number of Financed Properties field and the REO information was not provided, DU will use the number of mortgages and HELOCs disclosed in the liabilities section of the loan application as the number of financed properties.
- When none of the information above is provided on the loan application, DU will use the number of mortgages and HELOCs disclosed on the credit report as the number of financed properties.

Note: In order to account for the subject property, DU will add “1” to the number offinanced properties on purchase and construction transactions when the REO section, number of mortgages on the application, or number of mortgages on the credit report are used as the number of financed properties.

After determining the number of financed properties, DU will use that value to assess the eligibility of the loan, including the minimum credit score requirement for seven to ten financed properties, and the minimum required reserves CMS must verify.

DU will issue a message informing CMS of the number of financed properties that DU used and where that information was obtained (Number of Financed Properties field, REO section, number of mortgages on application, or number of mortgages on credit report). If DU used the information provided in the Number of Financed Properties field or in the REO section as the number of financed properties, and that information is inaccurate, CMS must update the data and resubmit the loan casefile to DU. If DU used the number of mortgages and HELOCs on the loan application or credit report as the number of financed properties, and that number is inaccurate, CMS must provide the correct number in the Number of Financed Properties field, or complete the Real Estate Owned section of the loan application and resubmit the loan casefile to DU.

Simultaneous Submissions

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

Multiple Properties Financed, continued

Examples - Counting Financed Properties

- The borrower is personally obligated on mortgages securing two investment properties and the co-borrower is personally obligated on mortgages securing three other investment properties, and they are jointly obligated on their principal residence mortgage. The borrower is refinancing the mortgage on one of the two investment properties. Thus, the borrowers have six financed properties.
- The borrower and co-borrower are purchasing an investment property and they are already jointly obligated on the mortgages securing five other investment properties. In addition, they each own their own principal residence and are personally obligated on the mortgages. The new property being purchased is considered the borrowers' eighth financed property.
- The borrower is purchasing a second home and is personally obligated on his or her principal residence mortgage. Additionally, the borrower owns four two-unit investment properties that are financed in the name of a limited liability company (LLC) of which he or she has a 50% ownership. Because the borrower is not personally obligated on the mortgages securing the investment properties, they would not be included in the property count and the result is only two financed properties.
- The borrower is purchasing and financing two investment properties simultaneously. The borrower does not have a mortgage lien against his or her principal residence but does have a financed second home and is personally obligated on the mortgage, two existing financed investment properties and is personally obligated on both mortgages, and a financed building lot. In this instance, the borrower will have five financed properties because the financed building lot does not need to be included in the property count.

Determining Value

First Mortgage Transaction Value

Purchases

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

Rate & Term Refinance

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

Cash-Out Refinance

- **Conforming Loans**

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

- **High Balance Loans**

  Refer to the CMS High Balance Product Matrices for additional information.

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

    If the borrower has held title to the property with a habitable structure for less than 12 months, the value is based on the lesser of current appraised value or original sales price.

Loan-to-Value (LTV) Ratios

Calculation of the LTV Ratio

The maximum allowable LTV ratio for a first mortgage is based on a number of factors including, the representative credit score, the type of mortgage product, the number of dwelling units, and the occupancy status of the property.

The following table describes the requirements for calculating LTV ratios for a first mortgage transaction. The result of these calculations must be truncated (shortened) to two decimal places, then rounded up to the nearest whole percent.

Loan-to-Value (LTV) Ratios (continued)

Calculation of the LTV Ratio (continued)

For example:

- 94.01% will be delivered as 95%, and
- 80.001% will be delivered as 80%.

The rounding rules noted above also apply to the CLTV and HCLTV ratio calculations. CMS systems must contain rounding methodology that results in the same or a higher LTV ratio.

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

Sales Price and Appraised Value Used by DU

DU uses information in the online loan application to obtain the sales price and appraised value it uses to calculate the LTV, CLTV, and HCLTV ratios.

To determine the sales price and appraised value, DU uses the amounts entered in the following data fields:

Sales price = Line a + Line b + Line c in Section VII, where:

- Line a = Purchase price (the sales price for purchase transactions, or the cost of construction for construction transactions).
- Line b = Alterations, improvements, repairs.
- Line c = For construction transactions, the cost or value of the land if the borrower acquired the lot separately.

Appraised value = Property Appraised Value in the Additional Data screen.

Note: If the estimated value that was submitted to DU differs from the actual value, CMS must correct the information in DU and resubmit the loan casefile.

Loan-to-Value (LTV) Ratios (continued)

Calculation of the CLTV Ratio

For first mortgage loans that are subject to subordinate financing CMS must calculate the LTV ratio and the CLTV ratio. (For first mortgage loans that are subject to a HELOC.

The CLTV ratio is determined by dividing the sum of the items listed below by the lesser of the sales price or the appraised value of the property.

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

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

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

Calculation of the HCLTV Ratio

For first mortgages that have subordinate financing under a HELOC, CMS must calculate the HCLTV ratio. This is determined by dividing the sum of the items listed below by the lesser of the sales price or appraised value of the property.

- the original loan amount of the first mortgage,
- the full amount of any HELOCs (whether or not funds have been drawn), and
- the unpaid principal balance (UPB) of all closed-end subordinate financing.

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

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

Loan-to-Value (LTV) Ratios (continued)

Permanently Modified HELOCs

If CMS determines the HELOC has been permanently modified and the outstanding UPB is less than the permanently modified HELOC, CMS must use the modified HELOC amount in calculating the HCLTV ratio for eligibility purposes and for delivery. CMS must obtain appropriate documentation that the HELOC has been permanently modified and include this documentation in the loan file.

If the outstanding UPB is greater than the permanently modified HELOC, CMS must use the outstanding UPB to calculate the HCLTV ratio for eligibility purposes and for delivery. As noted above, CMS must obtain appropriate documentation and include that documentation in the loan file.

In no case may the CLTV ratio exceed the HCLTV ratio.

Subordinate Financing Requirements

Fannie Mae purchases or securitizes first-lien mortgages that are subject to subordinate financing Subordinate liens must be recorded and clearly subordinate to Fannie Mae's first mortgage lien. CMS must disclose the existence of subordinate financing and the subordinate financing repayment terms to Fannie Mae, the appraiser, and the mortgage insurer. If a first mortgage is subject to subordinate financing, CMS must calculate the LTV, CLTV, and HCLTV ratios.

CMS must consider any subordinate liens secured by the subject property, regardless of the obligated party, when calculating CLTV and HCLTV ratios. This includes business loans, such as those provided by the Small Business Administration.

Acceptable Subordinate Financing Types

The table below provides the requirements for acceptable subordinate financing types.

✓	Acceptable Subordinate Financing Types
	Variable payment mortgages that comply with the details below.
	Mortgages with regular payments that cover at least the interest due so that negative amortization does not occur.
	Mortgages with deferred payments in connection with employer subordinate financing (see below).
	Mortgage terms that require interest at a market rate.

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

Loan-to-Value (LTV) Ratios, continued

Unacceptable Subordinate Financing Terms

The table below describes unacceptable subordinate financing terms.

✓	Unacceptable Subordinate Financing Terms
	Mortgages with negative amortization (with the exception of employer subordinate financing that has deferred payments).
	Subordinate financing that does not fully amortize under a level monthly payment plan where the maturity or balloon payment date is less than five years after the note date of the new first mortgage (with the exception of employer subordinate financing that has deferred payments). **Note**: Fannie Mae will accept these subordinate financing terms when the amount of the subordinate debt is minimal relative to the borrower's financial assets and/or credit profile.

Eligible Variable Payment Terms for Subordinate Financing

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

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

Eligible Repayment Terms for Employer Subordinate Financing

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

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

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

Loan-to-Value (LTV) Ratios (continued)

Re-Subordination Requirements for Refinance Transactions

If subordinate financing is left in place in connection with a first mortgage loan refinance transaction, Fannie Mae requires execution and recordation of a re-subordination agreement.

If state law permits subordinate financing to remain in the same subordinate lien position established with the prior first mortgage loan that is being refinanced, Fannie Mae does not require re-subordination. The subordinate lien must satisfy any specified criteria of the applicable statutes.

Note: Title insurance against the fact that a former junior lien is not properly subordinated to the refinance loan does not release CMS from compliance with these re-subordination requirements, or from Fannie Mae's requirement that the property is free and clear of all encumbrances and liens having priority over Fannie Mae's mortgage loan.

Defining Refinance Transactions Based on Subordinate Lien Payoff

The table below provides the underwriting considerations related to subordinate financing under refinance transactions:

Refinance transaction includes payoff of the first lien and …	Then CMS must underwrite the transaction as a …	Comments
the payoff of a purchase money second with no cash out,	Limited cash-out refinance	N/A
the payoff of a non-purchase money second, regardless of whether additional cash out is taken,	Cash-out refinance	N/A
the subordinate financing is being left in place, regardless of whether the subordinate financing was used to purchase the property, and the borrower is not taking cash out except out except to the extent permitted for a limited cash-out refinance transaction,	Limited cash-out refinance	The subordinate lien must be resubordinated to the new first mortgage loan.
the subordinate financing is being left in place, regardless of whether the subordinate financing was used to purchase the property, and the borrower is taking cash out,	Cash-out refinance	

Loan-to-Value (LTV) Ratios (continued)

General Purchase Transaction Eligibility Requirements

A purchase money transaction is one in which the proceeds are used to finance the acquisition of a property or to finance the acquisition and rehabilitation of a property. The table below provides the general requirements for purchase money mortgage transactions. Certain mortgage loans and products may have different eligibility requirements for purchase mortgage transactions. If applicable, the differences will be stated in the specific mortgage loan or product topic section:

✓	General Requirements
	The minimum borrower contribution requirements for the selected mortgage loan type must be met.
	Proceeds from the transaction must be used to • finance the acquisition of the subject property, • finance the acquisition and rehabilitation of the subject property, or • pay-off the outstanding balance on the installment land contract or contract for deed. Refer to Payoff of Installment Land Contract Requirements for additional information.
	Proceeds from the transaction may not be used to give the borrower cash back other than the following: • an amount representing reimbursement for the borrower's overpayment of fees and charges, including refunds that may be required in accordance with certain federal laws or regulations. The settlement statement must clearly indicate the refund, and the loan file must include documentation to support the amount and reason for the refund; and • a legitimate pro-rated real estate tax credit in locales where real estate taxes are paid in arrears. **Note:** If the borrower receives cash back for a permissible purpose as listed above, CMS must confirm that the minimum borrower contribution requirements associated with the selected mortgage product, if any, have been met. Reimbursements or refunds permitted above may also be applied as a principal curtailment.

Loan-to-Value (LTV) Ratios (continued)

Owner of Record and Chain of Title

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

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

If the seller is a corporation, partnership, or any other business entity, ensure the borrower is not an owner of the business entity selling the subject property.

Non-Arm's Length Transactions

Non-arm's length transactions are purchase transactions in which there is a relationship or business affiliation between the seller and the buyer of the property. Fannie Mae allows non-arm’s length transactions for the purchase of existing properties unless specifically forbidden for the particular scenario, such as delayed financing.

For the purchase of newly constructed properties, if the borrower has a relationship or business affiliation (any ownership interest, or employment) with the builder, developer, or seller of the property, Fannie Mae will only purchase mortgage loans secured by a principal residence.

Fannie Mae will not purchase mortgage loans on newly constructed homes secured by a second home or investment property if the borrower has a relationship or business affiliation with the builder, developer, or seller of the property.

Loan-to-Value (LTV) Ratios (continued)

Auctioneer's Fees

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

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

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

Redemption Periods

Properties with unexpired redemption periods have unacceptable title defects.

Redemption periods do not automatically expire upon the sale of the property to a new owner. If the property is a foreclosed property in a state that allows redemption periods, the loan must not close until the redemption period has expired.

Private Transfer Fee

The agencies prohibit conventional conforming loans on properties encumbered by private transfer fee covenants created on or after February 8, 2011. High Balance loans on properties encumbered by private transfer fee covenants are also ineligible regardless of the date the covenant was created.

Private Transfer Fee Covenant

Private transfer fee covenants are mechanisms attached to real property that require a fee to be paid to a third party (frequently the property developer) upon each re-sale of the property, typically for a period of 99 years. The fee may be expressed as a fixed amount or determined as a percentage of the value of the property or purchase price and may also be called a reconveyance fee or a capital recovery fee. The fee obligates successors in title to such real property to pay a private transfer fee upon transfer of an interest in the property.

- **Not Eligible:** Loans securing properties encumbered by a private transfer fee covenant, requiring payment to an organization that does not directly benefit the property on which it is assessed, are not eligible.
- **Eligible:** Properties encumbered by a private transfer fee covenant that provides a direct benefit* to the property, and requires payment to any of the following organizations:
    - Mandatory Home Owners Associations
    - Master and sub-associations
    - Nonprofit organizations as defined in the Internal Revenue Code

Loan-to-Value (LTV) Ratios (continued)

Private Transfer Fee Covenant (continued)

*Purposes that provided a "direct benefit" to the property include:

- Proceeds used exclusively to support maintenance and improvements to the property and acquisition, improvement, administration, and maintenance of property owned by the covered association; or
- Educational, charitable, recreational, environmental, conservation, or other similar activities that are:
  - Conducted in or protect the burdened community or "adjacent or contiguous property," (i.e., property that borders the burdened community which may be separated from the burdened community by a public right of way); or
  - Conducted on other property that is used primarily by residents of the burdened community.

If a private transfer fee exists, review title commitments and purchase contracts considering the following:

- If a private transfer fee is recorded, it will be identified in Schedule B of the title commitment.
- In some cases, a separate transfer fee disclosure may be provided to the purchaser of the property.

Some state laws require seller disclosure of private transfer covenants. In those states, the purchase contract or addenda may provide evidence that a private transfer fee transfer covenant exists.

Purchase of Pre-foreclosure or Short Sale Properties — Allowable Fees, Assessments, and Payments

Borrowers may pay additional fees, assessments, or payments in connection with acquiring a property that is a pre-foreclosure or short sale that are typically the responsibility of the seller or another party. Examples of additional fees, assessments, or payments include, but are not limited to, the following:

- Short sale processing fees (also referred to as short sale negotiation fees, buyer discount fees, short sale buyer fees);

  Note: This fee does not represent a common and customary charge and therefore must be treated as a sales concession if any portion is reimbursed by an interested party to the transaction.
- Payment to a subordinate lienholder; and
- Payment of delinquent taxes or delinquent HOA assessments. The following requirements apply:
- The borrower (buyer) must be provided with written details of the additional fees, assessments, or payments and the additional necessary funds to complete the transaction must be documented.
- The servicer that is agreeing to the pre-foreclosure or short sale must be provided with written details of the fees, assessments, or payments and has the option of renegotiating the payoff amount to release its lien.

Loan-to-Value (LTV) Ratios (continued)

Purchase of Pre-foreclosure or Short Sale Properties — Allowable Fees, Assessments, and Payments (continued)

- All parties (buyer, seller, and servicer) must provide their written agreement of the final details of the transaction which must include the additional fees, assessments, or payments. This can be accomplished by using the "Request for Approval of Short Sale" or "Alternative Request for the Approval of Short Sale" forms published by the U.S. Treasury *Supplemental Directive 09–09* or any alternative form or addendum.
- The settlement statement must include all fees, assessments, and payments included in the transaction.

Payoff of Installment Land Contract Requirements

When the proceeds of a mortgage loan are used to pay off the outstanding balance on an installment land contract (also known as contract or bond for deed) that was executed within the 12 months preceding the date of the loan application, Fannie Mae will consider the mortgage loan to be a purchase money mortgage loan.

The LTV ratio for the mortgage loan must be determined by dividing the new loan amount by the lesser of the total acquisition cost (defined as the purchase price indicated in the land contract, plus any costs the purchaser incurs for rehabilitation, renovation, or energy conservation improvements) or the appraised value of the property at the time the new mortgage loan is closed. The expenditures included in the total acquisition cost must be fully documented by the borrower.

When the installment land contract was executed more than 12 months before the date of the loan application, Fannie Mae will consider the mortgage loan to be a limited cash-out refinance. In this case, the LTV ratio for the mortgage loan must be determined by dividing the new loan amount by the appraised value of the property at the time the new mortgage loan is closed.

Cash-out refinance transactions involving installment land contracts are not eligible for delivery.

Short Payoffs

Definition

A short payoff is when a lender agrees to accept less than the full balance of the mortgage loan as payment in full for the debt.

Eligibility Requirements

Short payoffs are not eligible. FNMA will not accept a refinance transaction where a lender has approved a short payoff.

No Cash-Out Refinance

Definition	A No Cash-Out refinance transaction refers to a loan that is used to pay off an existing loan by obtaining a new first mortgage secured by the same property.
Eligibility Requirements	No Cash-out refinance transactions must meet the following requirements: • The transaction is being used to pay off an existing first mortgage loan (including an existing HELOC in first-lien position) by obtaining a new first mortgage loan secured by the same property. • Only subordinate liens used to purchase the property may be paid off and included in the new mortgage. Written confirmation must be obtained to show that all proceeds of an existing subordinate lien were used to fund part of the purchase price of the subject property. A copy of the Closing Disclosure or other documentation must be obtained. • Reasonable and customary loan cost or fees (including prepaid items) within limitations imposed by applicable laws. • Incidental cash back not to exceed the lesser of 2 percent of the balance of the new mortgage or $2000. • Payoff of prepayment penalties associated with the payoff of the existing mortgage. See the CMS Product Matrices for properties that have recently been listed for sale, subordination of secondary financing, and length of ownership requirements. • When borrowers want to refinance a property recently owned by an individual with whom they have an established relationship, the payoff from the purchase transaction must reflect that the mortgage was current at the time the borrower purchased the property, if the borrower has been on title less than six months from date of application.
Texas Conversion (Refinance) Transactions	The state of Texas permits conversion of Texas Home Equity cash-out transactions to rate/term refinance transactions under Tex. Const. Art. 16 §50(f)(2). Refer to Refinancing an Existing Home Equity Loan - Texas Conversion Transactions for detailed requirements to convert (refinance) a Texas 50(a)(6) loan to a non-home equity rate/term loan.

No Cash-Out Refinance (continued)

High Balance Loans

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

- Payoff of the outstanding principal balance of an existing first loan and lien plus any required per diem interest
- Payoff of subordinate financing (see CMS High Balance Product Matrices)
- Reasonable and customary loan cost or fees (including prepaid items) within limitations imposed by applicable laws.
- Incidental cash back. (see CMS High Balance Product Matrices) Pay off prepayment penalties associated with the payoff of the existing mortgage.

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

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

Property Settlement Buyout

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

- All parties must have jointly owned the subject property for 12 months preceding the date of the loan application.

  Note: Parties who inherit an interest in the property do not have to satisfy this requirement.

- All parties must be able to demonstrate they occupied the subject property as their primary residence (e.g., driver's license, bank statement, credit card bill, utility bill, etc. mailed to the individual at the subject property).

  Note: Parties who inherit an interest in the property do not have to satisfy this requirement.

No Cash-Out Refinance (continued)

Property Settlement Buyout (continued)

- All parties must provide a signed, written agreement that sates the terms of the property transfer and the disposition of the proceeds (divorce decree or separation agreement, buy-out agreement).
- The borrower who acquires sole ownership of the property may receive no cash-out from the proceeds of the refinance.
- The party who is buying out the other party's interest must be able to qualify for the loan.

When CMS does not release the borrower from liability under the mortgage, the borrower has a contingent liability.

CMS must obtain documentation to confirm the transfer of title to the property; this liability does not have to be considered as part of the borrower's recurring monthly debt obligations.

Ineligible Transactions

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

- No outstanding first lien on the subject property;
- The proceeds are used to pay off a subordinate lien that was not used to purchase the property;
- The borrower finances the payment of real estate taxes for the subject property in the loan amount, but does not establish an escrow account;
- The borrower finances the payment of real estate taxes that are more than 60 days delinquent for the subject property in the loan amount; and
- A short-term refinance mortgage loan that combines a first mortgage and a non-purchase- money subordinate mortgage into a new first mortgage or any refinance of that loan within six (6) months.
- The proceeds are used to pay for energy efficient improvements, including the payoff of PACE liens, which would cause the loan to be processed under the HomeStyle Energy program.

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

No Cash-Out Refinance (continued)

Acceptable Uses

The following are acceptable in conjunction with a limited cash-out refinance transaction:

- Modifying the interest rate and/or term for existing mortgages;
- Paying off the unpaid principal balance of the existing first mortgage (including prepayment penalties);
- Financing the payment of closing costs, points, and prepaid items. With the exception of real estate taxes that are more than 60 days delinquent, the borrower can include real estate taxes in the new loan amount as long as an escrow account is established, subject to applicable law or regulation. (For example, if a particular state law does not allow CMS to require an escrow account under certain circumstances, the loan would be eligible as a limited cash- out refinance without an escrow account.) If an escrow account is not being established.
- Receiving cash back in an amount that is not more than the lesser of 2% of the new refinance loan amount or $2,000;
- Buying out a co-owner pursuant to an agreement; or
- Paying off a subordinate mortgage lien (including prepayment penalties) used to purchase the subject property. CMS must document that the entire amount of the subordinate financing was used to acquire the property.

Cash Back to the Borrower

As noted above, the borrower may receive a small amount of cash back in a limited cash-out refinance transaction. CMS may also refund the borrower for the overpayment of fees and charges due to federal or state laws or regulations. Refunds such as these are not included in the maximum cash back limitation, provided that

- The settlement statement clearly identifies the refund, and
- The loan file includes documentation to support the amount and reason for the refund.

This applies to standard limited cash-out refinance transactions.

Note: These refunds may also be applied as a principal balance curtailment. CMS does not permit lender credits or premium pricing to be used to pay escrow shortages and/or late charges owed to the payoff lender in a refinance transaction. Refer to the Closing Policy for additional information.

No Cash-Out Refinance (continued)

Documentation Requirements

To treat a transaction as a limited cash-out refinance transaction, CMS must document that all proceeds of the existing subordinate lien were used to fund part of the subject property purchase price. Written confirmation must be maintained in the mortgage file.

The following are acceptable forms of documentation:

- A copy of the settlement statement for the purchase of the property;
- A copy of the title policy from the purchase transaction that identifies the subordinate financing;
- Other documentation from the purchase transaction that indicates that a subordinate lien was used to purchase the subject property.

Existing Subordinate Liens That Will Not Be Paid Off

When a new limited cash-out refinance transaction will not satisfy existing subordinate liens, the existing liens must be clearly subordinate to the new refinance mortgage. The refinance mortgage must meet Fannie Mae's eligibility criteria for mortgages that are subject to subordinate financing.

New Subordinate Financing

When a borrower obtains new subordinate financing with the refinancing of a first mortgage loan, Fannie Mae treats the transaction as a limited cash-out refinance provided the first mortgage loan meets the eligibility criteria for a limited cash-out refinance transaction.

Note: It is acceptable for borrowers to obtain cash from the proceeds of the new subordinate mortgage.

Refinances to Buy-Out An Owner's Interest

A transaction that requires one owner to buy out the interest of another owner (for example, as a result of a divorce settlement or dissolution of a domestic partnership) is considered a limited cash-out refinance if the secured property was jointly owned for at least 12 months preceding the disbursement date of the new mortgage loan.

All parties must sign a written agreement that states the terms of the property transfer and the proposed disposition of the proceeds from the refinance transaction. Except in the case of recent inheritance of the subject property, documentation must be provided to indicate that the security property was jointly owned by all parties for at least 12 months preceding the disbursement date of the new mortgage loan.

Borrowers who acquire sole ownership of the property may not receive any of the proceeds from the refinancing. The party buying out the other party's interest must be able to qualify for the mortgage pursuant to Fannie Mae's underwriting guidelines.

Cash-Out Refinance Transactions

Definition

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

Eligibility Requirements

Cash-out refinance transactions must meet the following requirements:

- The transaction must be used to pay off existing mortgages by obtaining a new first mortgage secured by the same property or be a new mortgage on a property that does not have a mortgage lien against it.
- Properties that were listed for sale must have been taken off the market on or before the disbursement date of the new mortgage loan.
- The property must have been purchased (or acquired) by the borrower at least six (6) months prior to the disbursement date of the new mortgage loan except for the following:
    - There is no waiting period if CMS documents that the borrower acquired the property through an inheritance or was legally awarded the property (divorce, separation, or dissolution of a domestic partnership).
    - The delayed financing requirements are met. See Delayed Financing Exception below.
    - If the property was owned prior to closing by a limited liability corporation (LLC) that is majority-owned or controlled by the borrower(s), the time it was held by the LLC may be counted towards meeting the borrower’s six month ownership requirement. (In order to close the refinance transaction, ownership must be transferred out of the LLC and into the name of the individual borrower(s). See General Borrower Eligibility Requirements for additional details.)
    - If the property was owned prior to closing by an inter vivos revocable trust, the time held by the trust may be counted towards meeting the borrower’s six month ownership requirement if the borrower is the primary beneficiary of the trust.
- For DU loan casefiles, if the DTI ratio exceeds 45%, six months reserves are required.

For the maximum allowable LTV, CLTV, and HCLTV ratios and credit score requirements for cash-out refinances, refer to the CMS Underwriting Matrices.

Cash-Out Refinance (continued)

Ineligible Transactions

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

- The mortgage is subject to a temporary interest rate buydown.
- The subject property was purchased by the borrower within the six (6) months preceding the disbursement date of the new mortgage loan except if delayed financing guidelines are met. See Delayed Financing Exception below.
- For certain transactions on properties that have a Property Assessed Clean Energy (PACE) loan, borrowers who refinance the first mortgage loan and have sufficient equity to pay off the PACE loan but choose not to do so will be ineligible for a cash-out refinance.
- The new loan amount includes the financing of real estate taxes that are more than 60 days delinquent and an escrow account is not established, unless requiring an escrow account is not permitted by applicable law or regulation. For example, if a particular state law does not allow CMS to require an escrow account under certain circumstances, the loan would be eligible for sale to Fannie Mae without an escrow account.

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

Acceptable Uses

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

- paying off the unpaid principal balance of the existing first mortgage;
- financing the payment of closing costs, points, and prepaid items. The borrower can include real estate taxes in the new loan amount. Delinquent real estate taxes (taxes past due by more than 60 days) can also be included in the new loan amount, but if they are, an escrow account must be established, subject to applicable law or regulation;
- paying off any outstanding subordinate mortgage liens of any age;
- taking equity out of the subject property that may be used for any purpose;
- financing a short-term refinance mortgage loan that combines a first mortgage and a non- purchase-money subordinate mortgage into a new first mortgage or a refinance of the short- term refinance loan within six months;
- paying off one or more student loans. Refer to Student Loan Cash-out Refinance section for additional details.

Delayed Financing Exception

Borrowers who purchased the subject property within the past six months (measured from the date on which the property was purchased to the disbursement date of the new mortgage loan) are eligible for a cash-out refinance if all of the following requirements are met.

Note: Delayed financing is not available on all CMS Products. See the CMS Product Matrices for availability

Cash-Out Refinance (continued)

Delayed Financing Exception (continued)

√	Requirements for a Delayed Financing Exception
	The original purchase transaction was an arms-length transaction.
	For this refinance transaction, the borrower(s) must meet Fannie Mae's borrower eligibility requirements as described in General Borrower Eligibility Requirements. The borrower(s) may have initially purchased the property as one of the following: • a natural person; • an eligible inter vivos revocable trust, when the borrower is both the individual establishing the trust and the beneficiary of the trust; • an eligible land trust when the borrower is the beneficiary of the land trust; or • an LLC or partnership in which the borrower(s) have an individual or joint ownership of 100%.
	The original purchase transaction is documented by a settlement statement, which confirms that no mortgage financing was used to obtain the subject property. (A recorded trustee's deed (or similar alternative) confirming the amount paid by the grantee to trustee may be substituted for a settlement statement if a settlement statement was not provided to the purchaser at time of sale.) The preliminary title search or report must confirm that there are no existing liens on the subject property.
	The sources of funds for the purchase transaction are documented (such as bank statements, personal loan documents, or a HELOC on another property).
	If the source of funds used to acquire the property was an unsecured loan or a loan secured by an asset other than the subject property (such as a HELOC secured by another property), the settlement statement for the refinance transaction must reflect that all cash-out proceeds be used to pay off or pay down, as applicable, the loan used to purchase the property. Any payments on the balance remaining from the original loan must be included in the debt-to-income ratio calculation for the refinance transaction.
	Note: Funds received as gifts and used to purchase the property may not be reimbursed with proceeds of the new mortgage loan.
	The new loan amount can be no more than the actual documented amount of the borrower's initial investment in purchasing the property plus the financing of closing costs, prepaid fees, and points on the new mortgage loan (subject to the maximum LTV, CLTV, and HCLTV ratios for the cash-out transaction based on the current appraised value).
	All other cash-out refinance eligibility requirements are met. Cash-out pricing is applicable.

Student Loan Cash-out Refinance

Overview

The student loan cash-out refinance is a cost-effective alternative to use existing home equity to pay off student loan debt. This feature provides the opportunity for borrowers to pay-off one or more student loans through the refinance transaction, potentially reducing their monthly debt payments.

The student loan cash-out refinance feature contains elements of both a cash-out refinance and a limited cash-out refinance transaction as described below.

Student Loans Eligible for Payoff

- At least one student loan must be paid off. Loan proceeds must be paid directly to the student loan servicer at closing.
- Only student loans for which the borrower is personally obligated can be paid through the transaction.
- Student loan debt must be paid in full with the proceeds – partial payments of student loan debt are not permitted.

Eligibility

The standard cash-out refinance LTV, CLTV, and HCLTV ratios apply.

Underwriting Method

DU Only

Maximum Cash Back

Lesser of 2% or $2,000 (over and above the student loan payoff).

Mortgage Payoff

First mortgage and purchase money seconds.

Other Requirements

- Property cannot be listed for sale at time of disbursement
- Payoff of taxes ineligible unless escrow account is established
- Payoff of delinquent taxes ineligible

Purchase or Refinance of Inherited Property

Limitation

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

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

Fixed-Rate Mortgage Eligibility

The eligibility requirements described in this topic apply to first mortgages. Eligibility criteria for second mortgages are determined when CMS requests a Master Agreement to cover second mortgage deliveries.

Fannie Mae purchases or securitizes conventional, fully amortizing, fixed-rate first mortgages.

The mortgage can be subject to a temporary interest rate buy-down plan, provided that the subject property is secured by a principal residence or a second home property

The payments must be structured as follows:

- Level monthly installments of principal and interest (P&I),
- Due on the first day of each month, and
- Payment of interest in arrears.

Temporary Interest Rate Buydowns

Provisions for Temporary Interest Rate Buydown Plans

The table below provides the general requirements under which Fannie Mae purchases or securitizes mortgage loans subject to temporary interest rate buydown plans.

✓	General Requirements for Mortgage Loans with Temporary Interest Rate Buydown Plans
	Temporary interest rate buydowns are allowed on fixed-rate mortgages for principal residences or second homes provided the rate reduction does not exceed 3%, and the rate increase will not exceed 1% per year.
	The buydown plan must be a written agreement between the party providing the buydown funds and the borrower.
	All of the terms of the buydown plan must be disclosed to Fannie Mae, the mortgage insurer, and the property appraiser.
	The mortgage instruments must reflect the permanent payment terms rather than the terms of the buydown plan. In no event may the buydown plan change the terms of the mortgage note.

Buydown Funds Provided by Interested Parties to the Transaction

When the source of the buydown funds is an interested party to the property sale or purchase transaction, Fannie Mae's interested-party contribution limits apply.

CMS-Funded Buydowns

When CMS funds the buydown, the buydown agreement must require that the funds in the buydown account be transferred to the new servicer if the mortgage is included as part of a subsequent transfer of servicing.

Buydown Agreements

The buydown agreement must provide that the borrower is not relieved of his or her obligation to make the mortgage payments required by the terms of the mortgage note if, for any reason, the buydown funds are not available.

The buydown agreement may include an option for the buydown funds to be returned to the borrower or to CMS, if it funded the buydown, if the mortgage is paid off before all of the funds have been applied.

A copy of the buydown agreement must be included in the delivery documentation for the mortgage.

Temporary Interest Rate Buydowns (continued)

Eligible Transaction Types

The following table lists the transaction types that are eligible and ineligible for temporary buydowns:

Transaction Type	Eligibility
Principal residence	Eligible
Second homes	Eligible
Investor properties	Ineligible
Cash-out refinance transactions	Ineligible

Qualifying the Borrower

When underwriting mortgage loans that have a temporary interest rate buydown, CMS must qualify the borrower based on the note rate without consideration of the bought-down rate.

Terms of the Buydown

Fannie Mae does not place a limit on the total dollar amount of an interest rate buydown.

The total dollar amount of an interest rate buydown must be consistent with the terms of the buydown period.

An interest rate buydown plan must provide for:

- a buydown period not greater than 36 months, and
- increases of not more than 1% in the portion of the interest rate paid by the borrower in each 12-month interval.

More frequent changes are permitted as long as the total annual increase does not exceed 1%.

Temporary Interest Rate Buydowns (continued)

Buydown Funds

The table below provides Fannie Mae requirements for treatment of buydown funds.

✓	Requirement
	Buydown accounts must be established and fully funded by the time CMS submits the mortgage to Fannie Mae for purchase or securitization.
	Funds for buydown accounts must be deposited into custodial bank accounts. **Note:** Buydown funds cannot be included in accounts with CMS's other corporate funds.
	The borrower's only interest in buydown funds is to have them applied toward payments as they come due under the note.
	Buydown funds are not refundable unless the mortgage is paid off before all the funds have been applied.
	Buydown funds cannot be used to pay past-due payments.
	Buydown funds cannot be used to reduce the mortgage amount for purposes of determining the LTV ratio.

Disposing of Buydown Funds

If the mortgage is liquidated or the property is sold during the buydown period, CMS should dispose of the buydown funds in the following manner:

Status of Mortgage	Disposition of Funds
The mortgage is paid in full.	The funds should be credited to the total amount required to pay off the mortgage, or they may be returned to either the borrower or CMS as specified in the buydown agreement.
The mortgage is foreclosed.	The funds are used to reduce the mortgage debt.
The property is sold and the mortgage is assumed by the purchaser.	The funds may continue to be used to reduce the mortgage payments under the original terms of the buydown plan.

Mortgage Loan Limits

Mortgage Loan Limits Overview

Fannie Mae can only purchase loans up to a certain dollar amount. This dollar amount is known as the loan limit. Fannie Mae's loan limits are imposed under its federal charter as amended by law.

The loan limits apply to all conventional mortgage loans delivered to Fannie Mae and are based on the original loan amount of the loan (irrespective of the origination date). The limits are subject to change annually and vary, depending upon the number of units in the property, the property's location, and whether the loan is a first or second mortgage.

See CMS product matrix for additional information.

CMS is responsible for ensuring that the original loan amount of each mortgage loan does not exceed the applicable maximum loan limit for the specific area in which the property is located at the time the loan is delivered to Fannie Mae.

First Mortgage Loan Limits

Fannie Mae's first mortgage loan limits are defined in terms of general loan limits and high-cost area loan limits:

- The general limits apply to the majority of the mortgage loans that Fannie Mae purchases.
- The high-cost area loan limits apply to mortgage loans secured by properties in designated high-cost areas, as determined by Fannie Mae's regulator. The high-cost area loan limits vary across the country.

In addition, Fannie Mae's eligibility and delivery requirements may vary for high-balance mortgage loans.

Second Mortgage Loan Limits

Fannie Mae can purchase or securitize a second mortgage, provided the property is the borrower's principal residence. Unlike first mortgage loan limits, Fannie Mae's second mortgage loan limits are not dependent on the number of units in the property. The second mortgage loan limits apply whether or not Fannie Mae owns or has an interest in the first mortgage loan.

When a second mortgage is sold to Fannie Mae, the sum of the original loan amounts of the first and second mortgage loans may not exceed the applicable loan limit for first mortgage loans based on the location and number of units of the subject property. This combined loan limit requirement does not apply in cases in which Fannie Mae is acquiring a first mortgage that has a second (subordinate) mortgage that is not being acquired by Fannie Mae.

Loan Limits and Modified Mortgages

Loan limits for modified mortgage loans are based on the original loan amount of the mortgage loan and not on the unpaid principal balance of the mortgage loan at the time of modification or acquisition by Fannie Mae. A modified mortgage loan with an original loan amount exceeding the current loan limit is not eligible by Fannie Mae, even though the balance at the time of the modification may be at or below the current applicable loan limit.

Mortgage Loan Eligibility

Ability to Repay Loan Eligibility Requirements

The following provisions apply to loans with application dates on or after January 10, 2014.

Note: As to any mortgage loan for which the original application was made before January 10, 2014, but which was assumed on or after January 10, 2014, and subsequently purchased or securitized by Fannie Mae, then, for eligibility purposes, the application date is considered to be the date on which Truth in Lending Act disclosure requirements were triggered with respect to such assumption.

ATR Covered Loans

An ATR Covered Loan is a mortgage loan that is subject to the TILA's ability to repay requirements under Regulation Z and is otherwise not an ATR Exempt Loan (defined below). An ATR Covered Loan must meet the following requirements in addition to the other underwriting and eligibility requirements in the *Selling Guide*:

- have a loan term not exceeding 30 years;
- be a fully amortizing loan, as defined in Regulation Z:
- the loan must have regular periodic payments that are substantially equal that do not result in an increase in the principal balance or allow the borrower to defer repayment of principal; and
- have total points and fees not in excess of 3% of the total loan amount (or such different amount as provided in Regulation Z) as described below under Points and Fees Limitations.

The ATR Covered Loan requirements apply to acquisitions of newly originated loans. These new requirements do not apply to assumptions or modifications of existing Fannie Mae mortgage loans regardless of the dates on which the loans being assumed or modified were originally closed.

Mortgage Loan Eligibility (continued)

ATR Exempt Loans

An ATR Exempt Loan is, with certain exceptions, a loan that either is not subject to TILA or is exempt from the ability to repay requirements in Regulation Z (12 CFR § 1026.43(a) or (d)). For purposes of determining whether a loan is an ATR Exempt Loan, CMS must follow the TILA and Regulation Z definitions.

Note: The classification of certain transactions for TILA purposes and for eligibility and underwriting purposes by Fannie Mae do not always align. For example, Fannie Mae defines a four-unit property where the borrower occupies one of the units as a "principal residence." If under TILA such a loan is considered to be for commercial or business purposes, it will be exempt from TILA and therefore considered an ATR Exempt Loan by Fannie Mae.

Exception**:** A "non-standard mortgage" to "standard mortgage" refinance transaction as defined in Regulation Z (other than a loan secured by an investment property that fits within the "business purpose" definition for an exempt loan under TILA) shall be treated as an ATR Covered Loan.

Fannie Mae purchases or securitizes ATR Exempt Loans as long as such loans meet the other eligibility and underwriting requirements described in this Guide.

Points and Fees Limitations

For purposes of these requirements, "total points and fees" and "total loan amount" must be calculated in accordance with Regulation Z (12 CFR § 1026.32).

- ATR Covered Loans: Total points and fees may not exceed 3% of the total loan amount or such different amount in accordance with the qualified mortgage provisions of Regulation Z (12 CFR § 1026.43(e)(3)(i)). If CMS makes a cure payment in the amount and by the time required by 12 CFR § 1026.43(e)(3)(iii), such loan satisfies this requirement.
- ATR Exempt Loans: Total points and fees may not exceed 5% of the total loan amount. This determination may take into account either of the following adjustments:
  - permitted reduction of total points and fees pursuant to 12 CFR § 1026.31(h); or
  - in the case of loans not subject to TILA, restitution to the borrower of at least that portion of total points and fees that exceeded 5% at the time of loan closing.

Mortgage Loan Eligibility (continued)

HOEPA and State Higher-Priced Mortgage Loans	A mortgage loan that is subject to the Home Ownership and Equity Protection Act of 1994 (HOEPA), as described in Section 32 of Regulation Z, is not eligible for delivery to Fannie Mae. In addition, Fannie Mae does not purchase or securitize mortgage loans that meet the definitions under the following laws of the state in which the property is located (“state higher-priced loans”), regardless of whether any provision of such state law is preempted by federal law with respect to a particular loan or for a particular originator.
Acceptable Mortgage Loan Terms	Fannie Mae purchases or securitizes mortgage loans that have original terms up to 30 years. The term of a first mortgage may not extend more than 30 years beyond the date that is one month prior to the date of the first payment.
Impact of Special Assessments on Maximum Mortgage Loan Amount	If special assessments have been levied against the property and they are not paid before or at closing, the maximum mortgage amount otherwise available must be reduced by the amount of the unpaid special assessments (unless sufficient deposits to pay them will be collected as part of the mortgage payment). If the security property may be subject to liens for taxes and special assessments and the liens are not yet due and payable, Fannie Mae does not consider these conditions, restrictions, and encumbrances’ material and does not require a reduction in the maximum mortgage amount. CMS must provide documentation to show that the current installments of taxes and assessments (or future installments of special assessments that have been levied) – including those which may have been attached as prior liens, but which are not now in arrears - have been paid or that sufficient deposits are being collected to pay them.
Property Value for Loans Sold More than Four Months from Note Date	For mortgage loans that are more than four months old from the date of the note and mortgage to the date the loan is sold to Fannie Mae, the current value of the property cannot be less than the original value. If CMS is unable to warrant that the current value of the property is not less than the original value of the property, the loan is not eligible for delivery to Fannie Mae by CMS except on a negotiated basis.

Mortgage Loan Eligibility (continued)

Seasoned Mortgages

Seasoned mortgages are mortgages that are more than one year old from the first payment date to the loan purchase date for whole mortgage loans.

The table below provides the requirements for seasoned mortgages.

✓	Seasoned Mortgage Loan Requirements
	CMS underwriting of the borrower's credit and the security property for a seasoned mortgage loan must meet the current requirements set out in this Guide.
	The borrower has not had a 30-day delinquency in the 12-month period that precedes CMS delivery of the mortgage to Fannie Mae.
	If the current borrower assumed the mortgage and has owned the property for less than 12 months, he or she must have had no 30-day delinquency since purchasing the property.
	The borrower's ability to pay must not have changed adversely. **Note:** If the mortgage has been assumed, the new borrower's credit must be fully documented and underwritten in accordance with the same standards used for new mortgages, unless the transfer of ownership was one of the exempt transactions that legally prohibit a credit review.
	The current value of the property cannot be less than the original value. If CMS is unable to provide this warranty, the loan is not eligible for delivery to Fannie Mae by CMS except on a negotiated basis.
	The status of the title to the property must not have been affected adversely.
	The mortgage must satisfy Fannie Mae's current applicable mortgage eligibility requirements.
	If the mortgage loan is secured by a unit in a condo, or PUD project, the project must satisfy Fannie Mae's current applicable project eligibility requirements.
	If the mortgage loan was modified prior to delivery to Fannie Mae, it must be a modification that is eligible for delivery in accordance with the requirements of this Guide as described below under Modified Mortgages.

Mortgage Loan Eligibility (continued)

Nonstandard Payment Collection Options

A nonstandard payment collection option is a payment option that permits the borrower to make mortgage loan payments on a schedule other than a monthly basis. If the nonstandard payment collection option terms are included in the loan documents, then the mortgage loan is ineligible for delivery to Fannie Mae.

CMS may offer nonstandard payment collection plans as part of a separate agreement; however, the mortgage loan is eligible for delivery to Fannie Mae only under the following conditions:

- the agreement must not impact the terms and conditions of the mortgage note, nor the reporting or remittance of payments to Fannie Mae;
- the agreement must be cancelable by the borrower without cost; and
- the mortgage loan must be identifiable by CMS such that the information can be provided to Fannie Mae upon request.

Legal Requirements

First Mortgage Lien Position

If the mortgage being delivered to Fannie Mae is a first mortgage, the lien of the security instrument must be a first and paramount lien on the borrower's estate in the real property.

Personal Property

Personal property may not be included as additional security for any mortgage on a one-unit property unless otherwise specified by Fannie Mae. For example, certain personal property is pledged when the *Multistate Rider and Addenda* (Form 3170) is used.

Rental Property Leases

When the property that secures a first mortgage is rented, the rental agreement or lease cannot include provisions that could affect significantly Fannie Mae's position as mortgagee.

In some jurisdictions, leases that predate the mortgage have a superior claim to the mortgage even if they have not been recorded. Normally, a tenant's rights under a pre-existing lease remain intact on the sale of the leased premises.

Accordingly, if the lease is not subordinate to the mortgage, CMS must review each lease to ensure that any tenant's rights to purchase the property and any other rights that could affect adversely Fannie Mae's mortgagee interest have been waived formally by the tenant or tenants.

Legal Requirements (continued)

Escrow Accounts	First mortgages generally must provide for the deposit of escrow funds to pay as they come due, including taxes, ground rents, premiums for property insurance, and premiums for flood insurance. However, escrow deposits for the payment of premiums for borrower-purchased mortgage insurance (if applicable) are mandatory. Fannie Mae does not require an escrow deposit for property or flood insurance premiums for an individual unit in a condo, or PUD when the project in which the unit is located is covered by a blanket insurance policy purchased by the homeowners' association. If a special assessment levied against the property was not paid at loan closing, the borrower's payment must include appropriate accruals to ensure that any estimated annual payment toward the assessment will be accumulated by the time it comes due. For certain refinance transactions where the borrower is financing real estate taxes in the loan amount, an escrow account is required, subject to applicable law or regulation.
Escrow Waivers	Fannie Mae advocates the establishment of an escrow account for the payment of taxes and insurance, particularly for borrowers with blemished credit histories or first-time homeowners. Unless required by law, CMS may waive escrow account requirements for an individual first mortgage, provided the standard escrow provision remains in the mortgage loan legal documents. CMS cannot waive an escrow account for certain refinance transactions (see above) or for the payment of premiums for borrower-purchased mortgage insurance (if applicable). When the requirement for an escrow account is waived, CMS must retain Fannie Mae's right to enforce the requirement in appropriate circumstances. CMS must have a written policy governing the circumstances under which escrow accounts may be waived. When CMS permits escrow waivers, subject to the mortgage documents and applicable law, CMS's written policies must provide that the waiver not be based solely on the LTV ratio of a loan, but also on whether the borrower has the financial ability to handle the lump sum payments of taxes, insurance, and other items described above.

Legal Requirements (continued)

Waiver Eligibility

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

Property Type	Escrow Waiver Eligibility
Primary Residence	All states excluding CA and NM: <= 80% LTV California: <= 90% LTV New Mexico: < 80% LTV
Second Home	All states excluding CA: <= 80% LTV California: <= 90% LTV
Investment Property	All states excluding CA: <= 80% LTV California: <= 90% LTV

Principal Curtailment

Overview

A principal curtailment is the application of funds that are used to reduce the unpaid principal balance of the mortgage loan. Fannie Mae permits certain curtailments prior to loan delivery provided that the delivery data reflects the curtailment as described below.

Acceptable Curtailments

CMS will permit curtailments for the following reasons:

- CMS may apply a curtailment to refund the overpayment of fees or charges paid by the borrower, in any amount, in accordance with applicable regulatory requirements.
- If the borrower receives more cash back than is permitted for limited cash-out refinances, CMS can apply a curtailment to reduce the amount of cash back to the borrower to bring the loan into compliance with the maximum cash-back requirement. The maximum amount of the curtailment cannot exceed the lesser of $2,500 or 2% of the original loan amount for the subject loan. For example, if the borrower received $3,500 cash back at closing on a loan amount of $200,000, CMS could apply a $1,500 curtailment prior to delivery to Fannie Mae. This would result in “net cash back” to the borrower of $2,000, thus meeting Fannie Mae’s limited cash-out refinance requirement.

CMS must apply these curtailments prior to delivery of the loan to Fannie Mae.

Fannie Mae also allows additional principal payments remitted by a borrower to prepay the mortgage loan as permitted by the loan documents. All borrower-remitted curtailments received by CMS prior to delivery of the loan to Fannie Mae must be applied prior to delivery and may not be held until after loan delivery. Curtailments received after loan delivery must be applied in accordance with the *Servicing Guide*.

Principal Curtailment (continued)

Documentation

If the curtailment is made at the time of closing, the amount must be clearly documented on the settlement statement. If the curtailment is applied after closing, but before delivery, the mortgage loan file (or servicing file) must be documented with the amount of the curtailment and the reason or source of the curtailment (for example, CMS refund or borrower).

Establishing Borrower Ownership Interest

A borrower must establish ownership interest in the security property and become liable for the note (whether individually or jointly) by:

- Signing the security instrument,
- Signing the mortgage or deed of trust note,
- Taking title to the property in the name of the individual borrower(s).

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

Life Estate

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

Leasehold Estate

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

Reserve Requirements

Additional reserve requirements apply based on the number of financed properties the borrower will have. The borrower must have sufficient assets to close after meeting the minimum reserve requirements.

LTV Ratio Requirements for Loan Casefiles Underwritten through DU

DU analyzes the risk factors in the loan casefile for all borrowers on the mortgage loan. Regardless of whether an individual borrower will be occupying the property as his or her principal residence, DU will consider the income, assets, liabilities, and credit of that borrower.

For DU loan casefiles, if the income of a guarantor, co-signer, or co-borrower is used for qualifying purposes, and that guarantor, co-signer, or co-borrower will not occupy the subject property, the maximum LTV, CLTV, and HCLTV ratio may not exceed 95%.

Eligible Property and Occupancy Types

All property and occupancy types are eligible. For properties that are the borrower's principal residence, at least one individual must occupy the security property and sign the loan documents.

GENERAL PROPERTY ELIGIBILITY

Overview

Fannie Mae purchases or securitizes eligible mortgages in all markets across a broad geographic range. This topic describes Fannie Mae's property eligibility requirements. The requirements are designed to address a wide range of property types with varying characteristics; however, there may be instances when the unique nature of a particular property may require special consideration.

Number of Units

Fannie Mae purchases or securitizes first-lien mortgages that are secured by residential properties when the dwelling consists of one to four units. Under some circumstances, Fannie Mae limits the number of dwelling units for certain types of mortgages or transactions. For the maximum allowable LTV, CLTV, and HCLTV ratios and credit score requirements based on the property type and number of units, see the CMS Product Matrices.

Property Requirements

The mortgaged premises must be

- Residential in nature as defined by the characteristics of the property and surrounding market area
- Safe, sound, and structurally secure
- Adequately insured per Fannie Mae guidelines for property and flood
- The highest and best use of the property as improved (or as proposed per plans and specifications), and the use of the property must be legal or legal non-conforming use.
- Readily accessible by roads that meet local
- Served by utilities that meet community and
- Suitable for year-round use.

Note: Certain aspects of the location of a property will require special consideration. For example, properties in resort areas that attract people for seasonal or vacation use are acceptable only if they are suitable for year-round use.

Acceptable Forms of Property Ownership

Title to the property must be held as fee simple, leasehold estate (case by case) form of ownership.

General Property Eligibility (continued)

Acceptable Dwelling Types

Dwelling units for security properties may be detached, attached, or semi-detached. Properties may be located

- On an individual lot,
- In a condo project, or
- In a planned unit development (PUD) or subdivision project.

Properties located in a condo, or PUD project must meet Fannie Mae's project standards requirements.

Ineligible Properties

Fannie Mae does not purchase or securitize mortgages on:

- Vacant land or land development properties
- Properties that are not readily accessible by roads that meet local standards
- Agricultural properties, such as farms or ranches
- On-frame modular construction
- Single wide manufactured homes
- Units in condo or co-op hotels
- Boarding houses
- Bed and breakfast properties
- Properties that are not suitable for year-round occupancy regardless of location
- Co-ops
- Properties serviced by hauled water
- State-approved medical marijuana producing properties
- Properties with more than one unit where one of more of the units is a manufactured home

General Property Eligibility (continued)

Loan Eligibility and Occupancy Types

The following table describes the eligible transaction types, products, occupancy types, and properties for loans with resale restrictions.

Please note that CMS will only accept age-restricted properties and no other types of deed/resale restrictions.

Eligibility Based on Type of Deed Restriction	
	Age-Related
Transaction Types	Purchase and Refinance
Products	Loans must be fixed-rate or adjustable-rate mortgages with an initial fixed period of five years or more, and can be any Fannie Mae product described in this Guide.
Borrowers	Must meet applicable criteria of the deed restriction. **Note**: Age-related deed restrictions generally apply to the unit occupant and frequently require only one occupant to be aged 55 and over. In such a case, the borrower could be younger than 55 provided there is a unit occupant aged 55 and over. This occupant can be a non-borrower household member or a renter in the case of investment property.
Occupancy Types	All occupancy types
Properties	One- and two-unit properties, PUDs, condos, and co-ops Three- and four-unit properties are not eligible. Manufactured homes are not eligible unless they are located in a PERS-approved project.

Special Property Eligibility and Underwriting Considerations: Factory-Built Housing

Modular, Prefabricated, Panelized, or Sectional Housing Eligibility	**Modular Homes -** Fannie Mae purchases loans secured by modular homes built in accordance with the Uniform Building Code administered by state agencies responsible for adopting and administering building code requirements for the state in which the modular home is installed. Loans secured by on-frame modular construction are not eligible for sale to Fannie Mae. On- frame modular construction is defined as having a permanent chassis, but no evidence of compliance with the June 15, 1976, Federal Manufactured Home Construction and Safety Standards. **Prefabricated, Panelized, and Sectional Homes -** Loans secured by prefabricated, panelized, or sectional housing are eligible for purchase. These properties do not have to satisfy HUD's Federal Manufactured Home Construction and Safety Standards or the Uniform Building Codes that are adopted and administered by the state in which the home is installed. The home must conform to local building codes in the area in which it will be located.
Modular, Prefabricated, Panelized, or Sectional Housing Requirements	Factory-built housing not built on a permanent chassis such as modular, prefabricated, panelized, or sectional housing is not considered manufactured housing and is eligible under the guidelines for one-unit properties. These types of properties • must assume the characteristics of site-built housing, • must be legally classified as real property, and • must conform to all local building codes in the jurisdiction in which they are permanently located. The purchase, conveyance, and financing (or refinancing) must be evidenced by a valid and enforceable first-lien mortgage or deed of trust that is recorded in the land records, and must represent a single real estate transaction under applicable state law. Fannie Mae affords modular, prefabricated, panelized, or sectional housing homes the same treatment as site-built housing. Therefore, Fannie Mae does not have minimum requirements for width, size, roof pitch, or any other specific construction details.

Special Property Eligibility and Underwriting Considerations: Leasehold Estates

Leasehold Estates	Fannie Mae purchases or securitizes fixed-rate and adjustable-rate first-lien mortgages that are secured by properties on leasehold estates in areas in which this type of property ownership has received market acceptance. The mortgage must be secured by the property improvements and the borrower's leasehold interest in the land. The leasehold estate and the improvements must • constitute real property, • be subject to the mortgage lien, and • be insured by CMS title policy.

Special Property Eligibility and Underwriting Considerations: Leasehold Estates (continued)

Leasehold Estates (continued)

The leasehold estate and the mortgage must not be impaired by any merger of title between the lessor and lessee. In the event the mortgage is secured by a sublease of a leasehold estate, the documents must provide that a default under the leasehold estate will not by such default result in the termination of the sublease.

Lease Requirements

CMS must ensure compliance with the following requirements for leases associated with leasehold estate mortgage loans. In addition, CMS agrees that in accordance with Life-of-Loan Representations and Warranties, any failure to comply at any time with the lease requirements in the following table is a breach of the life of loan representations and warranties if it impacts first-lien enforceability.

✓	Lease and CMS Requirements
	The term of the leasehold estate must run for at least five years beyond the maturity date of the mortgage, unless fee simple will vest at an earlier date in the borrower.
	The lease must provide that the leasehold can be assigned, transferred, mortgaged, and sublet an unlimited number of times either without restriction or on payment of a reasonable fee and delivery of reasonable documentation to the lessor. The lessor may not require a credit review or impose other qualifying criteria on any assignee, transferee, mortgagee, or sub-lessee.
	The lease must provide for the borrower to retain voting rights in any homeowners' association.
	The lease must provide that in addition to the obligation to pay lease rents, the borrower will pay taxes, insurance, and homeowners' association dues (if applicable), related to the land in addition to those he or she is paying on the improvements.
	The lease must be valid, in good standing, and in full force and effect in all respects.
	The lease must not include any default provisions that could give rise to forfeiture or termination of the lease, except for nonpayment of the lease rents.
	The lease must include provisions to protect the mortgagee's interests in the event of a property condemnation.
	The loan must be serviced in compliance with the leasehold servicing requirements in the Servicing Guide.
	The lease must provide CMS with • the right to receive a minimum of 30 days' notice of any default by the borrower, and • the option to either cure the default or take over the borrower's rights under the lease.

Special Property Eligibility and Underwriting Considerations: Leasehold Estates (continued)

Additional Eligibility Requirements

The following requirements must be met before CMS can deliver leasehold estate mortgages to Fannie Mae for purchase or securitization:

- All lease rents, other payments, or assessments that have become due must be paid.
- The borrower must not be in default under any other provision of the lease nor may such a default have been claimed by the lessor.

Option to Purchase Fee Interest

The lease may, but is not required to, include an option for the borrower to purchase the fee interest in the land. If the option is included, the purchase must be at the borrower's sole option, and there can be no time limit within which the option must be exercised. If the option to purchase the fee title is exercised, the mortgage must become a lien on the fee title with the same degree of priority that it had on the leasehold. Both the lease and the option to purchase must be assignable.

The table below provides the requirements for establishing the purchase price of the land.

Status of Property Improvements	Purchase Price of Land
Already constructed at the time the lease is executed.	The initial purchase price should be established as the appraised value of the land on the date the lease is executed.
Already constructed at the time the lease is executed, and the lease is tied to an external index, such as the Consumer Price Index (CPI).	The initial land rent should be established as a percentage of the appraised value of the land on the date that the lease is executed. The purchase price may be adjusted annually during the term of the lease to reflect the percentage increase or decrease in the index from the preceding year. Leases may be offered with or without a limitation on increases or decreases in the rent payments.

Special Property Eligibility and Underwriting Considerations: Leasehold Estates (continued)

Option to Purchase Fee Interest (continued)

Status of Property Improvements	Purchase Price of Land
Will be constructed after the lease is executed.	The purchase price of the land should be the lower of the following: • the current appraised value of the land, or • the amount that results when the percentage of the total original appraised value that represented the land alone is applied to the current appraised value of the land and improvements. For example, assume that the total original appraised value for a property was \$160,000, and the land alone was valued at \$40,000 (thus representing 25% of the total appraised value). If the current appraised value is \$225,000, \$50,000 for land and \$175,000 for improvements, the purchase price would be \$50,000 (the current appraised value of the land, because it is less than 25% of \$225,000). **Note:** If the lease is tied to an external index, the initial land value may not exceed 40% of the combined appraised value of the land and improvements.

Special Property Eligibility Considerations

Multiple Parcels

The table below provides the requirements when the security property consists of more than one parcel of real estate.

✓	Multiple Parcels Requirements
	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 non- residential 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.

Mixed-Use Properties

Fannie Mae purchases or securitizes mortgages that are secured by properties that have a business use in addition to their residential use, such as a property with space set aside for a day care facility, a beauty or barber shop, or a doctor's office.

The following special eligibility criteria must be met:

- The property must be a one-unit dwelling that the borrower occupies as a principal residence.
- The borrower must be both the owner and the operator of the business.
- The property must be primarily residential in nature.
- The dwelling may not be modified in a manner that has an adverse impact on its marketability as a residential property.

Hawaiian Lava Zones

Fannie Mae will only purchase or securitize mortgage loans secured by properties that are located within lava zones 3 through 9 on the island 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.

Special Property Eligibility Considerations (continued)

Properties with Solar Panels

CMS does not permit Property Assessed Clean Energy (PACE) or Home Energy Renovation Opportunity (HERO) Program financing.

Fannie Mae will purchase or securitize a mortgage loan on a property with solar panels. 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).

✓	Requirements for Properties with Solar Panels that are Leased or Covered by a Power Purchase Agreement
	The solar panels may not be included in the appraised value of the property.
	The property must maintain access to 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, CMS 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

Special Property Eligibility Considerations (continued)

Properties with Solar Panels (continued)

✓	Requirements for Properties with Solar Panels that are Leased or Covered by a Power Purchase Agreement (continued)
	• has the discretion to: o terminate the lease/agreement and require the third-party owner to remove the equipment; o become, without payment of any transfer or similar fee, the beneficiary of the borrower's lease/agreement with the third party; or o enter into a new lease/agreement with the third party, under terms no less favorable than the prior owner.
	Any exceptions to coverage on the title insurance policy for recorded instruments relating to the solar panels must comply with Title Exceptions and Impediments.

Properties Affected by a Disaster

Overview

The *Mortgage Selling and Servicing Contract* requires CMS to warrant for each mortgage loan it delivers to Fannie Mae that the property is not damaged by fire, wind, or other cause of loss and that there are no proceedings pending for the partial or total condemnation of the property. CMS also warrants that the mortgage conforms to all applicable requirements in the *Selling Guide*, including the requirement that the mortgage is an acceptable investment. Finally, CMS represents and warrants that it knows of nothing involving the mortgage or the property that can reasonably be expected to cause the mortgage to become delinquent or adversely affect the mortgage's value or marketability.

Eligibility Requirements

CMS must be able to make the warranties that are described above. Therefore, before delivery of a mortgage loan to Fannie Mae where the property may have been damaged by a disaster, CMS is expected to take prudent and reasonable actions to determine whether the condition of the property may have materially changed since the effective date of the appraisal report. CMS is responsible for determining if an inspection of the property and/or new appraisal is necessary to support this warranty. If a property is located in a condo, both the condition of the unit and the condition of the building in which the unit is located must be assessed.

CMS should use the following criteria when determining if the mortgage loan can be delivered to Fannie Mae:

- If the property has been damaged and the damage does not affect the safety, soundness, or structural integrity of the property and the repair items are covered by insurance, CMS may deliver the mortgage to Fannie Mae. In these circumstances, CMS must obtain documentation of the professional estimates of the repair costs and must ensure that sufficient insurance proceeds are available for the borrower's benefit to guarantee the completion of the repairs.

Properties Affected by a Disaster, continued

Eligibility Requirements, continued

- If the property was damaged and the damage is uninsured or the damage affects the safety, soundness, or structural integrity of the property, the property must be repaired before the mortgage loan is delivered to Fannie Mae.

These requirements are necessary to support CMS's property representations and warranties, and apply through the end of the delivery process which is the whole loan purchase date or MBS settlement date. For DU loan casefiles with an appraisal waiver offer, CMS may exercise the offer as long as we have complied with the above requirements with regard to property condition and repairs. This applies in addition to the standard appraisal waiver requirements in Appraisal Waivers.

DU is updated periodically to incorporate ZIP codes included in FEMA-Declared Disaster Areas eligible for Individual Assistance. Fannie Mae may also add areas impacted by other disasters or emergencies at its discretion. Properties in those ZIP codes are excluded from consideration for a new appraisal waiver offer.

Appraisal Waiver Offers Following a Disaster

After Fannie Mae has received an acceptable appraisal that was performed following a disaster, that appraisal can serve as the basis for a future appraisal waiver. DU may issue appraisal waiver offers in disaster areas as soon as 120 days following a disaster. CMS may exercise these offers in accordance with the requirements in Appraisal Waivers.

Age of Documentation Requirements

When a loan is secured by a property located in a FEMA-Declared Disaster Area eligible for individual assistance, Fannie Mae provides additional flexibilities. The following requirements apply:

- The underwriting documentation, including credit reports and verifications of income and assets, must be dated no more than 180 days before the note date.
    - CMS may disregard the message in the DU Underwriting Findings Report that indicates if the loan casefiles has not already closed, the credit report has expired.
- The appraisal must be dated no more than 180 days before the note date. CMS must comply with the property eligibility requirements above.
- When CMS choses to receive representation and warranty relief offered by the DU validation service we must continue to comply with all conditions in the DU Underwriting Findings Report, including the close by date.
- Loans originated in accordance with the age of documentation flexibilities, must be delivered to Fannie Mae no later than two years from the date of the disaster declaration by FEMA.

See Disaster-Related Limited Cash-Out Refinance Flexibilities for information related to certain flexibilities offered for a disaster related limited cash-out transaction.

UNDERWRITING BORROWERS

General Information on DU - Overview

Fannie Mae's automated underwriting system, Desktop Underwriter (DU), evaluates mortgage delinquency risk and arrives at an underwriting recommendation by relying on a comprehensive examination of the primary and contributory risk factors in a mortgage application. It analyzes the information in the loan casefile to reach an overall credit risk assessment to determine eligibility for delivery to Fannie Mae.

No one factor determines a borrower's ability or willingness to make his or her mortgage payments. DU identifies low-risk factors that can offset high-risk factors. When several high- risk factors are present in a loan casefile without sufficient offsets, the likelihood of serious delinquency increases.

DU conducts its analysis uniformly, and without regard to race, gender, or other prohibited factors. DU uses validated, statistically significant variables that have been shown to be predictive of mortgage delinquency across all groups.

DU does not evaluate a loan's compliance with federal and state laws and regulations including, without limitation, a loan's potential status as a qualified mortgage under applicable laws and regulations. CMS bear sole responsibility for complying with applicable laws and regulations, and these compliance obligations may not be imposed upon or shared by Fannie Mae.

Underwriting with DU

Loans may be submitted to DU before or after the closing of the mortgage loan; however, the first submission to DU for underwriting purposes must occur before closing of the mortgage loan.

When the mortgage loan or borrower information changes and it no longer matches the information used when the loan casefile was last underwritten with DU, CMS must update the data and resubmit the loan casefile to DU.

When the loan casefile is resubmitted to DU after closing and prior to delivery to Fannie Mae, CMS is responsible for ensuring that:

- All information provided in the final submission to DU matches the terms of the closed loan;
- The loan delivery data matches both the closed loan and the final data submitted to DU; and
- The loan casefile receives an eligible recommendation from DU on the final submission.

CMS may request a new credit report after closing when the loan casefile is resubmitted and, as with all loan casefiles, must comply with the Fair Credit Reporting Act with regard to the purpose and nature of the inquiry. If the new credit report contains information that is different than the information used to prepare the final loan application that was signed by the borrower at closing, the loan application must be updated. (Borrower signature(s) are not required due to the update occurring post-closing.) CMS must include both the final signed and the updated unsigned loan applications in the loan file.

Underwriting Borrowers (continued)

Underwriting with DU (continued)

Note: The credit report must meet the allowable age of documents as of the note date. If the credit report expired prior to the note date and the loan casefile is being resubmitted to DU, a new credit report must be requested.

In certain instances, CMS may not be able to access the original DU loan casefile for resubmission purposes. CMS may create a new loan casefile in DU after closing to ensure that all information in the final DU submission matches the terms of the closed loan, provided all of the following conditions are met:

- The above lender responsibilities are met, including the updating of the final loan application, if applicable;
- The loan has not yet been delivered to Fannie Mae;
- The loan has the same information (for example, the same borrower(s) and property) as had previously been underwritten through DU prior to closing using another loan casefile, and that loan casefile received an eligible recommendation from DU;
- CMS retains the DU Underwriting Findings Report from the original loan casefile ID in the loan file;
- The DU submission using the new loan casefile occurs no more than 60 days after closing (based on the note date) as stated above, when a new credit report is requested, CMS complies with the Fair Credit Reporting Act.

If the resubmission to DU results in an “ineligible” recommendation, the mortgage loan may not be delivered to Fannie Mae.

DU Underwriting Reports

DU issues two types of reports:

- The DU Underwriting Findings report summarizes the overall underwriting recommendation and lists the steps necessary for CMS to complete the processing of the loan file. This is typically the first report viewed by an underwriter or a loan officer after the loan casefile has been underwritten with DU.
- The Underwriting Analysis report contains much of the same information requested on the Uniform Underwriting and Transmittal Summary (Form 1008).

Each time a loan casefile is resubmitted to DU, the information in these reports is updated with information from the most recent submission. The date and time of each submission are recorded on each report, along with the unique loan casefile ID.

Underwriting Borrowers (continued)

Loan Casefile Archival Policy

DU loan casefiles are archived and no longer retained in DU from the earlier of:

- 270 days from the date on which the loan casefile was last updated, or
- 540 days from the date on which the loan casefile was created.

These time frames are intended to ensure that the total volume of loans in the system is at a manageable level, reducing the time required by DU to search for and retrieve loan casefiles.

After a loan casefile is archived from DU, it cannot be restored. If a loan casefile that has been archived must be re-underwritten, a new loan casefile must be created and submitted to DU. The loan casefile will be subject to the policies in effect for the current version of DU.

In any event, Fannie Mae will not be responsible for retaining loan casefiles for CMS.

Loan Application Sections

The items listed below describe screens of the online loan application in the DU user interface and correspond to sections in the *Uniform Residential Loan Application* (URLA):

- **Section 1. Borrower Information**. Collects your personal information, income and employment.
- **Section 2. Financial Information – Assets and Liabilities**. Collects information about your financial assets, personal financial obligations and debts you owe.
- **Section 3. Financial Information – Real Estate**. Collects information about property you own and the debts and expenses related to the property.
- **Section 4. Loan and Property Information**. Collects information about the loan purpose and the property you are buying or refinancing.
- **Section 5. Declarations**. Asks specific questions about the property, how the property will be financed, and your past financial history.
- **Section 6. Acknowledgments and Agreements**. Informs you of your legal obligations related to the mortgage application and asks that you acknowledge certain information will be obtained, used, and shared.
- **Section 7. Military Service**. Collects information about your (or your deceased spouse's) military service.
- **Section 8. Demographic Information**. Requests information the Lender is required by law to ask you.
- **Section 9. Loan Originator Information**. Provides you with information about the loan originator.

Underwriting Borrowers (continued)

Loan Application-Additional Borrower Sections

The URLA – Additional Borrower contains the following sections:

- **Section 1. Borrower Information**. Identical to section on the URLA.
- **Section 2. Financial Information – Assets and Liabilities**. Contains only the following statement for the additional Borrower to complete: “My information for Section 2 is listed on the Uniform Residential Loan Application with (name of Borrower).” The name of the other borrower is entered here.
- **Section 3. Financial Information – Real Estate**. Contains only the following statement for the additional Borrower to complete: “My information for Section 3 is listed on the Uniform Residential Loan Application with (name of Borrower).”
- **Section 4. Loan and Property Information**. Contains only the following statement for the additional Borrower to complete: “My information for Section 4 is listed on the Uniform Residential Loan Application with (name of Borrower).”
- **Section 5. Declarations**. Identical to section on the URLA.
- **Section 6. Acknowledgments and Agreements**. Contains only the following statement for the additional Borrower to complete: “My signature for Section 6 is on the Uniform Residential Loan Application with (name of Borrower).”
- **Section 7. Military Service**. Identical to section on the URLA.
- **Section 8. Demographic Information**. Identical to section on the URLA.
- **Section 9. Loan Originator Information**. Identical to section on the URLA.

Underwriting Borrowers (continued)

General CMS Requirements

When underwriting loans with DU, CMS must:

- Employ prudent underwriting judgment in assessing whether a loan casefile should be approved and delivered to Fannie Mae;
- Confirm the accuracy of the data it submits, making sure that it did not fail to submit any data that might have affected the DU recommendation had it been known;
- Ensure that the loan complies with all of the verification messages and approval conditions specified in the DU Underwriting Findings report;
- Apply due diligence when reviewing the documentation in the loan file;
- Review the credit report to confirm that the data that DU evaluated with respect to the borrower's credit history was accurate and complete;
- Determine if there is any potentially derogatory or contradictory information that is not part of the data analyzed by DU; and
- Take action when erroneous data in the credit report or contradictory or derogatory information in the loan file would justify additional investigation or would provide grounds for a decision that is different from the recommendation that DU delivered.

For example, if a foreclosure was reported in the credit report but was not detected by DU (that is, it was not referenced in any verification messages), CMS must determine if the loan complies with the applicable guidelines.

Risk Factors Evaluated by DU

Overview

DU considers the following characteristics in the credit report to assess the creditworthiness of borrowers who have traditional credit histories: credit history, delinquent accounts, installment accounts, revolving credit utilization, public records, foreclosures, collection accounts, and inquiries.

The non-credit risk factors evaluated by DU include: the borrower's equity and LTV ratio, liquid reserves, loan purpose, loan term, loan amortization type, occupancy type, debt-to-income ratio, property type, co-borrowers, and self-employment.

DU performs a comprehensive evaluation of these factors, weighing each factor based on the amount of risk it represents and its importance to the recommendation. DU analyzes the results of this evaluation along with the evaluation of the borrower's credit profile to arrive at the underwriting recommendation for the loan casefile.

More information on these risk factors is provided below. Also see below for information about the risk factors DU considers when evaluating loans where no borrower has a credit score.

Risk Factors Evaluated by DU (continued)

Credit History

A borrower's credit history is an account of how well the borrower has handled credit, both now and in the past. An older, established history—even though the accounts may have zero balances will have a more positive impact on the borrower's credit profile than newly established accounts.

A borrower who has a relatively new credit history (a few recently opened accounts) is not automatically considered a high credit risk. Successfully managing newly established accounts, including making payments as agreed, signifies lower risk.

Delinquent Accounts

Payment history is a significant factor in the evaluation of the borrower's credit. DU considers the severity of the delinquencies (30, 60, 90, or more days late), the length of time since the delinquencies, and the number of accounts that were not paid as agreed.

A payment history that includes bills that are 30 days or more past-due, or a history of paying bills late as evidenced by a number of accounts with late payments, will have a negative impact on the borrower's credit profile. The amount of time that has elapsed since an account was delinquent is an important factor included in the evaluation of the payment history. For example, a 30-day late payment that is less than three months old indicates a higher risk than a 30-day late payment that occurred several years ago.

Installment Loans

DU evaluates how well a borrower manages debt for all types of installment loans such as mortgage, auto, unsecured, and student loans. Research has shown that borrowers with no active installment accounts represent a higher risk than borrowers who have active installment accounts.

Revolving Credit Utilization

The establishment, use, and amount of revolving credit a borrower has available are important. Trended credit data is used to evaluate the borrower's ability to manage revolving accounts. A borrower who uses revolving accounts conservatively, meaning low revolving credit utilization or regular payoff of revolving balance, is considered lower risk. A borrower whose revolving credit utilization is high or who only makes the minimum payment each month is considered higher risk.

Public Records, Foreclosures, and Collection Accounts

A credit history that includes any significant derogatory credit event is considered high risk. Significant derogatory credit events include bankruptcy filings, foreclosures, deeds-in-lieu of foreclosure, pre-foreclosure sales, mortgage charge-offs, judgments, tax liens, or accounts that have been turned over to a collection agency.

The more recent such events occurred, the more adverse the impact is on the credit profile. Although most public record information is retained in the credit history for seven years (ten years for bankruptcies), as time passes, it does become less significant to DU's credit evaluation.

Risk Factors Evaluated by DU (continued)

Inquiries

DU evaluates inquiries made within the most recent 12 months of the credit report date. Research has shown that a high number of inquiries can indicate a higher degree of risk. However, multiple inquiries made by different mortgage lenders or different auto loan creditors within the same time frame is not viewed by DU as multiple inquiries (these types of inquiries generally reflect borrowers shopping for favorable rates or terms). A borrower who has frequently applied for, or obtained, new or additional credit represents a higher risk.

Borrower's Equity and LTV

The amount of equity in the property is a very important component of the risk analysis. Research has shown that a borrower who makes a large down payment or who has considerable equity in his or her property is less likely to become delinquent on a mortgage loan than a borrower who makes a small down payment or has a small amount of equity in a property. In other words, the more equity a borrower has in the property, the lower the risk associated with the borrower's mortgage loan.

DU may use a low LTV ratio to offset other risks that it may identify in the loan application.

Liquid Reserves

Liquid reserves are those financial assets that are available to a borrower after a loan closes. Reserves are calculated as the total amount of liquid assets remaining after the loan transaction closes divided by the qualifying payment amount.

DU considers higher amounts of liquid reserves as more favorable than lower amounts or no reserves. Research has shown that mortgages to borrowers with higher amounts of liquid reserves tend to have lower delinquency rates. As with a low LTV ratio, DU may consider high amounts of reserves as an offset for other risks that it may identify in the loan application.

Risk Factors Evaluated by DU (continued)

Loan Purpose

There is a certain level of risk associated with every transaction, whether it is a purchase or a refinance. Purchase transactions represent less risk than refinance transactions. When evaluating refinance transactions, a limited cash-out refinance transaction represents less risk than cash- out refinance transaction.

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

The following are acceptable loan types:

- Purchase
- No Cash-out Refinance
- Cash-out Refinance
- Lease with Option to Purchase
- Purchase or Refinance of Inherited Property
- Inter-family Transactions
- Pending Sale of a Current Primary Residence
- Conversion of a Primary Residence to Second Home
- Conversion of a Primary Residence to Investment Property

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

Loan Term

Research has shown that mortgages to borrowers who choose to finance their mortgages over shorter terms and build up equity in their properties faster generally tend to perform better than mortgages with longer amortization periods.

Occupancy Type

Performance statistics on investor loans are notably worse than those of owner-occupied or second home loans. Owner-occupied transactions represent the least risk, followed by second home transactions, and investment property transactions having the highest risk level.

Debt-to-Income Ratio

In DU's evaluation, generally, the lower the borrower's debt-to-income ratio (DTI ratio), the lower the associated risk. As the ratio increases, the level of risk also tends to increase; and a high ratio will have the greatest adverse impact on the recommendation when there are also other high-risk factors present.

Risk Factors Evaluated by DU (continued)

Property Type

Another important factor that DU considers in the risk analysis is the collateral or property type. DU differentiates the risk based on the number of units, and in some cases the property type.

The level of risk associated with each property type is as follows, starting with those property types representing the least amount of risk:

- one-unit properties
- two-, three-, and four-unit properties

Co-borrowers

DU considers the number of borrowers (who have traditional credit) on a mortgage application in its evaluation because, generally, the presence of more than one borrower helps to reduce risk. Research has shown that mortgages that have more than one borrower tend to have a lower delinquency rate than mortgages with one borrower. However, additional borrowers tend to reduce risk only when they have good credit histories.

Self-Employment

Self-employment income can vary from year-to-year and because of the increased chance of uneven cash flows, self-employment adds a layer of risk that is not present with salaried borrowers. Research has shown that self-employed borrowers tend to become delinquent on their mortgages more often than salaried borrowers, when all other risk factors are held constant.

DU considers self-employment in the risk assessment when the only borrower on the loan is self- employed as his or her primary source of income, or when two of the borrowers on the loan are self-employed as their primary source of income.

Risk Factors Evaluated by DU (continued)

Allowable Age of Federal Income Tax Returns

For some types of sources of income, Fannie Mae requires CMS to obtain copies of federal income tax returns (personal returns and, if applicable, business returns). The “most recent year’s” tax return is defined as the last return scheduled to have been filed with the IRS.

The following table describes which tax-related documentation to obtain depending on the application date and disbursement date of the mortgage loan.

<table>
<tr><th>Application Date</th><th>Disbursement Date</th><th>Documentation Required</th></tr>
<tr><td rowspan="3">October 15[1], [current year minus 1] to April 14[2], current year</td><td>October 15[1] [current year minus 1] to April 14[2], current year</td><td>The most recent year’s tax return is required. The use of a Tax Extension (IRS Form 4868) is not permitted</td></tr>
<tr><td>April 15[1], current year to June 30, current year</td><td>The previous year’s tax return (the return due in April of the current year) is recommended, but not required.
CMS must ask the borrower whether he or she has completed and filed his or her return with the IRS for the previous year.
• If the answer is yes, CMS must obtain copies of that return.
• If the answer is no, CMS must obtain copies of tax returns for prior two years.
CMS must only obtain completed and signed IRS Form 4506-C for transcripts of tax returns provided by the borrower CMS. (CMS is not required to file IRS Form 4506-C for tax returns not provided by the borrower.)</td></tr>
<tr><td>July 1, current year to October 14[2], current year</td><td rowspan="2">CMS must obtain
• The most recent year’s tax return,
OR all of the following:
• A copy of IRS Form 4868 (Application for Automatic Extension of Time to File U.S. Individual Income Tax Return) filed with the IRS, CMS must review the total tax liability reported on IRS Form 4868 and compare it with the borrower’s tax liability from the previous two years as a measure of income source stability and continuance. An estimated tax liability that is inconsistent with previous years may make it necessary for CMS to require the current returns in order to proceed.
• IRS Form 4506-C transcripts confirming “No Transcripts Available” for the applicable tax year, and
• Returns for the prior two years</td></tr>
<tr><td rowspan="2">April 15[1], current year to October 14[2], current year</td><td>April 15[1], current year to December 31, current year</td></tr>
<tr><td>January 1, [current year plus 1] to April 14[2], [current year plus 1]</td><td>The most recent year’s tax return is required. The use of a Tax Extension (IRS Form 4868) is not permitted.</td></tr>
</table>

[1] Or the April/October filing dates for the year in question as published by the IRS.

[2] Or the day prior to the April/October filing dates for the year in question as published by the IRS.

Risk Factors Evaluated by DU (continued)

Allowable Age of Federal Income Tax Returns (continued)

Exceptions

- For business tax returns, if the borrower's business uses a fiscal year (a year ending on the last day of any month except December), CMS may adjust the dates in the above chart to determine what year(s) of business tax returns are required in relation to the application date/ disbursement date of the new mortgage loan.
- For loans with income validated by DU, CMS may rely on the age of tax transcript methodology provided by the service.

Amended Tax Returns

Tax returns that are amended and filed by the borrower with the IRS are acceptable in the following circumstances:

- Tax Returns Filed Prior to the Loan Application Date

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

- Tax Returns Filed After the Loan Application Date

  Tax returns filed after the application date may be acceptable when accompanied by the following:

  - A letter of explanation regarding the reason for the re-file. Borrower(s) must write, sign, and date all Letters of Explanation themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content.
  - Evidence of filing
  - Payment and the ability to pay the tax if the check has not cancelled
  - Borrower does not require use of amended income for qualification

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

DU Documentation Requirements

Required Documentation for the Permanent Loan File

The following documents must be maintained in the permanent loan file:

- the complete loan application (the full Form 1008),
- the final DU Underwriting Findings report, and
- the final Underwriting Analysis report produced by DU.

CMS is not required to prepare a *Uniform Underwriting and Transmittal Summary* (Form 1008) for loans underwritten with DU and subsequently delivered to Fannie Mae.

DU Documentation Requirements

DU indicates the minimum verification documentation requirements necessary for CMS to process the loan application. While DU may offer a reduced level of documentation, a more comprehensive level of documentation is always acceptable and in some instances should be required by CMS when circumstances in the loan file warrant it.

DU documentation requirements are based on the specific risk factors present in each loan file. The requirements appear in the DU Underwriting Findings report in the section titled Verification Messages/Approval Conditions. DU indicates the minimum documentation requirements for income and asset verification, credit-related documentation, and level of property fieldwork.

Approve/Eligible Recommendation

The following table describes these recommendations.

Approve/Eligible	
Eligible for Fannie Mae's limited waiver of certain mortgage loan eligibility and underwriting representations and warranties?	Yes, as long as the mortgage loan satisfies the applicable requirements related to limited waivers as described in this Guide.
Satisfies Fannie Mae's credit risk standards/ assessment?	Yes
Satisfies Fannie Mae's mortgage loan eligibility criteria?	Yes
Eligible for delivery to Fannie Mae?	Yes, if all approval conditions have been met.

Unacceptable Findings Not Eligible for CMS Financing

Approve/Ineligible Recommendations

These recommendations do not take into consideration any additional credit risk or other factors that might be associated with the reason the loan is ineligible for delivery to Fannie Mae. CMS must determine if the reason for the ineligibility creates an additional layering of credit risk that should be considered as CMS makes the underwriting decision.

Note: Not permitted for CMS financing.

DU Documentation Requirements (continued)

Unacceptable Findings Not Eligible for CMS Financing (continued)

Overview of Refer with Caution Recommendations

The layering and degree of risk factors that result in a Refer with Caution recommendation represent a greater risk of serious delinquency than for those loan casefiles that receive an Approve recommendation.

Any loan casefile that receives a Refer with Caution recommendation from DU does not represent a level of risk that is acceptable to Fannie Mae for DU loans. If the data DU considered was an accurate representation of the borrower's income, assets, liabilities, and credit profile, the loan is not eligible for delivery to Fannie Mae as a DU loan.

The following table provides further information about this DU recommendation.

Refer with Caution	
Eligible for Fannie Mae's limited waiver of certain mortgage eligibility and underwriting representations and warranties?	No
Satisfies Fannie Mae's credit risk standards/ assessment?	No, not the standards for DU loans
Satisfies Fannie Mae's mortgage eligibility criteria?	No, not the eligibility criteria for DU loans
Eligible for delivery to Fannie Mae?	Not as a DU loan

Note: ***Not permitted for CMS financing.***

Out of Scope Recommendation

An Out of Scope recommendation indicates that DU is unable to underwrite the particular product, mortgage, or borrower described in the submission.

Note: ***Not permitted for CMS financing.***

Erroneous Credit Report Data

CMS is responsible for ensuring that credit report data used by DU in its underwriting analysis is accurate. Significant, material credit errors in a borrower's credit report may have a negative impact on the underwriting recommendation from DU.

When there is documented evidence of material erroneous credit data, the underwriter should work with the credit repository to correct the data and resubmit the loan casefile to DU for underwriting. If there is not enough time to obtain corrected information or if there are extenuating circumstances that contributed to the derogatory credit. The borrower must meet FNMA extenuating circumstances seasoning requirement.

DU Documentation Requirements (continued)

Merged Credit Reports and the Impact on DU's Evaluation

Errors that are the result of the credit merge do not typically affect the credit or risk analysis of the loan casefile.

DU attempts to identify duplicate tradelines, including public record items, that are the result of the merge, and ignores duplicate accounts in the credit analysis.

Public record information is frequently duplicated on the credit report because the credit agencies do not attempt to merge or match items of this severe nature. A public record item may appear in the credit report three times—once from each repository—but the duplication will not affect the risk analysis of the case.

CMS Action Regarding Derogatory Credit Reported in Error

If it is determined that significant derogatory credit has been reported in error, CMS must obtain written documentation that supports the error. The following types of written documentation support erroneous information:

- A supplement to the credit report
- A new mortgage credit report,
- Documentation from the credit provider that reported the error.

Frozen Credit Report

DU issues an error message when a borrower has a security freeze on their credit report with Equifax, Experian, or TransUnion. DU will underwrite loan casefiles when a borrower has placed a freeze on their credit report at only one of the three credit repositories.

When credit is frozen at one of the three repositories, the loan casefile will be underwritten using the credit data received from the other repositories, and DU will issue the following Potential Red Flag message:

> *Based on the credit data received, a borrower has frozen their account with one of the credit repositories. No data from that repository was used in underwriting the loan casefile. The lender remains responsible for preventing fraud, which includes, but is not limited to, ensuring the borrower's identity has been verified. In addition, the lender must continue to investigate any liabilities or derogatory credit that is disclosed by the borrower but not reflected on the credit report.*

When credit is frozen at one of the three repositories, and no credit scores are received from the other two repositories, DU will evaluate the loan casefile using the guidelines specific to borrowers without traditional credit and issue a Potential Red Flag message. This new message will inform CMS that the borrower has frozen their account with one of the credit repositories, there is no data available from the other two repositories, and that CMS remains responsible for ensuring the borrower's identity has been verified and any credit disclosed by the borrower is investigated.

NOTE: *If credit is frozen at two or more of the credit repositories, DU will issue an Error recommendation and a message stating the loan casefile cannot be underwritten because a borrower has frozen their account at two or more credit repositories.*

DU Documentation Requirements (continued)

Ensuring DU Data and Delivery Information Accuracy

The data submitted to DU must reflect the loan as it was closed, including occupancy type, product type, amortization, loan term, property type, loan purpose, sales price, and appraised value.

Verification documents must be reviewed and the verified values compared to the data submitted to DU. The terms of the closed loan must match the terms of the final loan casefile submission in DU or fall within the tolerances listed in the following table:

Data Attribute and Description	Trigger	Action Required
• Interest rate increase • Discrepancies between the credit report payments and balances and those listed on the online loan application, including the presence of debt that is on the credit report but not on the application • Additional debt(s) disclosed by the borrower or identified CMS during the mortgage process • Verified income is less than the income on the loan application submitted to DU	The result of these changes cause the DTI ratio • to exceed 45% or • to increase by 3 percentage points or more (if the recalculated DTI ratio is less than 45%)	Loan casefile must be resubmitted to DU
Interest rate on fixed-rate and adjustable-rate mortgages	Interest rate decreases, not as the result of a permanent interest rate buydown	No resubmission required

DU Documentation Requirements (continued)

Ensuring DU Data and Delivery Information Accuracy (continued)

Data Attribute and Description	Trigger	Action Required
Interest rate on fixed-rate and adjustable-rate mortgages	Interest rate decreases as the result of a permanent interest rate buydown	Loan casefile must be resubmitted to DU
Verified income used to qualify the borrower for loans subject to HUD median income limits; for example, as with community lending mortgages.	Income is greater than the loan application indicates	Loan casefile must be resubmitted to DU
Assets — Funds Required to Close	The actual amount of assets required to close the transaction exceeds the amount of “Funds Required to Close” per the DU Underwriting Findings report	If CMS has documented sufficient liquid assets to cover the actual amount of assets required to close the transaction, no resubmission required Otherwise, loan casefile must be resubmitted to DU
Assets — Reserves Required to be Verified	Due to changes in the actual amount of assets required to close the transaction, the verified amount of reserves is less than the “Reserves Required to be Verified” per the DU Underwriting Findings report	If CMS has documented reserves that equal at least 90% of the Reserves Required to be Verified per the DU Underwriting Findings report, no resubmission required Otherwise, loan casefile must be resubmitted to DU
Loan amount tolerances for refinance transactions	(See below)	

DU Documentation Requirements (continued)

DU Tolerances for Refinance Transaction Loan Amount Changes

For refinance transactions, Fannie Mae allows the following tolerances to the loan amount:

- The loan amount may increase $500 or up to 1% of the loan amount, whichever is less.
- The loan amount may decrease 5% of the loan amount.

The loan amount tolerances are permitted provided the new LTV/CLTV does not result in

- changes to the amount of required mortgage insurance coverage,
- different loan-level price adjustments, or
- changes to loan eligibility.

For example, if a loan casefile is submitted with a loan amount of $100,000 and the appraised value is $120,000 (which equals 83.3% LTV); the actual loan amount can go up to $100,500 (which equals 83.75% LTV) without requiring resubmission.

On the other hand, if the original loan amount was $108,000 (90% LTV); an increase without resubmission is not permitted because it would result in an LTV of 91%. The higher LTV requires different mortgage insurance coverage, and may result in the loan not being eligible for delivery.

The loan amount tolerance does not apply to Fannie Mae's requirements regarding the amount of cash back to the borrower on a limited cash-out refinance transaction. (See Limited Cash-Out Refinance Transactions.)

Other Errors in the Credit Data

In some cases, errors are the result of reporting errors by the credit agency or individual creditors.

If the printed credit report contains derogatory information, and DU does not recognize or consider the derogatory information and does not reflect the derogatory information in the DU Underwriting Findings report, CMS must take action when information not considered by DU would result in a recommendation other than that returned by DU.

For example, if a borrower's credit report indicates that the borrower had a previous foreclosure, but the DU Underwriting Findings report does not reference the foreclosure, a reporting or data transfer error may have occurred, thus preventing DU from considering the foreclosure in its analysis of the loan. CMS must take action to ensure that the information is considered in the risk analysis.

DU Documentation Requirements (continued)

Non-Applicant Debts/Accounts

In a small number of cases, credit reports may include accounts identified as possible non- applicant accounts (or with another similar notation).

Non-applicant accounts may belong to the borrower, or they may truly belong to another individual.

Typical causes of non-applicant accounts include

- applicants who are Juniors/Seniors,
- individuals who move frequently,
- non-related individuals who have identical names, and
- debts the borrower applied for under a different Social Security number or under a different address (these may be indicative of potential fraud).

When DU encounters possible non-applicant accounts on the credit report, DU will include the accounts in the credit risk assessment, and will issue a message in the DU Underwriting Findings report alerting CMS of the existence of the accounts. If the debts are on the loan application, DU will also include them in the DTI ratio. If the debts do not belong to the borrower, CMS may provide supporting documentation, remove the debts from the loan application, and re-submit the loan casefile to DU in order for the DTI to be updated to exclude the non-applicant debts.

DU Underwriting Findings Report

Overview

The DU Underwriting Findings report summarizes the overall underwriting recommendation and eligibility component of the loan casefile and lists certain steps necessary for CMS to complete the processing of the loan file.

Specific messages are provided for each individual loan casefile. These detailed messages are designed to assist CMS in processing and closing loans. However, the level of documentation recommended by DU may not be adequate for every borrower and every situation.

The DU Underwriting Findings report is divided into sections. Each section contains a different type of message. Certain messages will be provided based on the DU credit risk assessment. For example, some messages are returned only on Approve recommendations, while other messages are returned only on Refer with Caution recommendations.

Potential Red Flag Messages

DU provides a number of "potential red flag" messages designed to help CMS detect inconsistencies in the loan casefile. Neither the presence nor absence of these messages alters CMS responsibility to ensure accurate information in all areas of the loan process or otherwise comply with applicable law, including the Fair Credit Reporting Act.

Note: The appearance of these messages does not affect the underwriting recommendation from DU. Rather, they are designed to help CMS detect inconsistencies. Furthermore, the absence of any of these messages does not indicate or imply Fannie Mae's acceptance of the data submitted to DU.

The following lists potential red flag message:

- **Excessive resubmissions:** A message alerts CMS when an unusually high number of loan resubmissions may be the result of data manipulation.

INCOME ASSESSMENT

Introduction

This chapter describes the requirements for evaluating income stability, adequacy, and likelihood of continuance — key factors used in qualifying the borrower and assessing his or her capacity to repay the mortgage over the life of the loan.

Unacceptable Income Sources

CMS considers any income that is not legal in accordance with all applicable federal, state and local laws, rules and regulations as an ineligible income source for all financing types and programs. Federal law restricts the following activities and therefore the income from these sources are not allowed for qualifying:

- Foreign shell banks
- Medical marijuana dispensaries
- Any business or activity related to recreational marijuana use, growing, selling or supplying of marijuana, even if legally permitted under state or local law.
- Businesses engaged in any type of internet gambling.

CMS may only consider income if it is legally derived. Per IRS regulations, income derived from trafficking in controlled substances is illegal and under federal law, marijuana is a controlled substance.

Stable and Predictable Income

Fannie Mae's underwriting guidelines emphasize the continuity of a borrower's stable income. The stable and reliable flow of income is a key consideration in mortgage loan underwriting.

Individuals who change jobs frequently, but who are nevertheless able to earn consistent and predictable income, are also considered to have a reliable flow of income for qualifying purposes.

To demonstrate the likelihood that a consistent level of income will continue to be received for borrowers with less predictable sources of income, CMS must obtain information about prior earnings. Examples of less predictable income sources include commissions, bonuses, substantial amounts of overtime pay, or employment that is subject to time limits, such as contract employees or tradesmen.

Variable Income

All income that is calculated by an averaging method must be reviewed to assess the borrower's history of receipt, the frequency of payment, and the trending of the amount of income being received. Examples of income of this type include income from hourly workers with fluctuating hours, or income that includes commissions, bonuses, or overtime.

History of Receipt: Two or more years of receipt of a particular type of variable income is recommended; however, variable income that has been received for 12 to 24 months may be considered as acceptable income, as long as the borrower's loan application demonstrates that there are positive factors that reasonably offset the shorter income history.

Income Assessment (continued)

Variable Income (continued)

Frequency of Payment: CMS must determine the frequency of the payment (weekly, biweekly, monthly, quarterly, or annually) to arrive at an accurate calculation of the monthly income to be used in the trending analysis (see below). Examples:

- If a borrower is paid an annual bonus on March 31 of each year, the amount of the March bonus should be divided by 12 to obtain an accurate calculation of the current monthly bonus amount. Note that dividing the bonus received on March 31 by three months produces a much higher, inaccurate monthly average.
- May it be averaged over the period when the declination occurred.
- If a borrower is paid overtime on a biweekly basis, the most recent paystub must be analyzed to determine that both the current overtime earnings for the period and the year-to-date overtime earnings are consistent and, if not, why. There are legitimate reasons why these amounts may be inconsistent yet still eligible for use as qualifying income. For example, borrowers may have overtime income that is cyclical (transportation employees who operate snow plows in winter, package delivery service workers who work longer hours through the holidays). CMS must investigate the difference between current period overtime and year-to-date earnings and document the analysis before using the income amount in the trending analysis.

Income Trending: After the monthly year-to-date income amount is calculated, it must be compared to prior years' earnings using the borrower's W-2's or signed federal income tax returns (or a standard Verification of Employment completed by the employer or third-party employment verification vendor).

- If the trend in the amount of income is stable or increasing, the income amount should be averaged.
- If the trend was declining, but has since stabilized and there is no reason to believe that the borrower will not continue to be employed at the current level, the current, lower amount of variable income must be used.

If the trend is declining, the income may not be stable. Additional analysis must be conducted to determine if any variable income should be used, but in no instance

Continuity of Income

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

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

Income Assessment (continued)

Continuity of Income (continued)

If CMS is notified that the borrower is transitioning to a lower pay structure, for example due to pending retirement, CMS must use the lower amount to qualify the borrower.

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

Expiration Date Not Defined	Defined Expiration Date*
CMS does **not** need to document 3–year continuance • automobile allowance • base salary • bonus, overtime, commission, or tip income • capital gains income • corporate retirement or pension • disability income — long-term • foster-care income • interest and dividend income (unless other evidence that asset will be depleted) • military income • mortgage credit certificates • part-time job, second job, or seasonal income • rental income • self-employment income • Social Security, VA, or other government retirement or annuity	CMS must document 3–year continuance • alimony or child support • distributions from a retirement account – for example, 401(k), IRA, SEP, Keogh • mortgage differential payments • notes receivable • public assistance • royalty payment income • Social Security (not including retirement or long-term disability) • trust income • VA benefits (not including retirement or long-term disability)

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

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

Income Assessment (continued)

Income from Gambling

When the borrower has income derived from gambling the following requirements must be documented in order to use for qualifying:

- The income must be reported as self-employed; and
- Two years tax returns must be provided to document income has not declined

Determining the Need for Federal Income Tax Returns

CMS must obtain copies of the borrower's signed federal income tax returns filed with the IRS for the past two years for the following sources of income or employment. If the borrower

- is employed by family members;
- is employed by interested parties to the property sale or purchase;
- receives rental income from an investment property (only one year of tax returns is required unless the borrower meets one or more of the other conditions in this list);
- receives income from temporary or periodic employment (or unemployment) or employment that is subject to time limits, such as a contract employee or a tradesman;
- receives income from capital gains, royalties, real estate, or other miscellaneous non- employment earnings reported on IRS Form 1099;
- receives income that cannot otherwise be verified by an independent and knowledgeable source;
- uses foreign income to qualify;
- uses interest and dividend income to qualify;
- uses tip income reported on IRS Form 4137 that was not reported by the employer on the W-2 to qualify; or
- receives income from sole proprietorships, limited liability companies, partnerships, or corporations, or any other type of business structure in which the borrower has a 25% or greater ownership interest. Borrowers with a 25% or greater ownership interest are considered self-employed. CMS must document and underwrite the loan application using the requirements for self-employed borrowers, as described in Self-Employment Income.

Income Assessment (continued)

Verification of Income for Non-U.S. Citizen Borrowers

The following table describes income verification requirements for borrowers who are non-U.S. citizens:

Employment Type	Employment and Income Verification Requirements
Salaried or commissioned borrower employed by a U.S. company or individual	Same as for a U.S. citizen.
Self-employed	Same as for a U.S. citizen.
Employed by a foreign corporation or a foreign government and paid in foreign currency (“foreign income”)	CMS must obtain: • copies of the borrower's signed federal income tax returns filed with the IRS for the most recent two- year period, and • documentation to satisfy the standard documentation requirements in this Chapter. **Note:** All income must be translated to U.S. dollars.

Using Nontaxable Income to Adjust the Borrower’s Gross Income

CMS should give special consideration to regular sources of income that may be nontaxable, such as child support payments, Social Security benefits, workers’ compensation benefits, certain types of public assistance payments, and food stamps.

CMS must verify that the particular source of income is nontaxable. Documentation that can be used for this verification includes award letters, policy agreements, account statements, or any other documents that address the nontaxable status of the income.

If the income is verified to be nontaxable, and the income and its tax-exempt status are likely to continue, CMS may develop an “adjusted gross income” for the borrower by adding an amount equivalent to 25% of the nontaxable income to the borrower’s income.

If the actual amount of federal and state taxes that would generally be paid by a wage earner in a similar tax bracket is more than 25% of the borrower’s nontaxable income, CMS may use that amount to develop the adjusted gross income, which should be used in calculating the borrower’s qualifying ratio.

Standards for Employment Documentation

General Documentation Requirements

CMS must verify employment income for all borrowers whose income is used to qualify for the mortgage loan. This verification can be provided by the borrower, by the borrower's employer, or by a third-party employment verification vendor.

Employment Documentation Provided by the Borrower

The following table provides requirements for documentation provided by the borrower.

✓	Requirements — Paystubs and W–2s
	The paystub must be dated no earlier than 30 days prior to the initial loan application date and it must include all year-to-date earnings. Additionally, the paystub must include sufficient information to appropriately calculate income; otherwise, additional documentation must be obtained. Paystubs must comply with Allowable Age of Credit Documents and Federal Income Tax Returns.
	IRS W-2 forms must cover the most recent one- or two-year period, based on the documentation requirements for the particular income type. The W-2 forms must clearly identify the borrower as the employee. "Most recent" W-2 is defined as the W-2 for the calendar year prior to the current calendar year. Alternative documentation, such as an IRS Wage and Income (W-2) Transcript, a written *Request for Verification of Employment* (Form 1005 or Form 1005(S)) (see below) or the final year-to-date paystub, may be used as long as adequate information is provided.
	Documents must be computer-generated or typed by the borrower's employer(s), although paystubs that the borrower downloads from the Internet are also acceptable. Documents must clearly identify the employer's name and source of information.
	The documents must clearly identify the borrower as the employee.
	The information must be complete and legible.
	The original source of the information must be a third party, such as the borrower's human resources department, personnel office, payroll department, company's payroll vendor, or supervisor.

Standards for Employment Documentation (continued)

Employment Documentation Provided by the Borrower (continued)

✓	Requirements — Tax Returns
	When required, personal federal income tax returns must be copies of the original returns that were filed with the IRS. All supporting schedules must be included. Alternatively, CMS may obtain applicable transcripts of federal income tax returns. See Requirements and Uses of IRS Form 4506-C.
	"Most recent" tax return is defined as the last return scheduled to have been filed with the IRS. See Allowable Age of Credit Documents and Federal Income Tax Returns.
	The information must be complete and legible.
	Each tax return must be signed by the borrower unless CMS has obtained one of the following signature alternatives: • documentation confirming that the tax returns were filed electronically, • a completed IRS Form 4506-C (signed by the borrower) for the year in question, or • IRS transcripts that validate the tax return.

Employment Documentation Provided by the Borrower's Employer

CMS may use the *Request for Verification of Employment* (Form 1005 or Form 1005(S)) to document income for a salaried or commissioned borrower. The date of the completed form must comply with Allowable Age of Credit Documents and Federal Income Tax Returns.

The information on the Form 1005 or Form 1005(S) must be legible. The following fields on the form are optional:

Field #	Title of Optional Field
11	Probability of continued employment
14	If overtime or bonus is applicable, is its continuance likely?
16	Date of applicant's next pay increase
17	Projected amount of next pay increase
18	Date of applicant's last pay increase
19	Amount of last pay increase
24	Reason for leaving (Part III — Verification of Previous Employment)

The remaining fields on the form must be completed as applicable to the borrower. For example, overtime may not be completed if the borrower is in a position that does not pay overtime.

Standards for Employment Documentation (continued)

Employment Documentation Provided by the Borrower's Employer (continued)	When the borrower authorizes CMS to obtain verifications of employment and income directly from the employer, CMS must have the borrower sign Form 1005 or Form 1005(S). Alternatively, CMS may have the applicant sign a signature authorization form, which gives CMS blanket authorization to request the information it needs to evaluate the applicant's creditworthiness.
Employment Documentation Provided by a Third-Party Employment Verification Vendor	CMS may receive employment and income verification directly from a third-party employment verification vendor. These verifications are acceptable as long as • the borrower provided proper authorization for CMS to use this verification method, • the date of the completed verification is in compliance with Allowable Age of Credit Documents and Federal Income Tax Returns, • CMS has determined that the vendor has made provisions to comply with reasonable quality control requests from both CMS and any subsequent mortgagee, and • CMS understands it will be held accountable for the integrity of the information obtained from this source. If necessary, CMS must supplement these verifications by obtaining any missing information from the borrower or his or her employer.

Base Pay (Salary or Hourly), Bonus, and Overtime Income

Verification of Base Pay, Bonus, and Overtime Income

The following table provides verification requirements for base pay, bonus, and overtime income:

✓	Verification of Base Pay, Bonus, and Overtime Income
	A minimum history of two years of employment income is recommended. However, income that has been received for a shorter period of time may be considered as acceptable income, as long as the borrower's employment profile demonstrates that there are positive factors to reasonably offset the shorter income history. Borrowers relying on overtime or bonus income for qualifying purposes must have a history of no less than 12 months to be considered stable.
	Base Pay (Salary and Hourly): Obtain the following documents: • a completed Request for Verification of Employment (Form 1005 or Form 1005(S)), or • the borrower's recent paystub and IRS W-2 forms covering the most recent two- year period.
	Bonus or Overtime: Obtain the following documents: • a completed Form 1005 or Form 1005(S), or • the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.
	See General Income Information, for additional information on calculating variable income (applies to hourly paid employees with fluctuating hours and bonus and overtime).
	If the borrower has recently changed positions with his or her employer, determine the effect of the change on the borrower's eligibility and opportunity to receive bonus or overtime pay in the future.
	If a borrower who has historically been employed on a part-time basis indicates that he or she will now be working full-time, obtain written confirmation from the borrower's employer.
	A verbal VOE is required from each employer. See Verbal Verification of Employment, for specific requirements.
	See Standards for Employment Documentation, for additional information about verifying employment income.

Base Pay (Salary or Hourly), Bonus, and Overtime Income (continued)

Base Income Calculation Guidelines

After the applicable income documentation has been obtained, CMS must calculate the borrower's eligible qualifying base income. The following table provides guidance for standard employment documentation:

How Often Paid	How to Determine Monthly Income
Annually	Annual gross pay / 12 months
Monthly	Use monthly gross payment amount
Twice Monthly	Twice monthly gross pay x 2 pay periods
Biweekly	(Biweekly gross pay x 26 pay periods) / 12 months
Weekly	(Weekly gross pay x 52 pay periods) / 12 months
Hourly	(Hourly gross pay x average # of hours worked per week x 52 weeks) / 12 months
All of the above calculations must be compared with the documented year-to-date base earnings (and past year earnings, if applicable) to determine if the income amount appears to be consistent. See General Income Information, for additional information about variable income (bonus and overtime).	

Military Income

Military personnel may be entitled to different types of pay in addition to their base pay. Flight or hazard pay, rations, clothing allowance, quarters' allowance, and proficiency pay are acceptable sources of stable income, as long as CMS can establish that the particular source of income will continue to be received in the future.

Income paid to military reservists while they are satisfying their reserve obligations also is acceptable if it satisfies the same stability and continuity tests applied to secondary employment.

Base Pay (Salary or Hourly), Bonus, and Overtime Income (continued)

Verification of Commission Income

The following table provides verification requirements for commission income:

√	Verification of Commission Income
	A minimum history of 2 years of commission income is recommended; however, commission income that has been received for 12 to 24 months may be considered as acceptable income, as long as there are positive factors to reasonably offset the shorter income history.
	One of the following must be obtained to document commission income: • a completed Request for Verification of Employment (Form 1005 or Form1005(S)), or • the borrower's recent paystub and IRS W-2 forms covering the most recent two- year period.
	A verbal VOE is required from each employer. See Verbal Verification of Employment for specific requirements
	See General Income Information for additional information about calculating variable income
	See Standards for Employment Documentation for additional information about verifying employment income.

Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income

Documentation Requirements

The income sources discussed in this topic must be documented by obtaining the following:

- a completed Request for Verification of Employment (Form 1005 or Form 1005(S)); or
- the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period. (Signed federal income tax returns may also be required to verify unemployment income related to seasonal employment.)

A verbal VOE is also required from each employer. See Verbal Verification of Employment, for specific requirements.

As these income types may be hourly or seasonal, refer to General Income Information, for additional information on calculating variable income. Also see Standards for Employment Documentation, for additional information about verifying employment income.

Income from Secondary Sources

Fannie Mae does not require lenders to review or document income from secondary sources when that income is not needed to qualify. Business-related debt for which the borrower or co-borrower is personally obligated would likely be on their credit report and therefore already included in the debt-to-income ratio. As a practical consideration, borrowers with a primary source of income that is not derived from self- employment and is sufficient to cover the obligation have more flexibility and could discontinue a secondary self-employment activity should it prove unprofitable. Consequently, if the income not derived from self-employment is sufficient to qualify the borrower, no further inquiry regarding any secondary business losses is required.

The provisions of the Truth in Lending Act's Ability to Repay (ATR) provisions require verification of the amounts of income, assets, or debt obligations that the creditor relies on to determine a borrower's ability to repay using third-party records that provide reasonably reliable evidence of the borrower's income or assets. As a general rule, there is no ATR requirement for creditors to identify and examine losses or expenses related to income that the borrower does not declare as income for the purposes of obtaining a mortgage loan.

Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income (continued)

Verification of Secondary Employment Income

Secondary employment income is income that is derived from a second job or multiple jobs the borrower may have. CMS must verify the following if the secondary employment will be used to qualify the borrower.

✓	Verification of Secondary Employment Income
	Verification of a minimum history of two years of uninterrupted secondary employment income is recommended. However, income that has been received for a shorter period of time (no less than 12 months) may be considered as acceptable income, as long as there are positive factors to reasonably offset the shorter income history.
	A borrower may have a history that includes different employers, which is acceptable as long as income has been consistently received.

Verification of Seasonal Income

CMS must verify the following for seasonal income.

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

Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income (continued)

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

Fannie Mae requires CMS to have each borrower (regardless of income source) complete and sign a separate IRS Form 4506-C at or before closing. (As noted below, it may be necessary to have the borrower complete and sign multiple IRS Form 4506-Cs depending on the transcripts required to validate the information used in documenting income.)

In addition, CMS must document the requirement to obtain an executed IRS Form 4506-C with the IRS (directly or through an authorized designee) in their written quality control (QC) plan.

If the IRS Form 4506-C is executed prior to closing, the transcript(s) received from the IRS must be used to validate the income documentation provided by the borrower and used in the underwriting process. In this case, because the form has already been executed, a signed IRS Form 4506-C is not required to be included in the loan file.

Use of IRS Forms to Obtain Federal Income Tax Information

When federal income tax information is used to document income for qualifying purposes, CMS may obtain transcripts of the applicable federal income tax documents directly from the IRS (or designee) by using IRS Form 4506-C. For example, CMS may obtain Tax Return Transcripts for Form 1040, 1040A or 1040EZ or Wage and Income Transcripts for W2s, 1098s, and 1099s. However, in certain instances, copies of the actual returns, schedules, or forms are needed because the tax return transcripts will not provide the detail required to qualify the borrower. For example, CMS must obtain copies of Schedules B through F, Schedule K-1, Form 2106, or business returns. These schedules or forms are not required if:

- the income reflected on the applicable schedule transcripts is positive, and
- the income supported by that schedule or form is not being used for qualifying.

Alternatives to the IRS Form 4506-C

Use of IRS Form 4506-C has become the most efficient method for CMS to obtain electronic transcripts of the borrower's income tax information. It is also acceptable for CMS to use either IRS Request for Copy of Tax Return (IRS Form 4506) or IRS Tax Information Authorization (IRS Form 8821); however, these forms are not supported electronically by the IRS. In addition, IRS Short Form Request for Individual Tax Return Transcript (IRS Form 4506-C) is also acceptable, although it may only be used to obtain transcripts of IRS Form 1040 (no other tax forms are supported using IRS Form 4506-C).

Note: Borrowers with income from Puerto Rico must use Modelo SC 2907 (Solicitud De Copia De Planilla, Relevo De Herencia Y De Donacion) rather than one of the forms mentioned above. Applicable forms or processes for eligible borrowers filing tax returns in other U.S. territories must be adhered to and obtained when required.

Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income (continued)

Completing and Submitting the IRS Authorization Form

IRS Form 4506-C can be used to obtain transcripts for up to four years or tax periods but only one tax form number can be requested per each IRS Form 4506-C. For example, it is necessary to complete two IRS Forms 4506-C for a self-employed borrower whose income documentation includes both two years of personal tax returns and two years of business tax returns. One IRS Form 4506-C will be required to obtain a transcript of the personal 1040 returns and another will be required for the business returns (Form 1065, Form 1120, Form 1120A, etc.).

CMS must

- fill in as the recipient of the tax documents — either its name or the name of the servicer, if servicing will be transferred within 120 days of the taxpayer signing the form;
- indicate that the request is for documentation concerning the year or years for which the borrower's income was or will be used in underwriting the loan; and
- date the form(s) with the date on which the borrower signs the form (or ascertain that the borrower dates the form when he or she signs it).

IRS Forms 4506-C and 4506 are valid for 120 days after completion (including signature) by the borrower. IRS Form 8821 is valid for 60 days after completion.

Note: The borrower should not be required to sign an IRS authorization form before all items on the form, including the transcript being requested, the years/tax periods, and the date, have been completed.

Retaining the Tax Documents

All tax documents, including the IRS Form 4506-C transcript received from the IRS, and any subsequent explanation or documentation of discrepancies must be retained in the loan file for QC review.

Verbal Verification of Employment

CMS must obtain a verbal verification of employment (verbal VOE) for each borrower using employment or self-employment income to qualify. The verbal VOE must be obtained within 10 business days prior to the note date for employment income, and within 120 calendar days prior to the note date for self-employment income. The verbal VOE requirement is intended to help CMS mitigate risk by confirming, as late in the process as possible, that the borrower remains employed as originally disclosed on the loan application. A change in the borrower's employment status could have a significant impact on that borrower's capacity to repay the mortgage loan and must be fully reevaluated.

Alternatively, CMS may obtain the verbal VOE after closing, up to the time of loan delivery. If the verbal VOE cannot be obtained prior to delivery, the loan is ineligible for delivery to Fannie Mae.

Note: If the employer confirms the borrower is currently on temporary leave, CMS must consider the borrower "employed." See Other Sources of Income, for details on temporary leave.

Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income (continued)

Verbal Verification of Employment (continued)

The following table describes verbal VOE requirements:

Type of Income	Verbal VOE Requirements
Hourly, Salary, and Commission Income (Non- Military)	**Requirements:** • CMS must independently obtain a phone number and, if possible, an address for the borrower's employer. This can be accomplished by using a telephone book, the Internet, directory assistance, or by contacting the applicable licensing bureau. • CMS must contact the employer verbally and confirm the borrower's current employment status within 10 business days prior to the note date. **Note:** If the employer confirms the borrower is currently on temporary leave, CMS must consider the borrower "employed." See Other Sources of Income, for details on temporary leave. • The conversation must be documented. It should include the following: o name and title of the person who confirmed the employment CMS, o name and title of the person who completed the verification for the employer, o date of the call, and o the source of the phone number. **Exceptions:** • If the employer will not verbally verify employment, CMS can obtain a written verification (other than an additional paystub) confirming the borrower's current employment status within the same time frame as the verbal VOE requirements. The written documentation must include the name and title of the person who completed the verification for the employer. • If the borrower is a union member who works in an occupation that results in a series of short-term job assignments (such as skilled construction worker, longshoreman, or stagehand), and the union facilitates the borrower's placement in each assignment, CMS must obtain the verbal VOE from the union.

Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income (continued)

Verbal Verification of Employment (continued)

Type of Income	Verbal VOE Requirements
Hourly, Salary, and Commission Income (Non-Military) (continued)	• If the employer uses a third party employment verification vendor, CMS must obtain written verification from the vendor of the borrower's current employment status within the same time frame as the verbal VOE requirements. **Note:** Because third-party vendor databases are typically updated monthly, the verification must evidence that the information in the vendor's database was no more than 35 days old as of the note date. • When employment is validated by DU, DU includes in its assessment the age of the information in the vendor's database. The DU message will include a date by which the loan must close. This may differ from the age of data and 10 business day requirements above. Compliance with the DU message satisfies the requirement for completing the verification of employment.
Military Personnel	• If the borrower is in the military, in lieu of a verbal or written VOE, CMS must obtain either a military Leave and Earnings Statement dated within 30 calendar days prior to the note date (or 31 days for longer months), or • a verification of employment through the Defense Manpower Defense Manpower
Self-Employed Income	**Requirements:** • CMS must verify the existence of the borrower's business within 120 calendar days prior to the note date o from a third party, such as a CPA, regulatory agency, or the applicable licensing bureau, if possible; or o by verifying a phone listing and address for the borrower's business using a telephone book, the Internet, or directory assistance. • CMS must document the source of the information obtained and the name and title of CMS employee who obtained the information.

Rental Income

Eligible Properties

Rental income is an acceptable source of stable income if it can be established that the income is likely to continue. If the rental income is derived from the subject property, the property must be one of the following:

- a two- to four-unit principal residence property in which the borrower occupies one of the units, or
- a one- to four-unit investment property.

If the income is derived from a property that is not the subject property, there are no restrictions on the property type. For example, rental income from a commercial property owned by the borrower is acceptable if the income otherwise meets all other requirements (it can be documented in accordance with the requirements below).

Ineligible Properties

Generally, rental income from the borrower's principal residence (a one-unit principal residence or the unit the borrower occupies in a two- to four-unit property) or a second home cannot be used to qualify the borrower. However, Fannie Mae does allow certain exceptions to this policy for boarder income and properties with accessory units.

General Requirements for Documenting Rental Income

If a borrower has a history of renting the subject or another property, generally the rental income will be reported on IRS Form 1040, Schedule E of the borrower's personal tax returns or on Rental Real Estate Income and Expenses of a Partnership or an S Corporation form (IRS Form 8825) of a business tax return. If the borrower does not have a history of renting the subject property or if, in certain cases, the tax returns do not accurately reflect the ongoing income and expenses of the property, CMS may be justified in using a fully executed current lease agreement. Examples of scenarios that justify the use of a lease agreement are

- purchase transactions;
- refinance transactions in which the borrower purchased the rental property during or subsequent to the last tax return filing; or
- refinance transactions of a property that experienced significant rental interruptions such that income is not reported on the recent tax return (for example, major renovation to a property occurred in the prior year that affected rental income).

When the subject property will generate rental income, one of the following Fannie Mae forms must be used to support the income-earning potential of the property:

- For one-unit properties: Single-Family Comparable Rent Schedule (Form 1007) (provided in conjunction with the applicable appraisal report), or
- For two- to four-unit properties: Small Residential Income Property Appraisal Report (Form 1025).

Documenting Rental Income from Vacation Rentals by Owner

CMS requires two (2) years tax returns to document investment property rental income that shows expenses from Vacation Rentals by Owner (VRBO). Two (2) years rental income reported on IRS Form 1040, Schedule E of the borrower's personal tax returns will satisfy these requirements.

Rental Income (continued)

Documenting Rental Income from Subject Property

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

Does the Borrower Have a History of Receiving Rental Income From the Subject Property?	Transaction Type	Documentation Requirements
Yes	Refinance	Form 1007 or Form 1025, as applicable, and either • the borrower's most recent year of signed federal income tax returns, including Schedule E, or • copies of the current lease agreement(s) if the borrower can document a qualifying exception (see Partial or No Rental History on Tax Returns below).
No	Purchase	Form 1007 or Form 1025, as applicable, and copies of the current lease agreement(s). If the property is not currently rented, lease agreements are not required. CMS may use market rent supported by Form 1007 or Form 1025, as applicable. If there is a lease on the property that is being transferred to the borrower, CMS must verify that it does not contain any provisions that could affect Fannie Mae's first lien position on the property. See Title Exceptions and Impediments, for additional information.
No	Refinance	Form 1007 or Form 1025, as applicable, and copies of the current lease agreement(s).

If the borrower is not using any rental income from the subject property to qualify, the gross monthly rent must still be documented for CMS reporting purposes.

Rental Income (continued)

Documenting Rental Income From Property Other Than the Subject Property

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

Partial or No Rental History on Tax Returns

In order for CMS to determine qualifying rental income, CMS must determine whether or not the rental property was in service for the entire tax year or only a portion of the year.

In some situations, CMS's analysis may determine that using alternative rental income calculations or using lease agreements to calculate income are more appropriate methods for calculating the qualifying income from rental properties. This policy may be applied to refinances of a subject rental property or to other rental properties owned by the borrower.

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

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

If ...	Then ...
the property was acquired during or subsequent to the most recent tax filing year,	CMS must confirm the purchase date using the settlement statement or other documentation. • If acquired during the year, Schedule E (Fair Rental Days) must confirm a partial year rental income and expenses (depending on when the unit was in service as a rental). • If acquired after the last tax filing year, Schedule E will not reflect rental income or expenses for this property.
the rental property was out of service for an extended period,	• Schedule E will reflect the costs for renovation or rehabilitation as repair expenses. Additional documentation may be required to ensure that the expenses support a significant renovation that supports the amount of time that the rental property was out of service. • Schedule E (Fair Rental Days) will confirm the number of days that the rental unit was in service, which must support the unit being out of service for all or a portion of the year.

Rental Income (continued)

Partial or No Rental History on Tax Returns (continued)

If ...	Then ...
CMS other situation warrants an exception to use a lease agreement,	CMS must provide an explanation and justification in the loan file.

If the borrower is converting a principal residence to an investment property, see Qualifying Impact of Other Real Estate Owned, for guidance in using that rental income to qualify the borrower.

Income from Departure Residence

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

If the mortgaged property owned by the borrower is a current residence converting to investment use, the borrower must be qualified in accordance with, but not limited to the following:

- Lease agreements. When current lease agreements are used, CMS must calculate the rental income by multiplying the gross rent(s) by 75%. The remaining 25% of the gross rent will be absorbed by vacancy losses and ongoing maintenance expenses.
- DU will determine the reserve requirements based on the overall risk assessment of the loan, the minimum reserve requirement that may be required for the transaction, and whether the borrower has multiple financed properties.
- If the mortgage loan being delivered to Fannie Mae is secured by the borrower’s principal residence, there are no limitations on the number of other properties that the borrower will have financed.
- If the mortgage is secured by a second home or an investment property, the multiple financed properties policy applies.

Rental Income (continued)

Calculating Monthly Qualifying Rental Income (or Loss)

To determine the amount of rental income from the subject property that can be used for qualifying purposes when the borrower is purchasing a two- to four-unit principal residence or one- to four-unit investment property, CMS must consider the following:

If the borrower....	Then for qualifying purposes....
• currently owns a primary residence (or has a current housing expense), and • has at least a one-year history of receiving rental income or documented property management experience	there is no restriction on the amount of rental income that can be used.
• currently owns a primary residence (or has a current housing expense), and • has less than one-year history of receiving rental income or documented property management experience	• for a primary residence, rental income in an amount not exceeding PITIA of the subject property can be added to the borrower's gross income, or • for an investment property, rental income can be used to offset the PITIA of the subject property.
• does not own a primary residence, and • does not have a current housing expense	rental income from the subject property cannot be used.

CMS must establish a history of property management experience by obtaining one of the following:

- The borrower's most recent signed federal income tax return, including Schedules 1 and E. Schedule E should reflect rental income received for any property and Fair Rental Days of 365;
- If the property has been owned for at least one year, but there are less than 365 Fair Rental Days on Schedule E, a current signed lease agreement may be used to supplement the federal income tax return; or
- A current signed lease may be used to supplement a federal income tax return if the property was out of service for any time period in the prior year. Schedule E must support this by reflecting a reduced number of days in use and related repair costs. Form 1007 or Form 1025 must support the income reflected on the lease.

CMS must document the borrower has at least a one-year history of receiving rental income in accordance with *Documenting Rental Income From Property Other Than the Subject Property* above.

Please note: This policy does not apply to HomeReady loans with rental income from an accessory unit.

Rental Income (continued)

Method for Calculating the Income

The method for calculating rental income (or loss) for qualifying purposes is dependent upon the documentation that is being used.

Federal Income Tax Returns, Schedule E. When Schedule E is used to calculate qualifying rental income, CMS must add back any listed depreciation, interest, homeowners' association dues, taxes, or insurance expenses to the borrower's cash flow. Non-recurring property expenses may be added back, if documented accordingly.

If the property was in service

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

See Treatment of the Income (or Loss) below for further instructions.

Lease Agreements or Form 1007 or Form 1025. When current lease agreements or market rents reported on Form 1007 or Form 1025 are used, CMS must calculate the rental income by multiplying the gross monthly rent(s) by 75%. (This is referred to as "Monthly Market Rent" on the Form 1007.) The remaining 25% of the gross rent will be absorbed by vacancy losses and ongoing maintenance expenses.

See Treatment of the Income (or Loss) below for further instructions.

Treatment of the Income (or Loss)

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

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

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

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

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

Rental Income (continued)

Offsetting Monthly Obligations for Rental Property Reported through a Partnership or an S Corporation

If the borrower is personally obligated on the mortgage debt (as evidenced by inclusion of the related mortgage(s) on the credit report) and gross rents and related expenses are reported through a partnership or S corporation, the business tax returns may be used to offset the property's PITIA. The steps described below should be followed:

1. Obtain the borrower's business tax returns, including IRS Form 8825 for the most recent year.
2. Evaluate each property listed on Form 8825, as shown below:
   - From total gross rents, subtract total expenses. Then add back insurance, mortgage interest, taxes, homeowners' association dues (if applicable), depreciation, and non-recurring property expenses (if documented accordingly).
   - Divide by the number of months the property was in service.
   - Subtract the entire PITIA (proposed for subject property or actual for real estate owned) to determine the monthly property cash flow.
3. If the resulting net cash flow is **positive**, CMS may exclude the property PITIA from the borrower's monthly obligations when calculating the debt-to-income ratio.
4. If the resulting net cash flow is **negative** (that is, the rental income derived from the investment property is not sufficient to fully offset the property PITIA), the calculated negative amount must be included in the borrower's monthly obligations when calculating the debt-to- income ratio.

In order to include a positive net rental income received through a partnership or an S corporation in the borrower's monthly qualifying income; CMS must evaluate it according to Fannie Mae's guidelines for income received from a partnership or an S corporation.

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

Other Sources of Income

Documentation Requirements for Current Receipt of Income

The documentation required for each income source is described below. The documentation must support the history of receipt, if applicable, and the amount, frequency, and duration of the income. In addition, evidence of current receipt of the income must be obtained in compliance with the Allowable Age of Credit Documents policy, unless specifically excluded below. See Allowable Age of Credit Documents and Federal Income Tax Returns, for additional information.

Current receipt may be documented by various means, depending on the income type. Examples include but are not limited to

- current paystubs,
- bank statements confirming direct deposit,
- canceled checks from the payer's account to the borrower,
- court records, or
- copies of the borrower's bank statements showing the regular deposit of these funds.

Other Sources of Income (continued)

Adoption Income

The following table provides verification requirements for adoption income.

✓	Verification of Income From Alimony or Child Support
	Document the borrower's receipt of adoption income with letter or exhibits from the paying agency that state the amount, frequency, and duration of the benefit payments.
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application.

Alimony or Child Support

The following table provides verification requirements for alimony or child support.

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

Other Sources of Income (continued)

Automobile Allowance

For an automobile allowance to be considered as acceptable stable income, the borrower must have received payments for at least two years. CMS must add the full amount of the allowance to the borrower's monthly income, and the full amount of the lease or financing expenditure to the borrower's monthly debt obligations.

Boarder Income

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

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

The following table provides verification requirements for income from boarders.

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

Other Sources of Income (continued)

Capital Gains Income

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

✓	Verification of Capital Gains Income
	Document a two-year history of capital gains income by obtaining copies of the borrower's signed federal income tax returns for the most recent two years, including IRS Form 1040, Schedule D.
	Develop an average income from the last two years (according to the Variable Income section of General Income Information), and use the averaged amount as part of the borrower's qualifying income as long as the borrower provides current evidence that he or she owns additional property or assets that can be sold if extra income is needed to make future mortgage loan payments. **Note:** Capital losses identified on IRS Form 1040, Schedule D, do not have to be considered when calculating income or liabilities, even if the losses are recurring. Due to the nature of this income, current receipt of the income is not required to comply with the Allowable Age of Credit Documents policy. However, documentation of the asset ownership must be in compliance with the Allowable Age of Credit Documents policy (see Allowable Age of Credit Documents and Federal Income Tax Returns, for additional information).

Disability Income — Long-Term

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

√	Verification of Long-Term Disability Income
	Obtain a copy of the borrower's disability policy or benefits statement from the benefits payer (insurance company, employer, or other qualified disinterested party) to determine • the borrower's current eligibility for the disability benefits, • the amount and frequency of the disability payments, and • there is a contractually established termination or modification date.
	Generally, long-term disability will not have a defined expiration date and must be expected to continue. The requirement for re-evaluation of benefits is not considered a defined expiration date. If a borrower is currently receiving short-term disability payments that will decrease to a lesser amount within the next three years because they are being converted to long- term benefits, the amount of the long-term benefits must be used as income to qualify the borrower. For additional information on short-term disability, see Temporary Leave Income below.

Other Sources of Income (continued)

Employment Offers or Contracts

Borrowers with future employment are eligible. If the borrower is scheduled to begin employment after the loan closes, CMS may deliver the loan to Fannie Mae if it meets the following criteria:

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

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

- clearly identify the employer and the borrower, be signed by the employer, and be accepted and signed by the borrower;
- clearly identify the terms of employment, including position, type and rate of pay, and start date; and
- be non-contingent.

Note: If conditions of employment exist, CMS must confirm prior to closing that all conditions of employment are satisfied either by verbal verification or written documentation. This confirmation must be noted in the mortgage loan file.

Also note that for a union member who works in an occupation that results in a series of short-term job assignments (such as a skilled construction worker, longshoreman, or stagehand), the union may provide the executed employment offer or contract for future employment.

The employment start date as shown on the employment offer or contract must be within 90 days of the note date.

CMS must document, in addition to the amount of reserves required by DU or for the transaction, one of the following:

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

CMS must deliver the loan with Special Feature Code 707.

Other Sources of Income (continued)

Employment-Related Assets as Qualifying Income

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

✓	Asset Requirements
	Assets used for the calculation of the monthly income stream must be owned individually by the borrower, or the co-owner of the assets must be a co-borrower of the mortgage loan. The documentation must be in compliance with the Allowable Age of Credit Documents policy (see Allowable Age of Credit Documents and Federal Income Tax Returns, for additional information).
	Assets must be liquid and available to the borrower and must be sourced as one of the following: • A non-self-employed severance package or non-self-employed lump sum retirement package (a lump sum distribution) — these funds must be documented with a distribution letter from the employer (Form 1099–R) and deposited to a verified asset account. • For 401(k) or IRA, SEP, Keogh retirement accounts – the borrower must have unrestricted access to the funds in the accounts and can only use the accounts if distribution is not already set up or the distribution amount is not enough to qualify. The account and its asset composition must be documented with the most recent monthly, quarterly, or annual statement.
	If a penalty would apply to a distribution of funds from the account made at the time of calculation, then the amount of such penalty applicable to a complete distribution from the account (after costs for the transaction) must be subtracted to determine the income stream from these assets.
	If the employment–related assets are in the form of stocks, bonds, and mutual funds, 70% of the value (remaining after costs for the transaction and consideration of any penalty) must be used to determine the income stream to account for the volatile nature of these assets.
	A borrower shall only be considered to have unrestricted access to a 401(k) or IRA, SEP, Keogh retirement account if the borrower has, as of the time of calculation, the unqualified and unlimited right to request a distribution of all funds in the account (regardless of any possible tax withholding or applicable penalty applied to such distribution).

Other Sources of Income (continued)

Employment-Related Assets as Qualifying Income (continued)

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

✓	Asset Requirements
	"Net documented assets" are equal to the sum of eligible assets minus: (a) the amount of the penalty that would apply if the account was completely distributed at the time of calculation; (b) the amount of funds used for down payment, closing costs, and required reserves; (c) 30% of the remaining value of any stocks, bonds, or mutual funds assets (after the calculation in (b)).
	Ineligible assets are non-employment-related assets (for example, stock options, non- vested restricted stock, lawsuits, lottery winnings, sale of real estate, inheritance, and divorce proceeds). Checking and savings accounts are generally not eligible as employment-related assets, unless the source of the balance in a checking or savings account was from an eligible employment-related asset (for example, a severance package or lump sum retirement distribution).

Example: Calculation of Net Documented Assets	
IRA (made up of stocks and mutual funds)	$ 500,000
Minus 10% of $500,000 ($500,000 x .10) (Assumes a 10% penalty for early distribution which must be levied against any cash being withdrawn for closing the transaction as well as the remaining funds used to calculate the income stream.)	(-) $50,000
Total eligible documented assets	(=) $ 450,000
Minus funds required for closing (down payment, closing costs, reserves)	(-) $100,000
(**a) Subtotal**	(=) $ 350,000
Minus 30% of $350,000 ($350,000 x .30)	(-) $105,000

Example: Calculation of Net Documented Assets	
(b) Net Documented Assets	**(=) $245,000**
Monthly income calculation ($245,000/360 (or applicable term of loan in months)) See Income Calculation/Payout Stream in table below.	$680.56/month

Other Sources of Income (continued)

Employment-Related Assets as Qualifying Income (continued)

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

Parameter	Fannie Mae Requirement
Maximum LTV, CLTV, and HCLTV Ratio	70% 80% if the owner of the asset(s) being used to qualify is at least 62 years old at the time of closing. If the asset(s) is jointly owned, all owners must be borrowers on the loan and the borrower whose employment-related asset is being used as income must be at least 62 years old at the time of closing.
Minimum Credit Score	DU: 620 Manual: Higher of 620 or minimum Credit Score per the *Eligibility Matrix*
Loan Purpose	Purchase and limited cash-out refinance only
Occupancy	Principal residence and second home only
Number of units	As permitted by occupancy type.
Income Calculation/Payout Stream	Divide “Net Documented Assets” by the amortization term of the mortgage loan (in months).

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

Foreign Income

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

✓	Verification of Foreign Income
	Copies of his or her signed federal income tax returns for the most recent two years that include foreign income.
	CMS must satisfy the standard documentation requirements based on the source and type of income as outlined in Income Assessment. **Note:** All income must be translated to U.S. dollars. If the borrower is not a U.S. citizen, refer to Non–U.S. Citizen Borrower Eligibility Requirements, for additional information.

Other Sources of Income (continued)

Foster-Care Income

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

✓	Verification of Foster-Care Income
	Verify the foster-care income with letters of verification from the organizations providing the income.
	Document that the borrower has a two-year history of providing foster-care services. If the borrower has not been receiving this type of income for two full years, the income may still be counted as stable income if: • the borrower has at least a 12-month history of providing foster-care services, and • the income does not represent more than 30% of the total gross income that is used to qualify for the mortgage loan.

Housing or Parsonage Income

Housing or parsonage income may be considered qualifying income if there is documentation that the income has been received for the most recent 12 months and the allowance is likely to continue for the next three years. The housing allowance may be added to income but may not be used to offset the monthly housing payment.

Note: This requirement does not apply to military quarters' allowance. For information on military housing, refer to Base Pay (Salary or Hourly), Bonus, and Overtime Income.

Interest and Dividends Income

The following table provides verification requirements for interest and dividends income.

✓	Verification of Income From Interest and Dividends
	Verify the borrower's ownership of the assets on which the interest or dividend income was earned. Documentation of asset ownership must be in compliance with the Allowable Age of Credit Documents policy (see Allowable Age of Credit Documents and Federal Income Tax Returns, for additional information).
	Document a two-year history of the income, as verified by • copies of the borrower's signed federal income tax returns, or • copies of account statements.
	Develop an average of the income received for the most recent two years. Refer to the Variable Income section of General Income Information, for additional information.
	Subtract any assets used for down payment or closing costs from the borrower's total assets before calculating expected future interest or dividend income.

Other Sources of Income (continued)

Mortgage Differential Payments Income

An employer may subsidize an employee's mortgage payments by paying all or part of the interest differential between the employee's present and proposed mortgage payments.

When calculating the qualifying ratio, the differential payments should be added to the borrower's gross income.

The payments may not be used to directly offset the mortgage payment, even if the employer pays them to the mortgage lender rather than to the borrower.

The following table provides verification requirements for mortgage differential payment income.

✓	Verification of Income From Mortgage Differential Payments
	Obtain written verification from the borrower's employer confirming the subsidy and stating the amount and duration of the payments.
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application. If this income is used on a purchase transaction, current receipt is not required to be documented except as verified in the employer letter. For refinance transactions where the income is continuing with the new loan, the recent receipt must be in compliance with the Allowable Age of Credit Documents policy (see Allowable Age of Credit Documents and Federal Income Tax Returns, for additional information).

Non-Occupant Borrower Income

DU will consider a non-occupant borrower's income as qualifying income for a principal residence with certain LTV ratio limitations.

Notes Receivable Income

The following table provides verification requirements for notes receivable income.

✓	Verification of Income From Notes Receivable
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application.
	Obtain a copy of the note to establish the amount and length of payment.
	Document regular receipt of income for the most recent 12 months. Payments on a note executed within the past 12 months, regardless of the duration, may not be used as stable income.

Other Sources of Income (continued)

Public Assistance Income

The following table provides verification requirements for public assistance income.

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

Retirement, Government Annuity, and Pension Income

The following table provides verification requirements for retirement and pension income.

✓	Verification of Retirement and Pension Income
	Document current receipt of the income, as verified by • a statement from the organization providing the income, • a copy of retirement award letter or benefit statement, • a copy of financial or bank account statement, • a copy of signed federal income tax return, • an IRS W-2 form, or • an IRS 1099 form.
	If income from a government annuity or a pension account will begin on or before the first payment date, document the income with a benefit statement from the organization providing the income. The statement must specify the income type, amount and frequency of the payment, and include confirmation of the initial start date.
	If retirement income is paid in the form of a distribution from a 401(k), IRA, or Keogh retirement account, determine whether the income is expected to continue for at least three years after the date of the mortgage application. Eligible retirement account balances (from a 401(k), IRA, or Keogh) may be combined for the purpose of determining whether the three-year continuance requirement is met. **Note:** The borrower must have unrestricted access to the accounts without penalty.

If a borrower's retirement, annuity, or pension income is validated by the DU validation service, DU will issue a message indicating the required documentation. This documentation may differ from the requirements described above.

Other Sources of Income (continued)

Royalty Payment Income

The following table provides verification requirements for royalty income.

✓	Verification of Income From Royalty Payments
	Obtain copies of the: • royalty contract, agreement, or statement confirming amount, frequency, and duration of the income; and • borrower's most recent signed federal income tax return, including the related IRS Form 1040, Schedule E.
	Confirm that the borrower has received royalty payments for at least 12 months and that the payments will continue for a minimum of three years after the date of the mortgage application.

Refer to the Variable Income section of General Income Information, for additional information.

Schedule K-1 Income

For borrowers who have less than 25% ownership of a partnership, S corporation, or limited liability company (LLC), ordinary income, net rental real estate income, and other net rental income reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 may be used in qualifying the borrower CMS can confirm the business has adequate liquidity to support the withdrawal of earnings. If the Schedule K-1 provides this confirmation, no further documentation of business liquidity is required.

The following table provides verification of income requirements for Schedule K-1 borrowers with less than 25% ownership of a partnership, an S corporation, or an LLC.

✓	Verification of Schedule K-1 Income
	If the Schedule K-1 reflects a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then no further documentation of access to the income or adequate business liquidity is required. The Schedule K-1 income may then be included in the borrower's cash flow.
	If the Schedule K-1 does not reflect a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then CMS must confirm the business has adequate liquidity to support the withdrawal of earnings. CMS may use discretion in the method used to confirm the business has adequate liquidity.
	If the borrower has a two-year history of receiving "guaranteed payments to the partner" from a partnership or an LLC, these payments can be added to the borrower's cash flow.

Other Sources of Income (continued)

Schedule K-1 Income (continued)

✓	Verification of Schedule K-1 Income
	Note: An exception to the two-year requirement of receiving “guaranteed payments to the partner” is if a borrower has recently acquired nominal ownership in a professional services partnership (for example, a medical practice or a law firm) after having an established employment history with the partnership. In this situation, CMS may rely on the borrower’s guaranteed compensation. This must be evidenced by the borrower’s partnership agreement and further supported by evidence of current year-to-date income.

Documentation Requirements

The borrower must provide the most recent two years of signed individual federal income tax returns and the most recent two years of IRS Schedule K-1.

Social Security Income

The following table provides verification requirements for Social Security income.

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

Documentation Requirements

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

Other Sources of Income (continued)

Social Security Income (continued)

[a]An SSA Award letter may be used to document the income if the borrower is receiving Social Security payments or if the borrower will begin receiving payments on or before the first payment date of the subject mortgage as confirmed by a recently issued award letter.

[b]Examples of how a borrower might draw Social Security benefits from another person's account/work record and use the income for qualifying:

- A borrower may be eligible for benefits from a spouse, ex-spouse, or dependent parents (the benefit is paid to the borrower on behalf of the spouse, etc.); or
- A borrower may use Social Security income received by a dependent (a minor or disabled dependent).

Temporary Leave Income

Temporary leave from work is generally short in duration and for reasons of maternity or parental leave, short-term medical disability, or other temporary leave types that are acceptable by law or the borrower's employer. Borrowers on temporary leave may or may not be paid during their absence from work.

If CMS is made aware that a borrower will be on temporary leave at the time of closing of the mortgage loan and that borrower's income is needed to qualify for the loan, CMS must determine allowable income and confirm employment as described below.

✓	Temporary Leave — Employment Requirements
	The borrower's employment and income history must meet standard eligibility requirements as described in Employment and Other Sources of Income.
	The borrower must provide written confirmation of his or her intent to return to work.
	CMS must document the borrower's agreed-upon date of return by obtaining, either from the borrower or directly from the employer (or a designee of the employer when the employer is using the services of a third party to administer employee leave), documentation evidencing such date that has been produced by the employer or by a designee of the employer. Examples of the documentation may include, but are not limited to, previous correspondence from the employer or designee that specifies the duration of leave or expected return date or a computer printout from an employer or designee's system of record. (This documentation does not have to comply with the Allowable Age of Credit Documents policy.

Other Sources of Income (continued)

Temporary Leave Income (continued)

✓	Temporary Leave — Employment Requirements
	CMS must receive no evidence or information from the borrower's employer indicating that the borrower does not have the right to return to work after the leave period.
	CMS must obtain a verbal verification of employment in accordance with Verbal Verification of Employment. If the employer confirms the borrower is currently on temporary leave, CMS must consider the borrower employed.
	CMS must verify the borrower's income in accordance with Section Employment and Other Sources of Income. CMS must obtain • the amount and duration of the borrower's "temporary leave income," which may require multiple documents or sources depending on the type and duration of the leave period; and • the amount of the "regular employment income" the borrower received prior to the temporary leave. Regular employment income includes, but is not limited to, the income the borrower receives from employment on a regular basis that is eligible for qualifying purposes (for example, base pay, commissions, and bonus). **Note:** Income verification may be provided by the borrower, by the borrower's employer, or by a third-party employment verification vendor.

Requirements for Calculating Income Used for Qualifying

If the borrower **will** return to work as of the first mortgage payment date, CMS can consider the borrower's regular employment income in qualifying.

If the borrower will **not** return to work as of the first mortgage payment date, CMS must use the lesser of the borrower's temporary leave income (if any) or regular employment income. If the borrower's temporary leave income is less than his or her regular employment income, CMS may supplement the temporary leave income with available liquid financial reserves (see Minimum Reserve Requirements). Following are instructions on how to calculate the "supplemental income":

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

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

Other Sources of Income (continued)

Requirements for Calculating Income Used for Qualifying (continued)

After determining the supplemental income, CMS must calculate the total qualifying income.

> **Total qualifying income = supplemental income plus the temporary leave income**

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

Example:

Regular income amount: $6,000 per month

Temporary leave income: $2,000 per month

Total verified liquid assets: $30,000

Funds needed to complete the transaction: $18,000

Available liquid reserves: $12,000

First payment date: July 1

Date borrower will begin receiving regular employment income: November 1 Supplemental income: $12,000/4 = $3,000

Total qualifying income: $3,000 + $2,000 = $5,000

For loan casefiles underwritten with DU, refer to Income and Employment Documentation for DU, for data entry guidance.

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

Other Sources of Income (continued)

Tip Income

The following table provides verification requirements for tip income.

✓	Verification of Tip Income
	Obtain the following documents: • a completed *Request for Verification of Employment* (Form 1005 or Form 1005(S)), or • the borrower's recent paystub, and • IRS W-2 forms covering the most recent two-year period or the most recent two years tax returns with IRS Form 4137, Social Security and Medicare Tax on Unreported Tip Income, to verify tips not reported by the employer. See Standards for Employment Documentation, for additional information.
	Tip income may be used to qualify the borrower if CMS verifies that the borrower has received it for the last two years.
	CMS must determine the amount of tip income that may be considered in qualifying the borrower. Refer to the Variable Income section of General Income Information, for additional information.

Tip income must be entered in DU in the Other Monthly Income section of the loan application as "Other Types of Income" and verified according to these requirements.

Trust Income

The following table provides verification requirements for trust income.

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

Other Sources of Income (continued)

Unemployment Benefits Income

The following table provides verification requirements for income from unemployment benefits, such as those received by seasonal workers.

✓	Verification of Income From Unemployment Benefits
	Document that the borrower has received the payments consistently for at least two years by obtaining copies of signed federal income tax returns.
	Unemployment compensation cannot be used to qualify the borrower unless it is clearly associated with seasonal employment that is reported on the borrower's signed federal income tax returns. Verify that the seasonal income is likely to continue. See Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income, for additional information about verifying seasonal income.

Underwriting Factors and Documentation for a Self-Employed Borrower

Overview

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

Factors to Consider for a Self-Employed Borrower

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

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

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

Underwriting Factors and Documentation for a Self-Employed Borrower (continued)

Length of Self-Employment

Generally, Fannie Mae requires CMS to obtain a (2) two-year history of the borrower's prior earnings as a means of demonstrating the likelihood that the income will continue to be received.

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

Verification of Income

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

Alternatively, CMS may use IRS-issued transcripts of the borrower's individual and business federal income tax returns that were filed with the IRS for the most recent two years — as long as the information provided is complete and legible and the transcripts include the information from all of the applicable schedules. (See Requirements and Uses of IRS Form 4506-C.)

When two years of signed individual federal tax returns are provided, CMS may waive the requirement for business tax returns if:

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

For certain loan casefiles DU will issue a message permitting only one year of personal and business tax returns, provided CMS document the income by:

- obtaining signed individual and business federal income tax returns for the most recent year,
- confirming the tax returns reflect at least 12 months of self-employment income, and
- completing Fannie Mae's Cash Flow Analysis (Form 1084) or any other type of cash flow analysis form that applies the same principles.

Underwriting Factors and Documentation for a Self-Employed Borrower (continued)

Analysis of Borrower's Personal Income

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

CMS may use Form 1084 or any other type of cash flow analysis that applies the same principles as Fannie Mae's form.

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

CMS may use the Fannie Mae-approved vendor tool (Loanbeam) to complete the written analysis and calculate self-employment income. CMS may receive representation and warranty enforcement relief of the calculated amount if the following requirements are met:

- the information submitted to the tool is accurate and complete,
- CMS must not perform any manual overrides of the output results of Loanbeam findings
- the amount of self-employment income entered in DU must match the amount of income calculated by Loanbeam, and
- the loan must be delivered with SFC 777.

Analysis of Borrower's Business Income

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

The purpose of this analysis is to:

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

Underwriting Factors and Documentation for a Self-Employed Borrower (continued)

Analysis of Borrower's Business Income, continued

CMS may use Fannie Mae's *Comparative Income Analysis* (Form 1088) or any other method of trend analysis that enables it to determine a business's viability, as long as the method used fairly presents the viability of the business and results in a degree of accuracy and a conclusion that is comparable to that which would be reached by use of Form 1088. A copy of the written analysis and conclusions must be retained in the individual mortgage file.

Use of Business Assets

When a borrower intends to use business assets as funds for the down payment, closing costs, and/or financial reserves, CMS must perform a business cash flow analysis to confirm that the withdrawal of funds for this transaction will not have a negative impact on the business.

In order to assess the impact, CMS may require a level of documentation greater than what is required to evaluate the borrower's business income (for example, several months of recent business asset statements in order to see cash flow needs and trends over time, or a current balance sheet). This may be due to the amount of time that has elapsed since the most recent tax return filing, or CMS need for information to perform its analysis. See Depository Accounts, for additional information on business assets.

Income Verification for Self-Employed Co-Borrowers

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

Verbal Verification of Employment

For requirements regarding verbal VOEs, see Verbal Verification of Employment.

Business Structures

Overview

The legal structure of a business determines the following:

- the way business income or loss is reported to the IRS,
- the taxes that are paid,
- the ability of the business to accumulate capital, and
- the extent of the owner's liability.

There are five principal business structures: sole proprietorships, partnerships, limited liability companies (LLCs), S corporations, and corporations. Knowledge of the structure of a self-employed borrower's business will assist CMS in analyzing and evaluating the stability of the business and the degree of the borrower's involvement.

Note: Refer to IRS Forms Quick Reference, for a summary of the IRS forms referenced in this section and their full titles.

Business Structures (continued)

Sole Proprietorships

A sole proprietorship is an unincorporated business that is individually owned and managed.

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

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

The income, expenses, and taxable profits of a sole proprietorship are reported on the owner's IRS Form 1040, Schedule C, and are taxed at the tax rates that apply to individuals. (See Income or Loss Reported on IRS Form 1040, Schedule C.) When evaluating a sole proprietorship CMS must:

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

Partnerships

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

General Partnership — Under a general partnership, each partner has responsibility for running the business, is personally liable for the debts of the entire business, and is responsible for the actions of every other partner (unless otherwise specified in the partnership agreement).

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

Business Structures (continued)

Partnerships (continued)

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

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

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

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

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

Limited Liability Companies

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

Business Structures (continued)

Limited Liability Companies (continued)

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

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

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

S Corporations

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

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

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

The cash flow of an S corporation is otherwise evaluated similarly to that of a regular corporation.

Business Structures (continued)

Corporations

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

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

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

Business Structures (continued)

IRS Forms Quick Reference

The following table lists the IRS forms referenced in this section and provides the full titles.

IRS Form Number	Title
Form 990	*Return of Organization Exempt From Income Tax Form*
Form 1040	*U.S. Individual Income Tax Return*
Form 1040, Schedule B	*Interest and Ordinary Dividends*
Form 1040, Schedule C	*Profit or Loss from Business (Sole Proprietorship)*
Form 1040, Schedule D	*Capital Gains and Losses*
Form 1040, Schedule E	*Supplemental Income and Loss*
Form 1040, Schedule F	*Profit or Loss From Farming*
Form 1065	*U.S. Return of Partnership Income*
Form 1065, Schedule K-1	*Partner's Share of Income, Deductions, Credits, etc.*
Form 1099-A	*Acquisition or Abandonment of Secured Property*
Form 1099-C	*Cancellation of Debt*
Form 1099-DIV	*Dividends and Distributions*
Form 1099-MISC	*Miscellaneous Income*
Form 1120	*U.S. Corporation Income Tax Return*
Form 1120-S	*U.S. Income Tax Return for an S Corporation*
Form 1120-S, Schedule K-1	*Shareholder's Share of Income, Deductions, Credits, etc.*
Form 2106	*Employee Business Expenses*
Form 4506-C	*IVES Request for Transcript of Tax Return*
Form 4506	*Request for Copy of Tax Return*
Form 4797	*Sales of Business Property*
Form 6252	*Installment Sale Income*
Form 8821	*Tax Information Authorization*
Form 8825	*Rental Real Estate Income and Expenses of a Partnership or an S Corporation*
Form W-4	*Employee's Withholding Allowance Certificate*

General Information on Analyzing Individual Tax Returns

Analyzing Individual Tax Returns

In analyzing a self-employed borrower's personal income, CMS should focus on earnings trends and the actual sources of the income, not just on the total amount of the income. CMS must confirm the stability and likelihood of continuance for each source of income that the borrower reports on his or her IRS Form 1040. CMS should not include any income that does not appear to be stable or likely to continue. CMS should, however, consider all recurring income that the borrower can expect to continue receiving over time.

Income may be considered as recurring if the loan application package does not include any specific indication of an upcoming change in the borrower's employment or income, the borrower's employment history has no gaps or other significant fluctuations in income, and any income received under a contractual agreement (other than an "at will" contract) will continue to be received for at least three years.

Examples of recurring income include:

- regular salaries or wages,
- bonus or commission income that has been received on a consistent basis,
- interest income from long-term investments that are not being liquidated in connection with the mortgage transaction, and
- earnings from the operation of the borrower's business.

Any nonrecurring loss (such as an extraordinary one-time expense) should not be included in the cash flow analysis; therefore, in developing the borrower's qualifying income, CMS should adjust the borrower's cash flow by the amount of any nonrecurring loss.

Adjusted Gross Income Approach

IRS Form 1040 permits a taxpayer to adjust his or her total reported income by reporting certain deductions in the "Adjusted Gross Income" section.

If CMS uses the adjusted gross income approach to its cash flow analysis, it should add back to the borrower's cash flow all deductions in this section that represent:

- voluntary payments to savings accounts (IRA and Keogh deductions),
- deductions for taxes or health insurance plans,
- deductions for obligations that must be counted in the calculation of the borrower's debt-to- income ratio (such as alimony or payments on student loans), and
- other nonrecurring expenses (such as moving expenses or penalties for early withdrawal of savings).

Income Reported on IRS Form 1040

Overview

To get an accurate picture of the borrower's cash flow, CMS will need to make certain adjustments to some of the income (or loss) that the borrower reported on IRS Form 1040 since it may not be recurring income. CMS also may need to further analyze the accompanying tax schedules or supplemental tax forms.

This section describes how CMS should treat various components of the income (or loss) that a self-employed borrower reported on IRS Form 1040 in its cash flow analysis.

Note: Eligibility criteria for accepting income from specific non-business sources is generally the same as that for salaried or commissioned borrowers.

Wages, Salary, and Tips

If an amount is shown for wages, salary, or tips for a self-employed borrower, it may mean:

- the borrower operates as a corporation and pays himself or herself a salary or
- the borrower's spouse is employed and receives a salary (either from the borrower's business or from another employer).

If the income relates to the borrower's spouse who is employed by another company and the income will be used in qualifying for the mortgage, the spouse's income must be verified directly with his or her employer since it may be more appropriate to use the spouse's current earnings in underwriting the mortgage. Any income that is based on current earnings or that will not be used for qualifying purposes should be deducted from the borrower's cash flow.

Interest and Dividend Income

The taxable interest and dividend income that is reported on IRS Form 1040, Schedule B, may be counted as stable income only if it has been received for the past two years. However, the income cannot be counted if the borrower is using the interest-bearing or dividend-producing asset as the source of the down payment or closing costs.

Any taxable interest or dividend income that is not recurring must be deducted from the borrower's cash flow.

Tax-exempt interest income may be counted as stable income only if it has been received for the past two years and is expected to continue. If so, this income can be added to the borrower's cash flow.

State and Local Tax Refunds

Taxable state and local tax refunds, credits, or offsets of state and local income taxes should not be used as qualifying income since the income was accounted for in the previous year's tax returns. Therefore, the borrower's cash flow must be adjusted accordingly.

Alimony Received

Alimony may be accepted as qualifying income if it meets the requirements described in Other Sources of Income. Any reported alimony received that is determined to be nonrecurring must be deducted from the borrower's total income reported on IRS Form 1040.

Income Reported on IRS Form 1040 (continued)

IRA Distributions, Pensions and Annuities, and Social Security Benefits	Income received from IRA distributions, pensions, annuities, and Social Security benefits may be accepted as qualifying income. See Other Sources of Income, for specific requirements. The nontaxable portion of such recurring income must be added to the borrower's cash flow. The tax-exempt portion of income from these sources may be increased to reflect the tax savings, as described in General Income Information. If the income from these sources is determined to be nonrecurring, the income must be deducted from the borrower's cash flow.
Unemployment Compensation	Unemployment compensation may be considered as acceptable qualifying income if it meets the requirements described in Other Sources of Income. Any reported unemployment compensation that is determined to be nonrecurring must be deducted from the borrower's cash flow.
Other Income (or Loss)	If the borrower reported income from other sources, CMS must verify that the income is an eligible source for qualifying purposes per the requirements described in Other Sources of Income, for the applicable income source. Income that is determined to be nonrecurring or ineligible for qualifying purposes must be deducted from the borrower's cash flow. If the borrower reported any nonrecurring losses, the borrower's cash flow should be increased by the amount of the losses.
Automobile Depreciation	If a borrower claims a "standard mileage" deduction, the business miles driven should be multiplied by the depreciation factor for the appropriate year, and the calculated amount added to the borrower's cash flow. If a borrower claims an "actual depreciation expense" deduction, the amount the borrower claimed should be added to the borrower's cash flow.

Income or Loss Reported on IRS Form 1040, Schedule C

Income (or Loss) from a Sole Proprietorship	The income (or loss) from a borrower's sole proprietorship is calculated on IRS Form 1040, Schedule C, then transferred to IRS Form 1040. CMS may need to make certain adjustments to the net profit or loss shown on Schedule C to arrive at the borrower's cash flow. For example, Schedule C may include income that was not obtained from the profits of the borrower's business. If CMS determines that such income is not recurring, it should adjust the borrower's cash flow by deducting the nonrecurring income. See Business Structures, for more information on sole proprietorships.
Recurring vs. Non-recurring Income and Expenses	CMS must determine whether income is recurring or non-recurring. Non-recurring income must be deducted in the cash flow analysis, including any exclusion for meals and entertainment expenses reported by the borrower on Schedule C. The following recurring items claimed by the borrower on Schedule C must be added back to the cash flow analysis: depreciation, depletion, business use of a home, amortization, and casualty losses.

Income or Loss Reported on IRS Form 1040, Schedule D

Overview

IRS Form 1040, Schedule D, is used to report capital gains and losses. Income received from a capital gain is generally a one-time transaction; therefore, it should not usually be considered part of the borrower's stable monthly income.

Calculating Borrower Cash Flow from Schedule D and Required Documentation

If the income calculated on the Schedule D shows that the borrower has realized capital gains for the last two years, as may be the case when the borrower's business has a constant turnover of assets that produces regular gains, the recurring gains can be considered in determining the borrower's stable monthly income. In this case, the borrower must provide evidence of ownership of additional property or assets that can be sold if extra income is needed to make future mortgage payments.

The table below provides the requirements for calculating cash flow from Schedule D and the associated required documentation.

If …	Then …
recurring capital gains relate to the sale of business property,	CMS must obtain a copy of the applicable Sale of Business Property (IRS Form 4797) to support the recurring nature of the capital gains.
Schedule D includes principal payments on an installment sales contract,	CMS must obtain a copy of: • the Installment Sale Income (IRS Form 6252), and • the note or contract to verify that the borrower will continue to receive the payments for at least three years.
the capital gain on the principal payment and interest income from an installment sales contract is determined to be nonrecurring,	the amount must be deducted from the borrower's cash flow.

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

Income or Loss Reported on IRS Form 1040, Schedule E

Overview

Income received from rents, royalties, and distributions from partnerships, corporations, estates, trusts, etc., is calculated on IRS Form 1040, Schedule E, and transferred to IRS Form 1040.

Rather than using Schedule E for income related to distributions from partnerships, corporations, estates, and trusts, CMS should rely on Schedule K-1 (see Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1).

Royalty Income

Schedule E should be used to determine the supplemental income to use for royalties. CMS must include the total amount of royalty payments received, and must document the borrower's receipt of royalty income for 12 months and the likelihood of continued receipt of such income for at least three years (see Other Sources of Income).

Rental Income

If rental income is reported on Schedule E, only the rental income that relates to properties shown on the Schedule of Real Estate Owned on the borrower's loan application should be included.

All regular and ongoing expenses for the properties, such as maintenance, advertising, management fees, utilities, homeowners' association dues, and supply costs, should be subtracted from the borrower's cash flow.

Depending on the approach used to calculate cash flow, adjustments will need to be made for depreciation and any one-time extraordinary expenses, such as the costs of repairing damage that resulted from a natural disaster.

In most situations, the full amount of the mortgage payment for a rental property will be factored into the net rental income calculation, but it may also be counted as part of the liabilities that are considered in the calculation of the borrower's total debt-to-income ratio. Therefore, CMS must add back any portion of the mortgage payment, including interest, taxes, and insurance, necessary to avoid double counting of these expenses.

CMS must pay particular attention to the effect of "passive loss" limitations or prior "carryovers" related to the borrower's rental properties and, depending on the method it uses for the cash flow analysis, make any special adjustments necessary to account for them.

Income or Loss Reported on IRS Form 1040, Schedule F

Requirements

Income received from farming is calculated on IRS Form 1040, Schedule F, and transferred to IRS Form 1040.

Note: Other income on Schedule F may represent income that is not obtained from the borrower's farming operations.

CMS may need to make certain adjustments to the net income amount that was transferred to IRS Form 1040. For example, certain federal agricultural program payments, co-op distributions, and insurance or loan proceeds are not fully taxable, so they would not be reported on IRS Form 1040. These income sources may or may not be stable or continuous and could be a one-time occurrence.

If CMS verifies that the net income amounts that were transferred to IRS Form 1040 are stable, consistent, and continuing, the borrower's cash flow must be adjusted by the nontaxable portion of any recurring income from these sources. Otherwise, the income must be deducted from the borrower's cash flow.

CMS can adjust the borrower's cash flow by adding the amount of any deductions the borrower claimed on Schedule F for depreciation, amortization, casualty loss, depletion, or business use of his or her home.

Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1

Requirements

The version of Schedule K-1 that is utilized to report a borrower's share of income (or loss) is based on how the business reports earnings for tax purposes:

- Partnership — reported on IRS Form 1065, Schedule K-1;
- S corporation — reported on IRS Form 1120S, Schedule K-1; and
- LLC — reported on either IRS Form 1065 or IRS Form 1120S, Schedule K-1, depending on how the federal income tax returns are filed for the LLC.

CMS must use caution when including income that the borrower draws from the borrower's partnership or S corporation as qualifying income. Ordinary income, net rental real estate income, and other net rental income reported on Schedule K-1 may be included in the borrower's cash flow provided CMS can confirm that the business has adequate liquidity to support the withdrawal of earnings, as described below:

- If the borrower has a two-year history of receiving "guaranteed payments to the partner" from a partnership or an LLC, these payments can be added to the borrower's cash flow.

Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 (continued)

Requirements (continued)

- If the Schedule K-1 reflects a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then no further documentation of access to the income or adequate business liquidity is required. But if the Schedule K-1 does not reflect a documented, stable history, then CMS must confirm adequate business liquidity, as discussed below.

If business tax returns are required, then CMS must consider the type of business structure and analyze the business returns, according to the requirements described in Underwriting Factors and Documentation for a Self-Employed Borrower.

CMS may use discretion in selecting the method to confirm that the business has adequate liquidity to support the withdrawal of earnings. When business tax returns are provided, for example, CMS may calculate a ratio using a generally accepted formula that measures business liquidity by deriving the proportion of current assets available to meet current liabilities.

It is important that CMS select a business liquidity formula based on how the business operates. For example:

- The Quick Ratio (also known as the Acid Test Ratio) is appropriate for businesses that rely heavily on inventory to generate income. This test excludes inventory from current assets in calculating the proportion of current assets available to meet current liabilities.

  Quick Ratio = (current assets — inventory) ÷ current liabilities

- The Current Ratio (also known as the Working Capital Ratio) may be more appropriate for businesses not relying on inventory to generate income.

  Current Ratio = current assets ÷ current liabilities

For either ratio, a result of one or greater is generally sufficient to confirm adequate business liquidity to support the withdrawal of earnings.

Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 (continued)

Documentation Requirements

The following table describes the documentation that the borrower must provide. The borrower must select one item from each row.

✓	Documentation Requirements
	• the most recent two years of signed individual federal income tax returns—IRS Form 1040; or
	• the most recent one year of signed individual federal income tax returns, if permitted by DU
	• the most recent two years of IRS Schedule K-1; or • the most recent year IRS Schedule K-1, if permitted by DU
	• the most recent two years of business federal income tax returns (IRS Form 1065 or IRS Form 1120S), unless the requirements to waive business tax returns have been met; or • the most recent one year of business federal income tax returns, if permitted by DU

Analyzing Partnership Returns for a Partnership or LLC

Overview

Partnerships and some LLCs use IRS Form 1065 for filing informational federal income tax returns for the partnership or LLC. The partner's or member-owner's share of income (or loss) is carried over to IRS Form 1040, Schedule E. See Business Structures, for more information on partnerships and LLCs.

A borrower with an ownership interest in a partnership or LLC may receive income in the form of wages or other compensation from the partnership or LLC in addition to the borrower's proportionate share of income (or loss) reported on the Schedule K-1.

Evaluating the Business Income

When the borrower has 25% or more ownership interest in the business and business tax returns are required, CMS must perform a business cash flow analysis and evaluate the overall financial position of the borrower's business to determine whether

- income is stable and consistent, and
- sales and earnings trends are positive.

If the business does not meet these standards, business income cannot be used to qualify the borrower.

Analyzing Partnership Returns for a Partnership or LLC (continued)

Borrower's Proportionate Share of Income or Loss

The borrower's proportionate share of income or loss is based on the borrower's partnership percentage of Ending Capital in the business as shown on IRS Form 1065, Schedule K-1.

CMS can only consider the borrower's proportionate share of the business income or loss after making the adjustments to the business cash flow analysis discussed below.

Adjustments to Business Cash Flow

Items that can be added back to the business cash flow include depreciation, depletion, amortization, casualty losses, and other losses that are not consistent and recurring.

The following items should be subtracted from the business cash flow:

- meals and entertainment exclusion,
- other reported income that is not consistent and recurring, and
- the total amount of obligations on mortgages or notes that are payable in less than one year.

These adjustments are not required for lines of credit or if there is evidence that these obligations roll over regularly and/or the business has sufficient liquid assets to cover them.

Income from Partnerships, LLCs, Estates, and Trusts

Income from partnerships, LLCs, estates, or trusts can only be considered if CMS obtains documentation, such as the Schedule K-1, verifying that

- the income was actually distributed to the borrower, or
- the business has adequate liquidity to support the withdrawal of earnings. If the Schedule K-1 provides this confirmation, no further documentation of business liquidity is required.

CMS may use discretion in selecting the method to confirm that the business has adequate liquidity to support the withdrawal of earnings. When business tax returns are provided, for example, CMS may calculate a ratio using a generally accepted formula that measures business liquidity by deriving the proportion of current assets available to meet current liabilities. It is important that CMS select a business liquidity formula based on how the business operates. For example:

- The Quick Ratio (also known as the Acid Test Ratio) is appropriate for businesses that rely heavily on inventory to generate income. This test excludes inventory from current assets in calculating the proportion of current assets available to meet current liabilities.

  Quick Ratio = (current assets — inventory) ÷ current liabilities

Analyzing Partnership Returns for a Partnership or LLC (continued)

Income from Partnerships, LLCs, Estates, and Trusts (continued)

- The Current Ratio (also known as the Working Capital Ratio) may be more appropriate for businesses not relying on inventory to generate income.

  Current Ratio = current assets ÷ current liabilities

For either ratio, a result of one or greater is generally sufficient to confirm adequate business liquidity to support the withdrawal of earnings.

Analyzing Returns for an S Corporation

Overview

S corporations and some LLCs pass gains and losses on to their shareholders, who are then taxed at the tax rates for individuals. S corporations and some LLCs use IRS Form 1120S, Schedule K-1, for filing federal income tax returns for the corporation. The shareholder's share of income or loss is carried over to IRS Form 1040, Schedule E. See Business Structures, for more information on S corporations. A borrower with an ownership interest in an S corporation or LLC may receive income in the form of wages or dividends in addition to his or her proportionate share of business income (or loss) reported on Schedule K-1.

Evaluating the Business Income

When the borrower has 25% or more ownership interest in the business, CMS must perform a business cash flow analysis in order to evaluate the overall financial position of the business and confirm

- the business income is stable and consistent, and
- the sales and earnings trends are positive.

If the business does not meet these standards, business income cannot be used to qualify the borrower.

Borrower's Proportionate Share of Income or Loss

The borrower's proportionate share of income or loss is based on the borrower's (shareholder) percentage of stock ownership in the business for the tax year as shown on IRS Form 1120S, Schedule K-1. The cash flow analysis should consider only the borrower's proportionate share of the business income (or loss), taking into account any adjustments to the business income that are discussed below. Business income may only be used to qualify the borrower if CMS obtains documentation verifying that

- the income was actually distributed to the borrower, or
- the business has adequate liquidity to support the withdrawal of earnings. If the Schedule K-1 provides this confirmation, no further documentation of business liquidity is required.

Analyzing Returns for an S Corporation (continued)

Borrower's Proportionate Share of Income or Loss (continued)

CMS may use discretion in selecting the method to confirm that the business has adequate liquidity to support the withdrawal of earnings. When business tax returns are provided, for example, CMS may calculate a ratio using a generally accepted formula that measures business liquidity by deriving the proportion of current assets available to meet current liabilities.

It is important that CMS select a business liquidity formula based on how the business operates. For example:

- The Quick Ratio (also known as the Acid Test Ratio) is appropriate for businesses that rely heavily on inventory to generate income. This test excludes inventory from current assets in calculating the proportion of current assets available to meet current liabilities.

  Quick Ratio = (current assets — inventory) ÷ current liabilities

- The Current Ratio (also known as the Working Capital Ratio) may be more appropriate for businesses not relying on inventory to generate income.

  Current Ratio = current assets ÷ current liabilities

For either ratio, a result of one or greater is generally sufficient to confirm adequate business liquidity to support the withdrawal of earnings.

Adjustments to Business Cash Flow

Items that can be added back to the business cash flow include depreciation, depletion, amortization, casualty losses, and other losses that are not consistent and recurring.

The following items should be subtracted from the business cash flow:

- meals and entertainment exclusion,
- other reported income that is not consistent and recurring, and
- the total amount of obligations on mortgages or notes that are payable in less than one year.

These adjustments are not required for lines of credit or if there is evidence that these obligations roll over regularly and/or the business has sufficient liquid assets to cover them.

Analyzing Returns for a Corporation

Overview

Corporations use IRS Form 1120 to report their taxes. See Business Structures, for more information on corporations.

Corporate Fiscal Year

When funds from a corporation that operates on a fiscal year that is different from the calendar year are used in qualifying a self-employed borrower CMS must make time adjustments to relate the corporate income to the borrower's individual tax return, which is on a calendar year basis.

Analyzing Returns for a Corporation (continued)

Determining the Corporation's Financial Position

After determining the income available to the borrower for qualifying purposes, CMS must evaluate the overall financial position of the corporation. Ordinary income from the corporation can be used to qualify the borrower only if the following requirements are met:

- the business income must be stable and consistent,
- the sales and earnings trends must be positive, and
- the business must have adequate liquidity to support the borrower's withdrawals of cash without having severe negative effects.

Borrower's Share of Income or Loss

The cash flow analysis can only consider the borrower's share of the business income or loss, taking into consideration adjustments to business income provided below. Earnings may not be used unless the borrower owns 100% of the business.

Adjustments to Cash Flow

Items that can be added back to the business cash flow include depreciation, depletion, amortization, casualty losses, net operating losses, and other special deductions that are not consistent and recurring.

The following items should be subtracted from the business cash flow:

- meals and entertainment exclusion,
- tax liability and amount of any dividends, and
- the total amount of obligations on mortgages or notes that are payable in less than one year. These adjustments are not required if there is evidence that these obligations roll over regularly and/or the business has sufficient liquid assets to cover them.

Analyzing Profit and Loss Statements

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

A year-to-date profit and loss statement is not required for most businesses, but if the borrower's loan application is dated more than 120 days after the end of the business's tax year, CMS may choose to require this document if it believes that it is needed to support its determination of the stability or continuance of the borrower's income.

If CMS did not count the borrower's year-to-date salary or draws in determining the borrower's qualifying income, it may add them to the net profit shown on the profit and loss statement as well as adding any of the allowable adjustments it used in analyzing the tax returns for the business, such as nonrecurring income and expenses, depreciation, and depletion.

However, only the borrower's proportionate share of these items may be considered in determining the amount of income from the business that the borrower can use for qualifying purposes.

Income and Employment Documentation for DU

General Income Documentation Requirements

DU indicates the minimum income verification documentation required to process a loan application. This level of documentation may not be adequate for every borrower and every situation. CMS must determine whether additional documentation is warranted. If CMS is unable to determine the stability of the borrower's income on the basis of the available documentation, the income must be removed and the loan resubmitted to DU.

Note: Only actual employer information should be entered in Section IV. For example, do not enter "retired" or "homemaker" as the borrower's current employer.

Base Pay (Salary or Hourly) Income

DU will require the following:

- a completed Request for Verification of Employment (Form 1005), or
- the borrower's recent paystub and IRS W-2 forms covering the most recent one-year period.

Bonus and Overtime Income

DU will require the following:

- a completed Form 1005, or
- the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.

Verification of Commission Income

A minimum history of 2 years of commission income is recommended; however, commission income that has been received for 12 to 24 months may be considered as acceptable income, as long as there are positive factors to reasonably offset the shorter income history.

One of the following must be obtained to document commission income:

- a completed Request for Verification of Employment or
- the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.

A verbal VOE is required from each employer.

See General Income Information, for additional information about calculating variable income.

See Standards for Employment Documentation, for additional information about verifying employment income.

Income and Employment Documentation for DU (continued)

Secondary Employment Income (Second Job and Multiple Jobs)

When the second job income is not from self-employment, DU will require the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.

Note: The income from any second or multiple jobs must be included in the Base Income field in Section V.

Self-Employment Income

For DU loan casefiles where two years of the most recent signed personal and two years of the most recent signed business federal income tax returns are required, business tax returns do not have to be provided unless the business is a corporation, an S corporation, a limited liability company, or a partnership. Under certain conditions, the requirements for business tax returns may be waived.

For certain loan casefiles, DU will issue a message permitting only one year of personal and business tax returns, provided CMS documents the income by

- obtaining signed individual and business federal income tax returns for the most recent year,
- confirming the tax returns reflect at least 12 months of self-employment income, and
- completing Fannie Mae’s Cash Flow Analysis (Form 1084) or any other type of cash flow analysis form that applies the same principles.

Refer to Underwriting Factors and Documentation for a Self-Employed Borrower for additional information about waiving the business return requirement and for required forms and calculations. A copy of the written analysis must be included in the permanent loan file.

Note: The net income from self-employment should be entered in the Base Income field in Section V. CMS should answer “Yes” in the self-employment indicator.

Income and Employment Documentation for DU (continued)

Verbal Verification of Employment

A verbal VOE is required for each employer. For requirements regarding verbal VOEs, see Verbal Verification of Employment.

Other/Non-Employment Income

Other/non-employment income must be entered as "Other Income" in Section V. The other income types available in DU are listed below. Income types not in the Other Income List must be entered as "Other Types of Income" (for example, housing or parsonage income).

- accessory unit
- alimony or child support
- automobile/expense account
- boarder income
- capital gains
- dividends/interest
- employment-related assets
- foreign income
- foster-care
- military base pay, clothes allowance, combat pay, flight pay, hazard pay, overseas pay, prop pay, quarters allowance, rations allowance, variable housing allowance. (All military income can be combined and entered as Base Income in Section V for conventional loans.)
- non-borrower household income
- notes receivable and installment debt
- other types of income
- pension and retirement income
- royalty payment
- seasonal income
- Schedule K-1
- Social Security disability income
- temporary leave (see data entry instructions below)
- tip income
- trust income
- unemployment and public assistance income

Income and Employment Documentation for DU (continued)

Temporary Leave Income

When income from temporary leave is being used to qualify for the mortgage loan, CMS must enter the appropriate qualifying income amount into DU based on the requirements provided in Other Sources of Income.

- If the borrower will return to work as of the first mortgage payment date, CMS can consider the borrower's regular employment income in qualifying and must enter the income into DU using the applicable income type.
- If the borrower will not return to work as of the first mortgage payment date, but is able to qualify using the lesser of the borrower's temporary leave income (if any) or regular employment income, that “lesser of” income amount must be entered into DU. Entry of the income into DU depends on what was derived as the “lesser of” amount:
  - When the borrower's temporary leave income is used, enter the income amount into DU as an Other Monthly Income amount of “Temporary Leave.”
  - When the borrower's regular employment income is used, enter the income amount in DU using the applicable income type.
- If the borrower's temporary leave income is less than the regular employment income and CMS is able to “supplement” the temporary income with available liquid reserves (per Other Sources of Income), the following must be applied:
  - CMS must enter the combined temporary leave income and supplemental income from reserves in DU as an Other Monthly Income amount of “Temporary Leave.” The combination of these two incomes may not exceed the borrower's regular monthly employment income.
  - As DU is not able to determine that supplemental income is being used, nor is it able to determine the amount of reserves used to supplement the temporary income, CMS must manually reduce the amount of the borrower's total liquid assets by the amount of reserves used to supplement the temporary income (in order to avoid the reserves being used for both income and assets).

Income and Employment Documentation for DU (continued)

Nontaxable Income

DU does not provide any unique messaging identifying the use of adjusted gross income.

See General Income Information, for guidance on how to calculate adjusted gross income for nontaxable income. This topic also defines the requirements that nontaxable income must meet to be considered for qualifying purposes in DU. If these requirements are not met, the borrower's income must be adjusted downward.

Note: Certain loan origination systems offer an automatic calculation of adjusted gross income when nontaxable income types are entered in the loan application.

Income from Rental Property in DU

Entering Net Rental Income in DU

"Net rental income" for DU loan casefiles does not include rental income from the subject property. It applies only to rental properties already owned by the borrower. For rental income on the subject property, see Subject Net Cash Flow below.

To submit net rental income to DU, CMS can either:

- Calculate the total net rental income for all rental properties (except the subject property) and enter the amount (either positive or negative) in the Net Rental field in Section V. If Real Estate Owned (REO) data is entered, DU will ignore a zero value in this Net Rental field.

  Therefore, CMS must enter either a positive or negative amount. In other words, if the net rental income is a "breakeven" amount, the user must enter either $0.01 or $−0.01. Otherwise, DU will use the value from Section VI R.
- Complete the REO data entered in the Uniform Residential Loan Application (URLA) (or in a loan origination system) for each rental property (except the subject property). DU will preliminarily calculate the net rental income using the following formula:

  (gross rental income × 75%) − property PITIA expense = net rental income

CMS should override DU's preliminary calculation, if it is different from CMS calculation, by entering the net rental income amount directly in the Net Rental field in the URLA, Section VI R.

If both methods are used, DU will use the net rental income from Section V (if it is a value other than zero) and issue a message when there is a conflict of data.

If the combined total net rental income for all rental properties is positive, DU adds the net rental income to the qualifying income. If the total is negative, DU treats the loss as a liability and includes it in the debt-to-income ratio.

Income from Rental Property in DU (continued)

Special Situations

If the borrower is purchasing a principal residence and is retaining his or her current residence as a rental property, show the current principal residence as Rental in the Property Disposition field and complete the Net Rental field in the URLA. The conversion of a principal residence to an investment property must follow the guidelines described in Qualifying Impact of Other Real Estate Owned.

If the borrower's principal residence is a two- to four-unit property, rental income from the principal residence can be used to qualify the borrower. With the exception of subtracting theborrower's principal mortgage payment from the gross rental income, all other calculations and documentation requirements in this section apply.

To use net rental income from a borrower's owner-occupied two- to four-unit property when the borrower is purchasing or refinancing a second home or investment property, enter the net rental income from the borrower's principal residence as Net Rental in Section V.

Documentation of Net Rental Income

If the debt-to-income ratio already includes the entire rental property payment (that is, income from the property is not considered), rental income documentation is not required.

Entering Subject Net Cash Flow in DU

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

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

Documentation of Subject Net Cash Flow

If the borrower is being qualified with the entire payment, without benefit of rental income, documentation of gross monthly rent for the subject property is only required for CMS reporting purposes.

Calculation of Subject Net Cash Flow

Two- to four-unit principal residence: Calculate the subject net cash flow, and enter this amount in Section V. It will be included in the total qualifying income. Do not subtract the PITIA from the rental income, because the PITIA is included in the total proposed mortgage payment and is considered in the qualifying ratio. Do not enter a negative subject net cash flow value, because the entire PITIA is already included in the qualifying ratio.

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

ASSET ASSESSMENT

Minimum Reserve Requirements

What Are Liquid Financial Reserves?

Liquid financial reserves are those liquid or near liquid assets that are available to a borrower after the mortgage close. Liquid financial reserves include cash and other assets that are easily converted to cash by the borrower by

- drafting or withdrawing funds from an account,
- selling an asset,
- redeeming vested funds, or
- obtaining a loan secured by assets from a fund administrator or an insurance company.

Reserves are measured by the number of months of the qualifying payment amount for the subject mortgage (based on PITIA) that a borrower could pay using his or her financial assets.

Funds to close are subtracted from available assets when considering sufficient assets for reserves.

Acceptable Sources of Reserves

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

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

Unacceptable Sources of Reserves

The following cannot be counted as part of the borrower's reserves:

- funds that have not been vested;
- funds that cannot be withdrawn under circumstances other than the account owner's retirement, employment termination, or death;
- stock held in an unlisted corporation;
- non-vested stock options and non-vested restricted stock;
- cryptocurrency (digital assets such as bitcoins)
- personal unsecured loans;
- interested party contributions (IPCs);
- cash proceeds from a cash-out refinance transaction on the subject property.

Minimum Reserve Requirements (continued)

Supplementing Borrower Funds

Funds received from acceptable sources may be used to supplement the borrower's funds to satisfy any financial reserve requirement.

Determining Required Minimum Reserves

Minimum required reserves vary depending on

- the transaction,
- the occupancy status and amortization type of the subject property,
- the number of units in the subject property, and
- the number of other financed properties the borrower currently owns.

DU loan casefiles: DU will determine the reserve requirements based on the overall risk assessment of the loan, the minimum reserve requirement that may be required for the transaction, and whether the borrower has multiple financed properties.

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

Calculation of Reserves for Multiple Financed Properties

If the borrower owns other financed properties (determined in accordance with additional reserves must be calculated and documented for financed properties other than the subject property and the borrower's principal residence. The other financed properties reserves amount must be determined by applying a specific percentage to the aggregate of the outstanding unpaid principal balance (UPB) for mortgages and HELOCs on these other financed properties. The percentages are based on the number of financed properties:

- 2% of the aggregate UPB if the borrower has one to four financed properties,
- 4% of the aggregate UPB if the borrower has five to six financed properties, or
- 6% of the aggregate UPB if the borrower has seven to ten financed properties (DU only).

Minimum Reserve Requirements (continued)

Calculation of Reserves for Multiple Financed Properties (continued)

The aggregate UPB calculation does not include the mortgages and HELOCs that are on

- the subject property,
- the borrower's principal residence,
- properties that are sold or pending sale, and
- accounts that will be paid by closing (or omitted in DU on the online loan application).

Simultaneous Second Home or Investment Property Transactions

If CMS is processing multiple second home or investment property applications simultaneously, the same assets may be used to satisfy the reserve requirements for both mortgage applications. Reserves are not cumulative for multiple applications.

Example: CMS is simultaneously processing two refinance applications for two investment properties owned by the borrower. The application for property A requires reserves of $5,000. The application for property B requires reserves of $10,000. Because the reserves are covering the same properties, CMS does not have to verify $15,000 in reserves, but only those required per each application.

Examples of Reserves Calculations

The following tables contain examples of reserves calculations for borrowers with multiple financed properties.

Example 1: Three Financed Properties

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations	
Subject: Second Home	$78,750	$776	2 Months PITIA =	2 Months PITIA =
Principal	$0	$179	**N/A**	N/A
Investor	*$87,550*	$787	**$230,050 x 2% =**	$4,601
Investor	*$142,500*	$905		
	$230,050		**Total =**	**$6,153**

Minimum Reserve Requirements (continued)

Examples of Reserves Calculations (continued)

Example 2: Six Financed Properties

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations	
Subject: Investor	$78,7500	$776	6 Months PITIA =	$4,656
Principal	$133,000	$946	N/A	$0
Investor	*$87,550*	$787	$345,030 x 4% =	$13,801
Investor	*$142,500*	$905		
Investor	*$84,950*	$722		
Investor	*$30,030*	$412		
	$345,030		**Total =**	**$18,457**

Example 3: Eight Financed Properties (DU ONLY)

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations	
Subject: Investor	$78,750	$776	6 Months PITIA =	$4,656
Principal	$133,000	$946	N/A	$0
Investor	*$87,550*	$787	$629,530 x 6% =	$37,772
Investor	*$142,500*	$905		
Investor	*$84,950*	$722		
Investor	*$30,030*	$412		
Second Home	*$124,500*	$837		
Investor	*$160,000*	$1,283		
	$629,530		**Total =**	**$42,427**

Interested Party Contributions (IPCs)

Overview

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

Interested parties to a transaction include, but are not limited to, the property seller, the builder/ developer, the real estate agent or broker, or an affiliate who may benefit from the sale of the property and/or the sale of the property at the highest price possible. A lender or employer is not considered an interested party to a sales transaction unless it is the property seller or is affiliated with the property seller or another interested party to the transaction. (For Fannie Mae's purposes, an affiliation exists when there is direct common ownership or control by a lender over the interested party or vice versa, or when there is direct common ownership or control by a third party over both CMS and the interested party. A typical ongoing business relationship — for example, the relationship between a builder and a lender that serves as its financial institution — does not constitute an affiliation.)

IPCs are either financing concessions or sales concessions. Fannie Mae considers the following to be IPCs:

- funds that are paid directly from the interested party to the borrower;
- funds that flow from an interested party through a third-party organization, including nonprofit entities, to the borrower;
- funds that flow to the transaction on the borrower's behalf from an interested party, including a third-party organization or nonprofit agency; and
- funds that are donated to a third party, which then provides the money to pay some or all of the closing costs for a specific transaction.

See Types of Interested Party Contributions (IPC), for more information.

Fannie Mae does not permit IPCs to be used to make the borrower's down payment, meet financial reserve requirements, or meet minimum borrower contribution requirements.

Interested Party Contributions (IPCs) (continued)

IPC Limits

The table below provides IPC limits for conventional mortgages.

IPCs that exceed these limits are considered sales concessions. The property's sales price must be adjusted downward to reflect the amount of contribution that exceeds the maximum, and the maximum LTV/CLTV ratios must be recalculated using the reduced sales price or appraised value.

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

CMS Checklist for IPCs

CMS must ensure that all of the following requirements for an IPC are satisfied.

✓	CMS Checklist for IPCs
	Ensure that any and all IPCs have been identified and taken into consideration.
	Provide the appraiser with all appropriate financing data and IPCs for the subject property granted by anyone associated with the transaction.
	Ensure that the property value is adequately supported.
	Ensure that the LTV and CLTV ratios, after any IPCs are taken into consideration, remain within Fannie Mae's eligibility limits for the particular product.
	Ensure that mortgage insurance coverage, if applicable, has been obtained, based on the LTV ratio after any IPC adjustments have been made.
	Scrutinize all loan and sales contract documents, including but not limited to the sales contract, the loan estimate, the *Uniform Residential Loan Application* (URLA) (particularly Section VII, Details of Transaction), the appraisal report, and the settlement statement.
	Ensure that all elements of the settlement statement were taken into consideration during the underwriting process.
	Ensure that fees and expenses are consistent between all documents. Analyze any differences and review any discrepancies.

Interested Party Contributions (IPCs) (continued)

Lenders Incentives for Borrowers

Cash or Cash-like Incentives for all Transaction Types: CMS may provide the borrower with a cash or cash-like (e.g., a gift card) incentive that is not reflected on the settlement statement provided that

- the amount of the incentive does not exceed $500, and
- no repayment is required.

Because the lender is not typically a party to the sales transaction, these types of lender incentives are not considered IPCs and, as a result, are not included in the IPC limit calculation. Furthermore, these incentives are not considered cash out to the borrower and do not have to be included in the cash back to borrower at closing calculation.

Note: Documentation of compliance with this policy will not be required at the loan level. However, CMS must establish policies and/or procedures to ensure that the loans with these types of incentives that it delivers to Fannie Mae, whether or not the loans were originated by CMS, are in compliance with this policy.

Types of Interested Party Contributions (IPCs)

Undisclosed IPCs

Mortgages with undisclosed IPCs are not eligible for delivery to Fannie Mae. Examples of these types of contributions include, but are not limited to, moving expenses, payment of various fees on the borrower's behalf, "silent" second mortgages held by the property seller, and other contributions that are given to the borrower outside of closing and are not disclosed on the settlement statement.

Types of Interested Party Contributions (IPCs) (continued)

Down Payment Assistance Programs

Down Payment Assistance programs are permitted. Requests to review Down Payment Assistance Programs for use with CMS agency first mortgage programs may be submitted to DPAPrograms@Carringtonms.com.

All requests must include a completed Down Payment Assistance New Program Request Submission Form along with the required exhibits.

Financing Concessions

Financing concessions that are paid on the borrower's behalf are subject to Fannie Mae's IPC limits. Financing concessions are:

- financial contributions from interested parties that provide a benefit to the borrower in the financing transaction;
- payments or credits related to acquiring the property; and
- payments or credits for financing terms, including pre-paids.

Typical fees and/or closing costs paid by a seller in accordance with local custom, known as common and customary fees or costs, are not subject to Fannie Mae IPC limits. Payoff of a PACE loan by a seller is not subject to Fannie Mae IPC limits because it is not a financing concession. Financing concessions that exceed the limits listed below are considered sales concessions and are subject to Fannie Mae IPC limits.

Financing concessions typically include origination fees, discount points, commitment fees, appraisal costs, transfer taxes, stamps, attorneys' fees, survey charges, title insurance premiums or charges, real estate tax service fees, and funds to subsidize a temporary or permanent interest rate buydown (if these fees are not considered common and customary fees or costs based on local custom, as described above). Financing concessions can also include prepaid items, such as:

- interest charges (limited to no more than 30 days of interest);
- real estate taxes covering any period after the settlement date (only if the taxes are being impounded by the servicer for future payment);
- property insurance premiums (limited to no more than 14 months);
- homeowners' association (HOA) assessments covering any period after the settlement date (limited to no more than 12 months);
- initial and/or renewal mortgage insurance premiums; and
- escrow accruals required for renewal of borrower-purchased mortgage insurance coverage.

Types of Interested Party Contributions (IPCs) (continued)

Sales Concessions

Sales concessions are IPCs that take the form of non-realty items. They include cash, furniture, automobiles, decorator allowances, moving costs, and other giveaways, as well as financing concessions that exceed Fannie Mae limits. Consequently, the value of sales concessions must be deducted from the sales price when calculating LTV and combined LTV ratios for underwriting and eligibility purposes.

Interest Rate Buydowns

If a temporary or permanent interest rate buydown is being offered to the borrower, the cost of the subsidy to fund that buydown must be included in the IPC calculation, if received from an interested party or a lender affiliated with an interested party.

CMS must determine if the cost of the subsidy meets allowable IPC limits. This can be accomplished by confirming the current market interest rate—in other words, the rate that is offered without the payment of any discount points—and the discount points being charged to obtain the interest rate being offered with the buydown.

Note: Fees for standby commitments that a builder obtains for blanket coverage before it enters into a contract with a borrower are not subject to Fannie Mae's IPC limits because they are not attributable to the specific mortgage transaction.

Payment Abatements

Payment abatement is considered to be a financing concession since it is an incentive provided to the borrower by an interested party, in which the interested party provides funds to pay or reimburse a certain number of monthly payments on the borrower's behalf. The monthly payments may cover, in whole or in part, principal, interest, taxes, insurance and other assessments (PITIA). These funds are provided to CMS or a third party to be distributed over the term of the abatement period or credited against the borrower's future obligations.

Loans with payment abatements of any type are not eligible for delivery to Fannie Mae regardless of whether they are disclosed on the settlement statement. This prohibition applies to transactions in which an interested party is directly funding the abatement and/or if the funding for the abatement is flowing through another entity such, as non-profit down payment assistance program.

Note: The payment of HOA fees is not considered abatement unless the payment of the fee extends for more than 12 months. The payment of HOA fees for 12 months or less is considered an interested party contribution.

Verification of Depository Assets

Verification of Deposits and Assets

CMS can use any of the following types of documentation to verify that a borrower has sufficient funds for closing, down payment, and/or financial reserves:

- Request for Verification of Deposit (Form 1006 or Form 1006(S)). The information must be requested directly from the depository institution, and the complete, signed, and dated document must be sent directly from the depository institution.
- Copies of bank statements or investment portfolio statements. The statements must:
  - clearly identify the borrower as the account holder,
  - include the account number (account number may be truncated and must display at least the last four digits of the borrower's asset account),
  - include the time period covered by the statement,
  - include all deposits and withdrawal transactions (for depository accounts),
  - include all purchase and sale transactions (for financial portfolio accounts), and
  - include the ending account balance.
- Direct verification by a third-party asset verification vendor. These verifications are acceptable as long as:
  - the borrower provided proper authorizations for CMS to use the verification method,
  - the verified information provided must conform with the information that would be provided on Form 1006, Form 1006(S), or on bank statements,
  - the date of the completed verification is in compliance with Allowable Age of Credit Documents and Federal Income Tax Returns,
  - CMS has determined that the vendor maintains reasonable practices that ensure reliable and authorized verifications of deposit and asset information, and
  - CMS understands it will be held accountable for the integrity of the information obtained from this source.
- Copies of retirement account statements. They must be the most recent statements, and they must identify the borrower's vested amount and the terms. (See Retirement Accounts, for additional information.)

Verification of Depository Assets (continued)

Verification of Deposits and Assets (continued)

The number of required bank or investment portfolio statements varies per transaction type as shown in the following table.

Documentation Requirements	
Purchase transactions	The statements must cover the most recent full two-month period of account activity (60 days, or, if account information is reported on a quarterly basis, the most recent quarter).
Refinance transactions	The statements must cover the most recent full one-month period of account activity (30 days, or, if account information is reported on a quarterly basis, the most recent quarter).

If the latest bank statement is more than 45 days earlier than the date of the loan application, CMS should ask the borrower to provide a more recent, supplemental, bank-generated form that shows the account number, balance, and date. The statements may be computer-generated forms, including online account or portfolio statements downloaded by the borrower from the Internet.

Documents that are faxed to CMS or downloaded from the Internet must clearly identify the name of the depository or investment institution and the source of information—for example, by including that information in the Internet or fax banner at the top of the document.

If necessary, CMS must supplement these verifications by obtaining any missing information from the borrower or the depository institution.

Depository Accounts

Funds held in a checking, savings, money market, certificate of deposit, or other depository accounts may be used for the down payment, closing costs, and financial reserves. The funds must be verified as described in Verification of Deposits and Assets. Unverified funds are not acceptable for the down payment, closing costs, or financial reserves.

CMS must investigate any indications of borrowed funds. These must be identified differently based upon how the asset account was verified.

Business Assets

Business assets may be an acceptable source of funds for the down payment, closing costs, and financial reserves when a borrower is self-employed and the individual federal income tax returns have been evaluated by CMS including, if applicable, the business federal income tax returns for that particular business (non-Schedule C). The borrower must be listed as an owner of the account and the account must be verified in accordance with Verification of Deposits and Assets. CMS must perform a business cash flow analysis to confirm that the withdrawal of funds for this transaction will not have a negative impact on the business. See Self-Employment Income, for additional information on the analysis of a self-employed borrower.

Verification of Depository Assets (continued)

Evaluating Large Deposits

When bank statements (typically covering the most recent two months) are used, CMS must evaluate large deposits, which are defined as a single deposit that exceeds 50% of the total monthly qualifying income for the loan. Requirements for evaluating large deposits vary based on the transaction type, as shown in the table below.

Transaction Type	Evaluation Requirements
Refinance transactions	Documentation or explanation for large deposits is **not** required; however, CMS remains responsible for ensuring that any borrowed funds, including any related liability, are considered.
Purchase transactions	• If funds from a large deposit are needed to complete the purchase transaction (that is, are used for the down payment, closing costs, or financial reserves), CMS must document that those funds are from an acceptable source. Occasionally, a borrower may not have all of the documentation required to confirm the source of a deposit. In those instances CMS must use reasonable judgment based on the available documentation as well as the borrower's debt-to-income ratio and overall income and credit profile. Examples of acceptable documentation include the borrower's written letter of explanation, proof of ownership of an asset that was sold, or a copy of a wedding invitation to support receipt of gift funds. CMS must place in the loan file written documentation of the rationale for using the funds. Borrower(s) must write, sign, and date all Letters of Explanation themselves. The Lender or Broker may identify the subject
	• Verified funds must be reduced by the amount (or portion) of the undocumented large deposit (as defined above), and CMS must confirm that the remaining funds are sufficient for the down payment, closing costs, and financial reserves. When CMS uses a reduced asset amount, net of the unsourced amount of a large deposit, that reduced amount must be used for underwriting purposes. **Note:** When a deposit has both sourced and unsourced portions, only the unsourced portion must be used to calculate whether or not it must be considered a large deposit.

Verification of Depository Assets (continued)

Evaluating Large Deposits (continued)

Transaction Type	Evaluation Requirements
	Examples • **Scenario 1**: Borrower has monthly income of $4,000 and an account at ABC Bank with a balance of $20,000. A deposit of $3,000 is identified, but $2,500 of that deposit is documented as coming from the borrower's federal income tax refund. Only the unsourced $500 [the deposit of $3,000 minus the documented $2,500] must be considered in calculating whether it meets the large deposit definition. The unsourced $500 is 12.5% of the borrower's $4,000 monthly income, falling short of the 50% definition of a large deposit. Therefore, it is not considered a large deposit and the entire $20,000 balance in the ABC Bank account can be used for underwriting purposes. • **Scenario 2**: Using the same borrower example, a deposit of $3,000 is identified, but only $500 is documented as coming from the borrower's federal income tax refund, leaving $2,500 unsourced. In this instance, the unsourced $2,500 is 63% of the borrower's $4,000 monthly income, which does meet the definition of a large deposit. Therefore, the unsourced $2,500 must be subtracted from the account balance of $20,000 and only the remaining $17,500 may be used for underwriting purposes.

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

Verification of Depository Assets (continued)

Request for Verification of Deposit

When a *Verification of Deposit* (Form 1006 or Form 1006(S)) (VOD) is used and depository activity is not included, CMS must verify the source of funds for

- accounts opened within the last 90 days of the application date, and
- account balances that are considerably greater than the average balance reflected on the VOD.

Individual Development Accounts

Some nonprofit agencies will match the funds a borrower regularly deposits into a savings account that has been designated as an account that is used solely for the accumulation of funds to purchase a home. Such accounts are referred to as individual development accounts, or IDAs.

Nonprofit agencies that offer IDA programs have options with respect to accumulating and holding the matching funds, which include:

- the use of a parallel "savings" account that is separate from the home buyer's savings account;
- separately designated matching funds within a single agency account via accounting processes to allocate matching funds to a particular home buyer; and
- the use of a trustee account that contains both the home buyer's funds and the agency's matching funds.

When a home buyer reaches the target amount and is ready to complete the home purchase, the funds are disbursed from the nonprofit agency account to the closing agent via a single check or multiple checks.

If the agency's matching funds are held in an account that is separate from the home buyer's account, the matching funds need not be commingled with the home buyer's funds prior to disbursement to the closing agent. It is acceptable to allow the separate disbursement of funds from the agency and from the home buyer, as long as the terms of the IDA program are met.

Funds that the borrower deposited into an IDA may be used for either closing costs or the down payment.

Verification of Depository Assets (continued)

Use of IDA Funds to Meet Borrower Minimum Contribution Requirements

Funds that the borrower deposited into an IDA may be used for either the closing costs or the down payment. Depending on the repayment terms of the IDA program, the borrower may or may not be required to meet the minimum down payment requirements from his or her own funds, as outlined below:

IDA Repayment Terms	Allowable Use of Matching Funds
The nonprofit agency • requires repayment of the matching funds, • agrees to defer or forgive repayment provided that certain conditions are met, or • files a lien against the property.	The borrower may use the matching funds to supplement the down payment provided he or she has met the minimum borrower contribution requirements. The minimum borrower contribution must come from the borrower's own funds unless: • the LTV or CLTV ratio is less than or equal to 80%; or • the borrower is purchasing a one-unit principal residence and meets the requirements to use gifts, donated grant funds, or funds received from an employer to pay for some or all of the borrower's minimum contributions. See Personal Gifts; Donations From Entities; and Employer Assistance, for additional information.
The nonprofit agency • does not require repayment of the matching funds and • does not file a lien against the property.	The borrower may use the matching funds for some or all of the down payment without first being required to meet the minimum borrower contribution requirement from his or her own funds.

Note: If the IDA program includes provisions for a second mortgage that will be sold to Fannie Mae, CMS must have a negotiated contract for the sale of said second mortgage and the second mortgage must be in compliance with the requirements set forth in the negotiated contract.

Verification of Depository Assets (continued)

CMS Checklist for IDAs

CMS must ensure that all of the following requirements for an IDA are satisfied:

✓	CMS Checklist for IDAs
	Document how the nonprofit agency's IDA program operates.
	Verify the rate at which the agency matches borrower deposits into the account.
	Determine that the borrower satisfied the program's vesting requirements.
	Document the borrower's regular payments into the account and the agency's regular deposits of matching funds into the account.

Pooled Savings (Community Savings Funds)

Funds from a community savings account or any other type of pooled savings may be used for the down payment if the borrower can document regular contributions to the fund.

Acceptable documentation includes written confirmation from the party managing the pooled savings fund and documentation of regular borrower contributions.

The borrower's obligation to continue making contributions to the fund must be considered as part of the borrower's debt when calculating the total debt-to-income ratio.

Verification of Assets for Non-U.S. Citizen Borrowers

CMS must document all sources of funds used for down payments and closing costs.

Funds that a non-U.S. citizen borrower recently deposited in a U.S. depository institution are an acceptable source of funds provided all of the following requirements are met:

- There is documented evidence of funds transfer from the country from which the borrower immigrated,
- It can be established that the funds belonged to the borrower before the date of the transfer, and
- The sources of all funds used for closing can be verified just as they would for a borrower who is a U.S. citizen.

Verification of Non- Depository Assets

Stocks, Stock Options, Bonds, and Mutual Funds

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

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

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

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

Refer to Retirement Accounts, for the requirements pertaining to the use of retirement accounts for the down payment, closing costs, or reserves.

Verification of Non- Depository Assets (continued)

Trust Accounts

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

To document trust account funds, CMS must:

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

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. CMS must verify the ownership of the account and confirm that the account is vested and allows withdrawals regardless of current employment status.

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

Personal Gifts

Gift Funds

A borrower of a mortgage loan secured by a principal residence or second home may use funds received as a personal gift from an acceptable donor. Gift funds may fund all or part of the down payment, closing costs, or financial reserves subject to the minimum borrower contribution requirements below. Gifts are not allowed on an investment property.

Acceptable Donors

A gift can be provided by:

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

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

Personal Gifts (continued)

Minimum Borrower Contribution Requirements

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

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

[a] If the borrower receives a gift from a relative or domestic partner who has lived with the borrower for the last 12 months, or from a fiancé or fiancée, the gift is considered the borrower's own funds and may be used to satisfy the minimum borrower contribution requirement as long as both individuals will use the home being purchased as their principal residence.

Personal Gifts (continued)

Documentation Requirements

Gifts must be evidenced by a letter signed by the donor, called a gift letter. The gift letter must:

- specify the dollar amount of the gift;
- specify the date the funds were transferred;
- include the donor's statement that no repayment is expected; and
- indicate the donor's name, address, telephone number, and relationship to the borrower.

When a gift from a relative or domestic partner is being pooled with the borrower's funds to make up the required minimum cash down payment, the following items must also be included:

- A certification from the donor stating that he or she has lived with the borrower for the past 12 months and will continue to do so in the new residence.
- Documents that demonstrate a history of borrower and donor shared residency. The donor's address must be the same as the borrower's address. Examples include but are not limited to a copy of a driver's license, a bill, or a bank statement.

Verifying Donor Availability of Funds and Transfer of Gift Funds

CMS must verify that sufficient funds to cover the gift are either in the donor's account or have been transferred to the borrower's account. Acceptable documentation includes the following:

- a copy of the donor's check and the borrower's deposit slip,
- a copy of the donor's withdrawal slip and the borrower's deposit slip,
- a copy of the donor's check to the closing agent, or
- a settlement statement showing receipt of the donor's check.

When the funds are not transferred prior to settlement, CMS must document that the donor gave the closing agent the gift funds in the form of a certified check, a cashier's check, or other official check.

Gift of Equity

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

Documentation Requirements

The following documents must be retained in the loan file:

- a signed gift letter (see Personal Gifts), and
- the settlement statement listing the gift of equity.

Personal Gifts (continued)

Gifts of Equity and Interested Party Contributions

If the requirements listed in this topic are met, the gift of equity is not subject to Fannie Mae's interested party contribution requirements (see Interested Party Contributions (IPC)).

Donations from Entities

Donations from Entities

A borrower of a mortgage loan secured by a principal residence may use donated gift or grant funds from acceptable entities to fund all or part of the down payment, closing costs, or financial reserves subject to the minimum borrower contribution requirements described below.

Donated gift or grant funds may also be applied towards energy-related improvements if

- the program under which the funds are made available allows such a use, and
- the minimum borrower contribution requirements are met.

Donated gifts and grants are not allowed on a second home or an investment property.

Acceptable entities include churches, municipalities, nonprofit organizations (excluding credit unions), a regional Federal Home Loan Bank under one of its affordable housing programs, and public agencies.

Minimum Borrower Contribution Requirements

The following table describes the minimum borrower contribution requirements for transactions that contain donated gifts or grants.

LTV, CLTV, or HCLTV Ratio	Minimum Borrower Contribution Requirement from Borrower's Own Funds	
80% or less	One- to four-unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from a donated gift or grant.
Greater than 80%	One-unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from a donated gift or grant.

Donations from Entities (continued)

Minimum Borrower Contribution Requirements (continued)

LTV, CLTV, or HCLTV Ratio	Minimum Borrower Contribution Requirement from Borrower's Own Funds	
Greater than 80%	Two- to four-unit principal residence	The borrower must make a 5% minimum borrower contribution from his or her own funds. After the minimum borrower contribution has been met, donated gifts or grants can be used to supplement the down payment, closing costs, reserves, and energy-related improvements.

Documentation Requirements

The donated gift or grant must be documented with either a copy of the letter awarding the gift or grant to the borrower or a copy of the legal agreement that specifies the terms and conditions of the gift or grant. The document must include language indicating that repayment of the gift or grant is not expected, and how the funds will be transferred to the borrower, CMS, or closing agent.

The transfer of gifts or grants must be documented with a copy of the donor's canceled check, a copy of the settlement statement showing receipt of the check, or similar evidence. The documentation must be included in the individual mortgage file.

Lender Contributions

Lender-sourced contributions to fund closing costs and prepaid fees that are normally the responsibility of the borrower are permitted provided the following:

A lender-sourced contribution may not be:

- used to fund any portion of the down payment;
- subject to repayment requirements, or require financial obligation apart from the subject mortgage; or
- passed to the lender from a third party.

The amount of the lender contribution should not exceed the amount of borrower-paid closing costs and prepaid fees. Otherwise, the amount of the contribution is not limited except when the lender is an interested party to a purchase transaction as defined in Interested Party Contributions, and in that case, the interested party contribution (IPC) policy applies. Any excess lender credit required to be returned to the borrower in accordance with applicable regulatory requirements is considered an overpayment of fees and charges, and may be applied as a principal curtailment or returned in cash to the borrower.

Employer Assistance

Forms of Employer Assistance

The employer assistance may be in the form of:

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

A borrower of a mortgage loan secured by a principal residence may use funds provided by an employer to fund all or part of the down payment or closing costs subject to the minimum borrower contribution requirements below. Employer assistance can also be used for financial reserves for all types of assistance with the exception of unsecured loans (which may only be used for the down payment and closing costs). Employer assistance funds are not allowed on a second home or an investment property.

Funds must come directly from the employer, including through an employer-affiliated credit union.

When employer assistance is extended as a secured second mortgage, the transaction must satisfy Fannie Mae's eligibility criteria for mortgages that are subject to subordinate financing (see Subordinate Financing).

If the secured second mortgage or unsecured loan does not require regular payments of either principal and interest or interest only, CMS does not need to calculate an equivalent payment for consideration as part of the borrower’s monthly debt. If regular payments are required for the secured second mortgage, the payments must be included in the calculation of the debt-to-income ratio.

Employer Assistance (continued)

Minimum Borrower Contribution Requirements

The following table describes the minimum borrower contribution requirements for transactions that contain employer assistance.

LTV, CLTV, or HCLTV Ratio	Minimum Borrower Contribution Requirement from Borrower's Own Funds	
80% or less	One- to four-unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from employer assistance.
Greater than 80%	One-unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from employer assistance.
	Two- to four-unit principal residence	The borrower must make a 5% minimum borrower contribution from his or her own funds. After the minimum borrower contribution has been met, employer assistance can be used to supplement the down payment, closing costs, and reserves (except for unsecured loans, which may not be applied to reserves).

Employer Assistance (continued)

Documentation Requirements

CMS must document:

- that the program is an established company program, not just an accommodation developed for an individual employee.
- the dollar amount of the employer's assistance.
- an unsecured loan from an employer with an award letter or legal agreement from the note holder and must disclose the terms and conditions of the loan.
- the terms of any other employee assistance being offered to the borrower (such as relocation benefits or gifts).
- that the borrower received the employer assistance funds directly from the employer (or through the employer-affiliated credit union).

Sales Contract Deposit (Earnest Money Deposit)

The deposit on the sales contract (earnest money) for the purchase of the security property is an acceptable source of funds for both the down payment and the closing costs.

Verification of Source of Funds

If the deposit is being used as part of the borrower's minimum contribution requirement, CMS must verify that the funds are from an acceptable source. See Verification of Deposits and Assets.

A *Request for Verification of Deposit* (Form 1006 or Form 1006(S)) must indicate that the average balance for the past two months was large enough to support the amount of the deposit.

Bank statements must evidence that the average balance for the past two months was large enough to support the amount of the deposit. If a copy of the canceled deposit check is used to document the source of funds, the bank statements must cover the period up to (and including) the date the check cleared the bank account.

If it cannot be determined that these funds were withdrawn from the borrower's account, additional verification of the source and evidence that the funds have actually changed hands from the borrower to the seller, the realtor, the escrow agent, or the settlement attorney should be provided. Large earnest money deposits and deposits that exceed the amount customary for the area should be closely evaluated.

Documentation for Receipt of the Deposit

Receipt of the deposit must be verified by either a copy of the borrower's canceled check or a written statement from the holder of the deposit.

Verification of Non- Depository Accounts

Anticipated Sales Proceeds

If the borrower's currently owned home is listed for sale but has not been sold, CMS may qualify the borrower on the basis of anticipated sales proceeds.

CMS must document the actual proceeds received by the borrower.

Determining the Amount of Net Proceeds

The following table describes how to determine the amount of net proceeds based on a borrower's anticipated equity.

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

Sales Proceeds Needed for Down Payment and Closing Costs

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

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.

Employee Relocation

When the borrower's employer assumes responsibility for paying off the existing mortgage in connection with a relocation plan, CMS must obtain a copy of the executed buy-out agreement to document the source of funds. A photocopy of a sales contract or a listing agreement is not considered an acceptable source of verification of proceeds from the sale.

Verification of Non- Depository Accounts (continued)

Trade Equity

Trade equity is an acceptable source of funds to supplement the borrower's minimum borrower contribution provided the following requirements are met:

- The seller's equity contribution for the traded property must be a true-value consideration supported by a current appraisal.
- The borrower must make the minimum required contribution from his or her own funds unless:
  - the LTV or CLTV ratio is less than or equal to 80%; or
  - the borrower is purchasing a one-unit principal residence and meets the requirements to use gifts, donated grant funds, or funds received from an employer to pay for some or all of the borrower's minimum contribution. See Personal Gifts; Donations From Entities; and Employer Assistance, for additional information.

These requirements apply to all transactions that involve property trades, including those that are evidenced by two separate contracts that have the buyer and the seller on one contract reversing roles on the second contract.

Calculating the Equity Contribution

The equity contribution is determined by subtracting the outstanding mortgage balance of the property being traded, plus any transfer costs, from the lesser of either the property's appraised value or the trade-in value agreed to by both parties.

Documentation Requirements

For real property, the transfer deed must be recorded. In addition, CMS must obtain the following:

- A search of the land records to verify the ownership of the property and to determine whether there are any existing liens on the property.
- Proof of title transfer and satisfaction of any existing mortgage liens for which the borrower was liable.

Rent Credit for Option to Purchase

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

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

Verification of Non- Depository Accounts (continued)

Documentation Requirements

CMS must obtain the following documentation:

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

Sweat Equity

Generally, sweat equity is not an acceptable source of funds for the down payment, closing costs, and reserves, since it is difficult to accurately assess the contributory value of sweat equity work. Only for specific transactions and if all eligibility requirements are met does Fannie Mae consider sweat equity to be an acceptable source of funds.

Bridge/Swing Loans

A bridge (or swing) loan is an acceptable source of funds provided the following requirements are met:

- The bridge loan cannot be cross-collateralized against the new property.
- CMS must document the borrower's ability to successfully carry the payments for the new home, the current home, the bridge loan, and other obligations.

Fannie Mae does not have a specified limitation on the term of bridge loans.

Borrowed Funds Secured by an Asset

Borrowed funds secured by an asset are an acceptable source of funds for the down payment, closing costs, and reserves, since borrowed funds secured by an asset represent a return of equity.

Assets that may be used to secure funds include automobiles, artwork, collectibles, real estate, or financial assets, such as savings accounts, certificates of deposit, stocks, bonds, and 401(k) accounts.

Secured Loans as Debt

When qualifying the borrower, CMS must consider monthly payments for secured loans as a debt.

If a secured loan does not require monthly payments, CMS must calculate an equivalent amount and consider that amount as a recurring debt.

When loans are secured by the borrower's financial assets, monthly payments for the loan do not have to be considered as long-term debt.

Reducing the Asset by the Amount Borrowed

If the borrower uses the same financial asset as part of his or her financial reserves, CMS must reduce the value of the asset by the amount of proceeds and related fees for the secured loan.

Verification of Non- Depository Accounts (continued)

Documentation Requirements

CMS must document the following:

- the terms of the secured loan,
- evidence that the party providing the secured loan is not a party to the sale, and
- evidence that the funds have been transferred to the borrower.

Credit Card Financing

Fannie Mae permits certain costs that must be paid early in the application process, such as lock- in fees, origination fees, commitment fees, credit report fees, and appraisal fees, to be charged to the borrower's credit card because these fees do not represent extraordinary amounts and the credit card debt is considered in the borrower's total monthly debt-to-income ratio. Borrowers are not required to pay off these credit card changes before closing. Under no circumstances may credit card financing be used for the down payment.

CMS may allow credit card financing for the payment of common and customary fees paid outside of closing up to a maximum of 2% of the loan amount if CMS:

- confirms that the borrower has sufficient liquid funds (financial reserves) to cover these charges (in addition to funds needed for other closing costs and the down payment that he or she will be paying); or
- recalculates the credit card payment, per Monthly Debt Obligations, to account for the new charges and includes the updated payment in the qualifying ratio calculation.

For DU, CMS must apply this policy manually, by either including the fees charged to the borrower's credit card on line f. Estimated Closing Costs of the Details of Transaction, and removing any "Borrower Paid Fees" entered in the Other Credits section of the Details of Transaction for the fees paid outside of closing; or by increasing the monthly credit card payment in the liabilities section of the loan casefile submitted to DU to include the charges if not reflected in the credit report.

Personal Unsecured Loans

Personal unsecured loans are not an acceptable source of funds for the down payment, closing costs, or financial reserves.

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

Verification of Non- Depository Accounts (continued)

Documentation Requirements

CMS must document the following:

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

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

Cash Value of Life Insurance and Debt-to-Income Ratios

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

CMS must assess repayment or additional obligation considerations to determine the impact on borrower qualification or reserves.

If penalties for failure to repay the loan are limited to the surrender of the policy, payments on a loan secured by the cash value of a borrower's life insurance policy do not have to be considered in the total debt-to-income ratio.

If additional obligations are indicated, the obligation amount must be factored into the total debt- to-income ratio, or subtracted from the borrower's financial reserves.

Documenting Borrower Receipt of Funds

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

Verification of Non- Depository Accounts (continued)

Anticipated Savings

CMS may preliminarily qualify a borrower on the basis that anticipated savings will be sufficient to meet the funds needed for closing. CMS must verify that savings are actually accumulated by the borrower before loan closing.

The estimate for a borrower's anticipated savings must be realistically developed. To calculate potential saved funds, CMS should reduce the borrower's expected after-tax income for the expected savings period by existing housing expenses, monthly debt expenses based on data from the credit report, and expected living expenses, such as food, transportation, etc.

Cash-on-Hand

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

DU REQUIREMENTS FOR ASSET ASSESSMENT

Asset Verification

Liquid Assets

DU analyzes the value of liquid assets entered in the online application in its risk assessment. Assets may be excluded from the online application if the borrower can qualify without them.

The online loan application provides the following categories of liquid assets: DAP (Down Payment Assistance), Bridge Loan, Certificate of Deposit, Checking Account, Gift, Gift of Equity, Money Market Fund, Mutual Fund, Net Equity, Other Liquid Asset, Retirement Fund, Savings Account, Secured Borrowed Funds, Stock, and Trust Funds.

Non-Liquid Assets

DU does not consider the amount of non-liquid assets. Non-liquid assets do not have to be verified, and will not be identified in a verification message.

The online loan application provides the following categories of non-liquid assets: Cash Deposit on Sales, Net Worth of Business, and Other Non-Liquid Asset.

Reserve Requirements

For loan casefiles underwritten with DU, DU will determine the reserve requirements based on the overall risk assessment of the loan casefile and the minimum reserves that may be required for the transaction. Reserves may be considered a compensating factor in DU's risk analysis, and may serve to improve the underwriting recommendation.

Asset Verification (continued)

Asset Values in the DU Underwriting Findings Report

The DU Underwriting Findings report will identify the following values:

- "Total Available Assets," which is the total of all borrower(s)' liquid assets entered into DU;
- "Funds Required to Close," which will include the cash needed to complete the transaction plus any debts marked paid by closing on purchase or limited cash-out refinance transactions, other than subject property mortgage(s);
- "Reserves Required to be Verified," which is the amount of reserves that must be verified;
- "Total Funds to be Verified," which is the sum of the "Funds Required to Close" and the "Reserves Required to be Verified"; and
- "Excess Available Assets, not required to be verified by DU," which are liquid assets that DU is not requiring CMS to verify.

The Excess Available Assets not required to be verified by DU (Excess Available Assets) amount represents the amount of assets remaining after subtracting the Total Funds to be Verified from the Total Available Assets. Excess Available Assets do not generally need to be verified.

Non-Occupant Borrower Asset Requirements

Assets that are owned by a non-occupant borrower can be included in the 5% minimum borrower contribution requirement (when applicable), and those funds must be entered in the online loan application. Total liquid assets for the occupying borrower and non-occupant borrower are included in DU's calculation of total available assets.

Asset Verification Documentation

DU indicates the minimum verification documentation requirements necessary for CMS to process the loan application. This level of documentation may not be adequate for every borrower and every situation. CMS must determine whether additional documentation is warranted.

Asset Verification (continued)

Depository Assets

For depository assets (checking and savings accounts, money market funds, and certificates of deposit), DU will require two consecutive monthly bank statements (60 days of account activity).

Monthly bank statements must be dated within 45 days of the initial loan application date.

Quarterly bank statements must be dated within 90 days of the initial loan application date, and CMS must confirm that the funds in the account have not been transferred to another asset account that is verified with more current documentation.

A *Verification of Deposit* (Form 1006 or Form 1006(S)) can be obtained in place of bank statements.

When DU validates assets, DU issues a message indicating the acceptable documentation. Compliance with the DU message satisfies the requirement for documenting assets. This documentation may differ from the requirements described above.

Bridge Loan (Liquid Asset)

Enter the amount of a bridge/swing loan under Bridge Loan in Section VI Assets. Do not include the amount of the bridge loan in any other liquid asset. (For example, do not enter the amount of the loan both as a bridge loan and in a checking account, even if the loan funds have been deposited.)

Bridge loans should also be considered in the Net Equity calculation for properties that are Pending Sale. (In other words, the amount of the bridge loan should be subtracted from the net proceeds to avoid counting this asset twice.)

Note: It may also be necessary to enter the bridge loan as a recurring liability in Section VI, Liabilities, with the corresponding monthly payment. See the bridge loan liability discussion in Monthly Debt Obligations.

Cash Deposit on Sales Contract (Earnest Money)

When cash deposit on sales contract (earnest money) is entered in Section VI Assets, DU does not consider it liquid. Therefore, in order to give the borrower credit for earnest money that is not already reflected in a liquid account, CMS must enter the earnest money amount as follows:

- If the earnest money check has not cleared the borrower's bank account, the amount can be included in a depository account, such as a checking or savings account.
- If the earnest money check has cleared the borrower's bank account, the amount can be entered as Other Credit in Section VII, where it is assumed to be verified.

Do not enter the amount in both places.

Asset Verification (continued)

Gifts

Gifts or donations from entities (grants) are permitted in accordance with Personal Gifts, and Donations From Entities. The entry of gifts or grants on the online loan application is as follows:

- When a gift is entered in Section VI Assets as a gift, the funds are included in available funds. It is important that the gift amount is identified separately as a gift even if the funds have already been deposited in a liquid asset account owned by the borrower (such as a checking or savings account). The balance of the liquid asset account entered in the loan application must be adjusted accordingly to prevent duplicate entry of funds. For example, if the borrower's verified checking account reflects a balance of $15,000, and $5,000 of that amount was from a gift, the checking account balance should be adjusted to reflect $10,000, and the $5,000 should be entered separately as a gift.
- When a gift is entered in Section II as a source of down payment, the funds are not included in the available funds.

Note: Gift funds are considered liquid only when the funds are entered as Gift in Section VI Assets.

Some loan origination systems (LOS) may not provide a "gift" data entry option, or the gift entry may not map correctly to DU. (For example, the LOS may identify the gift as a checking account when the data is transmitted to DU.) CMS must ensure that gift information has been properly identified in DU. For gift documentation requirements, see Personal Gifts.

Gifts of Equity

Enter a gift of equity in Section VI A.

A gift of equity must meet the gift of equity requirements defined in Gifts of Equity.

Net Equity (From Properties Pending Sale)

When full REO data is entered, DU automatically calculates the estimated net equity from properties marked Pending Sale in Section VI R using the following formula:

(Present Market Value × 90%) − Amount of Mtgs. & Liens)

However, because full REO data is not required, CMS can calculate the net equity outside of DU and enter the amount (positive or negative) as Net Equity in Section VI A.

If net equity is calculated from data in Section VI R and is also entered in Section VI A, DU will use the amount from Section VI A.

If a bridge loan is obtained, the amount of the bridge loan should be subtracted from the net proceeds.

When the net equity is positive, DU will add the amount to the funds available for closing. When the net equity is negative, DU will subtract the amount from the funds available for closing.

Asset Verification (continued)

Net Worth of Business	When net worth of business is entered in Section VI A, DU does not consider it liquid. If the borrower is using proceeds from the sale of his or her business, the net proceeds should be entered in a depository account, such as a checking or savings account.
Other Liquid Asset	Enter the value of personal assets that will be converted to a liquid asset (or sold) prior to closing. For example, enter as Other Liquid Asset the net cash value of life insurance, automobiles, or other personal assets that will be sold, or the amount of pending tax refunds that will be received prior to closing. A verification message will require evidence of the value of the asset and confirmation that the asset was converted to cash. **Note:** Some loan origination systems may not provide an asset type for other liquid assets, or the entry may not map correctly to DU. In such cases, assets that would otherwise have been entered as Other Liquid Asset should be included in a depository account, such as a checking or savings account, if the assets will be converted to cash prior to closing. Appropriate documentation should be included in the loan file.
Proceeds From Sold Properties	Proceeds from properties that have already been sold should be included in a depository account, such as a checking or savings account.
Secured Borrowed Funds	Borrowers can borrow against an asset they own, such as a 401(k) account or real estate, according to the requirements of Monthly Debt Obligations. The amount of the secured loan should be entered as Secured Borrowed Funds in Section VI A. The secured loan amount should be subtracted from the market value of the actual asset, and the net asset value should be entered in the appropriate field in Section VI A. For example, if the borrower has a vested value, less taxes and penalties, of $30,000 in a 401(k) account and borrows $10,000 against the 401(k), enter $10,000 as secured borrowed funds and enter $20,000 as retirement funds. Loans that are secured against a liquid asset owned by the borrower (such as a 401(k) or mutual fund) do not have to be entered as liabilities in Section VI Liabilities if the appropriate documentation is provided. Loans that are secured against real estate, or any other non-liquid asset, must be entered as liabilities in Section VI Liabilities.

CREDIT ASSESSMENT

General Requirements for Credit Scores

Credit Score Versions

Credit scores are required for most mortgage loans purchased or securitized by Fannie Mae. The classic FICO credit score is produced from software developed by Fair Isaac Corporation and is available from the three major credit repositories. Fannie Mae requires the following versions of the classic FICO score for DU underwritten mortgage loans:

- Equifax Beacon® 5.0;
- Experian®/Fair Isaac Risk Model V2SM; and
- TransUnion FICO® Risk Score, Classic 04.

CMS must request these FICO credit scores for each borrower from each of the three major credit repositories when they order the three in-file merged credit report. If the borrower's credit file includes complete and accurate information to ensure the validity of the credit score, CMS does not need to further evaluate the borrower's creditworthiness.

Note: The credit report will indicate if a credit score could not be produced due to insufficient credit. The credit report must be maintained in the mortgage loan file, whether the report includes traditional credit and a credit score or indicates that a credit score could not be produced due to insufficient credit.

Minimum Credit Score Requirements

Fannie Mae's minimum credit score requirements are published in the *Eligibility Matrix* and are based on the representative credit score for the transaction and the highest of the LTV, CLTV, or HCLTV ratios, as applicable. See Determining the Representative Credit Score for a Mortgage Loan for additional information. The following requirements apply:

Transaction Type	Minimum Representative Credit Score
DU loan casefiles	DU performs its own analysis of the credit report data, but in no case will credit scores be lower than 620 — fixed-rate loans
Loans delivered pursuant to any variance contained in CMS Master Agreement	Higher of 620 or the minimum credit score required by the variance

Exceptions to the Minimum Credit Score Requirement

Certain transactions are not subject to the minimum credit score requirement, including:

- mortgage loans where no borrower has a credit score (see Nontraditional Credit History)

General Requirements for Credit Scores (continued)

DU Credit Score Requirements

Credit scores are not an integral part of DU's risk assessment because DU performs its own analysis of the credit report data. However, CMS must request credit scores for each borrower from each of the three credit repositories when they order the three in-file merged credit report, described in Requirements for Credit Reports. If one or two of the credit repositories do not contain any credit information for the borrowers who have traditional credit, the credit report is still acceptable as long as

- credit data is available from one repository,
- a credit score is obtained from that repository, and
- CMS requested a three in-file merged report.

Loan-Level Price Adjustments Based on Credit Score

Loan-level price adjustments (LLPAs) are assessed based on the "representative" credit score for the loan, in addition to other eligibility and loan features. See the *Loan-Level Price Adjustment (LLPA) Matrix* for additional information about LLPAs, including information about how LLPAs are assessed for loans that include borrowers without a credit score.

Determining the Representative Credit Score for a Mortgage Loan

Representative Credit Score

The representative credit score for the mortgage loan is determined based on the credit scores of each borrower and is used to determine loan eligibility and for pricing purposes (i.e., assessing LLPAs). Follow these steps to calculate the representative credit score for a mortgage:

Step	Description
1	Fannie Mae recommends obtaining at least two credit scores for each borrower.
2	Select a single applicable score for underwriting each borrower. • When two credit scores are obtained, choose the lower score. • When three credit scores are obtained, choose the middle score. (If two of the three scores are the same, choose the middle of the three scores. For example: 700, 680, 680 =
3	If there is only one borrower, the single applicable score used to underwrite that borrower is the representative credit score for the mortgage. If there are multiple borrowers, determine the applicable credit score for each individual borrower and select the lowest applicable score from the group as the representative credit score for the mortgage. If there is a borrower on the loan who does not have a credit score, determine the representative credit score for the mortgage based on the credit scores of the other borrowers on the

Foreign Credit Reports and Credit Scores

Borrowers with foreign credit reports are ineligible for CMS financing.

Requirements for Credit Reports

Overview

CMS must obtain a credit report for each borrower on the loan application who has an individual credit record. The credit report must be based on data provided by the national credit repositories. Acceptable credit report formats are described in Types of Credit Reports.

General Requirements

Credit reports must meet the following general requirements:

- The report must include both credit and public record information for each locality in which the borrower has resided during the most recent two-year period.
- The report must include all discovered credit and legal information that is not considered obsolete under the Fair Credit Reporting Act. Although the Fair Credit Reporting Act currently specifies that credit information is not considered obsolete until after seven years, and bankruptcy information after ten years, Fannie Mae requires only a seven-year history to be reviewed for all credit and public record information.
- The report must be an original report, with no erasures, white-outs, or alterations. An automated credit report or one that is transmitted by fax is considered to be an "original" report.
- The report must include the full name, address, and telephone number of the credit reporting agency, as well as the names of the national repositories that the agency used to provide information for the report.
- The credit reporting agency must make responsive statements about all items on the credit report—indicating "unable to verify" or "employer refused to verify," when appropriate.

Public Records Information

The report must include all available public records information, identify the sources of the public records information, and disclose whether any judgments, foreclosures, tax liens, or bankruptcies were discovered (with these adverse items reported in accordance with the Fair Credit Reporting Act).

Public records information must be obtained from two sources, which may include any combination of the following:

- national repositories of accumulated credit records,
- direct searches of court records by employees of CMS or the consumer reporting agency, or
- record searches made by other public records search firms.

Requirements for Credit Reports (continued)

Acceptable and Unacceptable Changes

Collected credit report information should not be changed. However, it is permissible to delete duplicate information, translate codes to plain language, and make appropriate adjustments to resolve conflicting information to ensure the clarity of the report.

The following types of changes are unacceptable:

- deleting tradelines that pertain to a borrower's bankruptcy,
- adding a payment amount to a creditor's tradeline when the creditor does not require a payment, or
- restricting information collection to a shorter time period than Fannie Mae requires.

Credit repositories should only change the information called to its attention by a creditor or a party that is not associated with either the real estate sale or purchase transaction or the mortgage financing.

Required Creditor Information

For each debt listed, the report must provide:

- the creditor's name,
- the date the account was opened,
- the amount of the highest credit,
- the current status of the account,
- the required payment amount,
- the unpaid balance, and
- a payment history.

The report must indicate the dates that accounts were last updated with the creditors. Each account with a balance must have been checked with the creditor within 90 days of the date of the credit report.

Format for Reporting Payment History

All data must be presented in a format that is easy to read and that is understandable without the need for code translations.

The report must list the historical status of each account. This status must be presented in a "number of times past due" format and include the dates of the delinquencies.

The preferred format is "0 x 30, 0 x 60, 0 x 90 days" late. The following formats are also acceptable:

- "Rl, R2, R3, …," if it also gives historical negative ratings, such as "was R3 in 6/05."
- a consecutive numbering sequence, such as "0001000 …," provided the meaning is clear from the report.

Statements such as "current," "satisfactory," or "as agreed" are not satisfactory by themselves.

Requirements for Credit Reports (continued)

Unreported Debts	If the credit report does not include a reference for each significant open debt on the application, CMS must obtain a separate written verification for each unreported debt. CMS also needs to verify separately accounts listed as "will rate by mail only" or "need written authorization."
Assessing Borrower Credit Management Skills	The borrower's credit management skills can be assessed by analyzing repayment patterns, credit utilization, and level of experience in using credit.
Credit Report Requirements in Desktop Underwriter	CMS is required to request a three in-file merged credit report from one of the credit information providers listed on Fannie Mae's website. The credit report used by DU in the final loan casefile submission must be maintained in the mortgage loan file. A DU observation message will identify all of the credit reports evaluated by DU during the loan submission. The version of the credit report received by DU must be one that supports trended credit data. Trended credit data is expanded information on a borrower's credit history at a tradeline level on several monthly factors, including: amount owed, minimum payment, and payment made. **Note:** The borrower's present address must be within the U.S., U.S. territories, or an APO, FPO, or DPO military address located within the U.S. in order to obtain a credit report that is compatible with DU loan casefile requirements.
Credit Score Requirements	See General Requirements for Credit Scores, for additional information about credit report requirements related to credit scores.

Types of Credit Reports

In-File Credit Reports

An in-file credit report provides credit and public record information obtained from one or more credit repositories. The report contains "as is" information, which typically has not been updated or re-verified as a result of the credit inquiry.

The report must meet the following requirements:

- The report should include all information from three different credit repositories, or two repositories, if that is the extent of the data available for the borrower. If only one in-file credit report is available for a borrower, this is acceptable if CMS is able to obtain a credit score for the borrower and CMS requested information from three credit repositories.
- If the report does not include a reference for each significant debt reported by the borrower on the loan application, CMS must obtain a separate written verification for each unreported (or unrated) debt.
- If the report lists accounts that were not checked with the creditor within 90 days of the date of the in-file report, CMS must obtain an updated credit report or a separate written verification for those accounts.

Types of Credit Reports (continued)

Automated Merged Credit Reports

An automated merged credit report combines the in-file credit reports from multiple repositories into a single report. A joint merged credit report includes all credit repository credit data on more than one individual applicant.

The report must meet the following requirements:

- The report must include all information from three different credit repositories, or two repositories, if that is the extent of the data available for the borrower. If information from only one credit repository is available, this is acceptable if CMS is able to obtain a credit score for the borrower and CMS requested information from three different credit repositories.
- The report cannot be provided by a credit reporting agency that is affiliated with CMS in any way.
- The report must include all information reported for the borrower from the in-file credit reports.
- The report must identify the repositories that were used for the in-file credit reports.
- The report does not have to repeat duplicate information that is in in-file credit reports. However, if duplicate information is not exactly the same on each report, the automated merged report must either repeat the information or include the most derogatory of the duplicate information that pertains to payment history and/or current payment status.

Residential Mortgage Credit Reports

A residential mortgage credit report is a detailed account of the borrower's credit, employment, and residency history, as well as public records information.

The report must meet the following requirements:

- The credit reporting agency must contact at least two national repositories of accumulated credit records for each locality in which the borrower has lived during the most recent two- year period.
- All information must be obtained from, or verified by, sources other than the borrower. When co-borrowers have individually obtained credit, separate repository inquiries are necessary, although the results of both reports may be combined in one report, as long as the report clearly indicates that this has been done.
- The credit reporting agency must verify, either in writing or by telephone, the borrower's current employment and income (if it can be obtained). If the borrower has changed jobs in the past two years, the credit report also must mention the borrower's previous employment and income.
- The report must include a positive statement that the employment was verified, the date of the verification, and the name of the individual who confirmed the employment. If this information was not obtained by an employer interview, the credit reporting agency must indicate why that was not done.

Types of Credit Reports (continued)

Residential Mortgage Credit Reports (continued)

- The report must include the name of the party who ordered the report. If another party paid for the report, the credit report must provide that party's name, unless CMS ordered the report and the billed party has a documented agent or corporate relationship with CMS.
- The original report must be delivered to the office of the party who requested it, using any means acceptable under the Fair Credit Reporting Act or other similar regulations, such as sending it through the U.S. postal system, by messenger, over a fax machine, or through other automated means.
- The report must include a certification that it meets the standards for a residential mortgage credit report.

When the credit reporting agency has incomplete information, discovers that the borrower might not have disclosed all information that should be found in the public records, or obtains other information that indicates the possible existence of undisclosed credit records, the credit reporting agency must interview the borrower(s) to obtain additional information that is needed to provide an accurate report or perform additional research to verify whether the purported undisclosed records actually exist.

Accuracy of Credit Information in a Credit Report

For all mortgage loans (DU loan casefiles), CMS is responsible for reviewing the credit report, as well as all credit information, to determine that the credit report meets Fannie Mae's requirements and that the data evaluated by DU was accurate.

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

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

Note: If DU does not issue the disputed message, CMS is not required to further investigate.

CMS is responsible for determining whether the borrower's explanation is reasonable and/ or whether additional documentation is necessary to disprove the adverse information (e.g., canceled checks).

Types of Credit Reports (continued)

Number and Age of Accounts

CMS must review the borrower's credit report to determine whether he or she has an older established credit history or a newly established credit history, and whether there are a significant number of recently opened accounts or a mix of new accounts and older accounts.

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

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

Payment History

CMS must review the borrower's credit report to determine the current status of each credit account (including mortgage accounts), the timeliness of payments, and the frequency, recency, and severity of any delinquent payments.

- Credit histories that include no late payments, collection or charged-off accounts, foreclosures, deeds-in-lieu, bankruptcies, or other public records information represent a lower credit risk.
- Credit histories that include recent late payments represent a higher credit risk than those with late payments that occurred more than 24 months ago. When there are payments that were 30, 60, or 90 days (or longer) past due, CMS must determine whether the late payments represent isolated incidences or frequent occurrences. Delinquent payments must be evaluated in the context of the borrower's overall credit history, including the number and age of accounts, credit utilization, and recent attempts to obtain new credit. For example, a credit history that includes delinquent payments along with recent inquiries and a high balances-to- limits ratio indicates a high credit risk.
- Credit histories that include foreclosures, deeds-in-lieu, and public records information (such as bankruptcies, judgments, and liens) represent a higher credit risk. The greater the number of such incidences and the more recently they occurred, the higher the credit risk.

For information about mortgage payment history, see Previous Mortgage Payment History below.

Types of Credit Reports (continued)

Documenting Previous Mortgage History

CMS must review the borrower's credit report to determine the status of all mortgage accounts. If a borrower had previous mortgages, CMS does not have to independently verify the mortgage's payment history provided the credit report includes a reference to the mortgage (or mortgages) and reflects 12 months of the most recent payment activity.

If adequate mortgage payment history is not included in the borrower's credit report, CMS must use the following to verify the borrower's payment history on a previous mortgage(s):

- a standard mortgage verification;
- loan payment history from the servicer;
- the borrower's canceled checks for the last 12 months; or
- the borrower's year-end mortgage account statement, provided the statement includes a payment receipt history, and, if applicable, canceled checks for the months elapsed since the year-end mortgage account statement was issued.

Standard Mortgage Verifications from Servicers

When CMS relies on standard mortgage verifications from servicers or holders, it must ensure that the verifications include:

- the unpaid principal balance of the mortgage and monthly payment amount;
- the present status of the mortgage, such as current, 30 days' delinquent, etc.; and
- the borrower's payment history.

When a servicer fails to provide all of the requested information, CMS must rely on information provided through the borrower's canceled checks.

The checks must:

- be legible,
- identify the mortgage servicer or mortgage holder as the payee,
- indicate that the servicer or holder endorsed the check for deposit, and
- indicate the date the servicer or holder deposited the check.

Existing Mortgage Payment Requirements

On the date of the loan application, the borrower's existing mortgage must be current, which means that no more than 45 days may have elapsed since the last paid installment date.

Types of Credit Reports (continued)

Excessive Mortgage Delinquency

CMS must review the borrower's credit history to determine previous mortgage delinquency, severity (e.g., 30, 60, or 90 days), and recency of the delinquency. Loans with excessive prior mortgage delinquencies are not eligible for delivery to Fannie Mae. Excessive prior mortgage delinquency is defined as any mortgage tradeline that has one or more 60-, 90-, 120-, or 150-day delinquency reported within the 12 months prior to the credit report date.

Inquiries: Recent Attempts to Obtain New Credit

CMS must review the section of the borrower's credit report that indicates the presence of creditor inquiries to determine the number and recency of the inquiries.

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

When the credit report indicates that recent inquiries took place, CMS must confirm that the borrower has not obtained any additional credit that is not reflected in the credit report or the mortgage application. If additional credit was obtained, a verification of that debt must be provided and the borrower must be qualified with the monthly payment.

Credit Utilization

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

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

Note: CMS is not required to analyze trended credit data in the credit report. See Requirements for Credit Reports, for additional information.

Authorized Users of Credit

When a credit account owner permits another person, typically a family member who is managing credit for the first time, to have access to and use an account, the user is referred to as an authorized user of the account. This practice is intended to assist related individuals in legitimately establishing a credit history and credit score based on the account and payment history of the account owner, even though the authorized user is not the account owner.

Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit

General Information

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

Note: The terms “preforeclosure sale” and “short sale” are used interchangeably in this Guide and have the same meaning (see Deed-in-Lieu of Foreclosure, Preforeclosure Sale, and Charge-Off of a Mortgage Account below).

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

This topic describes the amount of time that must elapse (the “waiting period”) after a significant derogatory credit event before the borrower is eligible for a new loan salable to Fannie Mae.

Identification of Significant Derogatory Credit Events in the Credit Report

CMS must review the credit report and Section VIII, Declarations, of the loan application to identify instances of significant derogatory credit events. CMS must review the public records section of the credit report and all tradelines, including mortgage accounts (first liens, second liens, home improvement loans, and HELOC’s loans), to identify previous foreclosures, deeds-in-lieu, preforeclosure sales, charge-offs of mortgage accounts, and bankruptcies. CMS must carefully review the current status of each tradeline, manner of payment codes, and remarks to identify these types of significant derogatory credit events. Remarks Codes are descriptive text or codes that appear on a tradeline, such as “Foreclosure,” “Forfeit deed-in-lieu of foreclosure,” and “Settled for less than full balance.”

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

Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit (continued)

Bankruptcy (Chapter 7 or Chapter 11)

A (4) four-year waiting period is required, measured from the discharge or dismissal date of the bankruptcy action.

Exceptions for Extenuating Circumstances

A (2) two-year waiting period is permitted if extenuating circumstances can be documented, and is measured from the discharge or dismissal date of the bankruptcy action.

Bankruptcy (Chapter 13)

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

- (2) two years from the discharge date, or
- (4) four years from the dismissal date.

The shorter waiting period based on the discharge date recognizes that borrowers have already met a portion of the waiting period within the time needed for the successful completion of a Chapter 13 plan and subsequent discharge. A borrower who was unable to complete the Chapter 13 plan and received a dismissal will be held to a (4) four-year waiting period.

Exceptions for Extenuating Circumstances

A (2) two-year waiting period is permitted after a Chapter 13 dismissal, if extenuating circumstances can be documented. There are no exceptions permitted to the (2) two-year waiting period after a Chapter 13 discharge.

Multiple Bankruptcy Filings

For a borrower with more than one bankruptcy filing within the past seven (7) years, a (5) five-year waiting period is required, measured from the most recent dismissal or discharge date.

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

Exceptions for Extenuating Circumstances

A (3) three-year waiting period is permitted if extenuating circumstances can be documented, and is measured from the most recent bankruptcy discharge or dismissal date. The most recent bankruptcy filing must have been the result of extenuating circumstances.

Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit (continued)

Foreclosure

A (7) seven-year waiting period is required, and is measured from the completion date of the foreclosure action as reported on the credit report or other foreclosure documents provided by the borrower.

Exceptions for Extenuating Circumstances

A (3) three-year waiting period is permitted if extenuating circumstances can be documented, and is measured from the completion date of the foreclosure action. Additional requirements apply between three (3) and seven (7) years, which include:

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

Note: The purchase of second homes or investment properties and cash-out refinances (any occupancy type) are not permitted until a (7) seven-year waiting period has elapsed.

Foreclosure and Bankruptcy on the Same Mortgage

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

Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit (continued)

Deed-in-Lieu of Foreclosure, Preforeclosure Sale, and Charge-Off of a Mortgage Account

These transaction types are completed as alternatives to foreclosure.

- A deed-in-lieu of foreclosure is a transaction in which the deed to the real property is transferred back to the servicer. These are typically identified on the credit report through Remarks Codes such as “Forfeit deed-in-lieu of foreclosure.”
- A preforeclosure sale or short sale is the sale of a property in lieu of a foreclosure resulting in a payoff of less than the total amount owed, which was pre-approved by the servicer. These are typically identified on the credit report through Remarks Codes such as “Settled for less than full balance.”
- A charge-off of a mortgage account occurs when a creditor has determined that there is little (or no) likelihood that the mortgage debt will be collected. A charge-off is typically reported after an account reaches a certain delinquency status, and is identified on the credit report with a manner of payment (MOP) code of “9.”

A (4) four-year waiting period is required from the completion date of the deed-in-lieu of foreclosure, preforeclosure sale, or charge-off as reported on the credit report or other documents provided by the borrower.

Exceptions for Extenuating Circumstances

A (2) two-year waiting period is permitted if extenuating circumstances can be documented.

Note: Deeds-in-lieu and pre-foreclosure sales may not be accurately or consistently reported in the same manner by all creditors or credit reporting agencies. See Identification of Significant Derogatory Credit Events in the Credit Report above for additional information.

Inaccurately Reported Foreclosure

Enter in DU: “Confirmed CR FC Incorrect” when the foreclosure on the credit report is reporting inaccurately

Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit (continued)

Summary — All Waiting Period Requirements

The following table summarizes the waiting period requirements for all significant derogatory credit events.

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

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

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

Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit (continued)

Requirements for Re-establishing Credit

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

- The waiting period and the related additional requirements are met.
- The loan receives a recommendation from DU that is acceptable for delivery to Fannie Mae.
- The borrower has traditional credit as outlined in Section B3–5.3, Traditional Credit History.

Extenuating Circumstances for Derogatory Credit

Extenuating Circumstances

Extenuating circumstances are nonrecurring events that are beyond the borrower's control that result in a sudden, significant, and prolonged reduction in income or a catastrophic increase in financial obligations.

If a borrower claims that derogatory information is the result of extenuating circumstances, CMS must substantiate the borrower's claim. Examples of documentation that can be used to support extenuating circumstances include

- documents that confirm the event
  - such as a copy of a divorce decree, medical reports or bills, notice of job layoff, job severance papers, etc.; and
- documents that illustrate factors that contributed to the borrower's inability to resolve the problems that resulted from the event
  - such as a copy of insurance papers or claim settlements, property listing agreements, lease agreements, tax returns (covering the periods prior to, during, and after a loss of employment), etc.

CMS must obtain a written explanation from the borrower explaining the relevance of the documentation. The written explanation must support the claims of extenuating circumstances, confirm the nature of the event that led to the bankruptcy or foreclosure-related action, and illustrate that the borrower had no reasonable options other than to default on his or her financial obligations. The written explanation may be in the form of a letter from the borrower, an email from the borrower, or some other form of written documentation provided by the borrower. Borrower(s) must write, sign, and date all letters of explanation themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content.

DU Credit Report Analysis

Inquiries: The report must list all inquiries that were made in the previous 90 days.

CMS should examine inquiries to determine whether they represent potential sources of undisclosed credit. If new debt was obtained, CMS may need to correct the loan application and resubmit it.

Extenuating Circumstances for Derogatory Credit (continued)

Trended Credit Data

CMS is not required to analyze trended credit data in the credit report. For more information, see Risk Factors Evaluated by DU.

Omitted Accounts

Supporting documentation is required when a credit report liability with a balance greater than zero is omitted from the loan application.

Possible Non-Applicant Debts

The DU Underwriting Findings report will list any debts that are identified as "possible non- applicant debts" on the credit report. The possible non-applicant accounts will be included in the credit risk assessment and, if the debts are on the loan application, DU will include them in the DTI ratio. If the debts do not belong to the borrower, CMS may provide supporting documentation, remove the debts from the loan application, and resubmit the loan casefile to DU in order for the DTI ratio to be updated to exclude the non-applicant debts.

Authorized User Tradelines

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

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

- the relationship of the borrower to the owner of the account,
- if the borrower uses the account, and
- if the borrower makes the payments on the account.

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

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

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

Extenuating Circumstances for Derogatory Credit (continued)

Disputed Credit Report Tradelines

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

Sample Scenarios:

The following scenarios are examples of when CMS would not need to obtain an updated credit report, provided the borrower can provide documentation to support the claim:

- A borrower's account was referred for collection by the creditor. Subsequently, the borrower paid off the account, but the pay-off was not reported on the tradeline. The borrower requested that a dispute be placed on the tradeline. The tradeline information was accurate, but because it did not reflect that the borrower paid off the account, it may be considered incomplete. The borrower must provide documentation that the account was paid in full.
- A borrower and his son have the same name (Sr. and Jr.). The borrower's credit report contains a tradeline that actually belongs to the son. The tradeline is reported as disputed. The borrower can provide confirmation that he is not obligated on the account.
- The servicer of the loan being disputed indicates a late payment in January of the previous year. The borrower can provide documentation (for example, canceled checks, bank statements) that indicates that the payment was made on time.

The following scenario would require CMS to either obtain an updated credit report and resubmit the loan casefile to DU:

- The credit report indicates a disputed tradeline on the borrower's mortgage being refinanced. The tradeline indicates a 60–day late payment in January of the previous year. The borrower cannot provide any documentation to support that the payment was made on time.

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

- further investigate the disputed tradeline on the credit report,
- obtain an updated credit report (with the undisputed tradeline

Extenuating Circumstances for Derogatory Credit (continued)

Disputed Credit Report Tradelines (continued)	However, CMS is required to ensure that the payment for the tradeline, if any, is included in the debt-to-income ratio if the account does belong to the borrower. **Note:** Tradelines reported as medical debt are not shown in the disputed tradeline message. Therefore, CMS is not required to investigate the disputed medical tradeline.
DU Debt Comparison	DU compares the balances and payments of the debts on the credit report with the debts on the loan application. If material differences are found, CMS must confirm that all debts from the credit report are included on the loan application and provide documentation to support the use of payments and balances lower than those on the credit report. If the debt affects the debt- to-income ratio by more than the allowable tolerances, CMS must add the debt to the loan application and resubmit the loan. Otherwise, CMS is expected to provide documentation that supports the omission from the loan application. See Debt-to-Income Ratios, and Accuracy of DU Data, DU Tolerances, and Errors in the Credit Report, for additional information.)
Contradictory, Derogatory, or Erroneous Information	CMS is obligated to take action when contradictory, derogatory, or erroneous information would justify additional investigation or would provide grounds for a decision that is different from the recommendation DU delivers. For example, if the credit report reflects a previous foreclosure but the information was not accurately mapped to DU, CMS must consider this when making its final underwriting decision.
Duplicate Public Records	Open judgments and all outstanding liens that are in the Public Records section of the credit report will be identified in the Underwriting Findings report, and must be paid off at or prior to closing. Documentation of the satisfaction of these liabilities, along with verification of funds sufficient to satisfy these obligations, must also be maintained in the permanent loan file.
Mortgage Delinquencies	DU applies the following guidelines to the processing of loans with mortgage delinquencies: • If any borrower's credit report contains a mortgage tradeline that is 60 or more days past due when the account was last reported by the creditor and the account was reported within the 12 months prior to the credit report date, the loan casefile will receive a Refer with Caution recommendation and will be ineligible for delivery to Fannie Mae. • If there is a mortgage that is disclosed on the loan application but not reported on the credit report, or the mortgage is on the credit report with an outstanding balance but the payment history has not been reported in the last six months, DU will issue a message requiring CMS to confirm that the account is not two or more payments past due as of the date of the application and that it has not been past due by two or more payments in the last 12 months. If CMS determines that the borrower does have a mortgage that is past due by two or more payments or has been past due by two or more payments in the last 12 months, then the loan casefile is not eligible for delivery to Fannie Mae.

Extenuating Circumstances for Derogatory Credit (continued)

Mortgage Delinquencies (continued)	• Borrowers may not bring past-due mortgage accounts current prior to closing in order to circumvent Fannie Mae's policy regarding past-due mortgages. However, CMS may apply some discretion with regard to the application of this policy if it determines and documents that the past-due account status was not the fault of the borrower—for example, if the servicer misapplied or lost the borrower's payment. • Loan casefiles will receive an Ineligible recommendation due to excessive prior mortgage delinquency if the borrower has a mortgage tradeline on his or her credit report that has one or more 60-, 90-, 120-, or 150-day delinquency reported within the 12 months prior to the credit report date. The above policies will apply to all mortgage tradelines, including first liens, second liens, home improvement loans, and HELOCs, loans.
Past-Due, Collection, and Charge-Off of Non-Mortgage Accounts	Accounts that are reported as past due (not reported as collection accounts) must be brought current. • For one-unit, principal residence properties, borrowers are not required to pay off outstanding collections or non-mortgage charge-offs—regardless of the amount. **Note:** If CMS marks the collection account Paid By Close in the online loan application, DU will issue a message in the DU Underwriting Findings report stating that the collection must be paid. • For two- to four-unit owner-occupied and second home properties, collections and non- mortgage charge-offs totaling more than $5,000 must be paid in full prior to or at closing. • For investment properties, individual collection and non-mortgage charge-off accounts equal to or greater than $250 and accounts that total more than $1,000 must be paid in full prior to or at closing.
Prior Bankruptcy, Foreclosure, Deed-in-Lieu of Foreclosure, Pre-foreclosure Sales, and Charge-Off of Mortgage Accounts	Per the requirements of Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit, an amount of time must elapse (the "waiting period") after a significant derogatory credit event before the borrower is eligible for a new loan salable to Fannie Mae. The waiting period commences on the completion, discharge, or dismissal date (as applicable) of the derogatory credit event and ends on the disbursement date of the new loan. Because DU does not have the disbursement date of the subject loan, DU uses the date of the credit report to measure whether or not the applicable waiting period has been met. However, because the credit report date may not result in an accurate calculation of the waiting period (it is earlier than the disbursement date), CMS may use the disbursement date to confirm that the waiting period has been met. See the table below for additional information.

Extenuating Circumstances for Derogatory Credit (continued)

Prior Bankruptcy, Foreclosure, Deed-in-Lieu of Foreclosure, Pre-foreclosure Sales, and Charge-Off of Mortgage Accounts (continued)

Event	Measurement of Waiting Period
Bankruptcy Foreclosure	• If the completion, discharge, or dismissal dates (as applicable) reflected in the credit report are complete and appear to comply with the applicable waiting period requirements, DU will issue a recommendation, but CMS must still confirm that the waiting period has been met and may base its determination on the disbursement date of the new loan. • If the completion, discharge, or dismissal dates (as applicable) reflected in the credit report are complete, but do not appear to comply with the applicable waiting period requirements, a Refer with Caution recommendation will be issued. DU uses the date of the credit report to determine whether or not the applicable waiting period has been met. CMS may obtain an updated credit report and resubmit the loan casefile to DU after the required time has elapsed. • If the completion, discharge, or dismissal dates (as applicable) reflected in the credit report are incomplete, CMS must confirm that the waiting period has been met and may base its determination on the disbursement date of the new loan.
Deed-in-Lieu of Foreclosure Preforeclosure Sale Mortgage Charge-Off	• DU will determine if the date of the event was within the applicable waiting period. However, the recommendation will not be changed and CMS must confirm the waiting period requirement has been met, and may base its determination on the disbursement date of the new loan.

Note: See Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit, for additional information regarding significant derogatory events. DU is not able to identify whether the borrower's derogatory credit event(s) was the result of extenuating circumstances. See below for information on how to treat extenuating circumstances and Extenuating Circumstances for Derogatory Credit, for additional information.

Extenuating Circumstances for Derogatory Credit (continued)

Bankruptcy

DU applies the following guidelines to prior bankruptcies:

- If a Chapter 13 bankruptcy was discharged within the last two years, dismissed within the last four years, or filed but neither discharged nor dismissed within the last four years, the loan casefile will receive a Refer with Caution recommendation and will be ineligible for delivery to Fannie Mae.
- If a non-Chapter 13 bankruptcy was filed, discharged, or dismissed within the last four years, the loan casefile will receive a Refer with Caution recommendation and will be ineligible for delivery to Fannie Mae.
- DU will not take bankruptcy information in the public record section of the credit report into account if the bankruptcy is dated more than seven years prior to the credit report date.
- DU will not take tradeline accounts that are reported with a bankruptcy status code or manner of payment (MOP) code of “7” into account if there is at least one bankruptcy reported in a public record within seven years of the credit report date. In this scenario, DU assumes the date filed and the date discharged in the public record are more accurate than the dates in the tradeline; i.e., specific filed and discharged dates do not exist in the tradeline.
- DU will use tradeline accounts that are reported with a bankruptcy status code or MOP code of “7” if there is not a bankruptcy reported in a public record within seven years of the credit report date. In this scenario, CMS will need to verify the actual filed and discharged dates to determine that the bankruptcy meets the DU bankruptcy policy.
- DU is not able to determine if multiple filings have occurred due to the manner in which bankruptcies are reported to the credit report. DU will issue a message when it appears that there may have been multiple bankruptcy filings. This message will list each of the bankruptcies seen on the credit report, and will instruct CMS to ensure the loan casefile meets the criteria for underwriting loan casefiles with multiple bankruptcies.

Underwriting when the Credit Report Contains Inaccurate Bankruptcy Information

- When DU identifies a bankruptcy on the credit report and the information is inaccurate, the Underwriter may instruct DU to disregard the bankruptcy information on the credit report in the eligibility assessment. This is done by entering “Confirmed CR BK Incorrect” in the Explanation filed for question b. in the Declarations section of the online loan application and resubmitting the loan casefile to DU. When the loan casefile is resubmitted to DU, the bankruptcy information on the credit report will not be used.
- If the Underwriter enters “Confirmed CR BK Incorrect”, the Underwriter must document that the Chapter 13 bankruptcy was discharged two or more years or dismissed four or more years from the disbursement date of the new loan, or that the non-Chapter 13 bankruptcy was discharged or dismissed four years or more years from the disbursement date of the new loan

Extenuating Circumstances for Derogatory Credit (continued)

Bankruptcy (continued)

Underwriting when a Bankruptcy Was Due to Extenuating Circumstances

- When DU identifies a bankruptcy on the credit report and that bankruptcy was due to extenuating circumstances, the Underwriter may instruct DU to disregard the bankruptcy information on the credit report in the eligibility assessment. This is done by entering "Confirmed CR BK EC" in the Explanation field for question b. in the Declarations section of the online loan application and resubmitting the loan casefile to DU. When the loan casefile is resubmitted to DU, the bankruptcy information on the credit report will not be used.
- If the Underwriter enters "Confirmed CR BK EC", the Underwriter must document that the bankruptcy was due to extenuating circumstances, and that the Chapter 13 bankruptcy was dismissed two or more years from the disbursement date of the new loan, or that the non-Chapter 13 bankruptcy was discharged or dismissed two or more years from the disbursement date of the new loan.

Foreclosure

DU applies the following guidelines to prior foreclosures:

- Mortgage accounts, including first liens, second liens, home improvement loans, and HELOCs, loans, will be identified as a foreclosure if there is an MOP code of "8" or a Remarks Code that indicates a foreclosure is present in the credit report data and associated to the tradeline.
- If a foreclosure was reported within the seven-year period prior to the credit report date, the loan casefile will receive a Refer with Caution recommendation and will be ineligible for delivery to Fannie Mae.
- If the filed date and the satisfied date of the foreclosure are both unknown, but it appears that the foreclosure occurred within the seven-year period prior to the credit report date, CMS must confirm that the foreclosure did not occur within the most recent seven-year period.
- Foreclosure laws vary by state and the time it takes to complete the process may vary by state. DU assumes that the date the foreclosure was reported in the tradeline is the date of the foreclosure sale or liquidation. CMS must confirm that all foreclosures are satisfied.
- Mortgage accounts that are identified as a deed-in-lieu of foreclosure or pre-foreclosure sale will not be identified as a foreclosure.

Extenuating Circumstances for Derogatory Credit (continued)

Foreclosure (continued)

Underwriting when Inaccurate Foreclosure Information Exists

- When DU identifies a foreclosure on a credit report tradeline and the foreclosure information on that tradeline is inaccurate, CMS may instruct DU to disregard the foreclosure information on the credit report in the eligibility assessment. This is done by entering “Confirmed CR FC Incorrect” in the Explanation field for question c. in the Declarations section of the online loan application and resubmitting the loan casefile to DU. When the loan casefile is resubmitted to DU, the foreclosure information on the credit report tradeline will not be used in the eligibility assessment.
- If CMS enters “Confirmed CR FC Incorrect,” CMS must then document the foreclosure was completed seven or more years from the disbursement date of the new loan, or that the account was not subject to foreclosure and the loan complies with all other applicable requirements.

Underwriting when Extenuating Circumstances Exist

- When DU identifies a foreclosure on a credit report tradeline and that foreclosure was due to extenuating circumstances, CMS may instruct DU to disregard the foreclosure information on the credit report in the eligibility assessment. This is done by entering “Confirmed CR FC EC” in the Explanation field for question c. in the Declarations section of the online loan application and resubmitting the loan casefile to DU. When the loan casefile is resubmitted to DU, the foreclosure information on the credit report tradeline will not be used in the eligibility assessment.
- If CMS enters “Confirmed CR FC EC,” CMS must then document that the foreclosure was due to extenuating circumstances, the foreclosure was completed three or more years from the disbursement date of the new loan, and the loan complies with all other requirements specific to a foreclosure due to extenuating circumstances.

Extenuating Circumstances for Derogatory Credit (continued)

Deed-in-Lieu of Foreclosure

- DU applies the following guidelines to prior DILs:
- DU will determine if a mortgage tradeline is a DIL by using specific Remarks Codes that are present in the credit report data and associated to the tradeline.
- When DU identifies a DIL, CMS must document that the event was completed four or more years from the disbursement date of the new loan, or two or more years from the disbursement date of the new loan when CMS confirms that the mortgage loan meets the applicable time frames and eligibility requirements for a deed-in-lieu of foreclosure due to extenuating circumstances.

Preforeclosure Sales or Short Sales

- DU will determine if a mortgage tradeline is a PFS by using specific Remarks Codes that are present in the credit report data and associated to the tradeline.
- When DU identifies a PFS, CMS must document that the event was completed four or more years from the disbursement date of the new loan, or two or more years from the disbursement date of the new loan when CMS confirms that the mortgage loan meets the applicable time frames and eligibility requirements for a pre-foreclosure sale due to extenuating circumstances.

Charge-Off of Mortgage Accounts

- Mortgage accounts, including first liens, second liens, home improvements loans, and HELOCs, loans, will be identified as a charge-off if there is an MOP code of “9” (collection or charge-off) and there is no information indicating the account may also be subject to a foreclosure (MOP code “8” or foreclosure Remarks Code), a deed-in-lieu of foreclosure (DIL Remarks Code), or a preforeclosure sale (PFS Remarks Code).
- When DU identifies a charge-off on a mortgage tradeline, CMS must document that the event was completed four or more years from the disbursement date of the new loan, or two or more years from the disbursement date of the new loan when CMS confirms that the mortgage loan meets the applicable time frames and eligibility requirements for a charge-off due to extenuating circumstances.

LIABILITY ASSESSMENT

General Information on Liabilities

CMS risk analysis must include all liabilities affecting income or assets that will affect the borrower's ability to fulfill the mortgage payment obligation.

A borrower's liabilities include the following:

- housing expense on the borrower's principal residence,
- all revolving charge accounts,
- installment loan debts with a remaining payment term greater than 10 months,
- lease payments,
- real estate loans,
- HELOCs,
- alimony and child support,
- maintenance payments, and
- all other debts of a recurring nature.

FNMA will allow an IRS repayment plan that is documented and accepted. Plan cannot be in delinquent status and there is no minimum to the number of payments made.

For each liability, CMS must determine the unpaid balance, the terms of repayment, and the borrower's payment history, and verify any other liability that is not shown on a credit report by obtaining documentation from the borrower or creditor.

If the credit report does not contain a reference for each significant open debt shown on the loan application—including outstanding mortgage debt, bank, student, or credit union loans—CMS must provide separate credit verification.

If a current liability appears on the credit report that is not shown on the loan application, the borrower should provide a reasonable explanation for the undisclosed debt. Documentation may be required to support the borrower's explanation. Borrower(s) must write, sign, and date all letters of explanation themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content.

If the borrower discloses, or CMS discovers, additional liabilities after the underwriting decision has been made, up to and concurrent with closing, CMS must recalculate the borrower's debt-to-income ratio. (See Debt-to-Income Ratios, for additional information.)

Liability Assessment (continued)

Monthly Obligations Not Included in Liabilities

Some obligations, often identified on a borrower's paystub, are not considered a liability and will not be included as a debt or deducted from the borrower's gross income when calculating the borrower's debt-to-income ratio. These obligations include items such as

- federal, state, and local taxes;
- Federal Insurance Contributions Act (FICA) or other retirement contributions, such as 401(k) accounts (including repayment of debt secured by these funds);
- commuting costs;
- union dues; and
- voluntary deductions.

Debt-to-Income Ratios

DTI Ratios

The DTI ratio consists of two components:

- total monthly obligations, which includes the qualifying payment for the subject mortgage loan and other long-term and significant short-term monthly debts (see Calculating Total Monthly Obligation below); and
- total monthly income of all borrowers, to the extent the income is used to qualify for the mortgage (see Income Assessment).

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

Debt-to-Income Ratios (continued)

Exceptions to the Maximum DTI Ratio

Fannie Mae makes exceptions to the maximum allowable DTI ratios for particular mortgage transactions, including:

- borrowers who do not have a credit score the maximum ratio may be lower for DU loan casefiles

Calculating Total Monthly Obligation

The total monthly obligation is the sum of the following:

- the monthly housing expense of the borrower's principal residence (or the qualifying payment amount if the subject mortgage loan is secured by the borrower's principal residence (see Monthly Housing Expense));
- the qualifying payment amount if the subject mortgage loan is secured by a second home or investment property (see Qualifying Payment Requirements);
- monthly payments on installment debts and other mortgage debts that extend beyond ten months;
- monthly payments on installment debts and other mortgage debts that extend ten months or less if the payments significantly affect the borrower’s ability to meet credit obligations;
- monthly payments on revolving debts;
- monthly payments on lease agreements, regardless of the expiration date of the lease;
- monthly alimony, child support, or maintenance payments that extend beyond ten months;
- monthly payments for other recurring monthly obligations; and
- any net loss from a rental property.

Note: Fannie Mae acknowledges that CMS may sometimes apply a more conservative approach when qualifying borrowers. This is acceptable as long as Fannie Mae’s minimum requirements are met, and CMS consistently apply the same approach to similar loans. For example, a lender might calculate a higher minimum payment on a credit card account than what Fannie Mae requires, which is acceptable as long as CMS consistently applies this calculation to all mortgage applications with revolving debts.

Debt-to-Income Ratios (continued)

DTI Ratio Tolerance and Re-underwriting Criteria

Fannie Mae expects CMS to have in place processes to facilitate borrower disclosure of changes in financial circumstances throughout the origination process and prefunding quality control processes to increase the likelihood of discovering material undisclosed debts.

As a result of the lender's normal processes and controls, CMS may need to re-underwrite the loan after initial underwriting. If the borrower discloses or CMS discovers additional debt(s) or reduced income after the underwriting decision was made up to and concurrent with loan closing, the loan must be re-underwritten if the new information causes the DTI ratio:

- to exceed 45%; or
- if the recalculated DTI ratio does not exceed 45%, to increase by 3 percentage points or more.

In all cases, if CMS determines that there is new subordinate financing on the subject property during the loan process, the mortgage loan must be re-underwritten.

Applying the Re-underwriting Criteria

The following steps are required if the borrower discloses or CMS discovers additional debt(s) or reduced income after the underwriting decision was made up to and concurrent with loan closing:

Step	Description
1	CMS must document the additional debt(s) and reduced income in accordance with General Information on Liabilities or Income Assessment, as applicable. **Note:** CMS is not required to obtain a new credit report to verify the additional debt(s). However, if CMS chooses to obtain a new credit report after the initial underwriting decision was made, the loan must be re-underwritten.
2	If there is new subordinate debt on the subject property, the mortgage loan must be re- underwritten.
3	CMS must recalculate the DTI ratio. For DU loan casefiles, the DTI ratio should be recalculated outside of DU.
4	If the recalculated DTI ratio exceeds 45%: • DU loan casefiles: The online loan application must be updated with the new information and the loan casefile must be re-underwritten through DU. DU offers flexibilities in the maximum allowable DTI ratios for loan casefiles with strong compensating factors.

Debt-to-Income Ratios (continued)

Applying the Re-underwriting Criteria (continued)

Step	Description
5	If the recalculated DTI ratio does not exceed 45%, but it increases by 3 percentage points or more: • DU loan casefiles: The online loan application must be updated with the new information and the loan casefile must be re-underwritten through DU.
6	The final loan application signed by the borrower must include all income and debts verified, disclosed, or identified during the mortgage process.
7	Upon delivery to Fannie Mae, CMS must deliver the qualifying monthly income and expense amounts that are on the final loan application.

Monthly Housing Expense

Monthly housing expense is the sum of the following and is referred to as PITIA:

- principal and interest (P&I);
- property, flood, and mortgage insurance premiums (as applicable);
- real estate taxes;
- ground rent;
- special assessments;
- any owners' association dues (including utility charges that are attributable to the common areas, but excluding any utility charges that apply to the individual unit);
- any monthly co-op corporation fee (less the pro rata share of the master utility charges for servicing individual units that is attributable to the borrower's unit);
- any subordinate financing payments on mortgages secured by the subject property.

CMS must enter all components of the monthly housing expense on the application including other financing P&I, property insurance, real estate taxes, mortgage insurance, homeowners' association dues, and other proposed housing expenses.

If the subject mortgage is secured by the borrower's principal residence, the monthly housing expense is based on the qualifying payment required in accordance with Qualifying Payment Requirements. This amount is the monthly housing expense used to calculate the debt- to-income (DTI) ratio.

If the subject mortgage is secured by a second home or an investment property, the qualifying payment amount is considered one of the borrower's monthly debt obligations when calculating the DTI ratio. The monthly housing expense in these cases represents the PITIA or rental payment obligation associated with the borrower's principal residence and third party verification of the payment amount must be documented. Follow applicable Agency guidelines for verification of housing payment history.

Refer to the Qualifying Payment Requirements for details on calculating the qualifying payment.

Debt-to-Income Ratios (continued)

Calculating Monthly Real Estate Tax Payment

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

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

Qualifying Payment Amount

The calculation of the qualifying payment amount for the subject property will differ based on the transaction type (as shown in the following table).

These policies apply DU loan casefiles. In all cases, qualification must consider the borrower's current obligations and other mortgage-related obligations, i.e. PITIA.

Mortgage loans subject to temporary interest rate buydowns must be qualified without consideration of the bought-down rate, based on the transaction type below.

Qualifying Interest Rate Requirements	
Transaction Type	**DU**
Fixed-rate mortgages	Note rate

Additional Information About ARM Qualifying for DU Loan Casefiles

For DU loan casefiles, the fully indexed rate is defined as the index plus the margin as entered in the online loan application.

Additional Qualifying Considerations for Specific Products

For additional temporary interest rate buydown requirements, see Temporary Interest Rate Buydowns.

Monthly Debt Obligations

Alimony/Child Support/Separate Maintenance Payments

When the borrower is required to pay alimony, child support, or maintenance payments under a divorce decree, separation agreement, or any other written legal agreement—and those payments must continue to be made for more than ten months—the payments must be considered as part of the borrower's recurring monthly debt obligations. However, voluntary payments do not need to be taken into consideration.

Business Debt in Borrower's Name

When a self-employed borrower claims that a monthly obligation that appears on his or her personal credit report is being paid by the borrower's business, CMS must confirm that it verified that the obligation was actually paid out of company funds and that this was considered in its cash flow analysis of the borrower's business.

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

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

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

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

Court-Ordered Assignment of Debt

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

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

Monthly Debt Obligations (continued)

Debts Paid by Others

Certain debts can be excluded from the borrower's recurring monthly obligations and the DTI ratio:

- When a borrower is obligated on a non-mortgage debt -- but is not the party who is actually repaying the debt -- CMS may exclude the monthly payment from the borrower's recurring monthly obligations. This policy applies whether or not the other party is obligated on the debt, but is not applicable if the other party is an interested party to the subject transaction (such as the seller or realtor). Non-mortgage debts include installment loans, student loans, revolving accounts, lease payments, alimony, child support, and separate maintenance.
- When a borrower is obligated on a mortgage debt - but is not the party who is actually repaying the debt - CMS may exclude the full monthly housing expense (PITIA) from the borrower's recurring monthly obligations if
  - the party making the payments is obligated on the mortgage debt,
  - there are no delinquencies in the most recent 12 months, and
  - the borrower is not using rental income from the applicable property to qualify.

In order to exclude non-mortgage or mortgage debts from the borrower's DTI ratio, CMS must obtain the most recent 12 months' cancelled checks (or bank statements) from the other party making the payments that document a 12-month payment history with no delinquent payments.

When a borrower is obligated on a mortgage debt, regardless of whether or not the other party is making the monthly mortgage payments, the referenced property must be included in the count of financed properties (if applicable per FNMA Selling Guide B2-2-03,Multiple Financed Properties for the Same Borrower)

Deferred Installment Debt

Deferred installment debts must be included as part of the borrower's recurring monthly debt obligations. For deferred installment debts other than student loans, if the borrower's credit report does not indicate the monthly amount that will be payable at the end of the deferment period, CMS must obtain copies of the borrower's payment letters or forbearance agreements so that a monthly payment amount can be determined and used in calculating the borrower's total monthly obligations.

For information about deferred student loans, see Student Loans below.

Monthly Debt Obligations (continued)

Federal Income Tax Installment Agreements

When a borrower has entered into an installment agreement with the IRS to repay delinquent federal income taxes, CMS may include the monthly payment amount as part of the borrower's monthly debt obligations (in lieu of requiring payment in full) if:

- There is no indication that a Notice of Federal Tax Lien has been filed against the borrower in the county in which the subject property is located.
- CMS must obtain the following documentation:
  - an approved IRS installment agreement with the terms of repayment, including the monthly payment amount and total amount due; and
  - evidence the borrower is current on the payments associated with the tax installment plan. Acceptable evidence includes the most recent payment reminder from the IRS, reflecting the last payment amount and date and the next payment amount owed and due date. At least one payment must have been made prior to closing.

The payments on a federal income tax installment agreement can be excluded from the borrower's DTI ratio if the agreement meets the terms in Debts Paid by Others or Installment Debt. If any of the above conditions are not met, the borrower must pay off the outstanding balance due under the installment agreement with the IRS in accordance with Debts Paid Off At or Prior to Closing.

Forbearance – Covid-19

Past Due Loans: All loans must be current prior to closing.

General Requirement: Missed payments are not "late" if after forbearance.

Acceptable Ways to bring Past Due Loans Current:

- Repayment plan with three payments made
- Payment deferral with three payments made
- Modification with three monthly trial payments

Forbearance Status: Not required to remove forbearance status provided loan is current and has no missed payments.

Eligibility for Rate/Term after Missed Payments: Loan must be reinstated or three payments made under a loss mitigation solution (repayment plan, deferral, or modification)

Eligibility for Cash Out after Missed Payments: Same as Rate/Term requirements.

Monthly Debt Obligations (continued)

Home Equity Lines of Credit	When the mortgage that will be delivered to Fannie Mae also has a home equity line of credit (HELOC) that provides for a monthly payment of principal and interest or interest only, the payment on the HELOC must be considered as part of the borrower's recurring monthly debt obligations. If the HELOC does not require a payment, there is no recurring monthly debt obligation so CMS does not need to develop an equivalent payment amount.
Garnishments	All garnishments with more than ten months remaining must be included in the borrower's recurring monthly debt obligations for qualifying purposes.
Installment Debt	All installment debt that is not secured by a financial asset—including student loans, automobile loans, and timeshares—must be considered part of the borrower's recurring monthly debt obligations if there are more than ten monthly payments remaining. However, an installment debt with fewer monthly payments remaining also should be considered as a recurring monthly debt obligation if it significantly affects the borrower's ability to meet his or her credit obligations. See Federal Income Tax Installment Agreements below for treatment of payments due under a federal income tax installment agreement. **Note:** A timeshare account should be treated as installment debt regardless of how it is reported on the credit report or other documentation (that is, even if reported as a mortgage loan).

Monthly Debt Obligations (continued)

Lease Payments

Lease payments must be considered as recurring monthly debt obligations regardless of the number of months remaining on the lease. This is because the expiration of a lease agreement for rental housing or an automobile typically leads to either a new lease agreement, the buyout of the existing lease, or the purchase of a new vehicle or house.

Loans Secured by Financial Assets

When a borrower uses his or her financial assets—life insurance policies, 401(k) accounts, individual retirement accounts, certificates of deposit, stocks, bonds, etc.—as security for a loan, the borrower has a contingent liability.

CMS is not required to include this contingent liability as part of the borrower's recurring monthly debt obligations provided CMS obtains a copy of the applicable loan instrument that shows the borrower's financial asset as collateral for the loan. If the borrower intends to use the same asset to satisfy financial reserve requirements, CMS must reduce the value of the asset (the account balance, in most cases) by the proceeds from the secured loan and any related fees to determine whether the borrower has sufficient reserves.

Open 30–Day Charge Accounts

Open 30–day charge accounts require the balance to be paid in full every month. Fannie Mae does not require open 30–day charge accounts to be included in the debt-to-income ratio.

See Debts Paid Off At or Prior to Closing, for additional information on open 30–day charge accounts.

Other Real Estate Owned—Qualifying Impact

For details regarding the qualifying impact of other real estate owned, see Qualifying Impact of Other Real Estate Owned.

Revolving Charge/Lines of Credit

Revolving charge accounts and unsecured lines of credit are open-ended and should be treated as long-term debts and must be considered part of the borrower's recurring monthly debt obligations. These tradelines include credit cards, department store charge cards, and personal lines of credit. Equity lines of credit secured by real estate should be included in the housing expense.

If the credit report does not show a required minimum payment amount and there is no supplemental documentation to support a payment of less than 5%, CMS must use 5% of the outstanding balance as the borrower's recurring monthly debt obligation.

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

Monthly Debt Obligations (continued)

Student Loans

For all student loans, whether deferred, in forbearance, or in repayment (not deferred), CMS must include a monthly payment in the borrower's recurring monthly debt obligation when qualifying the borrower.

If a monthly student loan payment amount is provided on the credit report, CMS may use that amount for qualifying purposes. If the credit report does not reflect the correct monthly payment, CMS may use the monthly payment that is on the student loan documentation (the most recent student loan statement) to qualify the borrower.

If the credit report does not provide a monthly payment for the student loan, or if the credit report shows $0 as the monthly payment, CMS must determine the qualifying monthly payment using one of the options below.

- If the borrower is on an income-driven payment plan, CMS may obtain student loan documentation to verify the actual monthly payment is $0. CMS may then qualify the borrower with a $0 payment.
- For deferred loans or loans in forbearance, CMS may calculate
  - a payment equal to 1% of the outstanding student loan balance (even if this amount is lower than the actual fully amortizing payment), or
  - a fully amortizing payment using the documented loan repayment terms

Calculating Student Loan Repayment on Deferred Loans

The following table specifies the repayment period to be used when calculating a fully amortizing payment on a deferred loan.

Calculating a Student Loan Repayment	
Total outstanding balance of all student loans	**Repayment Period**
$1 — $7,499	10 years
$7,500 — $9,999	12 years
$10,000 — $19,999	15 years
$20,000 — $39,999	20 years
$40,000 — $59,999	25 years
$60,000 +	30 years

Note: CMS is responsible for determining that the payment on the credit report or other documents provided by the student loan creditor or borrower are fully amortizing payments.

Example: Calculating an Amortizing Payment

Balance: $17,500

Repayment period: 15 years

Interest rate: 4.29%

Monthly Amortizing Payment: $132.00

Qualifying Impact of Other Real Estate Owned

Qualifying Considerations

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

- An existing investment property or a current principal residence converting to investment use, the borrower must be qualified in accordance with, but not limited to rental income, minimum reserves and, if applicable multiple financed properties for the same borrower.
- An existing second home or a current principal residence converting to a second home, the PITIA of the second home must also be counted as part of the borrower's recurring monthly debt obligations; or
- The borrower's current principal residence that is pending sale but will not close (with title transfer to the new owner) prior to the subject transaction, CMS must comply with the policies below.

Current Principal Residence Pending Sale

If the borrower's current principal residence is listed on the market or pending sale, but the transaction will not close with title transfer to the new owner prior to the subject transaction, and the borrower is purchasing a new principal residence, the current PITIA and the proposed PITIA must be used in qualifying the borrower for the new mortgage loan.

However, Fannie Mae will not require the current principal residence's PITIA to be used in qualifying the borrower as long as the following documentation is provided:

- The executed sales contract for the current residence, and
- Confirmation that any financing contingencies have been cleared.

Mortgage Assumption

When a borrower sells a mortgaged property and the property purchaser assumes the outstanding mortgage debt without a release of liability, the borrower has a contingent liability.

CMS is not required to count this contingent liability (PITIA) as part of the borrower’s recurring monthly debt obligations if CMS verifies that the property purchaser has at least a 12-month history of making regular, timely payments for the mortgage. CMS can document this by obtaining

- evidence of the transfer of ownership;
- a copy of the formal, executed assumption agreement; and
- a credit report indicating that consistent and timely payments were made for the assumed mortgage.

If CMS cannot document timely payments during the most recent 12-month period, the applicable mortgage payment must be counted as part of the borrower’s recurring monthly debt obligations.

Debts Paid Off At or Prior to Closing

Payoff or Paydown of Debt for Qualification

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

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

See Debt-to-Income Ratios for additional guidance on calculating total monthly obligations for qualifying purposes.

Open 30-Day Charge Accounts

For open 30-day charge accounts that do not reflect a monthly payment on the credit report, or 30-day accounts that reflect a monthly payment that is identical to the account balance, CMS must verify borrower funds to cover the account balance. The verified funds must be in addition to any funds required for closing costs and reserves.

Note: DU will include the balance of the 30-day charge accounts on the loan application in the Reserves Required to be Verified amount shown on the DU Underwriting Findings report. However, for transactions that do not require the verification of reserves, the balance of 30–day charge accounts in the Reserves Required to be Verified amount will be reduced by any cash out the borrower will receive through the transaction.

If the borrower paid off the account balance prior to closing, CMS may provide proof of payoff in lieu of verifying funds to cover the account balance.

Collections, Charge-Offs of Non-Mortgage Accounts, Judgments, and Liens

Delinquent credit—including taxes, judgments, charge-offs of non-mortgage accounts (see below for exceptions), tax liens, mechanics' or materialmen's liens, and liens that have the potential to affect Fannie Mae's lien position or diminish the borrower's equity—must be paid off at or prior to closing.

Collections and Charge-Offs Paid through Closing Transaction

If collection or charge-off accounts are being paid off through our closing transaction, a payoff demand or credit report or supplement will be required. The credit report or supplement must list the same information as a payoff demand (e.g. per diem amount, balance, rate, mailing address.)

The amount reflected on the credit report or supplement can be used UNLESS:

- The account is listed on the Title report
- The reporting date on the credit report is older than 90 days
- Underwriter discretion for layered risk

Example: The account is not recently rated, large balance owed and the borrower is short to close

DU: Requirements for Liability Assessment

Reconciling the Loan Application with the Credit Report

DU uses liabilities from the loan application, not debts from the credit report, to calculate the debt-to-income ratio.

To help ensure that all appropriate liabilities are included in the debt-to-income ratio, DU performs a series of reasonableness tests comparing loan application balances and payments with the credit report balances and payments. If the values on the loan application are less than the values on the credit report by more than selected tolerances, CMS must justify the discrepancies between the two. CMS must update the loan application values if the values are needed to calculate accurate ratios. The information must be updated either with verified values from the credit report or with independent, outside verifications.

Auto-Populating DU Liabilities From the Credit Report

CMS can automatically copy the borrower's liabilities from the credit report to Section VI Liabilities by selecting the auto-populate liabilities option from DU when the credit report is ordered. If CMS loan origination system does not offer this option, or if CMS elects not to use it, the liabilities must be entered manually in Section VI Liabilities.

When the auto-populate option is selected, it is not necessary to obtain additional borrower disclosure for tradelines appearing on the credit report. CMS is still required to obtain full disclosure from all borrowers, including borrowers who do not have traditional credit, of all existing credit obligations. Liabilities that do not appear on the credit report, such as monthly housing expenses for taxes, insurance, etc., must be disclosed in Section VI Liabilities prior to final submission to DU.

If the auto-populate liabilities option is selected BEFORE liabilities have been manually entered in the loan application:

- Open accounts will be automatically copied to Section VI Liabilities of the loan application.
- Closed accounts on the credit report are not automatically copied to the loan application. If the account has an outstanding balance, CMS must manually enter the liability in Section VI Liabilities and include the monthly payment in the debt-to-income ratio.
- Collection accounts on the credit report are not automatically copied to the loan application.

If the auto-populate liabilities option is selected AFTER liabilities have been manually entered in the loan application:

- DU will attempt to match existing liability accounts listed on Section VI Liabilities of the loan application to the credit report liabilities by using a combination of account name and account number.
- Open accounts from the credit report that were not manually entered on the loan application will be automatically copied to the loan application.
- DU will use the information on the loan application to calculate the debt-to-income ratio.

If duplicate accounts or accounts that do not belong to the borrower were copied to the loan application and included in the debt-to-income ratio, they may be omitted from Section VI Liabilities. Debts that are omitted will not be counted in the debt-to-income ratio.

UNDERWRITING PROPERTY

Appraisal Requirements

Definition of Market Value

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

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

Note: Adjustments to the comparables must be made for special or creative financing or sales concessions. No adjustments are necessary for those costs that are normally paid by sellers as a result of tradition or law in a market area; these costs are readily identifiable because the seller pays these costs in virtually all sales transactions. Special or creative financing adjustments can be made to the comparable property by comparisons to financing terms offered by a third-party institutional lender that is not already involved in the property or transaction. Any adjustment should not be calculated on a mechanical dollar for dollar cost of the financing or concession, but the dollar amount of any adjustment should approximate the market's reaction to the financing or concessionsbased on the appraiser's judgment.

Lender Responsibilities

CMS is responsible for ensuring that the subject property provides adequate collateral for the mortgage. For most loans, Fannie Mae requires that CMS obtain a signed and complete appraisal report that accurately reflects the market value, condition, and marketability of the property. Some loans may be eligible for an Appraisal Waiver, and an appraisal is not required if CMS exercises the waiver and complies with the related requirements. (See Appraisal Waivers, for additional information.)

If an appraisal is obtained, CMS is responsible for

- compliance with the Appraiser Independence Requirements;
- selection of the appraiser (see Appraiser Selection Criteria);
- compliance with the Uniform Appraisal Dataset (UAD) when applicable (see Uniform Appraisal Dataset (UAD) and the Uniform Collateral Data Portal (UCDP));

Appraisal Requirements (continued)

Lender Responsibilities (continued)

- ensuring the appraiser has utilized sound reasoning and provided evidence to support the methodology chosen to develop the value opinion, particularly in cases that are not covered by Fannie Mae policy;
- successful submission of the appraisal through the UCDP prior to delivery (see Uniform Appraisal Dataset (UAD) and the Uniform Collateral Data Portal (UCDP)); and
- continually evaluating the appraiser's work through the quality control process (see Quality Assurance).

Note: If an applicable law, regulation, or lender's policy requires CMS to obtain more than one appraisal in connection with a mortgage loan, for loans delivered to Fannie Mae, CMS must select and use the single most accurate appraisal for underwriting purposes and that appraisal must be delivered through the UCDP.

For certain loans, CMS is relieved of a number of responsibilities related to the appraisal and subject property value. See Limited Waiver and Enforcement Relief of Representations and Warranties for Mortgages Submitted to DU, for additional information.

Confirmation and Documentation of the Current Owner

Confirmation that the property seller in a purchase money transaction (or the borrower in a refinance transaction) is the owner of the subject property based on publicly available information helps to identify property flipping schemes, which typically involve various combinations of transactions and result in a sale of a recently acquired property for significant profit based on a misleading or fraudulent appraisal with an inflated property value.

CMS must confirm and document in the mortgage file that the property seller in a purchase money transaction or the borrower in a refinance transaction is the owner of the subject property when an appraisal is required. Examples of acceptable documentation include, but are not limited to:

- a copy of a recorded deed, mortgage, or deed of trust,
- a recent property tax bill or tax assessment notice,
- a title report,
- a title commitment or binder, or
- a property sale history report.

This documentation is especially important for transactions involving an assignment (or sale) of a contract for sale and back-to-back, simultaneous, double transaction closings, or double escrows to support the property acquisition, financing, and closing.

When the transaction is part of an employee relocation, the relocation company may be the assignee of the seller, which should be indicated on the sales contract. Additionally, theappraiser must comment on this condition in the appraisal report.

Appraisal Requirements (continued)

Objective and Unbiased Appraisals

CMS must ensure that the appraiser

- described the property and the neighborhood in factual, unbiased, and specific terms;
- considered all factors that have an effect on value; and
- was objective and unbiased in the development of the opinion of market value in the appraisal report.

A number of federal, state, and local laws prohibit discrimination in the appraisal of housing. Fannie Mae expects professional appraisers to fully understand that discriminatory valuation and appraisal reporting practices are not only illegal, but also unethical. Unintentional discrimination can occur as the result of what an appraiser states, or fails to state, in his or her appraisal report. CMS and the appraiser must ensure that the integrity of the loan decision is not influenced by subjective, racial, or stereotypical terms, phrases or comments in the appraisal report.

Prohibited practices include:

- use of unsupported, descriptive comments or drawing unsupported conclusions from subjective observations. These actions may have a discriminatory effect;
- use of unsupported assumptions, interjections of personal opinion, or perceptions about factors in the valuation process. These actions may have a discriminatory effect, and may or may not affect the use and value of a property;
- use of subjective terminology, including, but not limited to:
  - “pride of ownership,” “no pride of ownership,” and “lack of pride of ownership”;
  - “poor neighborhood”;
  - “good neighborhood”;
  - “crime-ridden area”;
  - “desirable neighborhood or location”; or
  - “undesirable neighborhood or location”;
- use of subjective terminology that can result in erroneous conclusions;
- actions that may have a discriminatory effect or may affect the use and value of the property; or
- basing the analysis or opinion of market value (either partially or completely) on the race, color, religion, sex, handicap, familial status, or national origin, of either the prospective owners or occupants of the property being appraised or the present owners or occupants of the properties in the vicinity of that property.

Appraisal Requirements (continued)

Reporting Unfavorable Conditions

CMS must ensure that appraiser comments regarding unfavorable conditions, such as the existence of an adverse environmental or economic factor, also discuss how the condition affects the value or marketability of the property being appraised and explain how the condition was taken into consideration in the valuation process. In such cases, the appraiser's analysis must reflect and include comparable sales that are similarly affected whenever possible. The appraiser must address the impact these factors may have, if any, on the value and marketability of the subject property. (See Property Condition and Quality of Construction of the Improvements, for further information).

Appraiser Selection Criteria

License and Certification

Fannie Mae requires CMS (or its authorized agent) to use appraisers that are state-licensed or state-certified (in accordance with the provisions of Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 and all applicable state laws). CMS (or its authorized agent) must document that the appraisers it uses are licensed or certified as appropriate under the applicable state law. CMS must ensure that the state license or state certification is active as of the effective date of the appraisal report. The appraiser must note his or her license or certification number on the individual appraisal report forms. Trainee appraisers are unacceptable to CMS.

Fannie Mae's appraisal report forms identify the appraiser as the individual who:

- personally inspected the property being appraised,
- inspected the exterior of the comparables,
- performed the analysis, and
- prepared and signed the appraisal report as the appraiser.

This does not preclude appraisers from relying on individuals who are not state-licensed or state-certified to provide significant professional assistance, such as an appraiser trainee or an employee of the appraiser doing market data research or data verification in the development of the appraisal. Under some state laws, a lender's use of an unlicensed or uncertified appraiser that is working as an employee or sub-contractor of a licensed or certified appraiser will satisfy the state's licensing and certification requirement, as long as the appraisal report is signed by a state-licensed or state-certified supervisory or review appraiser. The state-licensed or state- certified appraiser that signs the appraisal report must acknowledge in the report the extent of the professional assistance provided by others and the specific tasks performed by each individual, and must certify that each named individual is qualified to perform the tasks.

Appraisal Selection Criteria (continued)

Appraiser Trainees

Appraisers must be a state-licensed or certified. Trainee appraisers are unacceptable to CMS.

Knowledge and Experience

CMS must use appraisers that:

- have the requisite knowledge required to perform a professional quality appraisal for the specific geographic location and particular property type; and
- have the requisite knowledge about, and access to, the necessary and appropriate data sources for the area in which the appraisal assignment is located.

Appraisers that are not familiar with specific real estate markets may not have adequate information available to perform a reliable appraisal. Although the Uniform Standards of Professional Appraisal Practice (USPAP) allows an appraiser that does not have the appropriate knowledge and experience to accept an appraisal assignment by providing procedures with which the appraiser can complete the assignment, Fannie Mae does not allow the USPAP flexibility.

Selection of the Appraiser

CMS or any third party specifically authorized by CMS (including, but not limited to, appraisal companies, appraisal management companies, and Correspondent lenders) shall be responsible for selecting, retaining, and providing for payment of all compensation to the appraiser. CMS will not accept any appraisal report completed by an appraiser selected, retained, or compensated in any manner by any other third party (including Mortgage Brokers and real estate agents).

To ensure a separation of CMS's sales or mortgage operations functions and appraisal functions, an employee of CMS in the sales or mortgage production function shall have no involvement in the operations of the appraisal function.

All members of CMS' mortgage production staff; any person who is compensated on a commission basis upon the successful completion of a mortgage; and any person whose immediate supervisor is not independent of the mortgage production staff and process are prohibited from:

- Selecting, retaining, recommending, or influencing the selection of any appraiser for a particular appraisal assignment or for inclusion on a list or panel of appraisers approved or forbidden to perform appraisals for CMS; and
- Having any substantive communications with an appraiser or appraisal management company relating to or having an impact on valuation, including ordering or managing an appraisal assignment.

CMS personnel not described as prohibited above are not subject to the restrictions described, and may engage in communications with an appraiser. In addition, any party, including the parties described above, may request that an appraiser provide additional information or explanation about the basis for a valuation, or correct objective factual errors in an appraisal report.

Appraisal Selection Criteria (continued)

Selection of the Appraiser (continued)

If absolute lines of independence cannot be achieved as a result of the CMS's small size and limited staff, CMS must be able to clearly demonstrate that it has prudent safeguards to isolate its collateral evaluation process from influence or interference from its mortgage production process.

Any employee of CMS (or employee of a CMS-authorized appraisal company or appraisal management company) tasked with selecting appraisers for an approved panel or substantive appraisal review must be:

- Appropriately trained and qualified in the area of real estate appraisals; and
- In the case of an employee of CMS, wholly independent of the mortgage production staff and process.

In addition, CMS:

- is responsible for the qualifications and quality of work provided by the appraisers that are selected;
- may not use appraisals ordered or received by borrowers or other parties with an interest in the transaction, such as the property seller or real estate broker. Fannie Mae does allow lenders to use third-party vendors (for example, appraisal management companies) to manage the appraiser selection process. However, it should be noted that if a lender enters into a contract with any vendor, contractor, or third-party service provider, CMS is accountable for the quality of the work performed as if it was performed by an employee of CMS.

CMS (or its authorized agent):

- must establish policies and procedures to ensure that qualified individuals are being selected in accordance with Fannie Mae requirements, including the Appraiser Independence Requirements.
- must ensure that an appraiser has demonstrated the ability to perform high quality appraisals before using an appraiser's services. The quality of an appraiser's work is a key criterion that must be used in determining which appraiser CMS (or its authorized agent) uses for its assignments. The requirement for an appraiser to produce a high quality work product must always outweigh fee or turnaround time considerations.

Delegating these responsibilities to a third party does not relieve CMS of its responsibilities related to the appraisal or the value, condition, and marketability of the property. See Quality Assurance, for information related to ongoing review of appraisals.

Note: Fannie Mae does not approve appraisers. Therefore, when selecting appraisers, CMS must not give any consideration to an appraiser's representation that he or she is approved or qualified by Fannie Mae.

Appraisal Selection Criteria (continued)

Unacceptable Appraisal Practices

The following are examples of unacceptable appraisal practices:

- development of or reporting an opinion of market value that is not supportable by market data or is misleading;
- development of a valuation conclusion based either partially or completely on the sex, race, color, religion, handicap, national origin, familial status, or other protected classes of either the prospective owners or occupants of the subject property or the present owners or occupants of the properties in the vicinity of the subject property;
- development of a valuation conclusion based on factors that local, state, or federal law designate as discriminatory, and thus, prohibited;
- misrepresentation of the physical characteristics of the subject property, improvements, or comparable sales;
- failure to comment on negative factors with respect to the subject neighborhood, the subject property, or proximity of the subject property to adverse influences;
- failure to adequately analyze and report any current contract of sale, option, offering, or listing of the subject property and the prior sales of the subject property and the comparable sales;
- selection and use of inappropriate comparable sales;
- failure to use comparable sales that are the most locationally and physically similar to the subject property;
- creation of comparable sales by combining vacant land sales with the contract purchase price of a home that has been built or will be built on the land;
- use of comparable sales in the valuation process when the appraiser has not personally inspected the exterior of the comparable property;
- use of adjustments to comparable sales that do not reflect market reaction to the differences between the subject property and the comparable sales;
- not supporting adjustments in the sales comparison approach;
- failure to make adjustments when they are clearly indicated;
- use of data, particularly comparable sales data, provided by parties that have a financial interest in the sale or in the financing of the subject property without the appraiser's verification of the information from a disinterested source;
- development of an appraisal or reporting an appraisal in a manner or direction that favors the cause of either the client or any related party, the amount of the opinion of value, the attainment of a specific result, or the occurrence of a subsequent event in order to receive compensation or employment for performing the appraisal or in anticipation of receiving future assignments; or
- development of or reporting an appraisal in a manner that is inconsistent with the requirements of the USPAP in place as of the effective date of the appraisal.

Disclosure of Information to Appraisers

Overview

Any and all information about the subject property that CMS is aware of must be disclosed to the appraiser. The appraiser must determine if the information could affect either the marketability of the property or the opinion of the market value of the property.

Sales Contract Information

All financing data and sales concessions for the subject property that will be or have been granted by anyone associated with the transaction must be disclosed to the appraiser, as appropriate. Typically, this information is provided in the sales contract. Therefore, CMS must provide, or ensure that the appraiser is provided with, a copy of the complete, ratified sales contract and all addenda for the property that is to be appraised.

Information Disclosed to the Appraiser

Financial Information

The list below includes items that must be disclosed to the appraiser on purchase transactions, if applicable:

- settlement charges,
- loan fees or charges,
- discounts to the sales price,
- interest rate buydowns,
- below-market-rate financing,
- terms of any subordinate financing provided by interested parties,
- credits or refunds of borrower expenses,
- absorption of monthly payments,
- assignment of rent payments, and
- any other information not listed above that impacts property value.

Property Information

The list below includes items that must be disclosed, if applicable:

- condo or PUD fees;
- non-realty items included in the transaction;
- any environmental hazard in or on the subject property or in the vicinity of the property that CMS is aware of or learns from the borrower, the real estate broker, or any other party to the transaction (see Environmental Hazards Appraisal Requirements); and
- any other items that affect the safety, soundness, or structural integrity of a property of which CMS may be aware.

Disclosure of Information to Appraisers (continued)

Contract Changes After the Appraisal is Completed

If the contract is amended *after* the effective date of the appraisal in a way that does not affect the description of the property, then CMS is not required to provide the amended contract to the appraiser nor obtain a revised appraisal. Some examples of amendments that do not require CMS to provide the amended contract nor obtain revisions to the already-completed appraisal report include:

- sale price,
- transaction terms,
- financing concessions,
- seller-paid closing costs,
- names or initials,
- closing date, and
- correction of minor clerical errors such as misspellings.

Uniform Appraisal Dataset (UAD)

The UAD standardizes appraisal data elements for a subset of fields on specific appraisal report forms and includes all data elements required to complete these forms. Fannie Mae requires that the following appraisal report forms are completed utilizing Appendix D of the UAD Specification when reporting the results of an appraisal for a conventional mortgage loan:

- *Uniform Residential Appraisal Report* (Form 1004),
- *Individual Condominium Unit Appraisal Report* (Form 1073),
- *Exterior-Only Inspection Individual Condominium Unit Appraisal Report* (Form 1075)*, and
- *Exterior-Only Inspection Residential Appraisal Report* (Form 2055)*.

Other appraisal report forms may be completed using the standards contained in the UAD Specification to the extent those standards are applicable to that particular form. CMS may obtain the most recent version of Appendix D of the Uniform Appraisal Dataset Specification on Fannie Mae's website. Additional information concerning UAD may be found on Fannie Mae's website.

*These forms are currently not fieldwork options offered in DU.

Disclosure of Information to Appraisers (continued)

Uniform Collateral Data Portal (UCDP)

The UCDP is a portal through which lenders are required to electronically submit appraisal reports for conventional mortgage loans delivered to Fannie Mae. The following appraisal report forms including all exhibits, addenda and photographs, must be submitted through the UCDP and receive a "Successful" status from the UCDP prior to the delivery date of the loan:

- *Uniform Residential Appraisal Report* (Form 1004),
- *Small Residential Income Property Appraisal Report* (Form 1025),
- *Individual Condominium Unit Appraisal Report* (Form 1073),
- *Exterior-Only Inspection Individual Condominium Unit Appraisal Report* (Form 1075)*,
- *Exterior-Only Inspection Residential Appraisal Report* (Form 2055)*,
- *Individual Cooperative Interest Appraisal Report* (Form 2090),
- *Exterior-Only Inspection Individual Cooperative Interest Appraisal Report* (Form 2095)*.

If there are subsequent revisions to the appraisal report, the final version of the report that was utilized in making the underwriting decision must be submitted through the UCDP and receive a "Successful" status from the UCDP prior to the delivery of the loan. When submitting an appraisal report through the UCDP, CMS must ensure that it is the unaltered report submitted by the identified appraiser.

Additionally, for loans that require an appraisal, CMS must ensure that the appraised value as indicated on the appraisal submitted in UCDP matches the appraised value as reported at delivery. An exception is allowed for this requirement when the appraisal used to underwrite the loan is a desk or field review of an existing appraisal because those types of reports cannot be up-loaded to UCDP. In those instances, the appraised value reported at delivery will reflect the value as stated in the desk or field review. However, the original appraisal that was the subject of review must have been submitted to UCDP.

Appraisal report forms not listed above must not be delivered through UCDP. CMS must maintain the applicable appraisal report and attachments in the mortgage loan file as part of the underwriting documents in accordance with Individual Mortgage Loan Files. CMS may obtain detailed information on the UCDP page on Fannie Mae's website.

*These forms are currently not fieldwork options offered in DU.

DOCUMENTATION STANDARDS

Appraisal Report Forms and Exhibits

Scope of Work

Appraisers must use the most recent version of the appraisal report forms and include any other information, either as an attachment or addendum to the appraisal report form, needed to adequately support the opinion of market value. Although the scope of work for the appraisal or the extent of the appraisal process is guided by Fannie Mae's appraisal report forms, the forms do not limit or control the appraisal process. The appraiser's analysis should go beyond any limitations of the forms, with additional comments and exhibits being used if they are needed to adequately describe the subject property, document the analysis and valuation process, or support the appraiser's conclusions. The extent of the appraiser's data collection, analysis, and reporting must be determined by the complexity of the appraisal assignment.

List of Appraisal Report Forms

CMS must ensure that appraisal reports are completed on one of the following Fannie Mae forms. The table below provides Fannie Mae's acceptable appraisal report forms (see Single- Family Forms for a complete list).

Form	Purpose
Uniform Residential Appraisal Report (Form 1004)	For appraisals of one-unit properties and units in PUDs (including those that have an illegal second unit or accessory apartment) based on interior and exterior property inspections. Form 1004 also may be used for two-unit properties, if each of the units is occupied by one of the co-borrowers as his or her principal residence or if the value of the legal second unit is relatively insignificant in relation to the total value of the property (as might be the case for a basement unit or a unit over a garage). In addition, appraisals for units in condo projects that consist solely of detached dwellings may be documented on Form 1004, if the appraiser includes an adequate description of the project and information about the homeowners' association fees and the quality of the project maintenance. Appraisals reported on Form 1004 must be completed in accordance with the UAD Specification.
Exterior-Only Inspection Residential Appraisal Report (Form 2055)*	For appraisals of one-unit properties and units in PUDs based on exterior-only property inspections. Appraisals reported on Form 2055 must be completed in accordance with the UAD Specification.

Appraisal Report Forms and Exhibits (continued)

List of Appraisal Report Forms (continued)

Form	Purpose
Individual Condominium Unit Appraisal Report (Form 1073)	For appraisals of one-unit properties in condo projects based on interior and exterior property inspections. Appraisals reported on Form 1073 must be completed in accordance with the UAD Specification.
Exterior-Only Inspection Individual Condominium Unit Appraisal Report (Form 1075)*	For appraisals of one-unit properties in condo projects based on exterior-only property inspections. Appraisals reported on Form 1075 must be completed in accordance with the UAD Specification.
Small Residential Income Property Appraisal Report (Form 1025)	For appraisals of two- to four-unit properties (including two- to four- unit properties in PUD, condo~~,~~ projects) based on interior and exterior property inspections.
Appraisal Update and/ or Completion Report (Form 1004D)	For appraisal updates and/or completion reports for all one- to four-unit appraisal reports.

*These forms are currently not fieldwork options offered in DU.

Appraisal Report Forms and Exhibits (continued)

Exhibits for Appraisals

The exhibits in the following table must accompany the appraisal report. It should be noted that, in addition to these requirements, the appraiser is expected to provide any additional attachments or addenda to the appraisal report necessary to provide an adequately supported opinion of market value.

Exhibit	Requirements
Building sketch and calculations	An exterior building sketch that indicates dimensions and calculations that demonstrate how the estimate for gross living area is derived. If the floor plan is atypical or functionally obsolete, thus limiting the market appeal for the property in comparison to competitive properties in the neighborhood, Fannie Mae requires a floor plan sketch that includes the interior walls. For a unit in a condo, the sketch of the unit must indicate interior perimeter unit dimensions rather than exterior building dimensions (dimensions and estimates for gross living area shown in the condo documents is acceptable).
Street map	Showing the location of the subject property and the comparables that the appraiser used.
Exterior photographs	Clear, descriptive photographs showing the front, back, and a street scene of the subject property and the front of each comparable. The subject and all comparables must be appropriately identified. Acceptable photographs include original images from photographs or electronic images, copies of photographs from a multiple listing service, or copies from the appraiser's files. Photographs of comparable rentals utilized in the *Small Income Residential Appraisal Report* (Form 1025) are not required.

Appraisal Report Forms and Exhibits (continued)

Exhibits for Appraisals (continued)

Exhibit	Requirements
Interior photographs	At a minimum, the report must include photographs of the following: • the kitchen; • all bathrooms; • main living area; • examples of physical deterioration, if present; and • examples of recent updates, such as restoration, remodeling, and renovation, if present. **Note:** Interior photographs on proposed or under construction properties may be taken by the appraiser at the time of the inspection for the Certification of Completion, and provided with the Form 1004D.
Appraisal Update and/ or Completion Report (Form 1004D)	At a minimum, when completing the Appraisal Update portion of the report, a photograph of the front of the subject property must be included.
Single-Family Comparable Rent Schedule (Form 1007)	Required if the property is a one-unit investment property and the borrower is using rental income to qualify. Otherwise, Form 1007 is not required. (CMS may obtain this form for the purpose of reporting gross monthly rent at delivery. See Data Quality and Integrity.)

Appraisal Report Forms and Exhibits (continued)

Exhibits for Appraisals with Exterior-Only Property Inspections

The following exhibits are required for appraisals with exterior-only property inspections:

- street map that shows the location of both the subject property and the comparable sales, and
- a photograph that shows the front scene of the subject property.

Note: When appraisals based on exterior-only inspections are used in connection with a one-unit investment property, Form 1007 must accompany the appraisal if the borrower is using rental income to qualify. Otherwise, Form 1007 is not required.

Appraiser Certifications and Limiting Conditions

Each Fannie Mae appraisal report form includes an appraiser's certification (and, if applicable, a supervisory appraiser's certification) and a statement of assumptions and limiting conditions. Appraisers may not add limiting conditions.

The appraiser may not make changes or deletions to the existing certifications; however the appraiser may make additional certifications that can be included on a separate page or form. Acceptable additional certifications might include:

- those required by state law;
- those related to the appraiser's continuing education or membership in an appraisal organization; or
- those related to the appraiser's compliance with privacy laws and regulations in the development, reporting, and storage of an appraisal and the information on which it is based.

CMS is responsible for reviewing any additional certifications made by appraisers to ensure that they do not conflict with Fannie Mae's policies or standard certifications on Fannie Mae appraisal forms.

The appraiser's certification #23 is an acknowledgment by the appraiser that certain parties to a mortgage finance transaction that are not CMS/client and/or intended user may rely on the appraisal report. This certification clarifies that such other parties include the borrower, another lender at the request of the borrower, the mortgagee or its successors and assigns, mortgage insurers, government-sponsored enterprises, and other secondary market participants.

Fannie Mae will accept the following additional notice or statement when appraisers believe CMS/client is the only intended user:

> "The intended user of this appraisal report is CMS/client. The intended use is to evaluate the property that is the subject of this appraisal for a mortgage finance transaction, subject to the stated scope of work, purpose of the appraisal, reporting requirements of this appraisal report form, and definition of market value. No additional intended users are identified by the appraiser."

Appraisal Report Forms and Exhibits (continued)

Age of Appraisal and Appraisal Update Requirements

When an appraisal is obtained, the property must be appraised within the 240 days that precede the date of the note and mortgage.

When an appraisal report will be more than four (4) months old on the date of the note and mortgage, regardless of whether the property was appraised as proposed or existing construction, the appraiser must inspect the exterior of the property and review current market data to determine whether the property has declined in value since the date of the original appraisal.

This inspection and results of the analysis must be reported on the *Appraisal Update and/or Completion Report* (Form 1004D).

- If the appraiser indicates on the Form 1004D that the property value has declined, then CMS must obtain a new appraisal for the property.
- If the appraiser indicates on the Form 1004D that the property value has not declined, then CMS may proceed with the loan in process without requiring any additional fieldwork.

Note: The appraisal update must occur within the four (4) months that precede the date of the note and mortgage.

The original appraiser should complete the appraisal update; however, lenders may use substitute appraisers. When updates are completed by substitute appraisers, the substitute appraiser must review the original appraisal and express an opinion about whether the original appraiser's opinion of market value was reasonable on the date of the original appraisal report. CMS must note in the file why the original appraiser was not used.

See Quality Assurance, for information concerning changes to the appraised value. See Mortgage Loan Eligibility, for information regarding property valuation requirements for mortgage loans sold to Fannie Mae more than four (4) months from the note date.

Use of an Appraisal for a Subsequent Transaction

Fannie Mae will allow the use of an origination appraisal for a subsequent transaction if the following requirements are met:

- The subsequent transaction may only be a Limited Cash-Out Refinance.
- The appraisal report must not be more than 12 months old on the note date of the subsequent transaction. If the appraisal report is greater than 4 months old on the date of the note and mortgage, then an appraisal update is required. See preceding section, Age of Appraisal and Appraisal Update Requirements, for requirements for completing an appraisal update.
- CMS must ensure that the property has not undergone any significant remodeling, renovation, or deterioration to the extent that the improvement or deterioration of the property would materially affect the market value of the subject property.
- The borrower and CMS/client must be the same on the original and subsequent transaction.

Note: The appraisal must comply with all other requirements in the

Underwriting Property section of the *Selling Guide*.

Requirements for Postponed Improvements

Overview

Improvements for the subject property must be complete when the mortgage is delivered to Fannie Mae. However, in some circumstances, Fannie Mae does allow a loan to be delivered prior to improvements being completed.

Requirements for New or Proposed Construction

When the property securing the mortgage is new or proposed construction, the appraisal may be based on either plans and specifications or an existing model home. The table below describes requirements related to properties that are new or proposed construction that are not complete when the mortgage is delivered to Fannie Mae.

✓	Requirements for New or Proposed Construction
	Mortgages may be delivered before postponed items are complete; however, the postponed improvements must be completed within 180 days of the date of the mortgage note. Acceptable postponed items include items that: • are part of the sales contract (third-party contracts are not permissible); • are postponed for a valid reason, such as inclement weather or a shortage of building materials; and • do not affect the ability to obtain an occupancy permit.
	A certification of completion must be obtained to verify the work was completed and must: • be completed by the appraiser, • state that the improvements were completed in accordance with the requirements and conditions in the original appraisal report, and • be accompanied by photographs of the completed improvements.
	The cost of completing improvements must not represent more than 10% of the "as completed" appraised value of the property.
	CMS must establish a completion escrow for the postponed improvements, by withholding from the purchase proceeds funds equal to 120% of the estimated cost for completing the improvements. However, if the contractor or builder offers a guaranteed fixed-price contract for completion of the improvements, the funds in the completion escrow only need to equal the full amount of the contract price.
	CMS and borrowers must execute an escrow agreement that states how the escrow account will be managed and how funds from the escrow account will be disbursed.
	The completion escrow may not adversely affect the mortgage insurance or title insurance.

Requirements for Postponed Improvements, continued

Requirements for New or Proposed Construction (continued)

✓	Requirements for New or Proposed Construction
	Once a certificate of completion is obtained, CMS must release the final draw from the escrow account, which should include any funds in excess of the amount needed to pay for completion of the postponed items.
	CMS must obtain a final title report, which must not show any outstanding mechanic's liens, take any exceptions to the postponed improvements, or take any exceptions to the escrow completion of the improvements, CMS must obtain an endorsement to the title policy that ensures the priority of Fannie Mae's lien agreement. If the final title report is issued before the completion of the improvements, CMS must obtain an endorsement to the title policy that ensures the priority of Fannie Mae's lien.

Requirements for Existing Construction

CMS must review the appraisal to ensure that the property does not have minor conditions or deferred maintenance items that affect the safety, soundness, or structural integrity of the subject property. See Property Condition and Quality of Construction of the Improvements, for information concerning property condition and quality of construction ratings.

The tables below provide requirements related to existing properties that have physical deficiencies, minor conditions, or deferred maintenance items that may or may not affect the safety, soundness, or structural integrity of the property.

✓	Requirements for Existing Construction When There are Minor Conditions or Deferred Maintenance Items that Do Not Affect the Safety, Soundness, or Structural Integrity of the Property
	If the appraiser reports the existence of minor conditions or deferred maintenance items that do not affect the safety, soundness, or structural integrity of the property, the appraiser may complete the appraisal "as is" and these items must be reflected in the appraiser's opinion of value. Minor conditions and deferred maintenance items include, but are not limited to, worn floor finishes or carpet, minor plumbing leaks, holes in window screens, or cracked window glass and are typically due to normal wear and tear. CMS is not required to ensure that the borrower has had this work completed prior to delivery of the loan to Fannie Mae.
	If there are minor conditions or deferred maintenance items to be remedied or completed after closing, CMS may escrow for these items at its own discretion and still deliver the loan to Fannie Mae prior to the release of the escrow as long as CMS can ensure that these items do not affect the safety, soundness, or structural integrity of the property.

Requirements for Postponed Improvements (continued)

Requirements for Existing Construction (continued)

✓	**Requirements for Existing Construction** **When There are Incomplete Items or Conditions that Do Affect the Safety, Soundness, or Structural Integrity of the Property**
	When there are incomplete items or conditions that do affect the safety, soundness, or structural integrity of the property, the property must be appraised subject to completion of the specific alterations or repairs. These items can include a partially completed addition or renovation, or physical deficiencies that could affect the safety, soundness, or structural integrity of the improvements, including but not limited to, cracks or settlement in the foundation, water seepage, active roof leaks, curled or cupped roof shingles, or inadequate electrical service or plumbing fixtures. In such cases, CMS must obtain a certificate of completion from the appraiser before the mortgage is delivered to Fannie Mae. Although the original appraiser should complete any required certification of completion, CMS may use a substitute appraiser. See Appraisal Age and Use Requirements, for certifications completed by substitute appraisers.
	The certification does not need to include photographs of the property unless those that accompanied the original appraisal report are no longer representative of the completed property.

Review of the Appraisal Report

Overview

Fannie Mae's appraisal report forms and the appraisal review requirements for one- to four- unit properties have been developed with the intent that the USPAP standards are followed and that Fannie Mae's policies are entirely consistent with, and supportive of, fair lending practices. This topic provides CMS requirements related to the transaction details and the property and appraisal eligibility analysis.

Appraisal Report Analysis

When an appraisal is obtained, CMS must analyze the:

- current contract for sale for purchase money transactions,
- current offering or listing for sale for both purchase and refinance transactions when the home was listed for sale,
- comparable sales for both purchase and refinance transactions, and
- current ownership for the subject property (see Lender Responsibilities, for further information).

CMS is responsible for validating that:

- the property meets Fannie Mae's eligibility criteria (see General Property Eligibility, for eligibility requirements); and
- the appraiser has provided an accurate and reliable opinion of value that reflects the market value, condition, and marketability of the subject property in compliance with Fannie Mae's Selling Guide requirements. (See Quality Assurance, for further information).

Subject and Contract Sections of the Appraisal Report

Subject Section

The appraiser must identify the subject property by its complete property address and legal description. The appraiser must enter the physical property address, including the unit number for a condo, in a format that conforms to the United States Postal Service (USPS) address standards in Publication 28 – Postal Addressing Standards (pub28) for complete addresses.

Address standards can be found at usps.com. The subject address must be populated consistently throughout the form.

When the legal description is lengthy, the appraiser may attach the full legal description as an addendum to the appraisal report. The appraiser must also identify the property rights to be appraised. (For eligibility requirements, see General Property Eligibility.) Fannie Mae's appraisal report forms require the appraiser to research and identify whether the subject property is currently for sale or if it has been offered for sale in the 12 months prior to the effective date of the appraisal by selecting either the 'Yes' or the 'No' checkbox. If the answer is 'No,' the data source(s) used must be provided. If the answer is 'Yes,' the appraiser must report on each occurrence or listing and provide the following information:

- offering price(s),
- offering date(s), and
- data source(s) used.

For example, if the subject property is currently listed for sale and was previously listed eight months ago, the appraiser must report on both offerings.

Note: For appraisals required to be UAD compliant, Days on Market (DOM) must be reported.

See *Fannie Mae and Freddie Mac Uniform Appraisal Dataset Specification, Appendix D: Field- Specific Standardization Requirements,* and the associated FAQ's, for additional information and examples regarding these topics.

Contract Section

CMS must provide the appraiser with a copy of the complete, ratified contract. The appraiser must indicate whether an analysis was or was not performed on the contract for sale. If an analysis was performed, the appraiser must provide the results of the analysis. If an analysis was not performed, the appraiser must provide an explanation why the analysis was not performed.

For appraisals required to be UAD compliant, the appraiser must also indicate the type of sale for the transaction. The appraiser may report any other relevant information in this field or elsewhere in the report regarding the sale type, including whether more than one sale type applies.

Subject and Contract Sections of the Appraisal Report (continued)

Contract Section (continued)

The appraiser must:

- enter an amount in the Contract Price field if the Assignment Type is a purchase transaction. Contract price must be the same as the sales price for the subject property in the Sales Comparison Approach section;
- enter a contract date if the Assignment Type is a purchase transaction; and
- indicate if the property seller is the owner of record.

The appraiser must indicate if there is any financial assistance such as loan charges, sales concessions or gift, or down payment assistance to be paid by any party on behalf of the borrower, including any closing costs or other payments from the seller or other third party. If there is financial assistance, the appraiser must:

- report the total dollar amount of the loan charges or concessions that will be paid (if the appraiser is not able to determine a dollar amount for all or part of the financial assistance, the number must reflect the total known dollar amount); and
- provide a description of the items being paid.

Note: Financial assistance or concessions paid by any party on behalf of the borrower includes both monetary and non-monetary items, including below-market-rate mortgage financing, gifts of personal property, and payment of property taxes or HOA dues for a period of time.

See *Fannie Mae and Freddie Mac Uniform Appraisal Dataset Specification, Appendix D: Field-Specific Standardization Requirements*, for additional information regarding the Contract Section, and Adjustments to Comparable Sales, for additional information regarding evaluating sales or financing concessions for comparables.

Neighborhood Section of the Appraisal Report

Overview

Neighborhood characteristics and trends influence the value of one- to four-unit residences. Therefore, an analysis of the subject property's neighborhood is a key element in the appraisal process. As a reminder, Fannie Mae purchases mortgages secured by properties in all neighborhoods and in all areas, as long as the property is acceptable as security for the mortgage based on its value and marketability.

Neighborhood Section of the Appraisal Report (continued)

Neighborhood Analysis

Fannie Mae's appraisal report forms and guidelines do not require the appraiser to rate or judge the neighborhood. Fannie Mae requires the appraiser to perform an objective neighborhood analysis by identifying neighborhood boundaries, neighborhood characteristics, and the factors that affect the value and marketability of properties in the neighborhood.

Neighborhood boundaries. The appraiser should provide an outline of the neighborhood boundaries, which should be clearly delineated using 'North', 'South', 'East', and 'West'. These boundaries may include, but are not limited to streets, legally recognized neighborhood boundaries, waterways, or other natural boundaries that define the separation of one neighborhood from another. Appraisers should not reference a map or other addendum as the only example of the neighborhood boundaries.

Neighborhood characteristics. These can be addressed by the types of structures (detached, attached) and architectural styles in the neighborhood (such as row or townhouse, colonial, ranch, or Victorian); current land use (such as single-family residential, commercial, or industrial); typical site size (such as 10000 sf, or 2.00 ac); or street patterns or design (such as one-way street, cul-de-sac, or court).

Factors that affect the value and marketability of properties in the neighborhood. These can be addressed by such things as the proximity of the property to employment and amenities, employment stability, appeal to the market, changes in land use, access to public transportation, and adverse environmental influences.

The appraiser must fully consider all of the value-influencing characteristics in the neighborhood and arrive at an appropriate neighborhood description and opinion of value for the property, even if this requires more extensive research for particular property types or for properties in certain geographic locations.

An appraiser must perform a neighborhood analysis in order to identify the area that is subject to the same influences as the property being appraised, based on the actions of typical buyers. The results of a neighborhood analysis enable the appraiser not only to identify the factors that influence the value of properties in the neighborhood, but also to define the area from which to select the market data needed to perform a sales comparison analysis.

In performing a neighborhood analysis, the appraiser:

- collects pertinent data,
- conducts a visual inspection of the neighborhood to observe its physical characteristics and determine its boundaries, and
- identifies land uses and any signs that the land uses are changing.

Neighborhood Section of the Appraisal Report (continued)

Neighborhood Analysis (continued)

Fannie Mae expects the appraiser and CMS underwriter to be aware of the varying conditions that characterize different types of neighborhoods. Conditions that are typical in certain neighborhoods may not be present in other neighborhoods. This does not mean that the existence of certain types of conditions or characteristics are unacceptable; rather, it is an indication that they must be viewed in context with the nature of the neighborhood in which the security property is located. For example, some neighborhoods consist of a variety of property types that have different uses. It is not uncommon to find properties that have mixed-uses, such as residential properties that also have child-care facilities, doctor or dental offices, and other types of business or commercial uses. The presence of mixed-use properties or a variety of property types within a neighborhood should be viewed as a neighborhood characteristic that the appraiser considers when performing the neighborhood analysis and describing the neighborhood boundaries.

The appraiser must consider the influence of market forces, including but not limited to, economic, governmental, and environmental factors on property values in the neighborhood. Economic forces that must be considered include such things as the existence of vacant or boarded-up properties in the neighborhood, and the level of essential local support services. Examples of governmental forces that should be taken into consideration include the regulations, laws, and taxes that are imposed on properties. Environmental forces that must be considered include, among other things, the existence of a hazardous waste site on or near the property, and the proximity of a property to an airport. Certain other factors that are not appraisal factors, such as the racial or ethnic composition of a neighborhood or the age or sex of the individuals who live in a particular neighborhood, must not be considered in the valuation process.

The appraiser must determine, analyze, and consider factors in the valuation process based on his or her identification of all forces or factors that have the potential to influence the value of the property. The appraiser must report neighborhood conditions in factual, specific terms and be impartial and specific in describing favorable or unfavorable factors in a neighborhood. If an appraiser can demonstrate by market evidence that a characteristic has an effect on the value or marketability of the properties in the neighborhood, he or she must consider it in the valuation process. The appraiser must not make unsupported assumptions or interject personal opinion or perceptions about market forces or other factors that may or may not affect the use and value of a property. For example, a property located in an older neighborhood can be as sound an investment as a property located in a new neighborhood.

Neighborhood Section of the Appraisal Report (continued)

Degree of Development and Growth Rate

The degree of development of a neighborhood, which is referred to as “built-up” on the appraisal report forms, is the percentage of the available land in the neighborhood that has been improved. The degree of development of a neighborhood may indicate whether a particular property is residential in nature.

When reviewing an appraisal on a property located in a rural or relatively undeveloped area, CMS should focus on the characteristics of the property, zoning, and the present land use todetermine whether the property should be considered residential in nature. For example, if the typical one-unit building site in a particular area (based on the zoning, the highest and best use of the land, and the present land use) is two acres in size, the mortgage will be eligible for purchase or securitization regardless of the percentage of the total appraised value of the property that the site represents, as long as the appraiser demonstrates through the use of comparable sales that the property is a typical residential property for that particular neighborhood.

Because Fannie Mae does not purchase or securitize mortgages secured by agricultural-type properties, undeveloped land, or land-development-type properties, CMS must review the appraisal report for properties that have sites larger than those typical for residential properties in the neighborhood. Special attention must be given to the appraiser’s description of the neighborhood, zoning, the highest and best use determination, and the degree of comparability between the subject property and the comparable sales. If the subject property has a significantly larger site than the comparables used in the appraiser’s analysis, the subject property may not be a typical residential property for the neighborhood.

Trend of Neighborhood Property Values, Demand/Supply, and Marketing Time

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 information in the table below.

Trend of Property Values	Supply of Properties in the Subject	Marketing Time for Properties
• increasing, • stable, or • declining.	• shortage, • in-balance, or • over-supply.	• under three months, • three to six months, or • over six months.

The appraiser’s analysis of a property must take into consideration all factors that affect value. Because Fannie Mae purchases mortgages in all markets, this is particularly important for neighborhoods that are experiencing significant fluctuations in property values including sub- markets for particular types of housing within the neighborhood. Therefore, CMS must confirm that the appraiser analyzes listings and contract sales as well as closed or settled sales, and uses the most recent and similar sales available as part of the sales comparison approach, with particular attention to sales or financing concessions in neighborhoods that are experiencing either declining property values, an over-supply of properties, or marketing times over six months. The appraiser must provide his or her conclusions for the reasons a neighborhood is experiencing declining property values, an over-supply of properties, or marketing times over six months.

Neighborhood Section of the Appraisal Report (continued)

Trend of Neighborhood Property Values, Demand/Supply, and Marketing Time (continued)	When completing the One-Unit Housing Trends portion of the Neighborhood section of the appraisal report forms, the trends must be reflective of those properties deemed to be competitive to the property being appraised. If the neighborhood contains properties that are truly competitive (that is, market participants make no distinction between the properties), then all the properties within the neighborhood would be reflected in the One-Unit Housing Trends section. However, when a segmented or bifurcated market is present, the One-Unit Housing Trends portion must reflect those properties from the same segment of the market as the property being appraised. This ensures that the analysis being performed is based on competitive properties. For example, if the neighborhood contains a mix of property types not considered competitive by market participants, then a segmented or bifurcated market is present. The appraiser should also provide commentary on the other segment(s) of the neighborhood when segmentation is present.
Price Range and Predominant Price	The appraiser must indicate the price range and predominant price of properties in the subject neighborhood. The price range must reflect high and low prevailing prices for one-unit properties, two- to four-unit properties, condo units, depending on the property type being appraised and the appraisal form being used. Isolated high and low extremes should be excluded from the range, which means that the predominant price will be that which is the most common or most frequently found in the neighborhood. The appraiser may state the predominant price as a single figure or as a range, if more appropriate.

Neighborhood Section of the Appraisal Report (continued)

Over-Improvements

An over-improvement is an improvement that is larger or costlier than what is typical for the neighborhood. For example, a 4,000 square foot home located in an area of homes where the typical home is 2,000 square feet may be considered an over-improvement. Furthermore, a home with an in ground pool in an area where pools are not typical may also be considered an over-improvement. The appraiser must comment on over-improvements and indicate their contributory value in the Sales Comparison Approach 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.

The fact that the property is an over-improvement does not necessarily make the property ineligible. However, CMS must review appraisals on properties with over-improvements that may not be acceptable to the typical purchaser to ensure that only the contributory value of the over-improvement is reflected in the appraisal analysis.

Age Range and Predominant Age

The appraiser must indicate the age range and predominant age of properties in the subject neighborhood. The age range should reflect the oldest and newest ages for one-unit properties, two- to four-unit properties, condo units, depending on the property type and the appraisal form being used. However, isolated high and low extremes should be excluded from the range. The predominant age is the one that is the most common or most frequently found in the neighborhood. The appraiser may state the predominant age as a single figure or as a range when that is more appropriate.

When the age of the subject property is significantly different than the predominant age range, the appraiser must explain why the age is outside the range and comment on the marketability of the property and the adjustments that were made in the Sales Comparison Approach adjustment grid to reflect that condition.

Present Land Use

Fannie Mae's appraisal report forms provide an area for the appraiser to report the relative percentages of the developed land in the neighborhood when discussing the present land use, rather than simply referring to the zoning classifications. The appraiser must separately report the percentage of developed one-unit sites and two- to four-unit sites. Undeveloped land must be reported in the "Other" field. In addition, if there is a significant amount of undeveloped land in the neighborhood, the appraiser must include comments to confirm that he or she adequately described the neighborhood. If the present land use in the neighborhood is not one of those listed on the appraisal report form, such as parkland, the appraiser also must indicate the type of land use and its related percentage. The total of the types of land uses must equal 100%.

Neighborhood Section of the Appraisal Report (continued)

Present Land Use (continued)

Typically, dwellings best maintain their value when they are situated in neighborhoods thatconsist of other similar dwellings. However, some factors that are typical of a mixed-use neighborhood, such as easy access to employment centers and a high level of community activity, can actually enhance the market value of the property through increased buyer demand. Neighborhoods may frequently reflect a blend of residential and nonresidential land uses.

When different land uses and property types are present in a neighborhood, that fact should be considered a neighborhood characteristic that the appraiser needs to take into consideration when performing the neighborhood analysis and defining the neighborhood boundaries. To confirm that any positive or negative effects of the mixed land uses are reflected in the sales comparison analysis, the appraiser should select comparable sales from within the same neighborhood whenever possible. If this is not possible, the appraiser may need to make neighborhood or location adjustments to the Sales Comparison Approach adjustment grid for any sales that are not subject to the same neighborhood characteristic.

Site Section of the Appraisal Report

Overview

The property site should be of a size, shape, and topography that is generally conforming and acceptable in the market area. It must also have competitive utilities, street improvements, adequate vehicular access, and other amenities. Because amenities, easements, and encroachments may either detract from or enhance the marketability of a site, the appraiser must reflect them in his or her analysis and evaluation. The appraiser must comment if the site has adverse conditions or if there is market resistance to a property because the site is not compatible with the neighborhood or the requirements of the competitive market, and assess the effect, if any, on the value and marketability of the property.

Site Analysis

The appraisal must include the actual size of the site and not a hypothetical portion of the site for the subject property. For example, the appraiser may not appraise only 5 acres of an un-subdivided 40–acre parcel. The appraised value must reflect the entire 40–acre parcel.

Subject Property Zoning

The appraiser must report the specific zoning class in the appraisal, along with a general statement as to what the zoning permits, such as one- or two-unit, when he or she indicates a specific zoning such as R-1 or R-2. The appraisal must indicate whether the subject property presents:

- a legal conforming use,
- a legal non-conforming (grandfathered) use,
- an illegal use under the zoning regulations, or
- that there is no local zoning.

Site Section of the Appraisal Report (continued)

Subject Property Zoning (continued)

Fannie Mae only purchases or securitizes mortgage loans on properties if the improvements constitute a legal conforming use of the land. However, Fannie Mae will purchase or securitize a mortgage for a property that constitutes a legal, non-conforming use of the land in the following scenarios:

- the property is a one- to four-unit property or a unit in a PUD and the use of the land and the appraisal analysis reflects any adverse effect that the non-conforming use has on the value and marketability of the property; or
- the property is a condo unit and the improvements can be rebuilt to current density in the event of partial or full destruction, and the mortgage file includes either a copy of the applicable zoning regulations or a letter from the local zoning authority that authorizes reconstruction to current density.

Fannie Mae will not purchase or securitize a mortgage secured by a property that is subject to certain land-use regulations, such as coastal tideland or wetland laws, that create setback lines or other provisions that prevent the reconstruction or maintenance of the property improvements if they are damaged or destroyed. The intent of these types of land-use regulations is to remove existing land uses and to stop land development, including the maintenance or construction of seawalls, within specific setback lines.

For information regarding accessory units that comply or do not comply with zoning, see Improvements Section of the Appraisal Report.

Highest and Best Use

Fannie Mae will only purchase or securitize a mortgage that represents the highest and best use of the site as improved. If the current improvements clearly do not represent the highest and best use of the site as an improved site, it must be indicated on the appraisal report.

The appraiser determines highest and best use of a site as the reasonable and probable use that supports the highest present value on the effective date of the appraisal. For improvements to represent the highest and best use of a site, they must be legally permitted, financially feasible, and physically possible, and must provide more profit than any other use of the site would generate. All of those criteria must be met if the improvements are to be considered as the highest and best use of a site.

The appraiser's highest and best use analysis of the subject property should consider the property as it is improved. This treatment recognizes that the existing improvements should continue in use until it is financially feasible to remove the dwelling and build a new one, or to renovate the existing dwelling. If the use of comparable sales demonstrates that the improvements are reasonably typical and compatible with market demand for the neighborhood, and the present improvements contribute to the value of the subject property so that its value is greater than the estimated vacant site value, the appraiser should consider the existing use as reasonable and report it as the highest and best use.

Site Section of the Appraisal Report (continued)

Adjoining Properties

The appraiser must consider the present or anticipated use of any adjoining property that may adversely affect the value or marketability of the subject property.

Site Utilities

For mortgage loans to be eligible for purchase or securitization, the utilities of the property must meet community standards. If public sewer and/or water facilities, those that are supplied and regulated by the local government, are not available, community or private well and septic facilities must be available and utilized by the subject property. The owners of the subject property must have the right to access those facilities, which must be viable on an ongoing basis. Private well or septic facilities must be located on the subject site, unless the subject property has the right to access off-site private facilities and there is an adequate, legally binding agreement for access and maintenance.

If there is market resistance to an area because of environmental hazards or any other conditions that affect well, septic, or public water facilities, the appraisal must address the effect of the hazards on the value and marketability of the subject property (see Environmental Hazards Appraisal Requirements).

Off-Site Improvements

Off-site improvements include, but are not limited to, streets, alleys, sidewalks, curbs and gutters, and street lights. The subject property should front on a publicly dedicated and maintained street that meets community standards and is generally accepted by area residents.

If a property fronts on a street that is not typical of those found in the community, the appraiser must address the effect of that location on the value and marketability of the subject property.

The presence of sidewalks, curbs and gutters, street lights, and alleys depends on local custom. If they are typical in the community, they should be present on the subject site. The appraiser must comment on any adverse conditions and address their effect on the value and marketability of the subject property.

Community-Owned or Privately Maintained Streets

If the property is located on a community-owned or privately-owned and maintained street, an adequate, legally enforceable agreement or covenant for maintenance of the street is required. The agreement or covenant should include the following provisions and be recorded in the land records of the appropriate jurisdiction:

- responsibility for payment of repairs, including each party's representative share;
- default remedies in the event a party to the agreement or covenant fails to comply with his or her obligations; and
- the effective term of the agreement or covenant, which in most cases should be perpetual and binding on any future owners.

Site Section of the Appraisal Report (continued)

Community-Owned or Privately Maintained Streets (continued)

Note: If the property is located within a state that has statutory provisions that define the responsibilities of property owners for the maintenance and repair of a private street, no separate agreement or covenant is required.

If the property is not located in a state that imposes statutory requirements for maintenance and either there is no agreement or covenant for maintenance of the street, or an agreement or covenant exists but does not meet the requirements listed above, CMS may still deliver the loan. However, CMS is required to indemnify Fannie Mae (as described in Indemnification for Losses) against all losses incurred by Fannie Mae as a result of the physical condition of the street or in order to establish and/or retain access to the street.

Special Flood Hazard Areas

Fannie Mae's appraisal report forms provide an area for the appraiser to indicate whether the property is located in a Special Flood Hazard Area that is identified on the Federal Emergency Management Agency's (FEMA) Flood Insurance Rate Maps. The appraiser must also indicate the specific FEMA flood zone and the map number and its effective date. For additional information concerning Fannie Mae's policies on flood insurance, see Flood Insurance Coverage Requirements.

Improvements Section of the Appraisal Report

Overview

The appraisal must provide a clear, detailed, and accurate description of the improvements. The description must be as specific as possible, commenting on such things as needed repairs, additional features, and modernization, and should provide supporting addenda, if necessary. If the subject property has an accessory unit, the appraisal should describe it.

Conformity of Improvements to Neighborhood

The improvements should conform to the neighborhood in terms of age, type, design, and materials used for their construction. If there is market resistance to a property because its improvements are not compatible with the neighborhood or with the requirements of the competitive market because of adequacy of plumbing, heating, or electrical services; design; quality; size; condition; or any other reason directly related to market demand, the appraiser must address the impact to the value and marketability of the subject property. However, CMS should be aware that many older neighborhoods have favorable heterogeneity in architectural styles, land use, and age of housing. For example, older neighborhoods are especially likely to have been developed through custom building. This variety may be a positive marketing factor.

Improvements Section of the Appraisal Report (continued)

Unique Housing Types

In the appraisal and appraisal report review processes, special consideration must be given to properties that represent unique housing for the subject neighborhood. Mortgages secured by unique or nontraditional types of housing, including, but not limited to, earth houses, geodesic domes, and log houses, are eligible for delivery to Fannie Mae provided the appraiser has adequate information to develop a reliable opinion of market value. It is not necessary for one or more of the comparable sales to be of the same design and appeal as the property that is being appraised, although appraisal accuracy is enhanced by using comparable sales that are the most similar to the subject property. On a case-by-case basis, both the appraiser and the underwriter must independently determine whether there is sufficient information available to develop a reliable opinion of market value. This will depend on the extent of the differences between the special or unique property and the more traditional types of houses in the neighborhood and the number of such properties that have already been sold in the neighborhood.

When appraising unique properties,

- if the appraiser cannot locate recent comparable sales of the same design and appeal, but is able to determine sound adjustments for the differences between the comparables that are available and the subject property and demonstrate the marketability of the property based on older comparable sales, comparable sales in competing neighborhoods, the existence of similar properties in the market area, and any other reliable market data, the property is acceptable as security for a mortgage deliverable to Fannie Mae;
- if the appraiser is not able to find any evidence of market acceptance, and the characteristics of the property are so significantly different that he or she cannot establish a reliable opinion of market value, the property is not acceptable as security for a mortgage deliverable to Fannie Mae.

Fannie Mae does not specify minimum size or living area requirements for properties. There should be comparables of similar size to the subject property to support the general acceptability of a particular property type.

Actual and Effective Ages

Fannie Mae does not place a restriction on the actual age of the dwelling. Older dwellings that meet Fannie Mae's general requirements are acceptable. Improvements for all properties must be of the quality and condition that will be acceptable to typical purchasers in the subject neighborhood.

The relationship between the actual and effective ages of the property is a good indication of its condition. A property that has been well-maintained generally will have an effective age somewhat lower than its actual age. On the other hand, a property that has an effective age higher than its actual age probably has not been well-maintained or may have a particular physical problem. In such cases, CMS should pay particular attention to the condition of the subject property in its review of any appraisal report. When the appraiser makes adjustments for the "Year Built," he or she must explain the adjustments that were made.

Improvements Section of the Appraisal Report (continued)

Remaining Economic Life

Fannie Mae does not have any requirements related to the remaining economic life of the property. However, related property deficiencies must be discussed in the sections of the appraisal report that address the improvements analysis and comments on the condition of the property.

Fannie Mae's appraisal report forms are designed to meet the needs of several different user groups; consequently, the report forms address the remaining economic life for the property being appraised. However, appraisers are not required to report this information. If appraisers report this information, CMS does not need to consider remaining economic life because any related property deficiencies will be discussed in the sections of the appraisal report that address the improvements analysis and comments on the condition of the property.

Energy Efficient Improvements

An energy-efficient property is one that uses resource-effective design, materials, building systems, and site orientation to conserve nonrenewable fuels.

Special energy-saving items must be recognized in the appraisal process and noted on the appraisal report form. For example, when completing the appraisal report (Form 1004), special energy-efficient items are to be addressed in the Improvements section in the Additional features field. The nature of these items and their contribution to value will vary throughout the country because of climactic conditions, differences in utility costs, and overall market reaction to the cost of the feature. Some examples of special energy-efficient features may include, but are not limited to, energy efficient ratings or certifications, programmable thermostats, solar photovoltaic systems, low-e windows, insulated ducts, and tank-less water heaters.

Appraisers must compare energy-efficient features of the subject property to those of comparable properties in the Sales Comparison Approach adjustment grid. If the appraiser's analysis determines that an adjustment is warranted based on the market reaction to such item(s), the adjustment must be included in the adjustment grid.

Solar panels that are leased from or owned by a third party under a power purchase agreement or other similar arrangement are to be considered personal property items and are not included in the appraised value of the property. See Special Property Eligibility Considerations, for additional eligibility requirements for properties with solar panels.

Layout and Floor Plans

Dwellings with unusual layouts and floor plans generally have limited market appeal. A review of the room list and floor plan for the dwelling unit may indicate an unusual layout, such as bedrooms on a level with no bath, or a kitchen on a different level from the dining room. If the appraiser indicates that such inadequacies will result in market resistance to the subject property, he or she must make appropriate adjustments to reflect this in the overall analysis. However, if market acceptance can be demonstrated through the use of comparable sales with the same inadequacies, no adjustments are required.

Improvements Section of the Appraisal Report (continued)

Gross Living Area

The most common comparison for one-unit properties, including units in PUD, or condo, is above-grade gross living area. The appraiser must be consistent when he or she calculates and reports the finished above-grade room count and the square feet of gross living area that is above-grade. The need for consistency also applies from report to report. For example, when using the same transaction as a comparable sale in multiple reports, the room count and gross living area should not change.

When calculating gross living area

- The appraiser should use the exterior building dimensions per floor to calculate the above- grade gross living area of a property.
- For units in condo projects, the appraiser should use interior perimeter unit dimensions to calculate the gross living area.
- Garages and basements, including those that are partially above-grade, must not be included in the above-grade room count.

Only finished above-grade areas can be used in calculating and reporting of above-grade room count and square footage for the gross living area. Fannie Mae considers a level to be below- grade if any portion of it is below-grade, regardless of the quality of its finish or the window area of any room. Therefore, a walk-out basement with finished rooms would not be included in the above-grade room count. Rooms that are not included in the above-grade room count may add substantially to the value of a property, particularly when the quality of the finish is high. For that reason, the appraiser should report the basement or other partially below-grade areas separately and make appropriate adjustments for them on the Basement & Finished Rooms Below-Grade line in the Sales Comparison Approach adjustment grid.

For consistency in the sales comparison analysis, the appraiser should compare above-grade areas to above-grade areas and below-grade areas to below-grade areas. The appraiser may need to deviate from this approach if the style of the subject property or any of the comparables does not lend itself to such comparisons. For example, a property built into the side of a hill where the lower level is significantly out of ground, the interior finish is equal throughout the house, and the flow and function of the layout is accepted by the local market, may require the gross living area to include both levels. However, in such instances, the appraiser must be consistent throughout the appraisal in his or her analysis and explain the reason for the deviation, clearly describing the comparisons that were made.

Improvements Section of the Appraisal Report (continued)

Gross Building Area

The gross building area:

- is the total finished area including any interior common areas, such as stairways and hallways of the improvements based on exterior measurements;
- is the most common comparison for two- to four-unit properties;
- must be consistently developed for the subject property and all comparables used in the appraisal;
- must include all finished above-grade and below-grade living areas, counting all interior common areas such as stairways, hallways, storage rooms; and
- cannot count exterior common areas, such as open stairways.

Fannie Mae will accept the use of other comparisons for two- to four-unit properties, such as the total above-grade and below-grade areas discussed in Gross Living Area, provided the appraiser

- explains the reasons he or she did not use a gross building area comparison, and
- clearly describes the comparisons that were made.

Accessory Units

Fannie Mae will purchase a one-unit property with an accessory unit. An accessory unit is typically an additional living area independent of the primary dwelling unit, and includes a fully functioning kitchen and bathroom. Some examples may include a living area over a garage and basement units. Whether a property is defined as a one-unit property with an accessory unit or a two-unit property will be based on the characteristics of the property, which may include, but are not limited to, the existence of separate utilities, a unique postal address, and whether the unit is rented.

The appraiser is required to provide a description of the accessory unit, and analyze any effect it has on the value or marketability of the subject property.

If the property contains an accessory unit, the property is eligible under the following conditions:

- The property is defined as a one-unit property.
- There is only one accessory unit on the property; multiple accessory units are not permitted.
- The appraisal report demonstrates that the improvements are typical for the market through an analysis of at least one comparable property with the same use.
- The borrower qualifies for the mortgage without considering any rental income from the accessory unit.

Improvements Section of the Appraisal Report (continued)

Accessory Units (continued)

If it is determined that the property contains an accessory unit that does not comply with zoning, the property is eligible under the following additional conditions:

- CMS confirms that the existence will not jeopardize any future property insurance claim that might need to be filed for the property.
- The use conforms to the subject neighborhood and to the market.
- The property is appraised based upon its current use.
- The appraisal must report that the improvements represent a use that does not comply with zoning.
- The appraisal report must demonstrate that the improvements are typical for the market through an analysis of at least three comparable properties that have the same non-compliant zoning use.

(See Site Section of the Appraisal Report, for subject property zoning information.)

Additions without Permits

If the appraiser identifies an addition(s) that does not have the required permit, the appraiser must comment on the quality and appearance of the work and its impact, if any, on the market value of the subject property.

Properties with Outbuildings

CMS must give properties with outbuildings special consideration in the appraisal report review to ensure that the property is residential in nature. Descriptions of the outbuildings should be reported in the Improvements and Sales Comparison Approach sections of the appraisal report form.

Type of Outbuilding	Acceptability
Minimal outbuildings, such as small barns or stables, that are of relatively insignificant value in relation to the total appraised value of the subject property.	The appraiser must demonstrate through the use of comparable sales with similar amenities that the improvements are typical of other residential properties in the subject area for which an active, viable residential market exists.
An atypical minimal outbuilding.	The property is acceptable provided the appraiser's analysis reflects little or no contributory value for it.
Significant outbuildings, such as silos, large barns, storage areas, or facilities for farm-type animals.	The presence of the outbuildings may indicate that the property is agricultural in nature. CMS must determine whether the property is residential in nature, regardless of whether the appraiser assigns value to the outbuildings.

Property Condition and Quality of Construction of the Improvements

Appraiser Selection of Condition, Quality, and other Characteristic Ratings

The Condition and Quality ratings must be based on a holistic view of the property and any improvements. When selecting the Condition and Quality ratings, an appraiser must

- Consider all improvements to determine an overall Condition and Quality rating. The appraiser should select the rating that best reflects the property as a whole and in its entirety.
- Describe the subject property as of the effective date of the appraisal on an absolute basis, meaning the property must be rated on its own merits. The rating should not be selected on a relative basis, meaning it is not selected on how the property relates or compares to other properties in the neighborhood. Additionally, the Condition and Quality ratings for comparable properties must be made on an absolute basis (again, each comparative property on its own merits), not on a relative basis, and reflect the property as of the date of sale of that comparable property.

Note: These requirements also apply to all other ratings or descriptions, including the View and Location.

When an appraiser selects a rating and/or description of the subject property for a sales transaction, the selected rating and/or description must remain the same when reflecting that specific transaction. For example, if a C4 rating is selected for the sale of the subject property, then that property remains a C4 when using that specific sale as a comparable in future reports. The same expectation holds true for ratings and descriptions of comparable sales. When a comparable is used in a subsequent appraisal, the ratings and descriptions of that property should not change from one appraisal to the next when it reflects the same sale transaction.

Note: Properties can have the same rating or description and still require an adjustment. It should be noted that this does not only apply to Condition and Quality ratings and can apply to other ratings or descriptions as well. For example, all water views may not be equal. In this instance, an adjustment should be made and explained in the Additional Comments section of the form or in an addendum.

Property Condition and Quality of Construction of the Improvements (continued)

Property Condition

CMS must take the necessary steps to confirm that a property meets Fannie Mae's condition requirements as outlined in this topic.

The table below provides the requirements for property condition.

✓	Requirements
	The appraisal report must express an opinion about the condition of the improvements based on the factual data of the improvements analysis.
	Appraisals based on interior and exterior inspections must include complete visual inspections of the accessible areas of the property. **Note:** Appraisers are not responsible for hidden or unapparent conditions.
	Appraisal reports must reflect adverse conditions that were apparent during the inspection or discovered while performing research, such as, but not limited to, needed repairs, deterioration, or the presence of hazardous wastes, toxic substances, or adverse environmental conditions.
	Detrimental conditions of the improvements must be reported in the appraisal even if the conditions are typical for competing properties.
	The appraiser must consider and describe the overall condition and quality and condition of the property improvements. (See Identifying Property Condition; Definitions of Not Updated, Updated, and Remodeled; and Identifying Quality of Construction in this topic for details.)
	The appraiser must identify: • items that require immediate repair; and • items where maintenance may have been deferred, which may or may not require immediate repair.
	The appraisal Additional Comments section must address needed repairs and physical, functional, or external inadequacies.

Property Condition and Quality of Construction of the Improvements (continued)

Property Condition Ratings

For appraisals required to be completed with the UAD, the appraiser must assign one of the following standardized Condition ratings in the table below when identifying the condition of the improvements for the subject property and comparable sales.

	Description
C1	The improvements have been very recently constructed and have not previously been occupied. The entire structure and all components are new and the dwelling features no physical depreciation. **Note:** *Newly constructed improvements that feature recycled materials and/or components can be considered new dwellings provided that the dwelling is placed on a 100 percent new foundation and the recycled materials and the recycled components have been rehabilitated/re- manufactured into like-new condition. Improvements that have not been previously occupied are not considered "new" if they have any significant physical depreciation (that is, newly constructed dwellings that have been vacant for an extended period of time without adequate maintenance or upkeep).*
C2	The improvements feature no deferred maintenance, little or no physical depreciation, and require no repairs. Virtually all building components are new or have been recently repaired, refinished, or rehabilitated. All outdated components and finishes have been updated and/or replaced with components that meet current standards. Dwellings in this category either are almost new or have been recently completely renovated and are similar in condition to new construction. **Note:** *The improvements represent a relatively new property that is well-maintained with no deferred maintenance and little or no physical depreciation, or an older property that has been recently completely renovated.*
C3	The improvements are well-maintained and feature limited physical depreciation due to normal wear and tear. Some components, but not every major building component, may be updated or recently rehabilitated. The structure has been well-maintained. **Note:** *The improvement is in its first-cycle of replacing short-lived building components (appliances, floor coverings, HVAC, etc.) and is being well– maintained. Its estimated effective age is less than its actual age. It also may reflect a property in which the majority of short- lived building components have been replaced but not to the level of a complete renovation.*

Property Condition and Quality of Construction of the Improvements (continued)

Property Condition Ratings (continued)

	Description
C4	The improvements feature some minor deferred maintenance and physical deterioration due to normal wear and tear. The dwelling has been adequately maintained and requires only minimal repairs to building components/ mechanical systems and cosmetic repairs. All major building components have been adequately maintained and are functionally adequate. **Note:** *The estimated effective age may be close to or equal to its actual age. It reflects a property in which some of the short-lived building components have been replaced, and some short-lived building components are at or near the end of their physical life expectancy; however, they still function adequately. Most minor repairs have been addressed on an ongoing basis resulting in an adequately maintained property.*
C5	The improvements feature obvious deferred maintenance and are in need of some significant repairs. Some building components need repairs, rehabilitation, or updating. The functional utility and overall livability are somewhat diminished due to condition, but the dwelling remains useable and functional as a residence. **Note:** *Some significant repairs are needed to the improvements due to the lack of adequate maintenance. It reflects a property in which many of its short-lived building components are at the end of or have exceeded their physical life expectancy, but remain functional.*
C6	The improvements have substantial damage or deferred maintenance with deficiencies or defects that are severe enough to affect the safety, soundness, or structural integrity of the improvements. The improvements are in need of substantial repairs and rehabilitation, including many or most major components. **Note:** *Substantial repairs are needed to the improvements due to the lack of adequate maintenance or property damage. It reflects a property with conditions severe enough to affect the safety, soundness, or structural integrity of the improvements.*

Property Condition and Quality of Construction of the Improvements (continued)

Identifying Property Condition

As previously noted, the Condition rating selected for the property must reflect a holistic view of the condition of the property improvements. It would be inappropriate to select either a lower or higher overall rating on the basis of one or two minor inferior or superior areas of the property improvements. However, the C6 rating is an exception because it indicates that the property is impacted by one or more deficiencies that negatively affect the safety, soundness, or structural integrity of the property. As a result, if any portion of the dwelling is rated a C6, the whole dwelling must be rated a C6.

Properties with a Condition Rating of C6 are eligible for sale to Fannie Mae provided any deficiencies that impact the safety, soundness, or structural integrity of the property are repaired prior to delivery of the loan. See Physical Deficiencies That Affect Safety, Soundness, or Structural Integrity of the Subject Property in this topic for information related to completing appraisals on properties with safety, soundness, or structural integrity deficiencies.

Definitions of Not Updated, Updated, and Remodeled

For appraisals required to be completed using the UAD, as a subset of identifying the condition of the subject property, the appraiser must also identify the level of updating, if any, that the subject property has received by utilizing the definitions in the table below.

Level of Updating	Description
Not Updated	Little or no updating or modernization. This description includes, but is not limited to, new homes. Residential properties of fifteen years of age or less often reflect an original condition with no updating, if no major components have been replaced or updated. Those over fifteen years of age are also considered not updated if the appliances, fixtures, and finishes are predominantly dated. An area that is ‘Not Updated’ may still be well-maintained and fully functional, and this rating does not necessarily imply deferred maintenance or physical/functional deterioration.
Updated	The area of the home has been modified to meet current market expectations. These modifications are limited in terms of both scope and cost. An updated area of the home should have an improved look and feel, or functional utility. Changes that constitute updates include refurbishment and/ or replacing components to meet existing market expectations. Updates do *not* include significant alterations to the existing structure.

Property Condition and Quality of Construction of the Improvements (continued)

Definitions of Not Updated, Updated, and Remodeled (continued)

Level of Updating	Description
Remodeled	Significant finish and/or structural changes have been made that increase utility and appeal through complete replacement and/or expansion. A remodeled area reflects fundamental changes that include multiple alterations. These alterations may include some or all of the following: replacement of a major component (cabinet(s), bathtub, or bathroom tile), relocation of plumbing/ gas fixtures/appliances, significant structural alterations (relocating walls, and/ or the addition of square footage). This would include a complete gutting and rebuild.

Appraisals Completed "As Is"

Fannie Mae permits appraisals to be based on the "as is" condition of the property provided existing conditions are minor and do not affect the safety, soundness, or structural integrity of the property, and the appraiser's opinion of value reflects the existence of these conditions.

Minor conditions and deferred maintenance are typically due to normal wear and tear from the aging process and the occupancy of the property. While such conditions generally do not rise to the level of a required repair, they must be reported. Examples of minor conditions and deferred maintenance include worn floor finishes or carpet, minor plumbing leaks, holes in window screens, or cracked window glass.

Condition Ratings C1, C2, C3, C4, and C5 as previously defined are eligible for delivery in "as is" condition. Properties with the initial Condition Rating C6 indicate one or more deficiencies that impact the safety, soundness, or structural integrity of the property. Therefore, the appraisal must be completed subject to completion of the deficient item(s).

See Physical Deficiencies That Affect Safety, Soundness, or Structural Integrity of the Subject Property in this topic for additional details when completing appraisals on properties with safety, soundness, or structural integrity deficiencies.

Property Condition and Quality of Construction of the Improvements (continued)

Quality of Construction Rating

For appraisals required to be completed using the UAD, the appraiser must assign one of the following standardized quality ratings in the table below when identifying the quality of construction for the subject property and comparable sales.

Rating	Description
Q1	Dwellings with this quality rating are usually unique structures that are individually designed by an architect for a specified user. Such residences typically are constructed from detailed architectural plans and specifications and feature an exceptionally high level of workmanship and exceptionally high- grade materials throughout the interior and exterior of the structure. The design features exceptionally high quality exterior refinements and ornamentation, and exceptionally high-quality interior refinements. The workmanship, materials, and finishes throughout the dwelling are of exceptionally high quality.
Q2	Dwellings with this quality rating are often custom designed for construction on an individual property owner's site. However, dwellings in this quality grade are also found in high-quality tract developments featuring residences constructed from individual plans or from highly modified or upgraded plans. The design features detailed, high-quality exterior ornamentation, high-quality interior refinements, and detail. The workmanship, materials, and finishes throughout the dwelling are generally of high or very high quality.
Q3	Dwellings with this quality rating are residences of higher quality built from individual or readily available designer plans in above-standard residential tract developments or on an individual property owner's site. The design includes significant exterior ornamentation and interiors that are well finished. The workmanship exceeds acceptable standards and many materials and finishes throughout the dwelling have been upgraded from "stock" standards.
Q4	Dwellings with this quality rating meet or exceed the requirements of applicable building codes. Standard or modified standard building plans are utilized and the design includes adequate fenestration and some exterior ornamentation and interior refinements. Materials, workmanship, finish, and equipment are of stock or builder grade and may feature some upgrades.

Property Condition and Quality of Construction of the Improvements (continued)

Quality of Construction Rating (continued)

Rating	Description
Q5	Dwellings with this quality rating feature economy of construction and basic functionality as main considerations. Such dwellings feature a plain design using readily available or basic floor plans featuring minimal fenestration and basic finishes with minimal exterior ornamentation and limited interior detail. These dwellings meet minimum building codes and are constructed with inexpensive, stock materials with limited refinements and upgrades.
Q6	Dwellings with this quality rating are of basic quality and lower cost; some may not be suitable for year-round occupancy. Such dwellings are often built with simple plans or without plans, often utilizing the lowest quality building materials. Such dwellings are often built or expanded by persons who are professionally unskilled or possess only minimal construction skills. Electrical, plumbing, and other mechanical systems and equipment may be minimal or nonexistent. Older dwellings may feature one or more substandard or nonconforming additions to the original structure.

Identifying Quality of Construction

The same approach used in identifying the condition of the property is also applicable to identifying the quality of construction. The selected rating must reflect a holistic view of the quality of construction. However, the Q6 Rating is an exception because it indicates that the property is impacted by one or more deficiencies that negatively affect the safety, soundness, or structural integrity of the property. As a result, if any portion of the dwelling is rated a Q6, the whole dwelling must be rated a Q6.

Properties with a quality of construction rating of Q6 are eligible for sale to Fannie Mae provided any items in relation to the quality of construction that impact the safety, soundness, or structural integrity of the property are repaired prior to the delivery of the loan. See Physical Deficiencies That Affect Safety, Soundness, or Structural Integrity of the Subject Property in this topic for requirements when completing appraisals on properties with safety, soundness, or structural integrity deficiencies.

Property Condition and Quality of Construction of the Improvements (continued)

Physical Deficiencies That Affect Safety, Soundness, or Structural Integrity of the Subject Property

The appraisal report must identify and describe physical deficiencies that could affect a property's safety, soundness, or structural integrity. If the appraiser has identified any of these deficiencies, the property must be appraised subject to completion of the specific repairs or alterations. In these instances, the property condition and quality ratings must reflect the condition and quality of the property based on the hypothetical condition that the repairs or alterations have been completed.

If the appraiser is not qualified to evaluate the alterations or repairs needed, the appraisal must identify and describe the deficiencies and the property must be appraised subject to a satisfactory inspection by a qualified professional. The appraisal may have to be revised based upon the results of the inspection. If so, the report must indicate the impact, if any, on the final opinion of value. CMS must review the revised appraisal report to confirm that no physical deficiencies or conditions that would affect the safety, soundness, or structural integrity of the property are indicated. A certification of completion is required to confirm the necessary alterations or repairs have been completed prior to delivery of the loan.

Infestation, Dampness, or Settlement

If the appraisal indicates evidence of wood-boring insects, dampness, or abnormal settlement, the appraisal must comment on the effect on the value and marketability of the subject property. CMS must either provide satisfactory evidence that the condition was corrected or submit a professionally prepared report indicating, based on an inspection of the property, that the condition does not pose any threat of structural damage to the improvements.

Sales Comparison Approach Section of the Appraisal Report

Overview

The sales comparison approach to value is an analysis of comparable sales, contract sales, and listings of properties that are the most comparable to the subject property.

The appraiser's analysis of a property must take into consideration all factors that have an effect on value. The appraiser must analyze all closed sales, contract sales, and offerings or listings of properties that are the most comparable to the subject property in order to identify any significant differences or elements of comparison that could affect his or her opinion of value for the subject property as of the effective date of the appraisal report. This is particularly important in changing (increasing or declining values) markets. Analyzing closed sales, contract sales, and offerings or listings is an important analysis in any market and will result in more accurate reporting on market conditions, including trends that indicate that sale prices for contract sales and asking prices for recent offerings or listings have changed. (Also see Neighborhood Section of the Appraisal Report, for information regarding Trend of Neighborhood Property Values, Demand/Supply, and Marketing Time.)

Sales Comparison Approach Section of the Appraisal Report (continued)

Data and Verification Sources of Comparable Sales

Data and verification source(s) for each comparable sale must be reported on the appraisal report form. Examples of data sources include, but are not limited to, a multiple listing service, deed records, tax records, realtors, builders, appraisers, appraiser's files, and other third party sources and vendors. The appraiser must state the specific data source (such as tax records or deed records), and refrain from using broad categories, such as "public records." Data source(s) must be reliable sources for the area where the subject property is located.

Examples of verification sources include, but are not limited to, the buyer, seller, listing agent, selling agent, and closing documents in certain situations. Regardless of the source(s) used, there must be sufficient data to understand the conditions of sale, existence of financing concessions, physical characteristics of the subject property, and whether it was an arms-length transaction.

It is acceptable to obtain comparable sales data from parties that have a financial interest in either the sale or financing of the subject property; however, the appraiser must verify the data with a party that does not have a financial interest in the subject transaction. For example, if the real estate agent of the subject property has provided comparable sales data, that information must be verified through another disinterested source.

Prior Sales History of the Subject and Comparable Sales

Fannie Mae's appraisal report forms require the appraiser to report the three year subject property and twelve month comparable sales history.

Comparable Sales

Selection of Comparable Sales

The appraiser is responsible for determining which comparables are the best and most appropriate for the assignment. Fannie Mae expects the appraiser to account for all factors that affect value when completing the analysis. Comparable sales should have similar physical and legal characteristics when compared to the subject property. These characteristics include, but are not limited to, site, room count, gross living area, style, and condition. This does not mean that the comparable must be identical to the subject property, but it should be competitive and appeal to the same market participants that would also consider purchasing the subject property. Comparables that are significantly different from the subject property may be acceptable; however, the appraiser must describe the differences, consider these factors in the market value, and provide an explanation justifying the use of the comparable(s).

Comparable sales from within the same neighborhood (including subdivision or project) as the subject property should be used when possible. Sale activity from within the neighborhood is the best indicator of value for properties in that neighborhood as sales prices of comparable properties from the same location should reflect the same positive and negative location characteristics.

Comparable Sales (continued)

Selection of Comparable Sales (continued)

Fannie Mae does allow for the use of comparable sales that are located in competing neighborhoods, as these may simply be the best comparables available and the most appropriate for the appraiser's analysis. If this situation arises, the appraiser must not expand the neighborhood boundaries just to encompass the comparables selected. The appraiser must indicate the comparables are from a competing neighborhood and address any differences that exist. The appraiser must also provide an explanation as to why he or she used the specific comparable sales in the appraisal report and include a discussion of how a competing neighborhood is comparable to the subject neighborhood.

If a property is located in an area in which there is a shortage of truly comparable sales, either because of the nature of the property improvements or the relatively low number of sales transactions in the neighborhood, the appraiser might need to use as comparable sales, properties that are not truly comparable to the subject property. In some situations, sales of properties that are not truly comparable may simply be the best available and the most appropriate for the appraiser's analysis. The use of such sales is acceptable as long as the appraiser adequately documents his or her analysis and explains why these sales were used. (For additional information, see Neighborhood Section of the Appraisal Report.

When describing the proximity of the comparable sale to the subject property, the appraiser must be specific with respect to the distance in terms of miles and include the applicable directional indicator (for example, "1.75 miles NW"). The distance between the subject property and each comparable property is to be measured using a straight line between the properties.

Minimum Number of Comparable Sales

A minimum of three 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.

In no instance may the appraiser create comparable sales by combining vacant land sales with the contract purchase price of a home (improvements only). While these transactions cannot be used to meet the required minimum three closed comparables, these transactions, which are often completed as part of a construction-to-permanent loan transaction, may be included as additional support with appropriate commentary.

Age of the Comparable Sales

Comparable sales that have closed within the last 12 months should be used in the appraisal; however, the best and most appropriate comparable sales may not always be the most recent sales. For example, it may be appropriate for the appraiser to use a nine month old sale with a time adjustment rather than a one month old sale that requires multiple adjustments. An older sale may be more appropriate in situations when market conditions have impacted the availability of recent sales as long as the appraisal reflects the changing market conditions.

Comparable Sales (continued)

Age of the Comparable Sales (continued)	Additionally, older comparable sales that are the best indicator of value for the subject property can be used if appropriate. For example, if the subject property is located in a rural area that has minimal sales activity, the appraiser may not be able to locate three (3) truly comparable sales that sold in the last 12 months. In this case, the appraiser may use older comparable sales as long as he or she explains why they are being used.
Additional Requirements for New (or Recently Converted) Condos, Subdivisions, or PUDS	If the subject property is located in a new (or recently converted) condo, subdivision, or PUD, then it must be compared to other properties in the neighborhood as well as to properties within the subject subdivision or project. This comparison should help demonstrate market acceptance of new developments and the properties within them. 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. Two of the sales must be verifiable from reliable data sources, other than the builder. Sales or resales from within the subject subdivision or project are preferable to sales from outside the subdivision or project provided the developer or builder of the subject property is not involved in the transactions. In the event there are no closed sales inside a new subject project or subdivision because the subject property transaction is one of the first units to sell, the appraiser may use two pending sales in the subject project or subdivision in lieu of one closed sale. When the appraiser is using two pending comparable sales in lieu of a closed sale, the appraiser must also use at least three closed comparable sales from projects or subdivisions outside of the subject property's project or subdivision. To meet the requirement that the appraiser utilize one comparable sale from inside the subject subdivision or project, the appraiser may need to rely solely on the builder of the property he or she is appraising, as this data may not yet be available through typical data sources (for example, public records or multiple listing services). In this scenario, it is acceptable for the appraiser to verify the transaction of the comparable sale by viewing a copy of the settlement statement from the builder's file. When providing builder sales from competing projects that are not presently available through traditional data sources, the appraiser must verify the sale from the applicable settlement statement and indicate on the appraisal report that the settlement statement was the document utilized for verification. Additionally, the appraisal must include discussion and analysis of sales concessions and upgrades for the subject property relative to concessions and upgrades for each builder sale. (For special appraisal considerations regarding condo projects, see Condo Appraisal Requirements, and Project Standards.)

Comparable Sales (continued)

Rural Properties

Rural properties often have large lot sizes, and rural locations can be relatively undeveloped. Therefore, there may be a shortage (or absence) of recent truly comparable sales in the immediate vicinity of a subject property that is in a rural location. Comparable sales located a considerable distance from the subject property can be used if they represent the best indicator of value for the subject property. In such cases, the appraiser must use his or her knowledge of the area and apply good judgment in selecting comparable sales that are the best indicators of value. The appraisal must include an explanation of why the particular comparables were selected.

Use of Foreclosures and Short Sales

It is acceptable to use foreclosures and short sales as comparables if the appraiser believes they are the best and most appropriate sales available. The appraiser must address in the appraisal report the prevalence of such sales in the subject's neighborhood and the impact, if any, of such sales. The appraiser must identify and consider any differences from the subject property, such as the condition of the property and whether any stigma has been associated with it. The appraiser cannot assume it is equal to the subject property. For example, a foreclosure or short sale property may be in worse condition when compared to the subject property, especially if the subject property is new construction or was recently renovated. For appraisals that are required to be UAD compliant, the appraiser must identify the sale type as REO sale or Short sale, as appropriate. (For specific information regarding comparable sale adjustments, see Adjustments to Comparable Sales below, and for information regarding financing types, see *Fannie Mae and Freddie Mac Uniform Appraisal Dataset Specification, Appendix D: Field- Specific Standardization Requirements).*

Adjustments to Comparable Sales

Analysis of Adjustments

Fannie Mae does not have specific limitations or guidelines associated with net or gross adjustments. The number and/or amount of the dollar adjustments must not be the sole determinant in the acceptability of a comparable. Ideally, the best and most appropriate comparable would require no adjustment; however this is rarely the case as typically no two properties or transaction details are identical. The appraiser's adjustments must reflect the market's reaction (that is, market based adjustments) to the difference in the properties. For example, it would be inappropriate for an appraiser to provide a $20 per square foot adjustment for the difference in the gross living area based on a rule-of-thumb when market analysis indicates the adjustment should be $100 per square foot. The expectation is for the appraiser to analyze the market for competitive properties and provide appropriate market based adjustments without regard to arbitrary limits on the size of the adjustment.

If the extent of the appraiser's adjustments to the comparable sales is great enough to indicate that the property may not conform to the neighborhood, the underwriter must determine if the opinion of value is adequately supported. (For further information regarding comparable selection, see Comparable Sales.)

When there are no truly comparable sales for a particular property because of the uniqueness of the property or other conditions, the appraiser must select sales that represent the best indicators of value for the subject property and make adjustments to reflect the actions of typical purchasers in that market.

Adjustments to Comparable Sales (continued)

Sales or Financing Concessions

Comparable sales that include sales or financing concessions must be adjusted to reflect the impact, if any, on the sales price of the comparables based on the market at the time of sale. For information related to sales or financing concessions for the subject transaction, see Interested Party Contributions (IPCs).

Examples of sales or financing concessions include:

- interest rate buydowns or other below-market rate financing;
- loan discount points;
- loan origination fees;
- closing costs customarily paid by the buyer;
- payment of condo PUD fees or assessment charges;
- refunds of (or credit for) the borrower's expenses;
- absorption of monthly payments;
- assignment of rent payments; and
- inclusion of non-realty items in the transaction.

The dollar amount of sales or financing concessions paid by the seller must be reported for the comparable sales if the information is reasonably available (see UAD *Appendix D: Field– Specific Standardization Requirements*, for data entry instructions). Sales or financing data should be obtained from parties associated with the comparable transaction, such as the broker, buyer or seller, or a reliable data source. If information is not available because of legal restrictions or other disclosure-related problems, the appraiser must explain why the information is not available. If the appraisal report form does not provide enough space to discuss this information, the appraiser must make an adjustment for the concessions on the form and include an explanation in an addendum to the appraisal report.

The amount of the negative dollar adjustment for each comparable with sales or financing concessions should be equal to any increase in the purchase price of the comparable that the appraiser determines to be attributable to the concessions. The need to make negative dollar adjustments for sales or financing concessions and the amount of the adjustments to the comparable sales is not based on how typical the concessions might be for a segment of the market area. Large sales or financing concessions can be relatively typical in a particular segment of the market and still result in sale prices that reflect more than the value of the real estate. Adjustments based on dollar-for-dollar deductions that are equal to the cost of the concessions to the seller, as a strict cash equivalency approach would dictate, are not appropriate.

Adjustments to Comparable Sales (continued)

Sales or Financing Concessions (continued)

Fannie Mae recognizes that the effect of sales or financing concessions on sales prices can vary with the amount of the concessions and differences in various markets. Adjustments must reflect the difference between what the comparables actually sold for with the sales or financing concessions and what they would have sold for without the concessions so that the dollar amount of the adjustments will approximate the reaction of the market to the concessions.

Positive adjustments for sales or financing concessions are not acceptable. For example, if local common practice or law results in virtually all of the property sellers in the market area paying a 1% loan origination fee for the purchaser, and a property seller in that market did not pay any loan fees or concessions for the purchaser, the sale would be considered as a cash equivalent sale in that market. The appraiser must recognize comparable sales that sold for all cash or with cash equivalent financing and use them as comparable sales if they are the best indicators of value for the subject property. Such sales also can be useful to the appraiser in determining those costs that are normally paid by sellers as the result of common practice or law in the market area.

Date of Sale and Time Adjustments

The date of sale and the time adjustment (market conditions) are critical elements in determining an accurate value because the appraisal is based on a specific date in time (effective date of appraisal). The comparable sales being considered must be analyzed by the appraiser to determine if there have been any changes in market conditions from the time the comparable went under contract to the effective date of the appraisal. This analysis will determine whether a time adjustment is warranted. Adjustments may be either positive or negative depending on the market changes over the time period analyzed. Time adjustments should be supported by other comparables (such as sales, contracts) whenever possible; however, in all instances the appraiser must provide an explanation for the time adjustment in the appraisal report.

When completing Fannie Mae's appraisal report forms, the appraiser should provide the date of the sales contract and the settlement or closing date. Only the month and year need to be reported. For example, appraisers may use "s04/10" or "c02/10" where "s" reflects the settlement or closing date and "c" reflects the contract date. If the exact date is necessary to understand the adjustments, it must be explained elsewhere in the report or in an addendum. If the contract date is unavailable to the appraiser in the normal course of business, the appraiser must enter the abbreviation "Unk" for unknown, in place of the contract date.

Adjustments to Comparable Sales (continued)

Appraiser's Comments and Indicated Value in the Sales Comparison Approach

The appraiser must provide appropriate comment(s) reflecting the logic and reasoning for the adjustments provided, especially for the characteristics reported on the appraisal report form between the Sales or Financing Concessions and the Condition line items. A statement only recognizing that an adjustment has been made is not acceptable. When appropriate, the appraiser's analysis should also include narrative comments about a current contract, offering, or listing for the subject or comparable sales, current ownership, and recent prior sales or transfers. Additionally, the appraiser's comments must reflect his or her reconciliation of the adjusted (or indicated) values for the comparable sales and identify why the sale(s) were given the most weight in arriving at the indicated value for the subject property. It should be noted that the indicated value in the Sales Comparison Approach must be within the range of the adjusted sales price of the comparables that are reported in the appraisal report form.

Cost and Income Approach to Value

Cost Approach to Value

Fannie Mae does not require the cost approach to value. However, USPAP requires the appraiser to develop and report the result of any approach to value that is necessary for credible assignment results. For example, when appraising proposed or newly constructed properties, if the appraiser believes the cost approach is necessary for credible assignment results, then the cost approach must be provided. Appraisals that rely solely on the cost approach as an indicator of market value are not acceptable.

The cost approach to value assumes that a potential purchaser will consider building a substitute residence that has the same use as the property being appraised. This approach, then, measures value as a cost of production. It may be appropriate to use the cost approach when appraising new or proposed construction, property that is undergoing renovation, unique property, or property that features functional depreciation, to support the sales comparison approach analysis. The reliability of the cost approach depends on valid reproduction cost estimates, proper depreciation estimates, and accurate site values.

If the appraiser has completed the cost approach, CMS must thoroughly review the information provided to confirm that the appraiser's analysis and comments for the cost approach to value are consistent with comments and adjustments mentioned elsewhere in the appraisal report. For example, if the neighborhood or site description reveals that the property backs up to a shopping center, CMS should expect to see an amount indicated for external depreciation in the cost approach. Or, if the improvement analysis indicates that it is necessary to go through one bedroom to get to another bedroom, CMS should expect to see an amount indicated for functional depreciation.

Cost and Income Approach to Value (continued)

Income Approach to Value

The income approach to value is based on the assumption that market value is related to the market rent or income that a property can be expected to earn. The income approach to value is required in the valuation of two-unit to four-unit properties and may be appropriate in neighborhoods that consist of one-unit properties when there is a substantial rental market. The income approach to value may not be appropriate in areas that consist mostly of owner-occupied properties because adequate rental data does not exist for those areas. However, USPAP requires the appraiser to develop and report the result of any approach to value that is necessary for credible assignment results. If the appraiser believes the income approach is necessary for credible assignment results, then the income approach must be included. Appraisals that rely solely on the income approach as an indicator of market value are not acceptable.

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. If the appraiser has completed the income approach, CMS must thoroughly review the information provided to confirm that the appraiser's analysis and comments for the income approach are consistent with comments mentioned elsewhere in the report.

Valuation Analysis and Reconciliation

Overview

The valuation sections of Fannie Mae's appraisal report forms enable an appraiser to develop and report, in a concise format, an adequately supported opinion of market value based on the cost, sales comparison, and income approaches to value, as applicable. If the appraiser believes that additional information needs to be provided because of the uniqueness of the property or some other condition, he or she should provide additional supporting data in an addendum to the appraisal report form.

Reconciliation

In the Reconciliation section of the appraisal report form, the appraiser considers the reliability and applicability of each of the approaches to value that was utilized in the appraisal report. After consideration of each of the approaches to value, the appraiser will provide his or her final value opinion. In the Reconciliation section, appraisers must

- reconcile the reasonableness and reliability of each applicable approach to value,
- reconcile the reasonableness and validity of the indicated values,
- reconcile the reasonableness of available data, and
- select and report the approach or approaches that were given the most weight.

The reconciliation is based on the appraiser's judgment of the results developed as part of the valuation process and must never be an averaging technique with the exception of the use of a weighted average technique that includes proper explanation. The final reconciled indicated value must be within the range of the values indicated by the Approaches used in the appraisal report form.

Quality Assurance

Changes to the Appraised Value

CMS is responsible for confirming that appraisal reports are complete and that any changes to the reports are made by the appraiser that originally completed the report. If CMS has concerns with any aspect of the appraisal that result in questions about the reliability of the opinion of market value, CMS must attempt to resolve its concerns with the appraiser that originally prepared the report. If CMS is unable to resolve its concerns with the appraiser, then CMS must obtain a replacement report prior to making a final underwriting decision on the loan. Any request for a change in the opinion of market value must be based on material and substantive issues and must not be made solely on the basis that the opinion of market value as indicated in the appraisal report does not support the proposed loan amount. For information concerning the process CMS must follow to address a change of the opinion of market value, see Guidance on Addressing Appraisal Deficiencies in this topic.

CMS must pay particular attention and institute extra due diligence for those loans in which the appraised value is believed to be excessive or when the value of the property has experienced significant appreciation in a short time period since the prior sale. Fannie Mae believes that one of the best ways lenders can reduce the risk associated with excessive values or rapid appreciation is by receiving accurate appraisals from knowledgeable, experienced appraisers.

Guidance on Addressing Appraisal Deficiencies and Second Appraisals

If CMS considers an appraisal deficient, CMS the following options for addressing the deficiencies:

- contacting the appraiser to address deficiencies contained in the appraisal report,
- obtaining a desk review or a field review of the original appraisal, or
- obtaining a new appraisal of the subject property.

CMS can return the appraisal report to the appraiser that completed the assignment, identify the deficiencies found, and provide justification for requesting correction of the deficiencies the underwriter believes make the report unreliable.

If CMS is unable to obtain a revised appraisal that adequately addresses its concerns, a desk or field review of the report may be obtained. The review must be completed in accordance with the USPAP. Because the Scope of Work for either type of review allows for a change of the opinion of market value for something other than a mathematical error, the appraiser completing the appraisal review must:

- be licensed or certified in the state in which the property is located,
- have access to the appropriate data sources, and
- possess the knowledge and experience to appraise the subject property with respect to both the specific property type and geographical location.

Quality Assurance (continued)

Guidance on Addressing Appraisal Deficiencies and Second Appraisals (continued)

CMS may forego either type of review and obtain a new appraisal. When a new appraisal is obtained, CMS must document the deficiencies that are the basis for ordering the new appraisal and adhere to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value. CMS must either document the resolution of the noted deficiencies in the original appraisal or detail the reasons for relying on a second opinion of market value.

Lender Requirements

CMS must continually evaluate the quality of the appraiser's work through the normal review process of all appraisal reports, as well as through the spot-check field review or desk review of appraisals as part of its quality assurance system.

Fannie Mae's Use of Field Reviews

Fannie Mae utilizes field reviews and other types of reviews for quality control purposes. Based on the review, Fannie Mae may refer unacceptable appraisal reports to state appraiser licensing or regulatory boards for investigation and action considered appropriate. In such cases, Fannie Mae provides the state board with a copy of the appraisal field review report and the original appraisal report.

Fannie Mae's objectives in referring appraisal reports to state appraiser licensing or regulatory boards are:

- to emphasize continuing efforts to maintain the quality of appraisals,
- to protect Fannie Mae's interest,
- to improve the quality of mortgages delivered to Fannie Mae by identifying appraisers that have performed appraisals of a sufficiently poor quality as to impair the security interests,
- to help the industry enhance the quality of appraisals by identifying and referring individual appraisers that appear to be unethical or incompetent to the state appraiser licensing or regulatory boards for review, and
- to help enforce professional standards.

Note: Fannie Mae's decision to make such referrals does not affect CMS responsibility for managing the property valuation and appraisal review process.

Refusal to Accept Appraisals from Specific Appraisers

Fannie Mae may refuse to accept appraisals prepared by specific appraisers, or Fannie Mae may notify CMS that appraisals prepared by a given appraiser are no longer accepted. When CMS is notified that appraisals from specific appraisers are no longer accepted, CMS is prohibited from delivering mortgages to Fannie Mae secured by properties appraised by that individual immediately following its receipt of Fannie Mae's notice.

SPECIAL APPRAISAL AND OTHER VALUATION CONSIDERATIONS

Factory-Built Housing: Modular, Prefabricated, Panelized, or Sectional Housing

Overview	Modular homes must be built under the Uniform Building Code (UBC) that is administered by the state agency that is responsible for adopting and administering building code requirements for the state in which the modular home is installed. Prefabricated, panelized, or sectional housing does not have to satisfy either HUD's Federal Manufactured Home Construction and Safety Standards or the UBC that are adopted and administered by the state in which the home is installed. The home must conform to local building codes in the area in which it will be installed.
Appraisal Requirements for Modular, Prefabricated, Panelized, or Sectional Housing	Fannie Mae does not have minimum requirements for width, size, roof pitch, or any other specific construction detail for modular homes, or any other types of factory-built homes. Because quality can account for large differences in the values of factory-built homes, it is important for the appraiser to become familiar with the features that affect the quality of a factory-built home so that the information can be included in the appraisal report if needed to support his or her opinion of value.
Comparable Selection Requirements for Modular, Prefabricated, Panelized, or Sectional Housing	The process of selecting comparable sales for factory-built housing is generally the same as that for selecting comparable sales for site-built housing. Fannie Mae requires the appraiser to address both the marketability and comparability of modular homes and other types of factory- built housing. When the subject property is modular, prefabricated, panelized, or sectional housing, it is not required that one or more of the comparable sales be the same type of factory-built housing, although using comparable sales of similar types of homes generally enhances the reliability of the appraiser's opinion of value. Fannie Mae requires the appraiser to include in the appraisal report the most appropriate comparable sales data to support his or her opinion of value for the subject property. See Comparable Sales, for general requirements regarding comparable selection.

Manufactured Housing

Introduction

This chapter describes the requirements for originating and underwriting mortgage loans secured by manufactured housing.

This topic contains information on manufactured housing, including:

- Manufactured Housing Overview
- Lender Eligibility
- Variances
- Lender Indemnification

Manufactured Housing Overview

Any dwelling unit built on a permanent chassis and attached to a permanent foundation system is a manufactured home for purposes of Fannie Mae's guidelines.

The manufactured home and the land on which it is situated must be titled as real property.

Other factory-built housing (not built on a permanent chassis)—such as modular, prefabricated, panelized, or sectional housing—is not considered manufactured housing and mortgage loans secured by such housing are eligible under the guidelines stated in Eligibility.

Lender Eligibility

CMS is not required to obtain specific approval to deliver mortgages secured by manufactured homes.

However, CMS must obtain Fannie Mae's project acceptance for any condominium projects if they are composed of manufactured homes. Both the land and the dwelling must be subject to the Condo Association.

Variances

Unless specifically stated in the terms of the contract, variances or other terms contained in any lender's contract are not eligible for use with mortgages secured by manufactured homes.

Lender Indemnification

CMS is subject to all indemnification obligations as described in A2-1-03, Indemnification for Losses (08/30/2016).

Manufactured Housing Loan Eligibility

Introduction

This topic contains information on manufactured housing loan eligibility, including:

- General Loan Eligibility Criteria
- Ineligible Manufactured Housing Criteria
- Manufactured Housing Standards

General Loan Eligibility Criteria

Fannie Mae purchases mortgage loans secured by manufactured homes that meet the following general criteria:

- first-lien mortgages only,
- fully amortizing fixed-rate mortgages or
- principal residences and second home dwellings.

Refer to the Eligibility Matrix for maximum allowable LTV, CLTV, and HCLTV ratios.

Ineligible Manufactured Housing Criteria

The following are ineligible for mortgage loans secured by manufactured homes:

- temporary buydowns;
- investment properties;
- single-width manufactured homes;
- manufactured homes converted to storage units;
- homes located on leasehold estates.

Manufactured Housing Standards

The mortgage loan must be secured by both the manufactured home and the land on which it is situated, and both the manufactured home and the land must be legally classified as real property under applicable state law.

The purchase, conveyance, and financing (or refinancing) of the land and the manufactured home must be evidenced and secured by a single valid and enforceable note and first lien mortgage, deed of trust or security deed that is recorded in the land records, in states where applicable state law clearly provides for such a single lien.

See Special Property Eligibility and Underwriting Considerations: Factory-Built Housing (04/15/2014), for additional information.

Manufactured Housing Underwriting Requirements

Introduction

This topic contains information on manufactured housing loan eligibility, including: This topics contains information on manufactured housing underwriting considerations, including:

- Underwriting and DU Requirements
- Sales Price and Original Loan Amount
- Down Payment Requirements
- Trade Equity from the Borrower's Existing Manufactured Home
- Traded Manufactured Homes
- Purchase Money Transactions
- Limited Cash-Out Refinance Transactions
- Cash-Out Refinance Transactions

Underwriting and DU Requirements

Mortgages secured by manufactured homes must be underwritten through DU.

When entering the property information into DU, CMS must correctly identify the property type as manufactured housing. DU checks the subject property addresses against manufactured home property addresses in the DU property database. If DU's database indicates the property may be a manufactured home, DU will return a message alerting CMS. DU's issuance of this message does not necessarily mean the property is a manufactured home, nor does the absence of this message indicate that Fannie Mae accepts the accuracy of the property type as it was submitted.

CMS must research the subject property type. If it is determined the property is a manufactured home, CMS must correct the property type and resubmit the loan casefile to DU. If it is NOT a manufactured home, the loan may be delivered with the appraisal recommendation provided by DU.

Manufactured Housing Underwriting Requirements, continued

Sales Price and Original Loan Amount

The sales price of the manufactured home may include bona fide and documented transportation, site preparation, and dwelling installation at the site.

Any personal property items (non-realty items) purchased in conjunction with the manufactured home must be deducted from the sales price and cannot be financed as part of the mortgage.

In addition to the cost of the manufactured home and land, if applicable, the original loan amount may also include:

- the financing of borrower-purchased mortgage insurance premiums as provided for in B7-1-04, Financed Borrower-Purchased Mortgage Insurance (11/10/2014);
- the cost of bona fide and documented transportation, site preparation, and dwelling installation at the site.
- Financing of other costs is not permitted for purchase money mortgages, but is permitted for limited cash-out refinance transactions, as provided for in B2-1.2-02, Limited Cash-Out Refinance Transactions (10/24/2016)

Down Payment Requirements

A minimum down payment of 5% must come from the borrower's own funds unless:

- the LTV or CLTV ratio is less than or equal to 80%; or
- the borrower is purchasing a one-unit principal residence and meets the requirements to use gifts, donated grant funds, or funds received from an employer to pay for some or all of the borrower's minimum contribution. See B3-4.3-04, Personal Gifts (09/29/2015); B3-4.3-06, Donations From Entities (03/29/2016); and B3-4.3-08, Employer Assistance (09/29/2015), for additional information.

The borrower's equity in the land is considered the borrower's own funds. Where the borrower holds title to the land on which the manufactured home will be permanently attached, the value of the land may be credited toward the borrower's minimum down payment requirement. The borrower's equity contribution will be the difference between any outstanding liens against the land and the market value of the land.

Manufactured Housing Underwriting Requirements, continued

Down Payment Requirements, continued

The following table describes how to determine the value of the land based on when and how the borrower acquired the land.

Date of Land Purchase	Value of the Land	Documentation Requirements
More than 12 months preceding the loan application.	The current appraised value.	None
12 or fewer months preceding the date of the loan application.	The lesser of the sales price or the current appraised value.	CMS must document the borrower's cash investment by obtaining: • a copy of the settlement statement, • a copy of the warranty deed that shows there are no outstanding liens against the property, or • a copy of the release of any prior liens(s).
The borrower acquired the land at any time as a gift, inheritance, or other non-purchase transaction.	The current appraised value.	CMS must obtain appropriate documentation to verify the acquisition and transfer of ownership of the land.

Trade Equity from the Borrower's Existing Manufactured Home

Trade equity from the borrower's existing manufactured home may be used as part of the borrower's minimum down payment requirement. The maximum equity contribution from the traded manufactured home is 90% of the retail value for the traded manufactured home based on the NADA Manufactured Housing Appraisal Guide except:

- If the borrower has owned the traded manufactured home for less than 12 months preceding the date of the loan application, the maximum equity contribution is the lesser of 90% of the retail value or the lowest price at which the home was sold during that 12 month period.
- Any costs associated with the removal of the traded home or any outstanding indebtedness secured by liens on the home must be deducted from the maximum equity contribution.

Manufactured Housing Underwriting Requirements, continued

Traded Manufactured Homes

For traded manufactured homes, Fannie Mae requires a lien search in the appropriate real property and personal property records to verify ownership and to determine whether there are any existing liens on the manufactured home and land or on the home and the land if they are encumbered by separate liens. The seller of the new manufactured home must provide proof of title transfer and satisfaction of any existing liens on the traded manufactured home.

Purchase Money Transactions

Purchase money transactions are those in which the mortgage proceeds are used to finance the purchase of the manufactured home or the manufactured home and the land. The land may be previously owned by the borrower, either free of any mortgage or subject to a mortgage that will be paid off with the proceeds of the new purchase money mortgage.

Note: The borrower does not receive any cash back with a purchase money transaction.

New Manufactured Homes

The LTV ratio (and CLTV/HCLTV ratio, if applicable) for a loan secured by a newly built manufactured home that is being attached to a permanent foundation system in connection with a purchase transaction will be based on the lower of:

- the sales price of the manufactured home plus:
- the lowest sales price at which the land was sold during that 12 month period if the land was purchased in the 12 months preceding the loan application date; or
- the current appraised value of the land if the land was purchased more than 12 months preceding the loan application date.
- the "as completed" appraised value of the manufactured home and land.

Existing Manufactured Homes

The LTV ratio (and CLTV/HCLTV ratio, if applicable) for a loan secured by a manufactured home that already exists on its foundation will be based on the lowest of:

- the sales price of the manufactured home and land;
- the current appraised value of the manufactured home and land; or
- if the manufactured home was built in the 12 months preceding the loan application date, the lowest price at which the home was previously sold during that 12-month period, plus the lower of:
    - o the current appraised value of the land, or
    - o the lowest price at which the land was sold during that 12 month period (if there was such a sale).

Manufactured Housing Underwriting Requirements, continued

Limited Cash-Out Refinance Transactions

Limited cash-out refinance transactions may involve the following scenarios:

- payoff of an existing personal property lien on a new manufactured home (or an existing lien on the home and a mortgage on the land if encumbered by separate liens), or
- payoff of a first lien mortgage secured by an existing manufactured home and land (or existing mortgages for the home and land if encumbered by separate liens).

The maximum LTV ratio (and CLTV ratio, if applicable) for a limited cash-out refinance transaction for a loan secured by a manufactured home and land will be based on the lower of:

- the current appraised value of the manufactured home and land; or
- if the manufactured home was owned by the borrower for less than 12 months on the loan application date and:
    - o if the home and land are secured by separate liens, the lowest price at which the home was previously sold during that 12-month period plus the lower of the current appraised value of the land, or the lowest sales price at which the land was sold during that 12-month period (if there was such a sale);
    - o if the home and land are secured by a single lien, the lowest price at which the home and land were previously sold during that 12-month period.

Proceeds of a limited cash-out refinance mortgage may be used to:

- pay off the outstanding principal balance of an existing personal property lien or first lien mortgage secured by the manufactured home and land (or existing liens if the home and land were encumbered by separate first liens);
- pay off the outstanding principal balance of an existing subordinate mortgage or lien secured by the manufactured home and/or land, but only if it was used to purchase the manufactured home and/or land;
- finance costs of construction;
- finance closing costs (including prepaid expenses); and
- provide cash back to the borrower in an amount not to exceed the lesser of 2% of the balance of the new refinance mortgage or $2,000.

Manufactured Housing Underwriting Requirements, continued

Cash-Out Refinance Transactions

A cash-out refinance:

- involves the payoff of an existing first lien mortgage secured by the manufactured home and land (or existing liens if the home and land were encumbered by separate first liens); or
- enables the property owner to obtain a mortgage on a property that does not already have a mortgage lien against it, and permits the borrower to take equity out of the property in the form of mortgage proceeds that may be used for any purpose.

To be eligible for a cash-out refinance, the borrower must have owned both the manufactured home and land for at least 12 months preceding the date of the loan application. The LTV ratio (and CLTV/HCLTV ratio, if applicable) for a cash-out refinance for a loan secured by a manufactured home and land will be based on the current appraised value of the manufactured home and land.

Note: Two-closing construction-to-permanent cash-out refinance transactions are not permitted.

Special Property Eligibility and Underwriting Considerations: Factory-Built Housing

Introduction

This section contains information on factory-built housing, including:

- Manufactured Home Property Eligibility Requirements
- Modular, Prefabricated, Panelized, or Sectional Housing Eligibility
- Modular, Prefabricated, Panelized, or Sectional Housing Requirements

Manufactured Home Property Eligibility Requirements

Fannie Mae defines a "manufactured home" as any dwelling unit built on a permanent chassis and attached to a permanent foundation system. (For additional information, Manufactured Housing Loan Eligibility (04/15/2014).)

The table below provides additional manufactured housing property eligibility requirements. For manufactured housing appraisal requirements, see Factory- Built Housing: Manufactured Housing (04/15/2014).

	Requirements
	The manufactured home must be built in compliance with • the Federal Manufactured Home Construction and Safety Standards that were established June 15, 1976, as amended and in force at the time the home is manufactured; and • additional requirements that appear in HUD regulations at 24 C.F.R. Part 3280. Compliance with these standards will be evidenced by the presence of both a HUD Data Plate and the HUD Certification Label. If the original or alternative documentation cannot be obtained for both the Data Plate/Compliance Certificate and the HUD Certification Label, the loan is not eligible for delivery to Fannie Mae.

Special Property Eligibility and Underwriting Considerations: Factory-Built Housing, continued

Manufactured Home Property Eligibility Requirements, continued

	Requirements
	The HUD Data Plate/Compliance Certificate is a paper document located on the interior of the subject property that contains, among other things, the manufacturer's name and trade/model number. In addition to the data required by Fannie Mae, the Data Plate includes pertinent information about the unit, including a list of factory-installed equipment. The HUD Certification Label, sometimes referred to as a HUD "seal" or "tag," is a metal plate located on the exterior of each section of the home. The *Manufactured Home Appraisal Report* (Form 1004C) must show evidence of both the HUD Data Plate/Compliance Certificate and the HUD Certification Label.
	As an alternative to the original HUD Certification Label, the lender may be able to obtain a verification letter with the same information contained on the HUD Certification Label from the Institute for Building Technology and Safety (IBTS). A duplicate HUD Data Plate/Compliance Certificate may be available from IBTS or by contacting the In-Plant Primary Inspection Agency (IPIA) or the manufacturer. (A list of IPIA offices is posted on HUD's website.)
	The unit must not have been previously installed or occupied at any other site or location, except from the manufacturer or the dealer's lot as a new unit.
	The manufactured home must be a one-unit dwelling unit that is legally classified as real property. **Note:** Installation of a manufactured home as real property on a site where there is any other dwelling unit (or the construction of a separate accessory dwelling unit on a site with an existing manufactured home) will render the property ineligible.
	The towing hitch, wheels, and axles must be removed. The dwelling must assume the characteristics of site-built housing.
	The borrower must own the land on which the manufactured home is situated in fee simple, unless the manufactured home is located in a condo project. • For condos, both the land and dwelling must be subject to the condo regime. • Mortgages secured by manufactured homes located on leasehold estates are not eligible.
	Multi-width manufactured homes may be located either on an individual lot or in a project development. Project approval for mortgage loans secured by multi-width manufactured homes located on individual lots in subdivisions or in PUDs is generally not required, but Fannie Mae may choose to require project approval. For further information about project approval requirements, see Project Standards. Condo project developments must be Fannie Mae-approved.

Special Property Eligibility and Underwriting Considerations: Factory-Built Housing, continued

Manufactured Home Property Eligibility Requirements, continued

	Requirements
	Single-width manufactured homes located in a Fannie Mae-approved subdivision, condo, or PUD project development are ineligible.
	The manufactured home must be at least 12 feet wide and have a minimum of 600 square feet of gross living area. Fannie Mae does not specify other minimum requirements for size, roof pitch, or any other specific construction details for HUD-coded manufactured homes.
	Site preparation for delivery of the manufactured home must be completed.
	The manufactured home must be attached to a permanent foundation system in accordance with the manufacturer's requirements for anchoring, support, stability, and maintenance. The foundation system must be appropriate for the soil conditions for the site and meet local and state codes.
	The manufactured home must be permanently connected to a septic tank or sewage system, and to other utilities in accordance with local and state requirements.
	If the property is not situated on a publicly dedicated and maintained street, then it must be situated on a street that is community owned and maintained, or privately owned and maintained. There must be adequate vehicular access and there must be an adequate and legally enforceable agreement for vehicular access and maintenance. See B4-1.3-04, Site Section of the Appraisal Report (02/23/2016), for additional information about privately maintained streets.
	Mortgages secured by existing manufactured homes that have incomplete items, such as a partially completed addition or renovation, or defects or needed repairs that affect safety, soundness, or structural integrity, are not eligible for purchase until the necessary work is completed. Exceptions to the foregoing may be made only for minor items that do not affect the ability to obtain an occupancy permit – such as landscaping, a driveway, or a walkway - subject to all requirements and warranties for new or proposed construction provided in B4-1.2-03, Requirements for Postponed Improvements (03/29/2016).

Special Property Eligibility and Underwriting Considerations: Factory-Built Housing, continued

Manufactured Home Property Eligibility Requirements, continued

	Requirements
	Manufactured homes that have an addition or have had a structural modification are eligible under certain conditions. If the state in which the property is located requires inspection by a state agency to approve modifications to the property, then the lender is required to confirm that the property has met the requirement. However, if the state does not have this requirement, then the property must be inspected by a licensed professional engineer who can certify that the addition or structural changes were completed in accordance with the HUD Manufactured Home Construction Safety Standards. In all cases, the satisfactory inspection report must be retained in the mortgage loan file.

Modular, Prefabricated, Panelized, or Sectional Housing Eligibility

Modular Homes. Fannie Mae purchases loans secured by modular homes built in accordance with the Uniform Building Code administered by state agencies responsible for adopting and administering building code requirements for the state in which the modular home is installed. Loans secured by on-frame modular construction are not eligible for sale to Fannie Mae. On-frame modular construction is defined as having a permanent chassis, but no evidence of compliance with the June 15, 1976, Federal Manufactured Home Construction and Safety Standards.

Prefabricated, Panelized, and Sectional Homes. Loans secured by prefabricated, panelized, or sectional housing are eligible for purchase. These properties do not have to satisfy HUD's Federal Manufactured Home Construction and Safety Standards or the Uniform Building Codes that are adopted and administered by the state in which the home is installed. The home must conform to local building codes in the area in which it will be located.

Modular, Prefabricated, Panelized, or Sectional Housing Requirements

Factory-built housing not built on a permanent chassis such as modular, prefabricated, panelized, or sectional housing is not considered manufactured housing and is eligible under the guidelines for one-unit properties. These types of properties

- must assume the characteristics of site-built housing,
- must be legally classified as real property, and
- must conform to all local building codes in the jurisdiction in which they are permanently located.

The purchase, conveyance, and financing (or refinancing) must be evidenced by a valid and enforceable first-lien mortgage or deed of trust that is recorded in the land records, and must represent a single real estate transaction under applicable state law.

Fannie Mae affords modular, prefabricated, panelized, or sectional housing homes the same treatment as site-built housing. Therefore, Fannie Mae does not have minimum requirements for width, size, roof pitch, or any other specific construction details.

Manufactured Housing Pricing, Mortgage Insurance, and Special Feature Code Requirements

Introduction

This topic contains information about manufactured housing, including:

- Loan-Level Price Adjustments
- Mortgage Insurance
- Special Feature Code Requirements

Loan-Level Price Adjustments

An LLPA applies to all mortgages secured by manufactured homes delivered to Fannie Mae for whole loan purchase or MBS issuance. These LLPAs are in addition to any other price adjustments that are otherwise applicable to the particular transaction. For the current LLPAs, see the Loan-Level Price Adjustment (LLPA) Matrix.

Mortgage Insurance

For mortgage insurance coverage requirements, see Mortgage Insurance Coverage Requirements (09/29/2015).

Special Feature Code Requirements

Loans secured by manufactured homes must be delivered with SFC 235. This code is in addition to any other special feature codes that may apply.

Manufactured Housing Legal Considerations

Introduction

This topic contains information on manufactured housing legal considerations, including:

- Closing Instructions
- Post-Closing Items and Conversion to Real Property
- Certificate of Title
- Title Issues and Lien Requirements
- Title Insurance
- Loan Documents
- The Security Instrument
- Affidavit of Affixture
- Background Information Regarding Titling for Manufactured Homes
- Background Information on States where Surrender of a Certificate of Title is not Permitted

Manufactured Housing Legal Considerations, continued

Closing Instructions

Closing instructions must advise closing agents to obtain the required documentation necessary to ensure that the manufactured home is attached to a permanent foundation system on the land, thus becoming part of the real property.

If a closing agent is not available to perform this action, CMS can rely on the certification of completion completed by the appraiser.

In addition, where state law provides that a manufactured home may be exempt from certificate of title requirements (for instance, where a home is attached initially to a permanent foundation system), such closing instructions must instruct the closing agent to ensure that the manufactured home qualifies for exemption from certificate of title requirements, including monitoring of property installation procedures and the related documentation, and to provide CMS with documentary evidence of that for retention in the loan file.

Where state law allows for the elimination of the certificate of title, the closing instructions must instruct the closing agent to perform all necessary procedures to:

- assure that the certificate of title to the manufactured home is properly retired, and
- provide CMS with documentary evidence for retention in the loan file.

Additionally, CMS must obtain an insured closing protection letter for each mortgage loan that is secured by a manufactured home, if available.

If an insured closing protection letter is not available, then CMS must include a note in the file documenting its unavailability.

Post-Closing Items and Conversion to Real Property

If there are post-closing items related to conversion of the manufactured home from personal property to real property, CMS should consider use of a properly circumscribed power of attorney from the borrower that may be used to complete the post-closing items. All post-closing items must be documented in the loan file and, any relevant documents received after closing must be included in the loan file.

Manufactured Housing Legal Considerations, continued

Certificate of Title

The table below provides conditional requirements pertaining to the manufactured home certificate of title.

If …	Then …
state law permits the manufactured home to become real property when it is immediately affixed to the permanent foundation system, without issuance of a certificate of title,	CMS must if the transaction involves the purchase of a new manufactured home obtain, and retain as part of the loan file, evidence that no certificate of title was issued. For example, if CMS obtains the manufacturer's certificate of origin, this would be evidence, in most states, that no certificate of title could have been issued.
a certificate of title has been issued, but state law provides for or permits surrender of the certificate of title,	CMS must obtain, and retain as part of the loan file, evidence that the certificate has been surrendered. Such evidence includes: • the confirmation required to be provided by the authority to which the certificate was surrendered, or • if no such confirmation is obtainable: o a copy of the documents submitted in connection with the surrender, and o evidence that such documents were delivered to the appropriate authority.
a certificate of title has been issued, but state law does not permit the manufactured home to become real property without issuance of a certificate of title and does not provide for surrender of the certificate of title,	CMS must adhere to the following requirements: • The lien must be indicated on the certificate of title. • The certificate of title must be retained in the loan file. • CMS must assure that no other lien is indicated on the certificate of title. • Ownership of the manufactured home as shown on the certificate of title and ownership of the land as shown on the mortgage, deed of trust, or security deed must be identical (that is, the same individuals must sign both, each using the exact same name on both documents).
Note: Given certain provisions of Mississippi law and the practice in the state, the requirements in the last row of the above table apply to manufactured homes in Mississippi. (The other two options in this table do not apply.)	

Manufactured Housing Legal Considerations, continued

Title Issues and Lien Requirements

To be eligible for purchase by Fannie Mae:

- A manufactured home mortgage loan must be secured by a perfected lien (or liens) on real property consisting of the manufactured home and the land.
- The manufactured home must be legally classified as real property under applicable state law, including relevant statutes, regulations, and judicial decisions.

The following requirements are also applicable:

- The owner of the manufactured home must own the land on which the home is situated.
- The manufactured home must be attached to a permanent foundation on the land and comply with state and jurisdictional requirements for permanent affixation.
- A mortgage, deed of trust, or security deed must be recorded in the land records and must identify the encumbered property as including both the home and the land.
- If applicable state law so permits, any certificate of title to the manufactured home must be surrendered to the appropriate state government authority.
- If the certificate of title cannot be surrendered, CMS must indicate its lien on the certificate.

Fannie Mae prefers that a loan on the manufactured home and the land on which it is situated be secured by a single lien.

However, it is recognized that some state laws do not provide for a single lien on both the manufactured home and the land. Therefore, a loan documented by a lien on the land evidenced by a mortgage, deed of trust or security deed and by a real property lien on the manufactured home evidenced on the certificate of title or other document is acceptable.

Note: loans in which there is a chattel lien on the home plus a real property lien on the land are unacceptable.

Title Insurance

The mortgage must be covered under a standard real property title insurance policy that insures that the manufactured home is part of the real property that secures the loan.

American Land Title Association® (ALTA®) Endorsement 7, 7.1, or 7.2 or any other endorsement required in the applicable jurisdiction for manufactured homes to be treated as real property must be included in the file.

Manufactured Housing Legal Considerations, continued

Loan Documents

Fannie Mae prefers lenders to use the standard Fannie Mae Uniform Instruments (see Security Instruments below).

If the Uniform Instruments are not used, then CMS must adhere to the following requirements:

- A single note must be used evidencing all the debt related to the land and the home, and a mortgage, deed of trust, or Georgia security deed securing such indebtedness (plus the certificate of title if state law so requires).
- The note used must provide the nonstandard document warranties that are referenced in A2-2.1-03, Document Warranties (08/20/2013).

Loan documents are not acceptable if they:

- state that the home is personal property or contain other words to that effect;
- state that the parties do not intend to attach the home to a permanent foundation system on the land, or contain statements inconsistent with that intention;
- unless required by law, provide that rights of holders in due course are waived, or with other words provide that an assignee note holder may be held liable for claims the borrower may have against other parties; or
- include consumer finance paper which combines the note and security instrument in a single document or a retail installment sales contract.

The Security Instrument

The security instrument must:

- state that the manufactured home is an improvement to the land and an immovable fixture, or include similar language as may be required by applicable law to assure, to the greatest extent possible, that the manufactured home will be treated as real property under applicable state law. If applicable law provides specific obligatory wording, such wording must be used; and
- include a comprehensive description of the manufactured home and the land in the property description section.

The description must include the serial or VIN number (or the serial number or VIN for each unit if the home is multi-width), make, model, size, and any other information that may be required by applicable law to definitively identify the home.

Note: The serial number is located on the HUD Data Plate located on the interior of the home, usually near the electrical box. In addition, the serial number is generally cold-stamped on the frame front cross member of each transportable section.

Some jurisdictions may not allow any information in the property description section of the security instrument other than what is customary for other real property transactions. If this is the case, then an addendum may be used, which must be attached to the security instrument and included in the loan file.

Manufactured Housing Legal Considerations, continued

Affidavit of Affixture

The borrower(s) and any lender with a personal property security interest in the manufactured home must sign an Affidavit that acknowledges their intent for the manufactured home to be permanently part of the real property that secures the mortgage free of any personal property security interest. The Affidavit must also contain any specific language that may be required by applicable law.

It is preferable that the signed Affidavit be recorded, and it must be retained in the loan file.

Note: Failure to include the Affidavit of Affixture in the loan file may result in the loan being ineligible for delivery to Fannie Mae.

If state law requires a Uniform Commercial Code (UCC) filing in order to perfect a security interest in a manufactured home, CMS must make such filing in any and all appropriate locations.

Background Information Regarding Titling for Manufactured Homes

Titling is complex and further complicated by the lack of a federal standard. Consequently, all states devise their own laws resulting in diverse approaches to manufactured home titling and lien perfection. The variety of approaches is particularly challenging for lenders originating manufactured home loans in more than one state. Laws of some states do not clearly provide for a single lien on the manufactured home, together with the land on which it is situated, but instead, for example, require that the lien on the manufactured home be evidenced by notation on the certificate of title.

While the laws of some states establish a procedure for surrender of the certificate of title when the manufactured home has become so permanently affixed to the land that it has become real property, the laws of other states do not allow for the elimination of the certificate of title to a manufactured home regardless of the degree of affixation of the home to the land. In these states, the lien on the land (evidenced by the mortgage, deed of trust or security deed) may be legally distinct from the lien on the manufactured home (evidenced on the certificate of title), though both are liens on real property. In this instance, the manufactured home is often treated as an “immovable fixture” (personal property that has become so permanently attached to the land that it has become real property).

Research on state laws affecting manufactured housing liens indicates, more specifically, that in order to document a lien on a manufactured home that is real property, state laws take several approaches:

- surrendering the certificate of title when the manufactured home is permanently affixed to the land;
- statutory, regulatory, or judicial authority for recognizing a manufactured home as part of the real property, without surrender of the certificate of title. A few states also require UCC filings; or
- recognizing the manufactured home as real property without issuing a certificate of title when the unit is affixed to the land.

Most states permitting manufactured homes to be treated as real property without first being titled as personal property also have procedures for issuing a certificate of title and then surrendering it.

Manufactured Housing Legal Considerations, continued

Background Information on States where Surrender of a Certificate of Title is not Permitted

State law that does not provide for surrender of the certificate of title may pose some additional risk to the lender and Fannie Mae.

Under the UCC, as adopted in almost every state, a lien evidenced on any outstanding certificate of title will have priority over a lien on real property to which the manufactured home is affixed, which is evidenced by a mortgage, deed of trust, or security deed.

However, Fannie Mae believes that if a lender follows procedures tailored to take advantage of all protection offered under existing state law —including taking steps to assure that no certificate of title still exists that bears evidence of any lien securing any other loan—sufficient legal protection is afforded.

Condo Appraisal Requirements

Overview

A condo project is one in which individual owners hold title to units in the project along with an undivided interest in the real estate that is designated as the common area for the project.

Appraisal Requirements for Units in a Condo Project

The appraisal of an individual unit in a condo project requires the appraiser to analyze the condo project as well as the individual unit. The value and marketability of the individual units in a project depend on the marketability and appeal of the project itself. Therefore, the appraiser must pay special attention to:

- the location of the individual unit within the project,
- the project amenities, and
- the amount and purpose of the owner's association assessment.

See Comparable Sales, for general requirements regarding comparable selection.

Leasehold Interests Appraisal Requirements

Overview

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.

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.

Comparable Selection 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. See Comparable Sales, for general requirements regarding comparable selection.

Mixed-Use Property Appraisal Requirements

Overview

Fannie Mae purchases or securitizes mortgage loans secured by properties that have a business use in addition to their residential use provided that special eligibility criteria are met. These business uses can include, but are not limited to, properties with space set aside for day care facilities, beauty or barber shops, or doctor's offices. For eligibility criteria, see Special Property Eligibility Considerations.

Appraisal Requirements for Mixed-Use Properties

The appraisal requirements for mixed-use properties must

- provide a detailed description of the mixed-use characteristics of the subject property;
- indicate that the mixed use of the property is a legal, permissible use of the property under the local zoning requirements;
- report any adverse impact on marketability and market resistance to the commercial use of the property; and
- report the market value of the property based on the residential characteristics, rather than of the business use or any special business-use modifications that were made.

Environmental Hazards Appraisal Requirement

Overview

Fannie Mae purchases or securitizes mortgage loans secured by properties affected by environmental hazards if the effect of the hazard is measurable through an analysis of comparable market data as of the effective date of the appraisal, and the appraiser reflects in the appraisal report any adverse effect that the hazard has on the value and marketability of the subject property or indicates that the comparable market data reveals no buyer resistance to the hazard.

In rare situations, a particular environmental hazard may have a significant effect on the value of the subject property, although the actual effect is not measurable because the hazard is so serious or so recently discovered that an appraiser cannot arrive at a reliable opinion of market value because there is no comparable market data available, such as sales, contract sales, or active listings that are available to reflect the effect of the hazard. In such cases, the mortgage will not be eligible for delivery to Fannie Mae.

Appraisal Requirements

When the appraiser has knowledge of any hazardous condition, whether it exists in or on the subject property or on any site within the vicinity of the property, including but not limited to, the presence of hazardous wastes, toxic substances, asbestos-containing materials, urea- formaldehyde insulation, or radon gas, the appraiser must

- note the hazardous condition in the appraisal report;
- comment on any influence the hazard has on the property's value and marketability, if it is measurable through an analysis of comparable market data as of the effective date of the appraisal, or indicate that the comparable market data reveals no buyer resistance to the hazard; and
- make appropriate adjustments in the overall analysis of the property's value.

Fannie Mae expects the appraiser to consider and use comparable market data from the same affected area because the sales prices of settled sales, the contract sales prices of pending sales, and the current asking prices for active listings will reflect any negative effect on value and marketability of the subject property.

Note: Fannie Mae does not consider the appraiser to be an expert in the field of environmental hazards. The typical residential real estate appraiser is neither expected nor required to be an expert in this specialized field. The appraiser, however, has a responsibility to note in the appraisal report any adverse conditions that were observed during the inspection of the subject property or information that he or she became aware of through the normal research involved in performing an appraisal.

Environmental Hazards Appraisal Requirement (continued)

CMS Requirements

Fannie Mae requires CMS to disclose any information regarding environmental hazards to the appraiser and note the individual mortgage file accordingly if the real estate broker, the property seller, the property purchaser, or any other party to the mortgage transaction informs CMS that an environmental hazard exists in or on the property, or in the vicinity of the property. Fannie Mae also requires CMS to disclose such information to the borrower, and to comply with any state or local environmental laws regarding disclosure.

CMS must make the final decision about the need for inspections and the adequacy of the property as security for the mortgage. For example, because Fannie Mae requires the appraiser to comment on the effect of a hazard on the value and marketability of the subject property, the appraiser would have to note when there is market resistance to an area because of environmental hazards or any other conditions that affect well, septic, or public water facilities. When CMS has reason to believe that private well water that is on or available to a property might be contaminated as a result of the proximity of the well to hazardous waste sites, CMS is exercising sound judgment if it obtains a “well certification” to determine whether the water meets community standards.

Special Assessment or Community Facilities Districts Appraisal Requirements

Overview

Alternative methods for raising the capital necessary to satisfy utility and infrastructure requirements are sometimes used in the development of new residential communities. In some instances, this involves the creation of local districts called special assessment districts or community facilities districts that have the authority to assess homeowners for the cost of developing utility services and various infrastructure facilities, including, but not limited to, roads, sewer services, schools, police and fire protection services, and libraries.

CMS Responsibilities Related to Special Assessment or Community Facilities Districts

Fannie Mae expects CMS to know if a property is located in one of these districts and to be aware of the effect that assessments levied by the district could have on property values and the marketability of the subject property. The lender’s appraiser, therefore, must give special consideration to the valuation of properties located in these districts.

Special Assessment Districts

Special assessment districts, also called special tax districts or municipal utility districts, provide a specific service to homeowners living in a designated area. They are most often established to provide water or other utilities in areas that are not served by existing city or municipal utility services. The need for these districts arises when an existing utility service does not have sufficient capacity, or may not find it economically feasible to provide services for newly created subdivisions that are located beyond its current operating area. State law governing the establishment of special assessment districts varies greatly, as does the financial strength of the individual districts. These districts are granted the authority to assess owners of properties within their boundaries for funds that will be used to cover their operating costs and debt service.

Special Assessment or Community Facilities Districts Appraisal Requirements (continued)

Special Assessment Districts (continued)

Special assessment districts that are established to serve newly developing subdivisions with utilities often base their financial plans and the amount of the assessment to be charged to each property owner on the expected number of properties in the area to be served. The district then depends on the continuation of development to maintain its budget expectations. If, for any reason, development stops short of the degree of development that the district anticipated in preparing its budget, the district can become financially distressed and may need to impose an additional assessment on the existing homeowners.

Appraisal Requirements for Properties Located in Special Assessment Districts

The appraisal requirements for properties located in special assessment districts must

- report any special assessments that affect the property, and
- note in the appraisal report if the special assessment district is experiencing financial difficulty and that the difficulty has an effect on the value or marketability of the subject property.

To ensure that the reaction of the market to the potential liabilities that may arise within a financially troubled special assessment district is reflected in his or her analysis, the appraiser must consider current and expired listings or properties for sale within the district and any pending contract sales and recent closed sales within the district.

There may be some instances in which the financial difficulty of a special assessment district is so severe that its actual effect on the value and marketability of a property is not measurable because there is no comparable market data available to enable the appraiser to arrive at a reliable opinion of market value. When this is the case, a mortgage secured by a property in that district will not be eligible for delivery to Fannie Mae until such time that an active market develops that will enable the appraiser to demonstrate the value and marketability of the subject property.

Community Facilities Districts

Some jurisdictions have passed legislation that creates community facilities districts and permits them to levy a special tax to fund the capital costs of a wide variety of public improvements, as well as the ongoing operation and maintenance costs of a limited number of public services. Proceeds from the special tax are used to support the sale of tax-exempt bonds for the various capital improvements that are allowed under the legislation, including but not limited to, roads, sewer services, schools, police and fire protection services, and libraries.

The assessment that will be used to repay the tax-exempt bonds becomes an ongoing responsibility of the property owner, similar to state and local property taxes. The assessment lien and the obligation to pay the assessment passes with the title to the property when ownership of the property is transferred.

Such legislation generally requires full disclosure of the special assessment to any purchaser of a property located in a community facilities district. Therefore, CMS originating mortgages in community facilities districts should disclose to the appraiser any information that it becomes aware of regarding special assessments on a given property.

Special Assessment or Community Facilities Districts Appraisal Requirements (continued)

Appraisal Requirements for Properties Located in Community Facilities Districts

Appraisers must be aware of whether the subject property and the comparables are located within or affected by a community facilities district because properties subject to an assessment by one of these districts often compete against properties that are either subject to a significantly different assessment or no assessment at all. Appraisers must consider the reaction of the market, if any, to the assessment for the applicable community facilities district by analyzing similarly affected comparable sales in his or her analysis, and should note the effect of the assessment in the appraisal report.

Appraisal Waivers

Overview

In order for an Appraisal Waiver (formerly Property Inspection Waiver or Property Fieldwork Waiver) to be considered, a prior appraisal must be found for the subject property in Fannie Mae's Collateral Underwriter (CU) data. The CU appraisal must be associated with one of the borrowers on the loan casefile.

DU will compare the address for the subject property to the property addresses found in CU. When a property address match is found, DU will compare both the first and last names of the borrowers on the loan casefile to the borrowers associated to the prior appraisal. When a borrower name match is found, DU will use the information from the prior appraisal to determine if the loan casefile is eligible for the Appraisal Waiver. In some cases, the prior appraisal may not be acceptable. For example, if a CU "Overvaluation Flag" was issued on the prior appraisal, or the appraisal could not be scored, that prior appraisal will not be used and an Appraisal Waiver will not be offered on the new loan casefile.

Eligible Transactions

The Appraisal Waiver offer will be considered for the following transactions:

- one-unit properties, including condos;
- certain limited cash-out and cash-out refinance transactions on principal residence, second home, and investment property transactions;
- DU loan casefiles that receive an AUS "Approve" or "Accept" recommendation;
- Certain Purchase transactions: on principal residences and second homes up to 80% LTV/CLTV.

Appraisal Waivers (continued)

Ineligible Transactions

The following transactions are not eligible for an Appraisal Waiver:

- properties located in a disaster-impacted area;
- construction;
- two- to four-unit properties
- leasehold properties;
- co-op units; and
- DU loan casefiles that receive an Ineligible recommendation.
- Texas Section 50(a)(6) mortgage loans

Furthermore, CMS may not exercise an Appraisal Waiver offer and must order an appraisal if one or more of the following applies:

- DU was unable to identify ineligible criteria in the list above;
- CMS is required by law to obtain an appraisal; or
- CMS believes that an appraisal is warranted based on additional information the lender has about the property or subsequent events, such as a natural disaster.

Note: CMS may not exercise an Appraisal Waiver offer if an appraisal is obtained for the transaction.

Representations and Warranties

When a loan casefile is eligible for the Appraisal Waiver and the waiver is exercised by CMS, Fannie Mae accepts the value estimate submitted by CMS as the value for the subject property. The property value CMS enters in DU may be based on:

- The lender's estimate of value, determined at the discretion of CMS, or
- the borrower's estimate of value.

If CMS exercises the Appraisal Waiver offer, CMS is not responsible for the representations and warranties related to the value, marketability, and condition of the subject property. CMS continues to be required to represent and warrant that all of the information and data submitted to DU are complete and accurate.

Fannie Mae does not warrant that the estimated value provided by CMS is the actual value of the subject property. CMS may not make any statements to any third party (including the borrower) that Fannie Mae performed any kind of review, appraisal, or valuation of the property.

Appraisal Waivers (continued)

Rural High-Needs Appraisal Waiver

In selected rural high-needs areas, Fannie Mae may offer appraisal waivers through DU for certain transactions. This appraisal waiver may be combined with other loan products, such as HomeReady.

The rural high-needs appraisal waiver offer will be considered for the following transactions only:

- loan casefiles that receive an Approve/Eligible recommendation;
- purchase transactions;
- one-unit principal residence properties (excluding manufactured homes);
- borrowers with income at or below 100% of the area median income; and
- LTV ratios up to 97% and CLTV ratios up to 105% with a Community Seconds.

The following are ineligible for the rural high-needs appraisal waiver:

- cash-out or limited cash-out refinances;
- second homes and investment properties; and
- all other transactions that are ineligible for an appraisal waiver as listed above.

The following table provides the requirements related to the home inspection. These requirements must be met for CMS to exercise the rural high-needs appraisal waiver.

✓	CMS Must …
	Obtain a home inspection to determine the property condition. The inspection report must be retained in the loan file and made available to Fannie Mae upon request.
	Review the inspection report to verify the property condition. The content of the inspection report must be sufficient for CMS to determine whether the property is safe, sound, and structurally secure. Any issues that compromise safety, soundness, or structural integrity must be repaired before loan delivery.
	Obtain an affidavit signed by the borrower(s) confirming that they received a copy of the property inspection report, read the report, and were notified of any lender-required repairs.
	Confirm that the purchase contract contains an inspection contingency that offers that borrower(s) enough time to cancel the contract without penalty if they so choose, should the inspection reveal an issue with the property.

Appraisal Waivers (continued)

Rural High-Needs Appraisal Waiver, continued

✓	**CMS Must …**
	Confirm that the inspector has liability insurance.
	Use a professional inspector that meets the state license and education requirements for those states that regulate inspectors. **Note:** In states that do not have inspector licenses, inspectors that are professionally accredited members in good standing of a nationally recognized property inspection organization must be used. The national organization must require education, testing, and adherence to a code of ethics and to standards of practice.
	Represent and warrant that the property is safe, sound, and structurally secure and that the property is not in C6 condition. See Property Condition and Quality of Construction of the Improvements for additional information.

Exercising an Appraisal Waiver

CMS may only exercise the Appraisal Waiver if:

- the final submission of the loan casefile to DU resulted in an Appraisal Waiver offer,
- an appraisal is not obtained for the transaction, and
- the Appraisal Waiver offer is not more than four months old on the date of the note and the mortgage.

Lenders that elect to exercise the Appraisal Waiver must include SFC 801 at delivery. CMS may not adversely select against Fannie Mae in determining which Appraisal Waiver offers to accept. Fannie Mae may monitor the lender's exercise of the Appraisal Waiver offers and delivery of loans to Fannie Mae, and may take appropriate measures if adverse selection is identified.

PROJECT STANDARDS

General Information on Project Standards

Fannie Mae's Project Risk Overview

The quality of mortgages secured by units in condo and planned unit development (PUD) projects can be influenced by certain characteristics of the project or by the project as a whole. Before delivering a loan secured by an individual unit in a project, CMS must determine that the project meets Fannie Mae's eligibility requirements.

Project eligibility risk is a risk that is distinct from the credit risk presented by individual borrowers. Units located in a project present risks that are also distinct from the risks associated with properties that are not part of a homeowners' association (HOA) or project. These risks include the following:

- the financial stability and viability of the project;
- the condition and marketability of the project;
- limitations on the unit owner's ability to control the decision-making for the project, occupy the unit, or utilize the project's amenities and common elements;
- dissolution of the project and the unit owner's resulting rights and responsibilities;
- project-level litigation;
- project-level misrepresentation and fraud;
- the inability to cure a mortgage default due to restrictions in the project documents such as, but not limited to, right of first refusal provisions; and
- insurance coverage that is inadequate to protect the project from unexpected losses.

Project eligibility and financial strength are key drivers of credit performance on individual unit mortgages and critical to the long-term success of the project. Fannie Mae's project eligibility and underwriting requirements seek to mitigate project level risks and to ensure that projects are demonstrably well-managed.

CMS that sell mortgage loans secured by units in a condo, ~~,~~ or PUD project to Fannie Mae are expected to have staff that are knowledgeable about and qualified to evaluate the specific risks presented by these types of projects. The project review is in addition to the review CMS completes for underwriting the borrower, the transaction terms, and the individual unit appraisal.

Fannie Mae's project standards requirements are intended to address common project types across a broad geographic range. If a CMS determines that a project does not meet all of Fannie Mae's project eligibility criteria, but feels that the project has merit and warrants additional consideration, CMS may request an exception (see Projects with Special Considerations and Project Eligibility Waivers, for additional information).

General Information on Project Standards (continued)

Project Documentation

The documentation needed to complete a project review may differ depending on the project and review type. CMS will be responsible for determining the documentation needed to ensure that the project meets all of Fannie Mae's eligibility requirements. Project documentation may include, but is not limited to, the following:

- legal and recorded documents including the covenants, conditions and restrictions, declaration of condominium, or other similar documents that establish the legal structure of the project;
- project budgets, financial statements, and reserve studies;
- project construction plans;
- architects' or engineers' reports;
- completion reports;
- project marketing plans;
- environmental hazard reports;
- attorney opinions;
- appraisal reports;
- evidence of insurance policies and related documentation; and
- condominium project questionnaires.

Sources for project information include, but are not limited to, appraisers, HOAs, management companies, real estate brokers, insurance professionals, and project developers. CMS will be responsible for the accuracy of any information obtained from these sources.

Condominium Project Questionnaires

Fannie Mae provides two *Condominium Project Questionnaires* that will help CMS collect data to determine condo project eligibility. The forms are posted on CMS website under Mortgages>lending>forms & checklist:

- ***Condo Full Review Questionnaire***—contains a list of eligibility questions to support a Full Review, and
- ***Condo Streamlined Review Questionnaire***—contains a shorter list of questions to facilitate a Limited Review.

Condominium Homeowners' Associations

Condominium homeowners' associations (HOAs) are established to oversee the rules and bylaws governing the commonly owned property in a condominium project such as the roof, hallways, elevators, heating/cooling system and road or driveway access. Typically a board is elected to oversee the homeowners association.

In cases where the condominium HOA is longer operating as an HOA, the project is still a condominium and must comply with the binding legal documents (declaration and bylaws). The project must also comply with all Fannie Mae condominium guidelines to be eligible for Fannie Mae financing.

General Information on Project Standards (continued)

Project Types

The scope of Fannie Mae's requirements and the specific eligibility criteria to be met are dependent upon various project and/or loan level characteristics. The characteristics that define each project type are described in the following table.

Project Type	Identification Criteria
Established condo project	A project for which all of the following are true: • at least 90% of the total units in the project have been conveyed to the unit purchasers; • the project is 100% complete, including all units and common elements; • the project is not subject to additional phasing or annexation; and • control of the HOA has been turned over to the unit owners.
New condo project	A project for which one or more of the following is true: • fewer than 90% of the total units in the project have been conveyed to the unit purchasers; • the project is not fully completed, such as proposed construction, new construction, or the proposed or incomplete conversion of an existing building to a condo; • the project is newly converted; or • the project is subject to additional phasing or
Detached condo project	A project comprised solely of detached units or that comprises a mixture of attached and detached units and may be a new or established project.
Two- to four-unit condo project	A project comprised of two, three, or four residential units in which each unit is evidenced by its own title and deed. A two- to four-unit condo project may be either a new or an established project and may be comprised of attached and/or detached units.
Planned unit development (PUD) project	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 unit owners. See Eligibility Requirements for Units in PUD Projects, for additional detail used in determining whether a project is subject to Fannie Mae's PUD eligibility requirements.

General Information on Project Standards (continued)

Project Review Methods

Fannie Mae purchases or securitizes mortgage loans secured by units in condo and PUD projects that meet Fannie Mae's eligibility requirements. To determine whether the project meets these requirements, a number of project review methods are available. Whether a project review method is allowable or required depends on

- the number of units in the project (two- to -four or more than four);
- the unit type (attached or detached);
- the project type (condo or PUD);
- the project status (new or established); and
- the mortgage transaction.

The characteristics that dictate which method to use are shown in the following table.

Unit and Project Type	Project Review Methods
Attached condo unit in a new or newly converted project	• Full Review, or • Fannie Mae Review through the standard Project Eligibility Review Service (PERS) process
Attached condo unit in an established project	Based on the LTV, CLTV, and HCLTV ratios, occupancy, and location (projects in Florida), these projects may be reviewed using a Limited Review. Projects not meeting the Limited Review criteria must be reviewed using a: • Full Review, or • Fannie Mae Review through the streamlined PERS process (for established condo projects)
Unit in a new or established two- to four-unit condo project	Project review is waived, with the exception of some basic requirements that apply.
Detached condo unit in a new or established condo project	Project review is waived, with the exception of some basic requirements that may apply.
Multi-width manufactured home in an established condo project	Full Review

General Information on Project Standards (continued)

Project Review Methods (continued)

Unit and Project Type	Project Review Methods
• New condo projects consisting of manufactured homes • PUD and condo projects consisting of single-wide manufactured homes • Newly converted non-gut rehabilitation condo and co-op projects (with attached units) that contain more than four units • New or newly converted condo projects consisting of attached units located in Florida	Fannie Mae Review through the standard PERS process
Established condo or PUD projects consisting of manufactured homes that are subject to a community land trust, deed restriction, leasehold estate, or shared equity arrangement	Fannie Mae Review through the streamlined PERS process
Unit in a PUD project	Project review is waived, with the exception of some basic requirements that apply

A mortgage secured by a unit in a project that fails to meet any of the following requirements is not eligible for delivery to Fannie Mae:

- requirements specific to the project review method used to determine that project's eligibility;
- appraisal requirements (described in Condo Appraisal Requirements); or
- insurance requirements (described in Insurance, including all provisions applicable to projects in Additional Project Insurance).

For additional information on each project review type, see the following topics:

Project Review Type	Additional Information
Limited Review	• Limited Review Process • Geographic-Specific Condo Project Considerations
Full Review	• Full Review Process • Full Review: Additional Eligibility Requirements for Attached Units in New and Newly Converted Condo Projects
PERS	• Project Eligibility Review Service (PERS)

General Information on Project Standards (continued)

Waiver of Project Review

Fannie Mae does not require a thorough project review for several types of projects or loan transactions, including:

- detached condo units;
- units in a two- to -four unit condo project;
- units in a PUD project;
- Fannie Mae to Fannie Mae limited cash-out refinances with LTV ratios < 80%; and
- high LTV refinance loans.

See Waiver of Project Review for additional information and for the requirements that apply when a project review is waived.

Requirements Applicable to All Properties in a Condo or PUD Project

All mortgages secured by units in condo or PUD projects must comply with the following:

- requirements specific to the project review method used to determine that project's eligibility;
- property eligibility requirements (described in Chapter B2-3, Property Eligibility);
- priority of common expense assessments (described below);
- when an appraisal of the property is obtained, it must meet all applicable appraisal requirements (described in Appraisal Requirements); and
- insurance requirements (described in Insurance, including all applicable provisions in Liability and Fidelity/Crime Insurance Requirements for Project Developments).

General Information on Project Standards (continued)

Priority of Common Expense Assessments

Fannie Mae allows a limited amount of regular common expense assessments (typically known as HOA fees) to have priority over Fannie Mae's mortgage lien for mortgage loans secured by units in a condo or PUD project. This applies if the condo or PUD project is located in a jurisdiction that has enacted

- the Uniform Condominium Act,
- the Uniform Common Interest Ownership Act, or
- a similar statute that provides for unpaid assessments to have priority over first mortgage liens.

The table below describes the permitted priority of common expense assessments for purposes of determining the eligibility of a mortgage loan secured by a unit in a condo or PUD project for purchase by Fannie Mae.

If the condo or PUD project ...	Then...
is located in a jurisdiction that enacted a law on or before January 14, 2014, that provides that regular common expense assessments will have priority over Fannie Mae's mortgage lien for a maximum amount greater than six months,	the maximum number of months of regular common expense assessments permitted under the applicable jurisdiction's law as of January 14, 2014, may have priority over Fannie Mae's mortgage lien, provided that if the applicable jurisdiction's law as of that date referenced an exception for Fannie Mae's requirements, then no more than six months of regular common expense assessments may have priority over Fannie Mae's mortgage lien.
is located in any other jurisdiction,	no more than six months of regular common expense assessments may have priority over Fannie Mae's mortgage lien, even if applicable law provides for a longer priority period.

Notwithstanding any provisions to the contrary in the Guide, which do not require CMS to represent or warrant compliance with Fannie Mae project legal document requirements, the condo or PUD project legal documents must evidence compliance with the above priority of common expense assessment requirements.

General Information on Project Standards (continued)

Delivery Requirements

When delivering a loan for a unit located in a project, CMS must provide the Project Type Code and any applicable special feature codes as shown in the following table. CMS must also report all other applicable special feature code(s), including those specified in the lender's Master Agreement and in the *Special Feature Codes* document on Fannie Mae's website.

Project Type Code	Description
E	Established PUD project
F	New PUD project
P	Limited Review—New condo project
Q	Limited Review—Established condo project
R	Full Review (with or without CPM)—New condo project
S	Full Review (with or without CPM)—Established condo project
T	Fannie Mae Review—Condo project that received a Final Project Approval through PERS using the standard or streamlined process
U	FHA-approved condo project (applicable to FHA loans only)
V	• Detached condo loans delivered without a condo project review • Fannie Mae to Fannie Mae limited cash-out refinances without a condo project review
Special Feature Code	**Description**
588	Detached Condominium Used to identify detached units in a condo project
296	Project Eligibility Waiver Used to identify loans for which Fannie Mae has provided a project eligibility waiver

CMS is encouraged to include the condo HOA or Project IRS Federal Tax Identification Number (TIN) in the loan file and in CPM if CPM is used to review the project. See *Uniform Loan Delivery Dataset (ULDD) Quick Guide — Guidelines for Condominium/Cooperative Loans* for additional requirements about the delivery of project data.

General Information on Project Standards (continued)

Document Retention for Project Eligibility

CMS must retain all of the project documentation needed to demonstrate that the project meets Fannie Mae's eligibility requirements, including any documentation CMS relied upon to enter information into CPM. This documentation must be retained, and made available upon request, as long as CMS originate mortgages from the project, and until all mortgages sold to Fannie Mae have been liquidated.

Expiration for Project Reviews

Project reviews must meet the following timeline requirements.

Project Review Process Employed	Expiration of Project Review
• Limited Review • Full Review	Must have been completed within 180 days prior to the note date
Approved by Fannie Mae through PERS	PERS approval must be valid (unexpired) as of the note date

Mortgages secured by units in projects must be delivered to Fannie Mae within 120 days following the note date. When the elapsed time between note date and delivery date exceeds this limit, CMS may deliver the mortgage only if the project continues to meet Fannie Mae project eligibility requirements at the time of delivery.

Loans secured by units in a project that fails to meet Fannie Mae's project eligibility requirements under the applicable review type as of the note date are eligible for delivery after the project comes into compliance with the eligibility requirements (provided all standard mortgage seasoning and other applicable requirements are met). For example, if CMS closes a loan in a new project for which the pre-sales are less than the pre-sale requirement, CMS may deliver the loan after the project's pre-sales meet the Fannie Mae requirement (assuming the loan meets all other applicable requirements).

Waiver of Project Review

Transactions Eligible for a Waiver of Project Review

Fannie Mae does not require a thorough project review for the project types and transactions described in the following table.

Project or Transaction Type	Requirements
Detached condo unit	A detached condo is defined as any condo unit that is completely detached from other condo units in the project. The unit may share no adjoining walls, ceilings, floors, or other attached architectural elements (such as breezeways or garages) with any neighboring unit. A detached condo unit may be in a project consisting solely of detached units or in a development containing a mixture of attached and detached units. Site condos in which the unit owner owns the detached condo unit and the land upon which the unit is built are a type of detached condo. The waiver of project review applies for new and established projects.
Unit in a two- to four-unit condo project	Project review is waived for new and established condo projects that consist of no more than four units.
Unit in a PUD project	See B4-2.3-01, Eligibility Requirements for Units in PUD Projects, for the requirements that apply.
Fannie Mae to Fannie Mae limited cash-out refinance	Project review is waived for units in condo projects for Fannie Mae-owned loans that are refinanced as a limited cash-out refinance with a maximum loan-to-value ratio of 80% (CLTV or HCLTV ratios may be higher). (The waiver is not applicable to units in co-op projects.)

Exception to the waiver policy: If the property is a manufactured home or the project contains any manufactured homes, such property or project is not eligible for a review waiver and must be reviewed based on the applicable manufactured home project review requirement.

Requirements that Apply When the Project Review is Waived

The following requirements apply, in addition to those noted above, when a project review is waived:

- property eligibility requirements (described in Property Eligibility);
- the project is not a condo hotel or motel, houseboat project, or a timeshare or segmented ownership project (described in Ineligible Projects);
- priority of common expense assessments (described in General Information on Project Standards);
- when an appraisal of the property is obtained, it must meet all applicable appraisal requirements (described in Appraisal Requirements); and
- insurance requirements (described in Insurance, as applicable).

Project Review Requirements for High LTV Refinance Loans

Fannie Mae waives the project review requirements for high LTV refinance loans secured by units in a condo, co-op, or PUD project. See High LTV Refinance Loan and Borrower Eligibility for the requirements.

Ineligible Projects

List of Ineligible Project Characteristics

Fannie Mae will not purchase or securitize mortgage loans that are secured by units in certain condo projects if those projects have characteristics that make the project ineligible. Such characteristics are described in the table below, with additional details provided in the sections that follow. All eligible projects must be created and remain in full compliance with state law and all other applicable laws and regulations of the jurisdiction in which the project is located.

Note: If CMS determines that a project does not meet all of Fannie Mae's project eligibility requirements but believes that the project has merit and warrants additional consideration, CMS may request an exception (see Projects with Special Considerations and Project Eligibility Waivers, for additional information).

Ineligible Project Characteristics	Condo Project Type
Investment securities (i.e., projects that have documents on file with the Securities and Exchange Commission (SEC) or projects where unit ownership is characterized or promoted as an investment opportunity).	✓
Timeshare, fractional, or segmented ownership projects.	✓
New projects where the seller is offering sale or financing structures in excess of Fannie Mae's eligibility policies for individual mortgage loans. These excessive structures include, but are not limited to, builder/developer contributions, sales concessions, HOA assessments, or principal and interest payment abatements, and/or contributions not disclosed on the settlement statement.	✓
Projects with mandatory upfront or periodic membership fees for the use of recreational amenities, such as country club facilities and golf courses, owned by an outside party (including the developer or builder). Membership fees paid for the use of recreational amenities owned exclusively by the HOA or master association are acceptable.	✓
Projects that are managed and operated as a hotel or motel, even though the units are individually owned. (See section below for additional detail.)	✓
Projects with covenants, conditions, and restrictions that split ownership of the property or curtail an individual borrower's ability to utilize the property. (See section below for additional detail.)	✓

Ineligible Projects (continued)

List of Ineligible Project Characteristics (continued)

Ineligible Project Characteristics	Condo Project Type
Projects with property that is not real estate, such as houseboat projects. (See section below for additional detail.)	✓
Any project that is owned or operated as a continuing care facility. (See section below for additional detail.)	✓
Projects with non-incidental business operations owned or operated by the HOA including, but not limited to, a restaurant, spa, or health club. (See section below for additional detail and exceptions to this policy.)	✓
Projects that do not meet the requirements for live- work projects. (See section below for additional detail.)	✓
Projects in which the is named as a party to pending litigation, or for which the project sponsor or developer is named as a party to pending litigation that relates to the safety, structural soundness, habitability, or functional use of the project. (See section below for additional detail.)	✓
Any project that permits a priority lien for unpaid common expenses in excess of Fannie Mae's priority lien limitations. (See section below for additional detail.)	✓
Projects in which a single entity (the same individual, investor group, partnership, or corporation) owns more than the following total number of units in the project: • projects with 2 to 4 units – 1 unit • projects with 5 to 20 units – 2 units • projects with 21 or more units – 10% Units currently subject to any lease arrangement must be included in the calculation. This includes lease arrangements containing provisions for the future purchase of the units such as lease-purchase and lease-to-own arrangements. Units are not included in the calculation if they are owned by the project sponsor or developer and are vacant and being actively marketed for sale.	✓

Ineligible Projects (continued)

List of Ineligible Project Characteristics (continued)

Ineligible Project Characteristics	Condo Project Type
Multi-dwelling unit projects that permit an owner to hold title (or stock ownership and the accompanying estate or facilities other than the interest or rights it has in relation to unsold units occupancy rights) to more than one dwelling unit, with ownership of all of his or her owned units (or shares) evidenced by a single deed and financed by a single mortgage (or share loan). (See section below for additional detail.)	✓
The total space that is used for nonresidential or commercial purposes may not exceed 25%. (See section below for additional detail.)	✓
Newly converted non-gut rehabilitation projects with more than four attached units that have not been approved by Fannie Mae through the PERS process, as required.	✓
New or newly converted projects in Florida with attached units that have not been approved by Fannie Mae through the PERS process, as required.	✓
Projects that represent a legal, but non-conforming, use of the land, if zoning regulations prohibit rebuilding the improvements to current density in the event of their partial or full destruction. (See Site Section of the Appraisal Report.)	✓

Ineligible Projects (continued)

Projects that Operate as Hotels or Motels

Projects with one or more of the following characteristics may be operating as a hotel or motel and are therefore ineligible:

- hotel or motel conversions (or conversions of other similar transient properties), unless the project is an established project, meets all requirements for gut rehabilitation projects, and all units are residential dwelling units;
- projects that include registration services and offer rentals of units on a daily basis;
- projects that restrict the owner's ability to occupy the unit; and
- projects with mandatory rental pooling agreements that require unit owners to either rent their units or give a management firm control over the occupancy of the units.

These formal agreements between the developer, homeowners' association, and/or the individual unit owners, obligate the unit owner to rent the property on a seasonal, monthly, weekly, or daily basis. In many cases, the agreements include blackout dates, continuous occupancy limitations, and other such use restrictions. In return, the unit owner receives a share of the revenue generated from the rental of the unit.

Sources of Information for Researching Hotel or Motel Operations

CMS must perform an analysis of the project to determine whether it is operating as a hotel or motel. There are several sources of information on which to rely, including but not limited to:

- project legal and recorded documents and exhibits,
- the appraisal,
- the contract for sale, and
- the Internet.

Project characteristics that may indicate the project is operating as a hotel or motel include, but are not limited to:

- central telephone system,
- room service,
- units that do not contain full-sized kitchen appliances,
- daily cleaning service,
- advertising of rental rates,
- registration service,
- restrictions on interior decorating,
- franchise agreements,
- central key systems,
- location of the project in a resort area,

Ineligible Projects, continued

Sources of Information for Researching Hotel or Motel Operations (continued)

- owner-occupancy density — the project may have few or even no owner-occupants,
- projects converted from a hotel or motel,
- units that are less than 400 square feet,
- projects with a name that includes the word “hotel” or “motel,” or
- interior doors that adjoin other units.

CMS must thoroughly examine the appraisal, contract for sale, and other documents to determine if there are guaranteed rent-backs, references to mandatory rental pooling or management agreements, and SEC filing references and prospectus documents.

The Internet has become a useful tool for obtaining project and unit-specific information. The project’s website may contain information on the project type, amenities, and the availability of units for rent. Internet searches may identify unit owners offering their unit for short term rentals within the subject property’s project. As long as the project is not being operated as a hotel or motel and the units are not subject to mandatory rentals or to optional leasing programs to a hotel or motel, then the advertising of a unit for short term rental by the unit owner does not, alone, constitute the project as a hotel or motel. CMS is responsible for fully evaluating the project to understand if the practice of offering short-term rentals by unit owners is organized in such a way that the project’s predominant use is to operate as a hotel or motel.

Projects Subject to Split Ownership Arrangements

Projects with covenants, conditions, and restrictions that split ownership of the property or curtail an individual borrower’s ability to utilize the property are not eligible for delivery to Fannie Mae. These types of properties include, but are not limited to, the following:

- “common interest” apartments or community apartment projects that are projects or buildings owned by several owners as tenants-in-common or by an association in which individuals have an undivided interest in a residential apartment building and land, and have the right of exclusive occupancy of a specific apartment in the building;
- projects that restrict the owner’s ability to occupy the unit, even if the project is not being operated as a motel or hotel; and
- projects with mandatory rental pooling agreements that require unit owners to either rent their units or give a management firm control over the occupancy of the units.

These are formal agreements between the developer, association, and/or the individual unit owners that obligate the unit owner to rent the property on a seasonal, monthly, weekly, or daily basis. In many cases, the agreements include blackout dates, continuous occupancy limitations, and other such use restrictions. In return, the unit owner receives a share of the revenue generated from the rental of the unit.

Ineligible Projects (continued)

Projects that Contain Multi-Dwelling Unit Condos

Projects that contain multi-dwelling units are not permitted. These projects allow an owner to hold title (or share ownership and the accompanying occupancy rights) to a single legal unit that is sub-divided into multiple residential dwellings within the single legal unit, with ownership of the unit (or shares) evidenced by a single deed and financed by a single mortgage (or share loan). The sub-divided units are not separate legal units. This restriction applies regardless if the unit owner maintains one or more of the sub-divided units as rental units or uses one or more of the sub-divided units as accessory or lock-out units.

This provision does not apply to condo projects that allow an individual to buy two or more individual legal units with the intent of structurally and legally combining the units for occupancy as a single-unit dwelling. Mortgages secured by units in these types of projects are eligible for purchase and securitization by Fannie Mae provided all of the following requirements are met:

- The unit securing the mortgage represents a single legal unit under a single deed.
- Any construction or renovation to structurally combine units has no material impact on the structural or mechanical integrity of the project's buildings or the subject property unit.
- The individual units must be fully described in the legal description in the mortgage and under a single deed.
- The project's legal documents must have been amended to reclassify the combined units as a single unit in the project.
- All structural renovation to physically combine the units must be completed.

A condo unit with an accessory unit may be eligible on a case-by-case basis with a Fannie Mae PERS Project Approval or a loan-level Project Eligibility Waiver. See Projects with Special Considerations and Project Eligibility Waivers, for additional information on submitting an exception request.

Projects with Property that is not Real Estate

Fannie Mae acquires mortgage loans secured by real estate. Houseboats, boat slips, cabanas, timeshares, and other forms of property that are not real estate are not eligible for delivery to Fannie Mae. The marketability and value of individual units in a project may be adversely impacted by the inclusion of non-real estate property such as houseboats, timeshares, and other forms and structures that are not real estate. As such, projects containing these other non-real estate forms of property are not eligible.

Boat slips, cabanas, and other amenities are permitted when owned in common by the unit owners as part of the HOA.

Ineligible Projects (continued)

Projects that Operate as a Continuing Care Community or Facility	Mortgages secured by units in a project that operates, either wholly or partially, as a continuing care community are ineligible for delivery to Fannie Mae. These communities or facilities are residential projects designed to meet specialized health and housing needs and typically require residents to enter into a lifetime contract with the facility to meet all future health, housing, or care needs. These communities may also be known by other names such as life-care facilities. Projects that make continuing care services available to residents are eligible only if the continuing care facilities or services are not owned or operated by the HOA and residential unit owners are not obligated to purchase or utilize the services through a mandatory membership, contract, or other arrangement. Continuing care communities are not the same as age-restricted projects. Age-restricted projects that restrict the age of residents but do not require residents to enter into a long-term or lifetime contract for healthcare and housing as the resident's age are eligible.
Non-Incidental Business Arrangements	A condo project is ineligible if the HOA is receiving more than 10% of its budgeted income from non-incidental business arrangements related to the active ownership and/or operation of amenities or services available to unit owners and the general public. This includes, but is not limited to, businesses such as a restaurant or other food- and beverage-related services, health clubs, and spa services. Non-incidental income from the following sources is permitted provided the income does not exceed 15% of the project's budgeted income: • income from the use of recreational amenities or services owned by the HOA for the exclusive use by unit owners in the project or leased to another project according to a shared amenities agreement (as noted below), or • income from the leasing of units in the project acquired by the HOA through foreclosure. The single-entity ownership limits (described in the Ineligible Project Characteristics table above) will apply to the number of units owned and rented by the HOA.

Ineligible Projects (continued)

Commercial Space and Mixed-Use Allocation

Fannie Mae requires that no more than 35% of a condo project or 35% of the building in which the project is located be commercial space or allocated to mixed-use. This includes commercial space that is above and below grade.

Any commercial space in the project or in the building in which the residential project is located must be compatible with the overall residential nature of the project.

Note: Rental apartments and hotels located within the project must be classified as commercial space even though these may be considered “residential” in nature.

Calculation of Commercial Space. Commercial space allocation is calculated by dividing the total non-residential square footage by the total square footage of the project or building. CMS is responsible for determining the total square footage of the project, the square footage of the non-residential space, and the residential space square footage. This calculation includes the total square footage of commercial space even if the residential and commercial owners are represented by separate associations.

Non-residential square footage includes:

- retail and commercial space,
- parking space that is separate from parking allocated to residential unit owners, and
- space that is non-residential in nature and owned by a private individual or entity outside of the HOA structure.

Examples include, but are not limited to:

- public parking facilities (fee-based or free),
- rental apartments,
- hotels,
- restaurants, and
- private membership-based fitness facilities.

Non-residential square footage excludes amenities that are:

- residential in nature;
- designated for the exclusive use of the residential unit owners (such as, but not limited to, a fitness facility, pool, community room, and laundry facility); and
- owned by the unit owners or the HOA.

Ineligible Projects (continued)

Commercial Space and Mixed-Use Allocation (continued)

The following table shows which commercial or mixed-use space must be included in the calculation of the percentage of commercial space.

If the commercial or mixed-use space is…	Then its square footage is included in the calculation of commercial space percentage
owned, controlled, or operated by the subject property's HOA that is unrelated to the project-specific amenities offered for the exclusive use and enjoyment by the HOA members	Yes
owned by the subject property's HOA but controlled or operated by a separate private entity **Example:** Office space owned by the HOA but leased to a private business.	Yes
owned and controlled by a project HOA other than the subject property's HOA that shares the same master HOA with the subject property's HOA AND the commercial space is co-located in the project's building(s) that contain(s) the residential units	Yes
owned, controlled, or operated by a private entity that is co-located in the building(s) that contain(s) the project's residential units **Example:** • floors 1 to 4 consist of hotel and retail, • floors 5 to 7 consist of privately-owned and -managed rental apartments, and • the remaining floors consist of the condo project units.	Yes
owned, controlled, or operated by a private entity that is NOT co-located in the building(s) or common elements as declared in the project legal documents that contain(s) the project's residential units	No
owned and controlled by a project HOA other than the subject property's HOA that shares the same master HOA with the subject property's HOA BUT the commercial space is located in a building that is separate from the building(s) containing the project's residential units	No

Ineligible Projects (continued)

Live-Work Projects

Live-work projects are projects that permit individual residential unit owners to operate and run a small business from their residential unit. Units in projects that permit live-work arrangements are eligible for sale to Fannie Mae provided the following additional requirements are met:

- The overall character of the project is residential.
- Live-work units must be limited to residential units that are occupied as primary residences in which the unit owner is the owner and operator of the small business.
- The live-work unit must be primarily residential in character with minimal space designated to or modifications made to accommodate the unit owner's commercial activity.
- The commercial use must be consistent with the residential nature of the project.
- The project documents must permit commercial use and state what types of commercial use are acceptable.
- The project must conform to any applicable local ordinances governing the structure and operation of live-work projects including limitations on the number of live-work units or the percentage of live-work unit space permitted.

CMS must confirm that the live-work component of the project is considered and adequately addressed in the appraiser's assessment of the property. All of the following requirements must be met:

- The appraisal must include an adequate description of the live-work characteristics of the project and the unit.
- The market value of the unit is primarily a function of its residential characteristics, rather than of the business use or any special business-use modifications that were made.
- The future marketability of the unit will not be negatively impacted by the business use or any special business-use modifications that have been made.

Ineligible Projects (continued)

Litigation

Projects in which the HOA is named as a party to pending litigation, or for which the project sponsor or developer is named as a party to pending litigation that relates to the safety, structural soundness, habitability, or functional use of the project are ineligible for sale to Fannie Mae.

If CMS determines that pending litigation involves minor matters with no impact on the safety, structural soundness, habitability, or functional use of the project, the project is eligible provided the litigation is limited to one of the following categories:

- non-monetary litigation including, but not limited to neighbor disputes or rights of quiet enjoyment;
- litigation for which the insurance carrier has agreed to provide the defense, and the amount is covered by the HOA's or co-op corporation's insurance;
- the HOA or co-op corporation is the plaintiff in the litigation and upon investigation and analysis the lender has reasonably determined the matter is minor and will result in an insignificant impact to the financial stability of the project;
- the reasonably anticipated or known damages and legal expenses are not expected to exceed 10% of the project's funded reserves;
- the HOA or co-op corporation is seeking recovery of funds for issues that have already been remediated, repaired, or replaced and there is no anticipated material adverse impact to the HOA or co-op corporation if funds are not recovered;
- litigation concerning localized damage to a unit in the project that does not impact the overall safety, structural soundness, habitability, or functional use of the project; or
- the HOA or co-op corporation is named as the plaintiff in a foreclosure action, or as a plaintiff in an action for past due HOA or co-op assessments.

Litigation that involves personal injury or death does not meet Fannie Mae's criteria for minor litigation unless

- the claim amount is reasonably anticipated or known,
- the insurance carrier has agreed to provide the defense, and
- the reasonably anticipated or known damages are covered by the HOA's or co-op corporation's insurance.

Construction defect litigation in which the HOA or co-op corporation is the plaintiff are not considered a minor matter unless the HOA or co-op corporation is seeking recovery of funds for issues that have already been remediated, repaired, or replaced. In addition, there is no anticipated material adverse impact to the HOA or co-op if the funds are not recovered.

CMS must obtain documentation to support its analysis that the litigation meets Fannie Mae's criteria for minor litigation as described above.

If CMS is aware of pending litigation and is unable to determine whether the litigation may be deemed a minor matter, CMS may contact Fannie Mae's Project Standards team to determine whether Fannie Mae will accept delivery of mortgages secured by units in the project.

Ineligible Projects (continued)

Single-Entity Ownership

A project meets the definition of single-entity ownership when a single entity (the same individual, investor group, partnership, or corporation) owns more than the following total number of units in the project:

- projects with 5 to 20 units - 2 units
- projects with 21 or more units - 20%

Units currently subject to any rental or lease arrangement must be included in the calculation. This includes lease arrangements containing provisions for the future purchase of units such as lease-purchase and rent-to-own arrangements.

The following may be excluded from the single-entity ownership calculation:

- units that are owned by the project sponsor or developer and are vacant and being actively marketed for sale; or
- units that are controlled or owned by a non-profit entity for the purpose of providing affordable housing, units held in affordable housing programs (including units subject to non-eviction rent regulation codes), or units held by higher-education institutions for a workforce housing program.

The single-entity ownership requirement may be waived when the transaction is a purchase transaction that will result in a reduction of the single-entity ownership concentration. In such instances, the following requirements must be met:

- units owned by the single entity represent no more than 49% of the units;
- evidence is required that the single entity is marketing units for sale to further reduce single-entity ownership, with the goal of reducing the concentration to 20% or less o the project units;
- the single entity is current on all HOA assessments; and
- there are no pending or active special assessments in the project.

Environmental Hazard Assessments

Overview

An environmental hazard assessment is required for condo projects if an environmental problem is identified by CMS through performance of its project underwriting or due diligence. If environmental problems are identified, the problems must be determined to be acceptable. CMS should keep a copy of this assessment in file.

Types of Environmental Hazard Assessments

The table below describes two types of environmental hazard assessments.

Type	Performed by	Description
Phase I assessment (see *Suggested Format for Phase I Environmental Hazard Assessments*)	CMS or by someone employed by the lender	Gathers information from various sources to evaluate the environmental soundness of the project.
Phase II assessment	A qualified environmental consultant	When required • Phase I assessment identifies problems, or • Phase I assessment is inconclusive with regard to any particular hazard.

Acceptability of Consultants

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

Phase I Environmental Assessment

A Phase I assessment enables CMS to quickly determine whether adequate information exists to evaluate the environmental status of a property. A Phase I assessment is principally a screening process that focuses on reviewing the available documentation, interviewing people who are knowledgeable about the site operations, and inspecting the site, the building, and adjoining properties. Fannie Mae does not require a specific form for a Phase I assessment.

Any report that is thorough and professionally prepared will be acceptable. For a suggested format, see *Suggested Format for Phase I Environmental Hazard Assessments*.

Environmental Hazard Assessments (continued)

Phase II Environmental Assessment Description

A Phase II assessment provides a more detailed review of the site. It includes specific physical sampling for each hazard that was not acceptable under the Phase I assessment, as well as a review of historical records. It determines the presence or absence of specific environmental liabilities (such as asbestos or leaking underground storage tanks) or quantifies the extent of an observed or suspected environmental liability (such as soil or groundwater contamination).

Who Should Complete the Phase II Environmental Assessment

The specialized nature of the investigations conducted under a Phase II assessment requires the knowledge and experience of a qualified consultant.

CMS must use care in choosing firms to perform environmental hazard assessments and should confirm that the consultant it plans to use is not affiliated with the buyer or seller of the property or a firm engaged in a business that might present a conflict of interest. CMS should also evaluate whether the consulting firm's personnel have adequate and appropriate education and training to carry out the required duties.

Phase II Environmental Assessment Report Forms and Requirements

Fannie Mae does not specify an exact format for the consultant's report. Any report that is thorough and professionally prepared will be acceptable.

The table below provides the requirements for the Phase II Environmental Assessment Report.

✓	The consultant's report for a Phase II environmental
	include a full description of the sampling procedures
	include the laboratory results
	include the consultant's recommendations
	follow all regulatory standards and good management practices at all times, especially when physical sampling and laboratory analysis are involved
	include a certification in the report that: • the assessment was performed diligently and in accordance with all regulatory and good management standards; and • to the best of the consultant's knowledge, the results are complete and accurate
	include the signature of an officer of the consulting firm that conducted the work

Environmental Hazard Assessments (continued)

Kinds of Testing or Sampling Under Phase II Environmental Assessments

Examples of the kind of testing or sampling that occur under a Phase II assessment include but are not limited to the following:

- investigating the status of any enforcement actions related to neighboring properties under the Superfund or Resource, Conservation, and Recovery Acts;
- testing for underground storage leaks;
- sampling and analyzing the soil;
- sampling and analyzing the groundwater;
- testing soil or facilities that are suspected as being contaminated by polychlorinated biphenyls; and
- sampling and analyzing bulk asbestos and developing related abatement and maintenance programs, if necessary.

Unacceptable Environmental Conditions

Overview

The existence of one or more unacceptable environmental conditions generally will result in a project being ineligible. However, if CMS believes that the relative risk is minimal or can be managed, it may contact the Fannie Mae Project Standards team.

Unacceptable Environmental Conditions

The table below describes examples of unacceptable environmental conditions; however, this list is not exhaustive.

✓	Examples of Unacceptable Environmental Conditions
	a property that is (or has been) used as a landfill or other solid, hazardous, or municipal waste disposal site
	a property that is (or has been) used for activity related to the storage of oil, hazardous waste, or other toxic substances—except that the property may have been used for the storage of small quantities of hazardous substances that are generally recognized as appropriate for residential uses and maintenance of the property
	a property that is the subject of outstanding environmental or public health litigation or administrative action from private parties or public officials
	a high-risk neighboring property that has evidence of hazardous waste spills or soil or groundwater contamination on or around its site

Unacceptable Environmental Conditions (continued)

Unacceptable Environmental Conditions (continued)

✓	Examples of Unacceptable Environmental Conditions
	a property that has documented soil or groundwater contamination and/or a documented tank leak that is leaking at more than 0.05 gallons per hour (which is the National Fire Protection Association's standard)
	a property with soil sampling that has values for metal in excess of the following concentration limits in parts per million (ppm): • chromium: 100 ppm • arsenic: 20 ppm • zinc: 350 ppm • cadmium: 3 ppm • lead: 100 ppm • nickel: 100 ppm • copper: 170 ppm • selenium: 20 ppm
	a property that is contaminated from polychlorinated biphenyls (PCBs)
	a property with soil sampling that has values for other organic materials in excess of the following concentration limits in parts per million (ppm): • total volatile organics: 1 ppm • total hydrocarbons: 100 ppm • total petroleum hydrocarbons: 100 ppm

Unacceptable Environmental Conditions (continued)

Unacceptable Environmental Conditions (continued)

✓	Examples of Unacceptable Environmental Conditions
	a property with groundwater sampling that has values for other organic materials in excess of the following concentration limits in parts per million: • total organics (volatiles and base neutrals): 0.10 ppm • total petroleum hydrocarbons: 1.00 ppm
	a property with groundwater sampling that has values for metals in excess of the following concentration limits in parts per million: • arsenic: 0.05 ppm • lead: 0.05 ppm • boron: 1.00 ppm • mercury: 0.002 ppm • cadmium: 0.01 ppm • selenium: 0.01 ppm • chromium: 0.05 ppm • silver: 0.05 ppm
	a property with high radon levels (e.g., above four picocuries per liter) that can be corrected only through large capital improvements or extensive ongoing maintenance programs that are beyond the financial or technical abilities of the HOA for the project
	a property that has conditions representing material violations of applicable local, state, or federal environmental or public health statutes and laws
	a property that is contaminated by friable asbestos-containing materials

Unacceptable Environmental Conditions (continued)

Remedial Actions for Environmental Assessments Below Standards

Properties that fail to meet a particular standard may be corrected through remedial actions and then retested. Remedial actions must be undertaken with the advice and written endorsement of a qualified environmental consultant. All remedial actions must be taken in accordance with all regulatory and good management standards.

Typically, CMS must confirm the completion and effectiveness of remedial actions based on the following conditions:

- A qualified environmental consultant states in writing that remedial work needed to make the property eligible under the environmental standards can be completed within 90 days.
- The project's developer or sponsor signs a contract with a qualified firm to perform the remedial work within 90 days.

CMS must warrant that the job has been satisfactorily completed and the property meets Fannie Mae's environmental eligibility standards.

The project developer or sponsor must provide a performance escrow equal to 150% of the gross contract amount to ensure the completion of the remedial work.

Limited Review Process

Unit and Project Types Eligible for Limited Review

The underwriter will conduct the Limited Review. To be eligible for a Limited Review, the unit securing the mortgage must be located in one of the following project types and meet the other criteria described below:

- an attached unit in an established condo project, or
- a detached unit in a new or established condo project (including those projects with a mixture of attached and detached units).

Limited Review Process (continued)

Eligible Transactions for Limited Review of Attached Units in Established Condo Projects

An attached unit in an established condo project, including a two- to four-unit condo project, is eligible for a Limited Review if it meets the transaction requirements in the following table.

Eligible Transactions — For Limited Review Attached Units in Established Condo Projects (For Projects Outside of Florida) Including 2– to 4–unit Condo Projects	
Occupancy Type	**Maximum LTV, CLTV, and HCLTV Ratios**
Principal residence	90%
Second home	75%
Investment property	75%

Attached units in established projects located in Florida are subject to more restrictive LTV ratio requirements under the Limited Review process. See Geographic-Specific Condo Project Considerations, for additional information.

Limited Review Eligibility Requirements

In completing a Limited Review, CMS must ensure that the project and subject unit meet all of the eligibility requirements described in the following table.

✓	Limited Review Eligibility Requirements
	The project is not an ineligible project. (See Ineligible Projects.)
	If the subject unit is a detached unit, the unit securing the mortgage must be 100% complete.
	When an appraisal is obtained, the appraisal of the subject unit meets all applicable appraisal requirements, as stated in Appraisal Requirements.
	The unit securing the mortgage satisfies all insurance requirements as stated in Subpart B7, Insurance, including all provision applicable to condo projects in Additional Project Insurance.

These requirements apply DU loan casefiles loans.

Provided the project and loan transaction are eligible for and meet all of the eligibility requirements of the Limited Review process, CMS is not required to validate that the project also meets the eligibility requirements of another project review type. However, in the event CMS becomes aware of a circumstance that would cause the project or transaction to be ineligible under a Limited Review, CMS must use one of the other project review methods to determine project eligibility and the project must meet all of the eligibility requirements of that selected alternate project review type.

Full Review Process

Overview

The Full Review process is a method for the review of new and established condo projects. CMS performing a Full Review must ensure that the project meets all applicable eligibility requirements.

Unit and Project Types Eligible for a Full Review

A Full Review may be performed when the unit securing the mortgage is an attached unit located in one of the following project types:

- an established condo project, or
- a new or newly converted condo project.

These projects may also be reviewed by Fannie Mae through the PERS process (see Project Eligibility Review Service (PERS)). Detached condo units located in projects containing a mixture of attached and detached units are eligible for review using the Limited Review process (see Limited Review Process).

Two- to four-unit condo projects reviewed using the Full Review process must comply with all requirements of the Full Review, unless specifically stated otherwise.

Full Review Process (continued)

Full Review Eligibility Requirements for Attached Units in Condo Projects

When determining the eligibility of a condo project on the basis of a Full Review, CMS must ensure the condo project meets the eligibility requirements described in the following table.

✓	**Full Review Eligibility Requirements – For Attached Units in New, Established, or Two- to Four-Unit Condo Projects**
	The project must not be an ineligible project. (See Ineligible Projects.)
	The unit securing the mortgage satisfies all Fannie Mae's insurance requirements in Insurance, including all provisions applicable to condo projects in, Additional Project Insurance.
	When an appraisal is obtained, the appraisal of the subject unit must meet all applicable appraisal requirements, as stated in Appraisal Requirements.
	No more than 15% of the total units in a project may be 60 days or more past due on their common expense assessments (also known as HOA dues). For example, a 100–unit project may not have more than 15 units that are 60 days or more past due. **Note:** In a two- to four-unit project, no unit owners may be 60 or more days past due on their HOA common expense assessments. This ratio is calculated by dividing the number of units with common expense assessments that are past due by 60 or more days by the total number of units in the project.
	CMS must review the HOA projected budget to determine that it • is adequate (i.e., it includes allocations for line items pertinent to the type of condo project), and • provides for the funding of replacement reserves for capital expenditures and deferred maintenance that is at least 10% of the budget. To determine whether the association has a minimum annual budgeted replacement reserve allocation of 10%, CMS must divide the annual budgeted replacement reserve allocation by the association's annual budgeted assessment income (which includes regular common expense fees).

Full Review Process (continued)

Full Review Eligibility Requirements for Attached Units in Condo Projects (continued)

✓	**Full Review Eligibility Requirements –** **For Attached Units in New, Established, or Two- to Four-Unit Condo Projects**
	The following types of income may be excluded from the reserve calculation: • incidental income on which the project does not rely for ongoing operations, maintenance, or capital improvements; • income collected for utilities that would typically be paid by individual unit owners, such as cable TV or Internet access; • income allocated to reserve accounts; and • special assessment income. CMS may use a reserve study in lieu of calculating the replacement reserve of 10% provided the following conditions are met: • CMS obtains a copy of an acceptable reserve study and retains the study and the lender's analysis of the study in the project approval file, • the study demonstrates that the project has adequate funded reserves that provide financial protection for the project equivalent to Fannie Mae's standard reserve requirements, • the study demonstrates that the project's funded reserves meet or exceed the recommendations included in the reserve study, and • the study meets Fannie Mae's requirements for replacement reserve studies listed at the end of this section. **Note:** These requirements for a budget review, replacement reserves, and reserve study are not applicable to two- to
	For projects in which the units are not separately metered for utilities, CMS must: • determine that having multiple units on a single meter is common and customary in the local market where the project is located, and • confirm that the project budget includes adequate funding for utility payments. **Note:** These requirements are not applicable to two- to four-unit projects.

Full Review Process (continued)

Full Review Eligibility Requirements for Attached Units in Condo Projects (continued)

✓	Full Review Eligibility Requirements – For Attached Units in New, Established, or Two- to Four-Unit Condo Projects
	The project must be located on contiguous parcels of land. It is acceptable for a project to be divided by public or private streets.
	The structures within the project must be within a reasonable distance from each other.
	Common elements and facilities, such as recreational facilities and parking, must be consistent with the nature of the project and competitive in the marketplace.
	Unit owners in the project must have the sole ownership interest in, and rights to the use of the project's facilities, common elements, and limited common elements, except as noted below. Shared amenities are permitted only when two or more HOAs share amenities for the exclusive use of the unit owners. The associations must have an agreement in place governing the arrangement for shared amenities that includes the following: • a description of the shared amenities subject to the arrangement; • a description of the terms under which unit owners in the project may use the shared amenities; • provisions for the funding, management, and upkeep of the shared amenities; and • provisions to resolve conflicts between the associations over the amenities. Examples of shared amenities include, but are not limited to, clubhouses, recreational or fitness facilities, and swimming pools. The developer may not retain any ownership interest in any of the facilities related to the project. The amenities and facilities—including parking and recreational facilities—may not be subject to a lease between the unit owners or the HOA and another party. Parking amenities provided under commercial leases or parking permit arrangements with parties unrelated to the developer are acceptable.
	Fannie Mae permits the financing of a single or multiple parking space(s) with the mortgage provided that the parking space(s) and residential unit are included on one deed as evidenced on the legal description in the mortgage. In such cases, the LTV, CLTV, and HCLTV ratios are based on the combined value of the residential unit and the parking space(s).

Full Review Process (continued)

Full Review Eligibility Requirements for Attached Units in Condo Projects (continued)

✓	**Full Review Eligibility Requirements – For Attached Units in New, Established, or Two- to Four-Unit Condo Projects**
	Phase I and II environmental hazard assessments are not required for condo projects unless CMS identifies an environmental problem through the performance of its project underwriting or due diligence. In the event that environmental problems are identified, the problems must be acceptable, as described in *Suggested Format for Phase I Environmental Hazard Assessments.*
	For investment property transactions on attached units in established projects (including two- to four-unit projects), at least 50% of the total units in the project must be conveyed to principal residence or second home purchasers. This requirement does not apply if the subject mortgage is for a principal residence or second home. Financial institution-owned REO units that are for sale (not rented) are considered owner-occupied when calculating the 50% owner-occupancy ratio requirement. When the project does not meet the owner-occupied ratio of 50%, an investment property transaction will only be eligible if CMS submits the project to Fannie Mae • for review under PERS and the project is approved (see Project Eligibility Review Service (PERS), for additional information), or • for a single-loan project eligibility waiver and the waiver is approved (see Projects with Special Considerations and Project Eligibility Waivers, for additional information).
	If the project was a gut rehabilitation project, all rehabilitation work involved in a condo conversion must have been completed in a professional manner. “Gut rehabilitation” refers to the renovation of a property down to the shell of the structure, including the replacement of all HVAC and electrical components (unless the HVAC and electrical components are up to current code). For a conversion that was legally created during the past three years, the architect’s or engineer’s report (or functional equivalent), that was originally obtained for the conversion must comment favorably on the structural integrity of the project and the condition and remaining useful life of the major project components, such as the heating and cooling systems, plumbing, electrical systems, elevators, boilers, roof, etc.

Full Review Process (continued)

Full Review Eligibility Requirements for Attached Units in Condo Projects (continued)

✓	**Full Review Eligibility Requirements –** **For Attached Units in New, Established, or Two- to Four-Unit Condo Projects**
	Note: If the project is a newly converted non-gut rehabilitation project with more than four residential units, CMS must submit the project to Fannie Mae for review and approval. See Project Eligibility Review Service (PERS), for additional information.

	For newly converted two- to four-unit non-gut rehabilitation projects, the following requirements apply:
	• All rehabilitation work involved in a condo conversion must have been completed in a professional manner.
	• A current reserve study prepared by a qualified, independent professional company, accompanied by an engineer's report, or functional equivalent, must comment favorably on the structural integrity of the project and the remaining useful life of the major project components.
	• The project budget must contain line items for the following:
	  o reserves that adequately support the costs identified in the reserve study, even if the study recommends budgeting reserves greater than 10% of the project's income;
	  o funds to cover the total cost of any items identified in the reserve study or engineer's report that need to be replaced within five (5) years from the date of the study must be deposited in the HOA's reserve account, in addition to the amount stated immediately above; and
	  o a utility contingency of at least 10% of the previous year's utility costs if the utilities are not separately metered.
	Note: Newly converted gut rehabilitation projects must follow the standard gut rehabilitation requirements listed under the eligibility requirements above.

Full Review Process (continued)

Replacement Reserve Studies

Reserve studies may be used to determine the appropriate level of reserves the HOA must maintain to ensure the project's long-term success. Reserve studies will also provide useful information regarding the adequacy of the HOA's current reserve funds and offer recommendations to meet funding goals in the event the HOA has under-reserved for its needs in the past. CMS may review the most current reserve study or a reserve study update provided it has been completed within three (3) years of the date on which CMS approves the project.

Reserve studies must be prepared by an independent third party that has specific expertise in completing reserve studies. This expertise may include any of the following:

- a reserve study professional with reserve study credentials,
- a construction engineer,
- a certified public accountant who specializes in reserve studies, or
- any professional with demonstrated knowledge of and experience in completing reserve studies.

While Fannie Mae does not require that a standard format be used for the reserve study, the following items must be addressed:

- all major components and elements of the project's common areas for which repair, maintenance, or replacement is expected;
- the condition and remaining useful life of each major component;
- an estimate of the cost of repair, replacement, restoration, or maintenance of major components;
- an estimate of the total annual contributions required to defray costs (minus the existing reserves funded for this purpose), including inflation;
- an analysis of existing funded reserves; and
- a suggested reserve funding plan.

Note: Individual states may have various statutes concerning the use and content of reserve studies. Fannie Mae requires that a reserve study used by CMS in its analysis meet or exceed requirements set forth in relevant state statutes.

Full Review: Additional Eligibility Requirements for Attached Units in New and Newly Converted Condo Projects

Additional Requirements for Attached Units in New and Newly Converted Condo Projects

When performing a Full Review of attached units in new or newly converted condo projects, CMS must ensure compliance with the following additional requirements.

Note: These requirements are not applicable to attached units in new or newly converted projects in Florida, which must be reviewed by Fannie Mae through the PERS process.

✓	**Full Review Requirements – For Attached Units in New or Newly Converted Condo Projects**
	The project, or the subject legal phase, must be "substantially complete" unless other completion arrangements have been approved by Fannie Mae through the PERS review process. There may not be more than one legal phase per building. "Substantially complete" means that: • a certificate of occupancy or other substantially similar document has been issued by the applicable governmental agency for the project or subject phase; and • all the units and buildings in the legal phase in which the unit securing the mortgage is located are complete, subject to the installation of buyer selection items, such as appliances. **Note:** Fannie Mae does not require the installation of typical buyer selection items such as appliances, floor coverings, counter tops, or light fixtures that are common and customary for the market, although buyer selections that involve the modification of a unit floor plan must be complete. CMS is expected to obtain appropriate documentation to verify that all buyer selection items for the unit being financed are properly installed prior to closing. **Two- to four-unit projects:** All units, common elements, and facilities within the project must be 100% complete and not subject to additional phasing even when the project is a new or newly converted project.
	At least 50% of the total units in the project or subject legal phase must have been conveyed or be under contract for sale to principal residence or second home purchasers. • For a specific legal phase or phases in a new project, at least 50% of the total units in the subject legal phase(s), considered together with all prior legal phases, must have been conveyed or be under contract for sale to principal residence or second home purchasers. • For the purposes of this review process, a project consisting of one building cannot have more than one legal phase.

Full Review: Additional Eligibility Requirements for Attached Units in New and Newly Converted Condo Projects (continued)

Additional Requirements for Attached Units in New and Newly Converted Condo Projects (continued)

✓	Full Review Requirements – For Attached Units in New or Newly Converted Condo Projects
	Two- to four-unit projects: All but one unit in the project must have been conveyed or be under contract for sale to a principal residence or second home purchaser.
	Individual units in new condo projects must be available for immediate occupancy at the time of loan closing.
Not Applicable to Two- to Four-Unit Condo Projects	
	If the project is part of a larger development, and the unit owners are required to pay monthly assessments of more than $50 to a separate master association for that development, CMS must review the overall development plan for the master association to evaluate the acceptability of the project.
	The overall development plan of the project must be reviewed and the following must be acceptable: • consistency of future and existing improvements, • time limitations for expansion, and • reciprocal easements between legal phases.
	For projects (or the subject legal phase) that are only substantially complete rather than 100% complete, CMS must determine that acceptable completion assurance arrangements that guarantee the future completion of all project facilities, common elements, and limited common elements have been provided. These assurance arrangements may include • cash deposits, • letters of credit, • assignments of certificates of deposit, or • assignments of other assets that can be easily converted to cash. Similar arrangements must be provided to support assurances against construction and structural defects. The assurances must • protect each unit against defects that become apparent within one year from the date of its settlement, and • cover all common facilities for one year from the date on which units that represent at least 60% of the votes in the HOA have been transferred.
	The developer or sponsor should provide for and promote the unit owners' early participation in the management of the project.
	The project must meet the condo project legal document requirements in the following section.

Full Review: Additional Eligibility Requirements for Attached Units in New and Newly Converted Condo Projects (continued)

Condo Project Legal Document Review Requirements for Attached Units in New or Newly Converted Projects

The table below provides Fannie Mae's requirements for the review of the condo project's legal documents for attached units in new and newly converted condo projects containing more than four residential units.

Condo Project Legal Document Review Requirements – For Attached Units in New or Newly Converted Condo Projects	
Limitations on Ability to Sell / Right of First Refusal	Any right of first refusal in the condo project documents will not adversely impact the rights of a mortgagee or its assignee to: • foreclose or take title to a condo unit pursuant to the remedies in the mortgage, • accept a deed or assignment in lieu of foreclosure in the event of default by a mortgagor, or • sell or lease a unit acquired by the mortgagee or its assignee.
Rights of Condo Mortgagees and Guarantors	The project documents must give the mortgagee and guarantor of the mortgage on any unit in a condo project the right to timely written notice of: • any condemnation or casualty loss that affects either a material portion of the project or the unit securing its mortgage; • any 60-day delinquency in the payment of assessments • or charges owed by the owner of any unit on which it holds the mortgage; • a lapse, cancellation, or material modification of any insurance policy maintained by the homeowners' association; and • any proposed action that requires the consent of a specified percentage of mortgagees.

Full Review: Additional Eligibility Requirements for Attached Units in New and Newly Converted Condo Projects (continued)

Condo Project Legal Document Review Requirements for Attached Units in New or Newly Converted Projects (continued)

Condo Project Legal Document Review Requirements – For Attached Units in New or Newly Converted Condo Projects	
First Mortgagee's Rights Confirmed	No provision of the condo project documents gives a condo unit owner or any other party priority over any rights of the first mortgagee of the condo unit pursuant to its mortgage in the case of payment to the unit owner of insurance proceeds or condemnation awards for losses to or a taking of condo units and/or common elements.
Amendments to Documents	Required provisions related to amendments to project documents are as follow: • The project documents must provide that amendments of a material adverse nature to mortgagees be agreed to by mortgagees that represent at least 51% of the votes of unit estates that are subject to mortgages. • The project documents must provide for any action to terminate the legal status of the project after substantial destruction or condemnation occurs or for other reasons to be agreed to by mortgagees that represent at least 51% of the votes of the unit estates that are subject to mortgages. • The project documents may provide for implied approval to be assumed when a mortgagee fails to submit a response to any written proposal for an amendment within 60 days after it receives proper notice of the proposal, provided the notice was delivered by certified or registered mail, with a return receipt requested. Notwithstanding the foregoing, project documents that were recorded prior to August 23, 2007, may provide for implied approval to be assumed when a mortgagee fails to submit a response to any written proposal for an amendment within 30 days after it receives proper notice of the proposal, provided the notice was delivered by certified or registered mail, with a return receipt requested.

Geographic-Specific Condo Project Considerations

Florida — Attached Units in New and Newly Converted Condo Projects

PERS is required for new and newly converted condo projects consisting of attached units located in Florida. See Project Eligibility Review Service (PERS).

The following project review methods may not be used to review these types of projects in Florida:

- Limited Review, or
- Full Review.

Florida — Project Review Maximum LTV Requirements for Attached Units in New, Newly Converted, and Established Projects

The following tables describe the maximum LTV ratios that are permitted for the specific project review type for loans secured by units in condo projects located in Florida. Unless noted otherwise, these requirements are based on the LTV ratio of the mortgage loan.

Florida — Attached Units in New and Newly Converted Condo Projects Maximum LTV Ratios			
	PERS Approved[a]	**Full Review (with or without CPM)**	**Limited Review**
Principal Residence	95% DU	Not Eligible	
Second Home	90%		
Investor	85%		

[a]Refer to the *Eligibility Matrix* for the maximum allowable CLTV and HCLTV ratios. (For example, a mortgage loan for a unit in a PERS-approved project can have a CLTV ratio up to 105% if it meets the *Eligibility Matrix*

Florida — Attached Units in Established Condo Projects			
	Maximum LTV Ratios[a]		**Maximum LTV, CLTV, and HCLTV Ratios[b]**
	PERS Approved	**Full Review (with or without CPM)**	**Limited Review**
Principal Residence	95% DU		75/90/90%
Second Home	90%		70/75/75%
Investor	85%		Not Eligible

Geographic-Specific Condo Project Considerations (continued)

Florida — Project Review Maximum LTV Requirements for Attached Units in New, Newly Converted, and Established Projects (continued)

[a]Refer to the *Eligibility Matrix* for the maximum allowable CLTV and HCLTV ratios. (For example, a mortgage loan for a unit in a PERS-approved project can have a CLTV ratio up to 105% if it meets the *Eligibility Matrix*

[b]The CLTV and HCLTV ratios in this column align with the maximum CLTV and HCLTV ratios that are permitted for projects outside of Florida, as described in Limited Review Process.

Requirements for Review of Detached Condos

Detached Condo Definition

A detached condo is defined as any condo unit that is completely detached from other condo units in the project. The unit may share no adjoining walls, ceilings, floors, or other attached architectural elements (such as breezeways or garages) with any neighboring unit. A detached condo unit may be in a project consisting solely of detached units or in a development containing a mixture of attached and detached units. Site condos in which the unit owner owns the detached condo unit and the land upon which the unit is built are a type of detached condo.

Detached Condo Requirements

A project review is not required. Instead, lenders must confirm all the following requirements are met:

- The project and the unit are in compliance with all other Fannie Mae requirements for property eligibility and appraisal standards.
- The project and the unit have the required insurance as described in Insurance
- The detached unit is not a manufactured home and the condo project contains no manufactured homes (these projects must be evaluated through the Fannie Mae Project Eligibility Review Service).
- The project is in compliance with the requirements for priority of common expense assessments (see Ineligible Projects).

Project Eligibility Review Service (PERS)

Overview

PERS is a review method available to CMS to submit new, newly converted, and established projects to Fannie Mae to determine eligibility. Some projects must be submitted to PERS while a PERS submission is optional for other projects, as shown in the following table:

Standard PERS Process	Streamlined PERS Process
Required for: • new and newly converted condo projects consisting of attached units located in Florida; • newly converted non-gut rehabilitation attached units in condo projects that contain more than four residential units; and	**Optional for:** • established condo projects
Optional for: • all other new or newly converted condo projects, not listed above	

Standard PERS Submission Process

The standard PERS submission process is as follows:

Step	Action
1.	CMS performs a basic review to determine if the project satisfies all applicable Fannie Mae project eligibility and underwriting requirements prior to submission to PERS. **Note:** For additional lender pre-PERS submission review requirements for newly converted non-gut rehabilitation condo projects, see below.
2.	CMS completes a project submission package, which includes: • *Project Eligibility Review Service Document Checklist* (Form 1030), and • *Application for Project Approval* (Form 1026). See below for additional forms that may be required.

Project Eligibility Review Service (PERS) (continued)

Standard PERS Submission Process (continued)

Step	Action
3.	The condo project's legal documents must comply with the Fannie Mae's requirements listed in Full Review: Additional Eligibility Requirements for Attached Units in New and Newly Converted Condo Projects. • A qualified attorney engaged by CMS must review the condo project legal documents and determine that the documents are in compliance with Fannie Mae's requirements. • This determination must be documented by the attorney in writing but need not rise to the level of a formal, written legal opinion. The attorney may be the same person who prepared the legal documents or an attorney employed by the lender, but he or she cannot be an employee, principal, or officer of the developer or sponsor of the project. • CMS must complete the *Warranty of Condominium Project Legal Documents* (Form 1054) and attach the attorney review as part of the PERS submission process.
4.	CMS submits the complete project package, including all relevant supporting documentation, via email using the PERS Project Submission mailbox.
5.	A member of the Project Standards team reviews the package to determine if the project is eligible for approval.
6.	Upon completion of the review, Fannie Mae issues its decision to CMS via email and posts approved projects on its website. See Condo, and Planned Unit Development (PUD) Eligibility for approved projects listed for each state, the District of Columbia, and the U.S. Virgin Islands.
7.	Fannie Mae informs CMS of the specific review fee assessed for each PERS submission. CMS is billed for PERS review fees in their “Monthly Technology Invoice.” For fees, see the Project Eligibility Review Service (PERS) Overview on Fannie Mae's website.

Project Eligibility Review Service (PERS) (continued)

Required Forms for Standard PERS Submission

The forms shown below are required for a standard PERS submission.

Form	Title	Description
1026	*Application for Project Approval*	Requires certification that CMS has “underwritten” the project; includes non- residential space, common areas, sales plan, construction warranty, budget, builder/ developer information, status of construction, environmental issues, resale restrictions, phasing, project management.
1029	*Warranty of Project Presales*	Requires lender certification of sales and presales information.
1030	*Project Eligibility Review Service Document Checklist*	Checklist confirming all required documents have been provided (see below).
1051	*Project Development/Master Association Plan*	Requires lender certification of submitted information; includes master association and sub-association description and structure, common areas, title policy, master association budget, “as-built” survey or master plan.
1054	*Warranty of Condominium Project Legal Documents*	Requires lender certification of compliance with laws and Fannie Mae legal requirements.
1071	*Statement of Insurance and Fidelity Coverage*	Requires lender certification of all insurance requirements; addresses specific insurance types and clauses, and requires CMS to obtain and review all policies.
1073	*Individual Condominium Unit Appraisal*	Individual condominium appraisal report.
1073A	*Analysis of Annual Income and Expenses – Operating Budget*	Requires lender certification that the operating budget has been analyzed; detailed operating budget information to be completed by HOA and CMS.
1081	*Final Certification of Substantial Project Completion*	Lender certification that project is substantially complete; CMS to document any exceptions or uncompleted.

Project Eligibility Review Service (PERS) (continued)

Required Forms for Standard PERS Submission (continued)

The *Project Eligibility Review Service Document Checklist* (Form 1030) also requires that CMS submit the following project documentation to Fannie Mae with the PERS application.

✓	Project Documentation Required by Form 1030
	Prospectus, Public Offering Statement, or equivalent document
	Sample contract of sale
	Sample unit appraisal
	Phase 1 and/or Phase 2 Environmental Hazard Assessment (if underwriting analysis indicates any environmental concerns)
	Development plan, including marketing materials, unit floor plans, and pricing analysis
	Engineer’s survey/property condition assessment with reserve analysis and developer’s Schedule of Improvements (if the project is a conversion)
	Recorded plat map/site plan
	Budget prepared for the project
	Sales strategy from developer
	Letter from construction lender indicating loan is in good standing
	Photographs of subject project (include the site, improvements, recreation facilities, parking, and amenities) and comparable projects

Fannie Mae reserves the right to request additional documentation it deems necessary to conduct a full review of the project.

Additional Requirements—For Newly Converted Non-Gut Rehabilitation Condo

A non-gut rehabilitation refers to the renovation of a property that does not involve structural or functional changes, such as the replacement of all HVAC and electrical components. Rather, the rehabilitation might include, for example, the replacement of appliances and carpeting.

In order for a newly converted non-gut rehabilitation condo ~~t~~ to receive project approval through the standard PERS process, the project must comply with the following requirements.

✓	CMS Pre-PERS Submission Review Requirements – For Newly Converted Non-Gut Rehabilitation Condo
	The project cannot be an ineligible project in accordance with Ineligible Projects.

Project Eligibility Review Service (PERS) (continued)

Additional Requirements—For Newly Converted Non-Gut Rehabilitation Condo, continued

✓	CMS Pre-PERS Submission Review Requirements – For Newly Converted Non-Gut Rehabilitation Condo
	For condo projects—The condo project must comply with all requirements of the Full Review (as provided in Full Review Process and Full Review: Additional Eligibility Requirements for Attached Units in New and Newly Converted Condo Projects).
	All rehabilitation work involved in the condo conversion must have been completed in a professional manner.
	A current reserve study prepared by a qualified, independent professional company,accompanied by an engineer's report, or functional equivalent, must comment favorably on the structural integrity of the project and the remaining useful life of the major project components.
	The project budget must contain line items for: • reserves to adequately support the costs identified in the reserve study, and • a utility contingency of at least 10% of the previous year's utility costs if the utilities are not separately metered.
	Funds to cover the total cost of any items identified in the reserve study or engineer's report that need to be replaced within five years from the date of the study must be deposited in the reserve account of the HOA, in addition to the amount stated immediately above.
	The developer must provide a detailed description of the work proposed or already completed in order for the project units to be ready for sale.
	Generally, at least 50% of the total condo units or shares in the project or subject legal phase must have been conveyed or be under contract for purchase to principal residence or second home purchasers.
	Phasing of projects (single building or multiple buildings) will be considered on a project basis.
	The project sponsor or developer must provide a comprehensive sales and marketing strategy.
	All projects are subject to a site inspection.

Note: See Comparable Sales, for information about appraisals of units in newly converted condo projects.

Project Eligibility Review Service (PERS) (continued)

Streamlined PERS Submission Process—For Established Projects

The streamlined PERS submission process for established condo projects is as follows:

Step	Action
1.	CMS performs a basic review to determine if the project satisfies all applicable Fannie Mae project eligibility and underwriting requirements prior to submission to PERS.
2.	CMS completes a project submission package, which includes: • *Application for Approval of Established Project* (Form 1091). • *Condominium Project Questionnaire—Full Form* (Form 1076), or a substantially similar form, completed within the past 180 days. • An appraisal report for a representative unit in the project. This report must be prepared within 120 days of the PERS application, and include photographs of the project, private streets, recreational amenities, parking, commercial space, and common areas. • Current fiscal year's approved operating budget that reflects homeowners' association income and expenses. • Reserve study completed within the past 24 months (only required for projects that are not funding a minimum of a 10% dedicated expense allocation in the budget to a replacement reserve for the future repair/replacement of the project's major components).
3.	CMS submits the complete project package, including all relevant supporting documentation, via email using the PERS Project Submission mailbox.
4.	A member of the Project Standards team reviews the package to determine if the project is eligible for approval.
5.	Upon completion of the review, Fannie Mae issues its decision to CMS via email and posts approved projects on its website. See *Condo, and Planned Unit Development (PUD) Eligibility* for approved projects listed for each state, the District of Columbia, and the U.S. Virgin Islands.
6.	Fannie Mae informs the lender of the specific review fee assessed for each PERS submission. CMS is billed for PERS review fees in their "Monthly Technology Invoice." For fees, see the *Project Eligibility Review Service (PERS) Overview* on Fannie Mae's website.

Fannie Mae reserves the right to request additional documentation it deems necessary to conduct a full review of the project.

Project Eligibility Review Service (PERS) (continued)

Approval Designations

For both standard and streamlined PERS submissions, CMS must submit complete project packages to Fannie Mae via email to PERS Project Submission. Upon completion of its review, Fannie Mae will issue one of the following project approval designations:

- Conditional Project Approval,
- Final Project Approval,
- Ineligible, or
- Suspension of the Application.

Mortgages secured by units in projects must have a valid Fannie Mae Final Project Approval prior to delivery. Mortgages may not be delivered under the Conditional Project Approval, Ineligible, or Suspension of the Application designations.

Availability of Project Information

CMS submitting projects to PERS must ensure that the developer, builder, management company, and/or HOA will provide project information to Fannie Mae as and when requested without charge. In the event the requested information is not provided, Fannie Mae reserves the right to withdraw the PERS approval.

Decision Expiration Dates

Conditional Project Approval: expires 9 months from the date of issue. Final Project Approval: expires 24 months from the date of issue.

Note: Fannie Mae, in some instances and in its sole discretion, may set a shorter expiration term.

For information on requesting an extension, see the *Project Eligibility Review Service (PERS) Overview* on Fannie Mae's website.

Projects with Special Considerations

CMS may identify projects that merit special consideration even though the project characteristics do not meet all of the Fannie Mae eligibility requirements. In these instances, CMS can contact the Fannie Mae Project Standards team to discuss the possibility of accepting such projects. Exceptions to Fannie Mae eligibility and underwriting requirements are considered on a project-by-project basis.

Project Eligibility Review Service (PERS) (continued)

Project Eligibility Waivers

If CMS believes that a specific eligibility requirement should be waived for a particular project with respect to a single loan, then CMS must:

- first enter the project into CPM before requesting a waiver through the Credit Variance Administration System (CVAS), and
- request a waiver from Fannie Mae through CVAS.

Fannie Mae's Project Standards team will determine if a single loan project eligibility waiver is warranted. Fannie Mae charges a nonrefundable $200 review fee for each waiver request. A higher review fee may be charged based on the complexity of the waiver review.

Note: Project eligibility waivers are typically issued only for established projects, though Fannie Mae at its sole discretion reserves the right to allow this type of waiver for a unit in a new project on a case-by-case basis. New or newly converted projects must be reviewed for eligibility through an eligible CMS review process or by Fannie Mae through the PERS submission process. CMS must not request a project eligibility waiver for a unit in a new project to circumvent the required review for new projects.

Project Eligibility Waivers FNMA to FNMA Limited Cash-Out Refinances

Fannie Mae will waive the project eligibility review for certain Fannie Mae-owned loans that are being refinanced as a limited cash-out refinance. CMS must confirm the following:

- the loan-to-value ratio is no higher than 80% (CLTV or HCLTV ratios may be higher);
- the project has the required project-related property and flood insurance coverage; and
- the project is not a condo hotel or motel, houseboat project, or a timeshare or segmented ownership project.

NOTE: This waiver does not apply to co-op projects.

Eligibility Requirements for Units in PUD Projects

PUD Project Definition

A 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. For a project to qualify as a PUD for the purposes of this policy, all of the following requirements must be met:

- each unit owner's membership in the HOA 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, and
- the subject unit must not be part of a condo project.

Zoning is not a basis for classifying a project or subdivision as a PUD. Units in projects or subdivisions simply zoned as PUDs that include the following characteristics are not defined as PUD projects under Fannie Mae's policies. These projects:

- have no common property and improvements,
- do not require the establishment of and membership in an HOA, and
- do not require the payment of assessments. Fannie Mae classifies PUD projects as either
  - o Type E—established PUD projects in which the developer has turned over voting control of the HOA to the unit purchasers.
  - o Type F—new PUD projects in which the developer has not turned over voting control of the HOA to the unit purchasers.

Eligibility Requirements for Units in PUD Projects

CMS must determine that the subject unit meets the following requirements.

✓	Eligibility Requirements – For Units in PUD Projects
	The appraisal of the unit meets all appraisal requirements in Appraisal Requirements.
	The individual unit securing the mortgage must be substantially complete. Any unfinished items must be in compliance with Fannie Mae's policy for Postponed Improvements (see Requirements for Postponed Improvements).
	The unit securing the mortgage satisfies all Fannie Mae's insurance requirements in Insurance, including all provisions applicable to PUD projects.
	The PUD project must be in compliance with Fannie Mae's policy for priority liens (see Ineligible Projects).

Note: Any unit located in a condo project within a larger PUD project or master association must meet the applicable requirements for condo projects.

HIGH-BALANCE MORTGAGE LOAN ELIGIBILITY AND UNDERWRITING

Loan Limits

The high-balance loan requirements apply to mortgage loans with original loan amounts meeting the high-cost area loan limits established by the Federal Housing Finance Agency. Fannie Mae publishes on its website the maximum high-cost area loan limits that may apply by state (or territory); however, specific loan limits are established for each county (or equivalent) and may be lower for each specific high-cost area. Refer to *Loan Limits for Conventional Mortgages* for additional information, including the loan limits for each area.

CMS is responsible for ensuring that the original principal balance of each mortgage loan does not exceed the applicable maximum loan limit for the specific area in which the property is located. To assist lenders in determining the applicable limits, Fannie Mae posts reference material on its website, including the Loan Limit Geocoder, which lenders can use to look up loan limits based on a specific address (or batch of addresses).

Loan Eligibility and Underwriting Requirements

High-balance mortgage loans must meet all standard Fannie Mae eligibility and underwriting requirements, as outlined in this *Selling Guide*, except as noted in this section. The following guidelines apply to all high-balance mortgage loans:

- Loans must be conventional first-lien mortgages only.
- Loans must meet the LTV, CLTV, and HCLTV ratios as outlined in the Eligibility Matrix.
- All borrowers must have a credit score.
- All loans must be underwritten through DU.

For additional eligibility information, see the *Eligibility Matrix.* For information about loan delivery, see High-Balance Pricing, Mortgage Insurance, Special Feature Codes, and Delivery Limitations.

Note: Unless otherwise notified by Fannie Mae, existing variances in a lender's Master Agreement apply to high-balance mortgage loans; however, the more restrictive of the eligibility requirements of this section or the lender’s variance will apply.

High-Balance Pricing, Mortgage Insurance, Special Feature Codes, and Delivery Limitations

Mortgage Insurance Requirements

Mortgage insurance coverage is required for high-balance mortgage loans with LTV ratios greater than 80%. Financed borrower-purchased mortgage insurance is permitted; however, the maximum gross LTV (after the inclusion of the financed premium) cannot exceed 95%.

Mortgage Insurance Premiums

Mortgage insurance premiums paid on a monthly basis may be non-refundable. Single and split premium mortgage insurance premiums must be refundable. Mortgage insurance premiums may be paid monthly, annually, as a single premium, or a combination of these.

Note: Lender paid mortgage insurance must be paid as a single premium only.

PROPERTY-SPECIFIC PRODUCTS

Disaster-Related Limited Cash-Out Refinance Flexibilities Overview

Fannie Mae provides flexibilities to standard limited cash-out refinance policies for borrowers who have been impacted by a natural disaster. These guidelines:

- permit the refinance of non-purchase money subordinate mortgage loans obtained to finance disaster-related property repairs, and
- provide for a higher cash-out amount to reimburse borrowers for documented out-of-pocket expenses related to disaster-related property repairs.

This topic outlines the specific eligibility requirements for these additional flexibilities.

Location of Property

These flexibilities may be applied to mortgage loans on properties located in any counties, cities, or parishes that are designated by the Federal Emergency Management Agency (FEMA) as eligible for Individual Assistance as a result of a natural disaster (these areas are referred to as "FEMA Disaster Areas").

Occupancy Status

These guidelines are applicable only to mortgage loans secured by the borrower's principal residence, and may not be used in connection with second homes or investment properties.

Transaction Types

A borrower may obtain:

- a limited cash-out refinance to consolidate non-purchase money subordinate financing used for repair of disaster-related property damage to his or her principal residence. To be eligible, the subordinate financing, including any draws on an existing HELOC, must post-date the disaster. However, the borrower may pay off the entire HELOC through the limited cash-out refinance, provided that a portion of the amount was used for disaster-related expenses to repair property damage to the principal residence.
- cash-out for reimbursement of documented out-of-pocket expenses for the completed repair of disaster-related property damage to his or her principal residence in an amount not to exceed the lesser of 10% of the balance of the new refinance mortgage loan or $15,000.

All existing guidelines and requirements for limited cash-out refinance transactions listed in this section continue to apply, including those for Texas 50(a)(6) mortgages (see Texas Section 50(a)(6) Mortgage Loans).

Property-Specific Products (continued)

Documentation of Eligible Disaster-Related Expenses and Financing

CMS must document that the subordinate financing (or a portion of the HELOC) or the entire requested cash-out amount represents funds used for completed disaster-related property repairs.

Generally, documentation includes copies of receipts, work orders, canceled checks, etc., related to the cost of materials and labor.

The borrower may not receive any reimbursement for amounts representing his or her sweat equity in connection with the repairs.

Note: All documentation must post-date the disaster and be directly related to completed repairs of damage to the property resulting from the disaster.

Limited Cash-Out Refinance DU Requirements

Certain messages on the DU Underwriting Findings Report will not apply to mortgage loans originated under the disaster-related limited cash-out refinance requirements.

When the mortgage loan complies with the requirements of this section, CMS may disregard the following messages:

- This case is ineligible because the amount of cash taken out of the subject property equity exceeds the limit of 2% of the loan amount or $2,000 for limited cash-out refinances.
- If any subordinate lien that was not used to acquire the subject property is to be paid off with first mortgage proceeds, the loan is ineligible as a limited cash-out refinance. The loan must be resubmitted as a cash-out refinance.
- If subordinate liens are being paid off with the first mortgage proceeds, obtain written documentation that the subordinate lien was used to acquire the subject property.

Appraisal Requirements

The appraisal for the property must follow standard requirements in Appraisal Guidelines.

Those guidelines allow an appraisal to be based on the “as is” condition of the property provided there are no conditions that affect the safety, soundness, or structural integrity of the property. If those conditions do exist, the property must be appraised subject to completion of the specific alterations or repairs (“as repaired”) and a completion report must be obtained from the appraiser prior to delivery of the mortgage to Fannie Mae.

TEXAS SECTION 50(A)(6) MORTGAGE LOANS

Overview

A Texas Section 50(a)(6) mortgage loan is a mortgage originated under the provisions of Article XVI, Section 50(a)(6), of the Texas Constitution, which allow a borrower to take equity out of a homestead property under certain conditions.

Lender Eligibility

Unless otherwise notified in writing, CMS is eligible to sell and/or service Texas Section 50(a)(6) mortgage loans. However, CMS must meet the eligibility criteria specified in the Texas Constitution. If CMS intends to sell Texas Section 50(a)(6) mortgage loans originated by a third-party originator CMS is also responsible for ensuring that the originating lender qualifies as an "authorized lender" under the Texas Constitution.

Loan Origination and Compliance

In addition to Fannie Mae's other origination and compliance requirements for Texas Section 50(a)(6) mortgages in this chapter, CMS agrees to the following:

✓	Requirement
	By sale of a Texas Section 50(a)(6) mortgage to Fannie Mae, CMS represent and warrant that the mortgage loan complies with the Article XVI, Section 50(a)(6), of the Texas Constitution and all applicable requirements of the *Selling Guide*.
	The borrower's first payment must be due no later than two months after closing.
	CMS must provide the title company with a detailed closing instruction letter, and require an acknowledgment of its receipt. The closing instructions must require the title company to conduct the closing in a way that ensures compliance with all applicable provisions of Section 50(a)(6) of the Texas Constitution. For purposes of the compliance with the acknowledgment of the "fair market" value of the homestead property requirement, the "fair market value" must be based on an appraisal or an evaluation that is prepared "in accordance with a state or federal requirement applicable to the extension of credit" and the appraisal must be attached to the written acknowledgment. See Texas Section 50(a)(6) Underwriting and Collateral Considerations for Fannie Mae's appraisal requirements.
	The proceeds from a Texas Section 50(a)(6) mortgage must not be used to acquire or improve the homestead if a mortgage for that purpose could have been made under a different provision of the Texas Constitution. Fannie Mae has no other restrictions on the use of the loan proceeds.

Texas Section 50(a)(6) Mortgage Loans (continued)

Loan Origination and Compliance (continued)

✓	Requirement
	If the new mortgage is a Texas Section 50(a)(6) refinance transaction originated in order to cure a failure in the original mortgage to comply with Section 50(a) (6), then the Texas law requirement that at least 12 months have passed since any previous Section 50(a)(6) mortgage secured by the homestead property was closed does not apply and the mortgage is eligible for sale to Fannie Mae provided that it complies in all respects with Fannie Mae's requirements. However, unless a refinance transaction has been completed to cure a failure in the original mortgage transaction to comply with Section 50(a)(6), a Texas Section 50(a)(6) mortgage loan is ineligible for sale to Fannie Mae if CMS has either identified or been notified by the borrower of a failure to comply, whether or not there has already been a cure or an attempt to cure the failure to comply.
	DU does not contain the specific eligibility rules needed to determine eligibility in accordance with Article XVI, Section 50(a)(6) of the Texas Constitution or the *Selling Guide*.
	CMS must determine whether refinance mortgages securing properties in Texas are eligible for sale to Fannie Mae, and should be aware that even though a loan may receive an "Eligible" recommendation, the loan may not be eligible for delivery according to Section 50(a)(6) of the Texas Constitution or the *Selling Guide*.

Lender Certification

By sale of a Texas Section 50(a)(6) mortgage to Fannie Mae, CMS certifies that with respect to all of the Texas Section 50(a)(6) mortgages delivered to Fannie Mae, whether or not originated by CMS:

- All Texas Section 50(a)(6) mortgages were (or will be) originated pursuant to written processes and procedures that comply with the provisions of the Texas Constitution applicable to mortgage loans authorized by Section 50(a)(6), Article XVI of the Texas Constitution, as amended from time to time.
- CMS has in place a specific process for the receipt, handling, and monitoring of notices from borrowers that lender (or the mortgage originator, if CMS is the servicer but not the originator) failed to comply with the provisions of the law applicable to Texas Section 50(a) (6) mortgages. Such process must be adequate to ensure that CMS will correct the failure to comply by one of the authorized means no later than the 60th day after the date CMS is notified of the failure to comply by the borrower.

Texas Section 50(a)(6) Mortgage Loans (continued)

Lender Certification (continued)

- An attorney familiar with the provisions of Section 50(a)(6), Article XVI of the Texas Constitution was consulted (or will be consulted prior to origination of the Texas Section 50(a) (6) mortgages) in connection with the development and implementation of the processes and procedures used for the origination of the Texas Section 50(a)(6) mortgages.
- To ensure ongoing compliance with the law applicable to mortgage loans authorized by Section 50(a)(6), Article XVI of the Texas Constitution, the processes and procedures used for the origination of the Texas Section 50(a)(6) mortgages will be reviewed by CMS regularly and will be updated and revised, as appropriate pursuant to clarifications of the law, on a regular and continual basis.
- The matters certified herein are representations and warranties of CMS given to Fannie Mae in connection with each Texas Section 50(a)(6) mortgage.

Servicer's Obligations to Maintain Procedures for Curing Violation

In addition to having processes and procedures to ensure compliance with Texas Section 50(a) (6), CMS and servicers must have specific processes in place to cure any failure to comply with Section 50(a)(6) identified with respect to a mortgage loan serviced on behalf of Fannie Mae by one of the authorized means, as required by the "Lender Certification" requirements described above. CMS or servicer's failure to cure within 60 days after being notified of a failure to comply may, under Texas law, result in the forfeiture of all principal and interest due under the Texas Section 50(a)(6) mortgage loan. However, any action taken, or not taken, in connection with a failure to comply with Texas Section 50(a)(6), even if such action is a result of CMS or the servicer's effort to cure a failure to comply, that results in any of the following constitutes a breach of the lender's selling representations and warranties and/or servicing obligations and requirements:

- a forfeiture of any principal or interest due under the mortgage loan;
- invalidation of the mortgage as a first lien;
- abatement of accrual of interest and the borrower's obligations under the mortgage loan;
- reduction in the principal amount of the mortgage; or
- any modification of the amount, interest rate, term, or other provision of the mortgage loan.

Such action, taken or not taken, shall be deemed a failure to correct a significant defect and/or a servicing defect that permits Fannie Mae to exercise any of the remedies provided in the Lender Contract, including the right to require repurchase of the mortgage loan.

Texas Section 50(a)(6) Mortgage Loan Eligibility

Refinance Classifications

CMS should be aware that Fannie Mae's classification of mortgage transactions as "cash-out refinance" or "limited cash-out refinance" may differ from the way mortgages are classified under Texas law for purposes of compliance with the Amendment.

Texas law determines whether or not a mortgage is a Texas Section 50(a)(6) mortgage, and Fannie Mae's policy determines whether the mortgage must be delivered as a cash-out refinance transaction or as a limited cash-out refinance transaction.

CMS is responsible for determining:

- the applicability of Section 50(a)(6) of the Texas Constitution, regardless of Fannie Mae's definitions of cash-out and limited cash-out refinance transactions; and
- if the mortgage should be delivered to Fannie Mae as a cash-out refinance (including SFC 003 and payment of all applicable LLPAs) or a limited cash-out refinance transaction (including SFC 007).

All mortgages that constitute Texas Section 50(a)(6) mortgages under Texas law must comply with these provisions, regardless of whether the mortgage loan is classified as a "cash-out refinance" or "rate/term refinance" in the *Selling Guide*. See Texas Section 50(a)(6) Underwriting and Collateral Considerations.

Accordingly, CMS should not rely on Fannie Mae's categorization of refinance mortgages for purposes of determining whether compliance with the provisions of Section 50(a)(6) is required. Rather, such lenders should consult with their counsel to determine the applicability of Section 50(a)(6) to a particular loan transaction.

Eligible Mortgage Products and Transaction Types

Texas Section 50(a)(6) mortgages must be fully amortizing mortgages with payments due on a monthly basis. The following are eligible as Texas Section 50(a)(6) mortgages:

- first liens only;
- fixed-rate mortgages

The following are not eligible as Texas Section 50(a)(6) mortgages:

- loans that are not in first-lien position,
- loans with temporary interest rate buydowns.

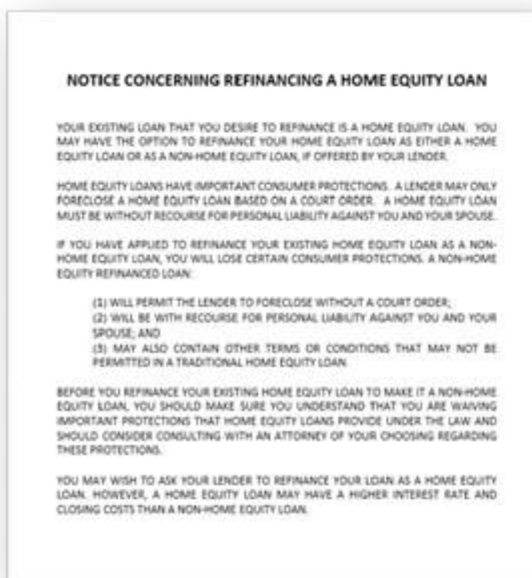
Texas Section 50(a)(6) Mortgage Loan Eligibility (continued)

Refinancing an Existing Home Equity Loan - Texas Conversion Transactions

Effective for loans made on or after 1/1/18, existing home equity loans (as identified in title work) may be refinanced as non-home equity loans (rate/term refinance transactions) and secured with a lien against the home, provided the following conditions are met:

- the refinance occurs at least a year after the home equity loan was closed;
- the additional loan amount only covers the actual costs of the refinancing, and does not provide the consumer with additional funds;
- the value of the new loan combined with the total of the outstanding principal balances of all other valid indebtedness secured by the homestead does not exceed 80% of the fair market value of the homestead on the date the extension of credit is made; and
- the lender provides the homeowner the written notice (required by and promulgated under Section (f)(2)(D) and referenced below) on a separate document no later than the third business day after the date the owner submits the loan application and at least 12 days before the closing of the refinance.

The 'Notice Concerning Refinance of a Texas Home Equity Loan Pursuant to Subsection (f)(2) of Article XVI, Section 50 of the Texas Constitution', must be provided to the owner:



NOTICE CONCERNING REFINANCING A HOME EQUITY LOAN

YOUR EXISTING LOAN THAT YOU DESIRE TO REFINANCE IS A HOME EQUITY LOAN. YOU MAY HAVE THE OPTION TO REFINANCE YOUR HOME EQUITY LOAN AS EITHER A HOME EQUITY LOAN OR AS A NON-HOME EQUITY LOAN, IF OFFERED BY YOUR LENDER.

HOME EQUITY LOANS HAVE IMPORTANT CONSUMER PROTECTIONS. A LENDER MAY ONLY FORECLOSE A HOME EQUITY LOAN BASED ON A COURT ORDER. A HOME EQUITY LOAN MUST BE WITHOUT RECOURSE FOR PERSONAL LIABILITY AGAINST YOU AND YOUR SPOUSE.

IF YOU HAVE APPLIED TO REFINANCE YOUR EXISTING HOME EQUITY LOAN AS A NON-HOME EQUITY LOAN, YOU WILL LOSE CERTAIN CONSUMER PROTECTIONS. A NON-HOME EQUITY REFINANCED LOAN:

(1) WILL PERMIT THE LENDER TO FORECLOSE WITHOUT A COURT ORDER;
(2) WILL BE WITH RECOURSE FOR PERSONAL LIABILITY AGAINST YOU AND YOUR SPOUSE; AND
(3) MAY ALSO CONTAIN OTHER TERMS OR CONDITIONS THAT MAY NOT BE PERMITTED IN A TRADITIONAL HOME EQUITY LOAN.

BEFORE YOU REFINANCE YOUR EXISTING HOME EQUITY LOAN TO MAKE IT A NON-HOME EQUITY LOAN, YOU SHOULD MAKE SURE YOU UNDERSTAND THAT YOU ARE WAIVING IMPORTANT PROTECTIONS THAT HOME EQUITY LOANS PROVIDE UNDER THE LAW AND SHOULD CONSIDER CONSULTING WITH AN ATTORNEY OF YOUR CHOOSING REGARDING THESE PROTECTIONS.

YOU MAY WISH TO ASK YOUR LENDER TO REFINANCE YOUR LOAN AS A HOME EQUITY LOAN. HOWEVER, A HOME EQUITY LOAN MAY HAVE A HIGHER INTEREST RATE AND CLOSING COSTS THAN A NON-HOME EQUITY LOAN.

For loans refinancing an existing home equity loan, the loan file must include the Texas Constitution Section 50(f-1) Affidavit Acknowledging Requirements of Subsection (f)(2), which must be properly executed under Texas law by the owner/owner's spouse.

NOTE: All the above requirements must be met in order for the home equity loan to be refinanced as a non-home equity loan.

Texas Section 50(a)(6) Mortgage Loan Eligibility (continued)

Texas Section 50(a)(6) Security Property

A Texas Section 50(a)(6) mortgage must be secured by a single-unit principal residence constituting the borrower's homestead under Texas law. Mortgages secured by two- to four-unit properties, investment properties, or second homes are not eligible. The security property may be

- a detached dwelling,
- an attached dwelling,
- a unit in a PUD project,
- a unit in a condo project

The borrower's property may not exceed the applicable acreage limit as determined by Texas law when the Texas Section 50(a)(6) mortgage is originated.

A borrower that owns adjacent land must submit appropriate evidence, such as a survey, that the mortgaged homestead property is a separate parcel that does not exceed the permissible acreage.

Texas Section 50(a)(6) Underwriting and Collateral Considerations

LTV/CLTV

Per Texas law, the maximum allowable LTV and combined LTV is 80%, notwithstanding any conflicting provisions of this Guide or any specific DU recommendation or finding. HELOC subordinate financing is not permitted, so no maximum HCLTV is applicable.

Underwriting and Loan Documentation

Texas Section 50(a)(6) mortgages are eligible for the reduced documentation requirements recommended by DU, provided that all other terms and conditions described herein for Texas Section 50(a)(6) mortgages shall apply.

This includes, but is not limited to, the additional representations and warranties, and requirements related to mortgage documentation, property valuation, title insurance, committing and delivery and servicing.

For a mortgage that represents the refinance of a Texas Section 50(a)(6) mortgage, the borrower must requalify even if CMS is currently servicing the existing mortgage that is being refinanced.

Property Valuation

CMS must obtain a new full appraisal, including both interior and exterior inspections, to determine current value on either *Uniform Residential Appraisal Report* (Form 1004), or *Individual Condominium Unit Appraisal Report* (Form 1073), even if DU recommends a different property valuation method or an Appraisal Waiver.

The appraisal for the property and the acknowledgment of fair market value must not include any property other than the homestead.

Texas Section 50(a)(6) Underwriting and Collateral Considerations (continued)

Property Valuation (continued)

The survey (or other acceptable evidence) must demonstrate that:

- the homestead property and any adjacent land are separate parcels, and
- the homestead property is a separately platted and subdivided lot for which full ingress and egress is available.

CMS selling the mortgage to Fannie Mae must not have any interest (such as an option to purchase, a security interest, or an easement) in any parcel adjacent to the homestead property that is owned by the borrower, if such interest could constitute additional security for the Texas Section 50(a)(6) mortgage.

Property Repairs

All property repairs must be completed prior to closing with no exceptions. Escrow holdbacks are not permitted.

Texas Section 50(a)(6) Mortgage Loan Delivery and Servicing Considerations

Special Feature Codes and Pricing

All Texas Section 50(a)(6) mortgages must be identified at delivery with SFC 304. In addition, CMS must enter the following special feature codes at loan delivery:

- SFC 304 and SFC 003 for each Texas Section 50(a)(6) mortgage that is classified as a cash-out refinance under Fannie Mae's policy,
- SFC 304 and SFC 007 for each Texas Section 50(a)(6) mortgage that is classified as a limited cash-out refinance under Fannie Mae's policy,
- These codes apply to both whole loans and MBS pool deliveries.

If CMS determines that a mortgage secured by a homestead property in Texas is classified as a cash-out refinance per this Guide but is not subject to Article XVI, Section 50(a)(6), of the Texas Constitution (i.e., is not a Texas Section 50(a)(6) mortgage), then the mortgage should be delivered as a standard (non-Texas Section 50(a)(6) mortgage) cash-out refinance transaction but should not be identified with SFC 304. (See Cash-Out Refinance Transactions.)

At delivery, all Texas Section 50(a)(6) mortgages that are classified as cash-out refinance transactions are subject to the loan-level price adjustments applicable to cash-out refinance mortgages per this Guide, as may be amended from time to time.

Servicing

CMS delivers a Texas Section 50(a)(6) mortgage to Fannie Mae may either service the mortgage, enter into a subservicing arrangement with another lender, or assign the servicing concurrent with its delivery to Fannie Mae.

Except as otherwise noted in the *Servicing Guide*, standard Fannie Mae servicing requirements apply to Texas Section 50(a)(6) mortgages.

Texas Section 50(a)(6) Mortgage Legal Considerations

Mortgage Documentation

CMS must originate Texas Section 50(a)(6) mortgages using the *Texas Home Equity Security Instrument (First Lien)* (Form 3044.1) and the specific Texas Section 50(a)(6) notes and riders, as well as a special Section 50(a)(6) borrower affidavit. Refer to Texas Section 50(a)(6) Mortgage Documentation.

The borrower(s) must be provided a complete and accurate copy of the Final URLA, no later than one (1) business day prior to loan closing.

The borrower(s) must be provided a complete and accurate copy of the Final Closing Disclosure no later than one (1) business day prior to loan closing.

Title Insurance

For all Texas Section 50(a)(6) mortgages, a title insurance policy written on Texas Land Title Association forms (standard or short form), supplemented by an *Equity Loan Mortgage Endorsement* (Form T-42) and a *Supplemental Coverage Equity Loan Mortgage Endorsement* (Form T-42.1), is required.

Note: There may be no exceptions or deletions to the coverage provided by Paragraphs 2(a) through (e) of the T-42 endorsement, and the endorsement must include the optional coverage provided by Paragraph 2(f), as well as the additional coverage provided by Endorsement T-42.1.

The title insurance policy cannot include language that:

- excludes coverage for a title defect that arises because financed origination expenses are held not to be “reasonable costs necessary to refinance” or
- defines the “reasonable costs necessary to refinance” requirement as a “consumer credit protection” law since the standard title policy excludes coverage when lien validity is questioned due to a failure to comply with consumer credit protection laws.

Texas Section 50(a)(6) Mortgage Documentation

Texas Section 50(a)(6) Mortgage Documentation

Section 50(a)(6) of Article XVI of the Texas Constitution permits a home equity loan to be secured by the borrower’s homestead property under certain conditions. Mortgages originated under this provision are referred to as Section 50(a)(6) mortgages. This provision includes numerous consumer safeguards and significant lender penalties for noncompliance. To facilitate compliance with the provisions of Section 50(a)(6), Fannie Mae has developed a special security instrument that must be used in connection with mortgages originated under these provisions and special notes and riders that must be used with this special security instrument, as well as a special affidavit that must be prepared and recorded in connection with each Section 50(a)(6) transaction.

Because of the complexities involved in closing Section 50(a)(6) mortgages and the possibility that a valid lien may not be created, it is important that a lender provide the title company with a detailed closing instruction letter and require an acknowledgment of its receipt.

Texas Section 50(a)(6) Mortgage Documentation (continued)

Texas Section 50(a)(6) Mortgage Documentation (continued)

The closing instructions must require the title company to conduct its closings properly to ensure compliance with Section 50(a)(6). To assist in this endeavor, the *Texas Home Equity Affidavit and Agreement First Lien* (Form 3185) must be prepared and recorded in connection with each Section 50(a)(6) mortgage transaction. This document sets out many of the consumer safeguards to which the borrower is entitled:

- the receipt of copies of all closing documents;
- a statement of all fees imposed or collected by the title company;
- a caution against signing documents with unfilled blanks;
- the receipt of a required notice concerning the extension of credit;
- the receipt of a final itemized disclosure of the actual fees, points, interest, costs, and charges that would be charged at closing;
- a cooling-off period before closing;
- no disbursement of funds until after the applicable rescission period; and
- a written acknowledgment of the fair market value of the property (with a copy of the property appraisal).

By signing this document, the borrower acknowledges the actions that were taken to ensure that he or she received all of the required notices and safeguards required under the revised Texas Constitution. Fannie Mae suggests that CMS also require each borrower to sign a closing receipt that itemizes the documents that he or she received at closing.

For additional Texas Section 50(a)(6) mortgage documentation (also called "Texas Home Equity" documentation) refer to Negotiated Texas Home Equity Notes (under Negotiated Instruments) and *Texas Home Equity Security Instrument* (also under Negotiated Instruments).

INSURANCE

Mortgage Insurance / Loan Guaranty Overview

General Requirements

CMS must ensure that any mortgage insurance Fannie Mae requires for a mortgage loan is in place. CMS must obtain and be able to produce evidence of any required mortgage insurance or loan guaranty.

Unless CMS has provided another charter-compliant form of credit enhancement, CMS must obtain a primary mortgage insurance policy for a conventional first mortgage loan that has an LTV ratio greater than 80% at the time it is purchased for Fannie Mae's portfolio or securitized. (For this purpose, the LTV ratio is calculated based upon the unpaid principal balance of the mortgage loan at the time it is purchased or securitized by Fannie Mae.)

- For a purchase money loan, the value used in determining the LTV ratio is the lower of the sales price or the appraised value of the security property.
- For a refinance loan, the value used in originating the loan can be derived from an appraisal, AVM, or other acceptable method.

Conventional mortgages may be insured by private mortgage insurers or state or local insuring agencies that have been approved under Fannie Mae's Qualified Mortgage Insurer Approval Requirements to insure loans sold to or serviced for Fannie Mae. For a listing of the eligible conventional mortgage insurers and their associated mortgage insurance codes, see *Approved Mortgage Insurers and Related Identifiers*. The website is the definitive source for approved mortgage insurers.

The form of mortgage insurance policy, including any endorsements, must be acceptable to Fannie Mae.

Use of Approved Forms

CMS is responsible for ensuring that only Fannie Mae-approved mortgage insurance forms and related endorsements and other forms (Forms) are used in connection with individual loans sold to or securitized by Fannie Mae. These Forms provide the terms of mortgage insurance coverage on individual loans. A list of Fannie Mae-approved Forms for each insurance provider is available on Fannie Mae's website – see Approved Mortgage Insurance Forms.

Any mortgage loan sold to or securitized by Fannie Mae that requires primary mortgage insurance (or is delivered with primary mortgage insurance even though not required) and has a loan application date on or after October 1, 2014, must be insured under one of the Fannie Mae- approved Forms. If such loan is insured under any pre-existing forms or agreements between lenders and mortgage insurers, the loan is not eligible for sale to Fannie Mae, and is subject to repurchase if identified after acquisition by Fannie Mae.

Mortgage Insurance / Loan Guaranty Overview (continued)

Use of Approved Forms (continued)

Any mortgage loan sold to or securitized by Fannie Mae that requires primary mortgage insurance (or is delivered with primary mortgage insurance even though not required) and has a loan application date prior to October 1, 2014, may be insured under either

- one of the Fannie Mae-approved Forms; or
- any pre-existing forms and agreements between lenders and mortgage insurers, as long as CMS first confirms with the mortgage insurer that such forms and agreements were approved by Fannie Mae for use at the time of the loan application date.

Exception

Insured balloon loans that are modified or refinanced may continue to be insured pursuant to the forms and agreements under which the existing loan is insured regardless of the loan application date of the new loan. However, the new loan must be insured pursuant to a modification of the existing mortgage insurance certificate, which may or may not involve the assignment of a new certificate number by the mortgage insurer. If the mortgage insurer issues an entirely new mortgage insurance certificate, this exception does not apply.

LTV Ratio Determination in New York State

Under a New York statute, a mortgage insurer must issue mortgage insurance based on a determination of the “fair market value” of the property. The term “fair market value” is not defined in the statute, but has been defined by the New York insurance regulator as being the “appraised value.” Per the statute, the issuance of mortgage insurance must be based on the “purchase price of the ownership interest and the proprietary lease.”

As a result, the determination of value for properties in New York is different from Fannie Mae’s standard definition of value that is used to calculate the LTV ratio. The following table identifies the value calculation that is to be used for mortgage loans secured by properties in New York for policies that are based on the LTV ratio.

LTV Ratio Calculation	Policy
LTV ratio based on the appraised value for non-co-op properties	CMS must base their determination of when mortgage insurance is required solely on the appraised value of the property. If the appraised value of the property exceeds the sales price, this determination may result in mortgage insurance not being placed on a mortgage loan as would otherwise be required using Fannie Mae’s standard definition. If this calculation results in mortgage insurance not being placed on the loan where mortgage insurance would otherwise have been required using Fannie Mae’s standard definition, CMS must deliver the loan to Fannie Mae using the MI Absence Reason Type of “No MI Based On Original LTV” (Sort ID 429).

Mortgage Insurance / Loan Guaranty Overview (continued)

LTV Ratio Determination in New York State (continued)

LTV Ratio Calculation	Policy
LTV ratio based on the lower of the sales price or appraised value (standard LTV ratio calculation) for all property types	Irrespective of the use of appraised value or sales price for determining whether mortgage insurance is required, this standard LTV ratio calculation must be used to determine the **level** of mortgage insurance coverage that is required on the mortgage loan. See Loan to Value (LTV) Ratios, and Mortgage Insurance Coverage Requirements, for additional information.
LTV ratio based on the lower of the sales price or appraised value (standard LTV ratio calculation) for all property types	The standard LTV ratio calculation must also be used • to determine whether the loan satisfies any of Fannie Mae's other eligibility criteria that are based on the LTV ratio of the loan; • to determine any loan-level price adjustments derived from Fannie Mae's pricing matrix that includes LTV ratios or CLTV ratios as a risk attribute in its lookup table; and when the loan is delivered to Fannie Mae (Sort ID 254). (The standard LTV ratio must be delivered even if the appraised value or sales price is used to determine that mortgage insurance coverage is not required.)

Payment of Mortgage Insurance Premiums

Premium plans for mortgage insurance may be:

- monthly plans – monthly premiums from accumulated escrow deposits (with no initial payment at closing), or
- annual plans – an initial payment at closing to cover the first year's premium and annual renewal premiums thereafter paid from accumulated escrow deposits, or
- single-premium plans – lump-sum premium at closing to purchase life-of-the-mortgage coverage.

Mortgage Insurability

Each loan CMS delivers to Fannie Mae must be insurable. A mortgage is insurable if a mortgage insurer would not decline to insure it by reason of any fraud, misrepresentation, negligence, or dishonest, criminal, or knowingly wrongful act in origination or servicing, and would not be entitled to deny a claim by reason of any of the foregoing.

Mortgage Insurance / Loan Guaranty Overview (continued)

Mortgage Insurance Coverage Requirements

The table below provides the mortgage insurance coverage requirements for first–lien mortgages. CMS requires standard coverage for the transaction type.

Mortgage Insurance Coverage Requirements				
	LTV Range			
Transaction Type	**80.01 – 85.00%**	**85.01-90.00%**	**90.01-95.00%**	**95.01-97.00%**
All property types other the standard manufactured homes				
Fixed-rate, term ≤ 20 years	6%	12%	25%	35%
Fixed-rate, term > 20 years	12%	25%	30%	35%
HomeReady Mortgages: Fixed-rate, term ≤ 20 years	6%	12%	25%	25%
HomeReady Mortgages: Fixed-rate, term > 20 years	12%	25%	25%	25%
Standard manufactured homes				
Fixed-rate, any term	12%	25%	30%	Not Applicable
HomeReady Mortgages	12%	25%	25%	

Financed Borrower-Purchased Mortgage Insurance

Financed Mortgage Insurance Requirements

Financed mortgage insurance transactions are defined by all of the following characteristics:

- All or a portion of the borrower-purchased mortgage insurance premium (split and single-premium plans) is included in the loan amount.
- The loan amount including the financed mortgage insurance premium cannot exceed the applicable maximum Fannie Mae loan limit. See Loan Limits.
- The loan purpose is purchase, construction, or limited cash-out refinance.

Financed Borrower-Purchased Mortgage Insurance (continued)

Financed Mortgage Insurance Requirements (continue)d)

- The mortgage loan is secured by a one-unit property that is the borrower's principal residence or second home.
- The mortgage insurance coverage amount can be standard coverage (which does not require an LLPA) or minimum coverage (with a corresponding LLPA).
- The mortgage insurance coverage amount is determined based on the base LTV ratio – the LTV ratio calculated without the financed premium.
- The gross LTV ratio – the LTV ratio calculated with the financed premium – is used to determine the maximum LTV ratio permitted for the transaction. The LTV ratio may never exceed the LTV ratio allowed per the Eligibility Matrix.
- If the loan is subject to any LLPAs, including LLPAs associated with minimum mortgage insurance coverage, the LLPAs are based on the gross LTV ratio.

Note: Refer to the Loan-Level Price Adjustment (LLPA) Matrix for certain exceptions to LLPAs for mortgage loans with financed mortgage insurance.

- CMS must ensure that language related to any financed mortgage insurance premium is included either directly in the applicable mortgage insurance master primary policy or in an endorsement to that policy, which language provides that the insurance benefit paid pursuant to the "percentage option" in satisfaction of a claim be calculated as:
  - [the claim amount minus the unamortized portion of the financed mortgage insurance premium] multiplied by the applicable coverage percentage, PLUS
  - the unamortized portion of the financed mortgage insurance premium.
- Certain delivery requirements for financed mortgage insurance transactions must be met. See Delivery Requirements below.

Note: Fannie Mae provides two options for limited cash-out refinance transactions that include mortgage insurance in the loan amount. A "financed mortgage insurance transaction" requires the lender to identify the upfront financed mortgage insurance amount separately and provide the required special feature code at delivery such that the base LTV can be determined. All of the above requirements must be met for the transaction to be defined as a financed mortgage insurance transaction. A "prepaid mortgage insurance transaction" permits the lender to include the amount of the upfront mortgage insurance premium and other allowable closing costs and prepaid items in the loan amount, and not separately identify the prepaid mortgage insurance at delivery. See Prepaid Mortgage Insurance Transactions below for additional information.

Financed Borrower-Purchased Mortgage Insurance (continued)

Ineligible Transactions

The following mortgage loans are not eligible for delivery to Fannie Mae if they include financed borrower-purchased mortgage insurance:

- mortgage loans secured by two- to-four-unit properties,
- mortgage loans secured by investment properties, and
- cash-out refinance loans.

Note: Lender-paid mortgage insurance premiums cannot be financed into the loan amount and are therefore not considered financed mortgage insurance transactions.

Delivery Requirements

The following delivery requirements apply to financed mortgage insurance transactions:

- The Financed MI Amount and MI Financed Indicator must be delivered.
- The delivery file must also contain the purchase price (for purchase transactions) and appraised value (for purchase and refinance transactions) to allow for accurate calculation of the base LTV ratio.
- The loan must be delivered with SFC 281.
- All other mortgage insurance-related data elements must be provided (MI Company Name, Percent of MI Coverage, Certificate Number, and MI Source).

For additional information, see Uniform Loan Delivery Dataset (ULDD) on Fannie Mae's website.

Prepaid Mortgage Insurance Transactions

Fannie Mae's refinance guidelines permit borrowers to finance the payment of closing costs, prepaid items, and points in the loan amount. When the borrower includes any portion of the borrower-paid mortgage insurance premium or monthly escrows into the loan amount (with other closing costs or prepaid items), it is considered a "prepaid mortgage insurance transaction" and not a financed mortgage insurance transaction. For a loan to be eligible for delivery to Fannie Mae with prepaid mortgage insurance, the loan must meet all the standard requirements of these guidelines, and the following requirements applicable to this type of loan:

- The mortgage insurance coverage amount is determined based on the LTV ratio that is calculated after the inclusion of all the closing costs, prepaid items, and points. (The concept of "gross LTV ratio" and "base LTV ratio" are not applicable to prepaid mortgage insurance transactions because the financed mortgage insurance amount is not identified at loan delivery.)
- The loan is not to be delivered as a financed mortgage insurance transaction – CMS should not deliver SFC 281 or the other financed mortgage insurance data elements.
- The Financed MI Premium Endorsement to the mortgage insurance policy should not be obtained.

Lender-Purchased Mortgage Insurance

Overview

Fannie Mae accepts lender-purchased mortgage insurance coverage for all loan types except adjustable-rate mortgages that permit negative amortization, or those that can be converted to fixed-rate mortgages.

Fannie Mae will consider accepting lender-purchased mortgage insurance for convertible adjustable-rate mortgages that are in MBS pools if CMS uses the “market rate” post- conversion disposition option and assumes all interest rate risk.

CMS allows lender-purchased mortgage insurance (LPMI) coverage.

- MI certificate must be obtained prior to clear to close.
- Full credit file needs to be submitted to MI Company.
- Lender Paid Disclosure Form must be provided to the borrower.
- CMS must deliver the loan with Special Feature Code (SFC) 019.
- Lump-sum (single) premium plan that provides coverage for the life-of-the loan is required.
- Mortgage insurance coverage must remain in effect until the mortgage is paid in full.

Lender-Purchased Mortgage Insurance (continued)

CMS Requirements

When providing lender-purchased mortgage insurance, CMS must:

- make any and all disclosures to the borrower that are either required by law, including the Homeowners Protection Act of 1998, or are otherwise appropriate for lender-purchased mortgage insurance coverage;
- pay for the mortgage insurance coverage as a corporate obligation with an initial premium and renewal premiums for each subsequent period of coverage, which may be a month or a year. Lump-sum premium plans that provide coverage for the life-of-the-mortgage loan also are acceptable;
- increase the servicing compensation it would otherwise be required to retain for the mortgage loan (whether the mortgage loan is submitted as a whole loan or MBS pool delivery) by at least the amount of the mortgage insurance renewal premium. (This is not required for lump-sum premium plans that provide life-of-the-mortgage coverage.);
- keep the mortgage insurance coverage in effect until the mortgage is paid in full;
- deliver the loan with SFC 019; and
- when servicing is transferred, CMS must provide the new servicer with a list of all mortgage loans with this type of insurance that are included in the portfolio that is being transferred (identifying the applicable premium rates), explaining the premium payment obligations and procedures applicable to these mortgage loans, and transferring the accruals on deposit for the payment of future renewal premiums to the new servicer (or making an appropriate adjustment to the servicing transfer settlement).

Title Insurance

Provision of Title Insurance

Before purchase or securitization, each first mortgage loan delivered to Fannie Mae must have a title insurance policy in place that satisfies Fannie Mae’s requirements.

By delivering a mortgage loan to Fannie Mae, CMS represents and warrants that the loan is covered by the required title policy issued by an acceptable insurer, including any required endorsements.

Title Insurer Requirements

Rating Requirements

A title insurer is acceptable if it has a rating from at least one independent rating agency that meets the following standards.

Rating Agency	Rating Requirements
Demotech, Inc.	Financial Stability Rating of “S” (Substantial) or better or a Statutory Accounting Rating of “C” (Average) or better
Duff & Phelps Credit Rating C	“BBB” or better
Fitch, Inc.	“BBB” or better
Kroll Bond Rating Agency, Inc.	“C” or better
Moody’s Investors Service	“Baa2” or better
Standard and Poor’s, Inc.	“BBB” or better

If Fannie Mae determines that a particular title agency is unacceptable even if it meets these ratings, it will notify CMS by posting the name of the insurer on Fannie Mae's website.

Insurer No Longer Eligible

If a title insurer that satisfied Fannie Mae’s rating requirement when a mortgage was closed no longer satisfies it at the time the mortgage is delivered to Fannie Mae, CMS must contact its lead Fannie Mae regional office to determine where or under what conditions the loan is eligible for delivery to Fannie Mae.

New Insurer Not Yet Rated

If a new title insurer has not yet been rated by at least one of Fannie Mae’s designated rating agencies, CMS may request a waiver of Fannie Mae’s requirement by sending its lead Fannie Mae regional office sufficient financial information about the title insurer to enable Fannie Mae to make a proper evaluation of the insurer’s financial condition and any risks that it might present to Fannie Mae.

Ineligible Insurer Covered by Reinsurance

If an insurer is fully covered by reinsurance with a company that satisfies Fannie Mae’s rating requirement, the insurer is acceptable provided that the primary insurer and the reinsuring company are both licensed to issue title insurance within the state where the property is located and are in good standing with that state’s insurance regulator.

Both insurance carriers must execute an *Assumption of Liability Endorsement* (Form 858) or an equivalent endorsement that provides for 100% reinsurance of the primary insurer’s policy and a 90-day written notice of termination of the reinsurance agreement. The alternative endorsement must be attached to the title insurance policy for each individual mortgage.

General Title Insurance Coverage

Terms of Coverage

The title insurance policy must ensure that the title is generally acceptable and that the mortgage constitutes a lien of the required priority on a fee simple or leasehold estate in the property.

The title policy also must list all other liens and state that they are subordinate to Fannie Mae's Mortgage lien.

Loan Origination Date	Title Policy Requirements
On or after January 1, 2008	The title policy must be written on one of the following forms: • the 2006 American Land Title Association (ALTA) standard form; • an ALTA short form if it provides coverage equivalent to the 2006 ALTA standard form and does not materially impair protection to Fannie Mae; • in states in which standard ALTA forms of coverage are, by law or regulation, not used, the state-promulgated standard or short form which provides same coverage as the equivalent ALTA form, provided that those forms do not materially impair protection to Fannie Mae.
Prior to January 1, 2008	The title policy must either use the appropriate 2006 ALTA form noted below, or ensure that title coverage meets the requirements in place at the time of mortgage loan origination.

General Title Insurance Coverage (continued)

Effective Date of Coverage	The effective date of the title insurance coverage written on forms that do not provide the gap coverage included in the 2006 ALTA policies may be no earlier than the later of the date of the final disbursement of loan proceeds or the date the mortgage was recorded. Because the 2006 ALTA forms provide protection for the time between loan closing and recordation of the mortgage, policies written on those forms may be effective as of loan closing.
Amount of Coverage	The amount of title insurance coverage must at least equal the original principal amount of the mortgage.
Other Requirements	If a mortgage is registered with MERS and is originated naming MERS as original mortgagee of record, solely as nominee for CMS named in the security instrument and the note, and CMS successors and assigns, then the "insured mortgage" covered by the title insurance policy must be identified in the title insurance policy as the security instrument given to MERS, solely as nominee for the lender and CMS successors and assigns. However, under no circumstances may MERS be named as the insured of a title policy. The title insurance coverage must include an environmental protection lien endorsement (ALTA Endorsement 8.1-06 or equivalent state form provides the required coverage). References are to the ALTA 2006 form of endorsement, but state forms may be used in states in which standard ALTA forms of coverage are, by law or regulation, not used, provided that those endorsements do not materially impair protection to Fannie Mae. As an alternative to endorsements, the requisite protections may be incorporated into the policy. For loans originated prior to January 1, 2008, endorsement forms that meet Fannie Mae’s requirements at the time of origination are acceptable. Title policies may not include the creditors’ rights exclusion language that ALTA adopted in 1990.

Special Title Insurance Coverage Considerations

Condo and PUD Unit Mortgages

The title insurance policy for a condo or PUD unit mortgage must describe all components of the unit estate.

For condo unit mortgages, an ALTA 4-06 or 4.1-06 endorsement or its equivalent is required. For PUD unit mortgages, an ALTA 5-06 or 5.1-06 endorsement or its equivalent is required. These endorsements must be attached to each policy or incorporated in the text of the policy.

If the unit owners own the common areas of the project as tenants in common, the policy for each unit mortgage must reflect that ownership.

If the homeowners' association owns the common elements, areas, or facilities of the project separately (or holds them in a leasehold estate), the title insurance on those areas must insure that ownership.

This title policy must show that title to the common elements, areas, or facilities is free and clear of any objectionable liens and encumbrances, including any statutory or mechanics' liens for labor or materials related to improvements on the common areas that began before the title policy was issued.

The title policy must protect Fannie Mae by insuring the following:

- that the mortgage is superior to any lien for unpaid common expense assessments. (In jurisdictions that give these assessments a limited priority over a first or second mortgage lien, the policy must provide assurance that those assessments have been paid through the effective date of the policy.)
- against any impairment or loss of title of Fannie Mae's first or second lien caused by any past, present, or future violations of any covenants, conditions, or restrictions of the master deed for the project. (It must specifically insure against any loss that results from a violation that existed as of the date of the policy.)
- that the unit does not encroach on another unit or on any of the common elements, areas, or facilities. (The policy also must insure that there is no encroachment on the unit by another unit or by any of the common elements, areas, or facilities.)
- that the mortgage loan is secured by a unit in a condo project that has been created in compliance with the applicable enabling statutes;
- that real estate taxes are assessable and lienable only against the individual condo unit and its undivided interest in the common elements, rather than against the project as a whole; and
- that the owner of a PUD unit is a member of the homeowners' association and that the membership is transferable if the unit is sold.

Special Title Insurance Coverage Considerations (continued)

Mortgages Subject to Leasehold Estates

A mortgage that is subject to a leasehold estate must have an ALTA Endorsement 13.1-06.

Other Mortgages

The table below provides the title insurance coverage requirements or endorsements for other types of mortgage loans.

Transaction Type	Title Insurance Requirements
Texas Section 50(a)(6) mortgage	Fannie Mae requires a Mortgagee Policy of Title Insurance (Form T-2), supplemented by an Equity Loan Mortgage Endorsement (Form T-42) including the optional coverage provided by Paragraph 2(f) and a Supplemental Coverage Equity Loan Mortgage Endorsement (Form T-42.1). Refer to Texas Section 50(a)(6) Mortgage Legal Considerations for more information.

Title Exceptions and Impediments

Title Exceptions

Fannie Mae will not purchase or securitize a mortgage secured by property that has an unacceptable title impediment, particularly unpaid real estate taxes and survey exceptions.

If surveys are not commonly required in particular jurisdictions CMS must provide an ALTA 9 Endorsement. If it is not customary in a particular area to supply either the survey or an endorsement, the title policy must not have a survey exception. However, if CMS substantiates that a first mortgage title policy was issued without a survey exception, Fannie Mae will purchase or securitize a second mortgage secured by the same property even though it has a survey exception.

Minor title impediments must not materially affect the marketability of the property. CMS must indemnify Fannie Mae (as described in Indemnification for Losses) for any Fannie Mae losses that can be directly attributed to the impediment(s).

Requests for waivers of exceptions to title should be submitted in writing to CMS lead Fannie Mae regional office and should provide appropriate justification for the waiver.

Property Insurance Requirements for Insurers

Provision of Property Insurance

Each borrower has the right to select his or her own insurance carrier to provide property insurance for the security property, provided that the insurance policy and coverage meet Fannie Mae's requirements. CMS must ensure that the insurance carrier, policy, and coverage meet Fannie Mae's requirements. In some cases, Fannie Mae may require additional coverage or consider coverage that differs from these requirements.

Rating Requirements

The property insurance policy for the insurable improvements of the property securing any first-lien mortgage loan, including master policies for condo, co-op, and PUD projects, must be written by a carrier that meets one of the rating requirements in the following table.

Rating Agency	Rating Category
A.M. Best Company, Inc.	Carriers rated by the A.M. Best Company, Inc. must have either: • 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*.
Demotech, Inc	“A” or better rating in Demotech’s Hazard Insurance Financial Stability Ratings
Kroll Bond Rating Agency	BBB” or better rating in Kroll Bond Rating Agency's Insurance Financial Strength Rating (IFSR)
Standard & Poor’s (S&P)	BBB” or better Insurer Financial Strength Rating in Standard & Poor’s Ratings Direct Insurance Service

Note: If a carrier is rated by more than one rating agency, it only has to meet the requirements for one of them.

Exceptions to Property Insurance Requirements

Fannie Mae also accepts the following types of property insurance policies 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.

Property Insurance Requirements for Insurers (continued)

Exceptions to the Rating Requirements

The following are exceptions to Fannie Mae's property insurance carrier rating requirements:

- **Second mortgages** — The property insurance policy for a property that secures a second mortgage does not have to be written by an insurance carrier that meets Fannie Mae's criteria, unless Fannie Mae has an interest in the first mortgage.
- **Mortgage impairment (or mortgagee interest) insurance** — If the servicer is covered by mortgage impairment (or mortgagee interest) insurance, Fannie Mae does not require confirmation that the borrower's property insurance coverage is with a firm that meets its rating requirements (although CMS should advise the borrower of Fannie Mae's requirements when it originates the mortgage).
- **Reinsurance arrangements** — The policies of an insurer that does not meet Fannie Mae's rating requirement are acceptable provided all conditions outlined in the following table are met:

✓	Conditions for Acceptable Reinsurance Arrangements
	The insurer is covered by reinsurance with a company that meets the A.M. Best Financial Strength Ratings or Standard & Poor's Insurer Financial Strength Rating, as listed in Property Insurance Rating Requirements.
	The primary insurer and the reinsuring company are authorized (or licensed, if required) to transact business within the state where the property is located.
	The reinsurance agreement has a "cut-through" endorsement that provides for the reinsurer to become immediately liable for 100% of any loss payable by the primary insurer in the event the primary insurer becomes insolvent.
	Both the primary insurer and the reinsuring company execute an Assumption of Liability Endorsement (Form 858), or any equivalent endorsement that provides for 100% reinsurance of the primary insurer's policy and a 90-day written notice to Fannie Mae of the termination of the reinsurance arrangement. Note: Form 858 (or the equivalent endorsement) must be attached to each insurance policy covered by the reinsurance agreement, unless the seller/servicer is covered by a mortgage impairment (or mortgagee interest) insurance policy.
	The reinsurance agreement does not allow contributions or assessments to be made against Fannie Mae or to become a lien on the property that is superior to Fannie Mae's lien.
	The insurance written under the policy cannot exceed any dollar limitation amount specified in the reinsurance endorsement.

General Property Insurance Coverage

Coverage Requirements

Property insurance for properties securing loans delivered to Fannie Mae 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.

Fannie Mae does not accept property 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.

CMS should advise borrowers that they may not obtain property 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.

Additional requirements apply to properties with solar panels that are leased from or owned by a third party under a power purchase agreement or other similar arrangement. See Special Property Eligibility Considerations, for additional requirements.

First Mortgages

For a first mortgage secured by a property on which an individually held insurance policy is maintained, Fannie Mae requires coverage equal to the lesser of the following:

- 100% of the insurable value of the improvements, as established by the property insurer; or
- the unpaid principal balance of the mortgage, as long as it at least 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.

Determining the Amount of Required Property Insurance Coverage provides a formula for determining the amount of property insurance coverage generally required for a first mortgage.

Second Lien Mortgages

When the existing coverage for a property that secures a second lien mortgage does not provide coverage equal to the lesser of 100% of the insurable value of the property improvements or the combined unpaid principal balance of the first and second mortgages (as long as that equals at least 80% of the insurable value of the improvements), CMS must require the borrower to obtain appropriate endorsements to bring the coverage in line with Fannie Mae's requirements. A copy of any endorsements should be sent to the first mortgage servicer.

General Property Insurance Coverage (continued)

Deductible Amount

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

Determining the Amount of Required Property Insurance Coverage

The following table describes how to calculate the amount of required property insurance coverage:

Step	Description
1	Compare the insurable value of the improvements as established by the property insurer to the unpaid principal balance of the mortgage loan.
1A	If the insurable value of the improvements is less than the unpaid principal balance, the insurable value is the amount of coverage required.
1B	If the unpaid principal balance of the mortgage loan is less than the insurable value of the improvements, go to Step 2.
2	Calculate 80% of the insurable value of the improvements.
2A	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.
2B	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.

Examples:

Category	Property A	Property B	Property C
Insurable Value	$90,000	$100,000	$100,000
Unpaid Principal Balance	$95,000	$90,000	$75,000
80% Insurable Value	—	$80,000	$80,000
Required Coverage	$90,000	$90,000	$80,000
Calculation Method	Step 1A	Step 2A	Step 2B

Property Insurance Coverage for Units in Project Developments

Coverage for Units in Project Developments

Fannie Mae generally does not require individual insurance policies for a condo unit that secures a first mortgage. However, if the legal documents for the project allow for unit insurance policies for each first mortgage that Fannie Mae purchases or securitizes in a condo, Fannie Mae will accept the individual unit insurance policies that meet the requirements in Evidence of Property Insurance and Property and Flood Insurance.

Required Coverage for Condo or PUD Projects

This section covers property insurance requirements for insurance policies covering the common elements of condo and PUD projects—the project's blanket or master policy.

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, Fannie Mae will accept a policy that includes the "broad form" covered causes of loss. The applicable requirements are:

- **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 that Fannie Mae purchases in a PUD project. If the project's legal documents allow for blanket insurance policies to cover both the individual units and the common elements, Fannie Mae will accept the blanket policies in satisfaction of its insurance requirements for the units.

- **Condo Requirements** — CMS must review the entire condo project insurance policy to ensure the HOA maintains a master or blanket type of insurance policy, with premiums being paid as a common expense. The insurance requirements vary based on the type of HOA master or blanket insurance policy as follows:

Property Insurance Coverage for Units in Project Developments (continued)

Required Coverage for Condo, or PUD Projects (continued)

- “Single Entity” policy: The policy must cover all of the general and limited common elements that are normally included in coverage. These include fixtures, building service equipment, and common personal property and supplies belonging to the HOA. The policy also must cover fixtures, equipment, and replacement of improvements and betterments that have been made inside the individual unit being financed. The amount of coverage must be sufficient to restore the condo unit to its condition prior to a loss claim event. If the unit interior improvements are not included under the terms of this policy type, the borrower is required to have an HO-6 policy with coverage, as determined by the insurer, which is sufficient to repair the condo unit to its condition prior to a loss claim event.
- “All-In” (sometimes known as an “all-inclusive”) policy: The policy must cover all of the general and limited common elements that are normally included in coverage. These include fixtures, building service equipment, and common personal property and supplies belonging to the HOA. The policy also must cover fixtures, equipment, and replacement of improvements and betterments that have been made inside the individual unit being financed. If the unit interior improvements are not included under the terms of this policy type, the borrower is required to have an HO-6 policy with coverage, as determined by the insurer, which is sufficient to repair the condo unit to its condition prior to a loss claim event.
- “Bare Walls” policy: This policy typically provides no coverage for the unit interior, which includes fixtures, equipment, and replacement of interior improvements and betterments.

  As a result, the borrower must obtain an individual HO-6 policy that provides coverage sufficient to repair the condo unit to its condition prior to a loss claim event, as determined by the insurer.

Amount of 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.

Property Insurance Coverage for Units in Project Developments (continued)

Policies with Coinsurance

Policies with coinsurance provisions can create additional risk for an HOA in the event of a loss if the amount of insurance coverage is less than the full insurable value. Master property policies that provide coverage at 100% of the insurable replacement cost of the project improvements, including the individual units, alleviate the risk of a coinsurance penalty being applied in the event of a loss.

If the policy has a coinsurance clause, inclusion of an Agreed Amount Endorsement or selection of the Agreed Value Option (which waives the requirement for coinsurance) is considered acceptable evidence that the 100% insurable replacement cost requirement has been met. If an Agreed Amount/Agreed Value provision is used, the Agreed Amount must be no less than the estimated replacement cost.

If the policy includes a coinsurance clause, but the coinsurance provision is not waived, the policy is still eligible if evidence acceptable to CMS confirms that the amount of coverage is at least equal to 100% of the insurable replacement cost of the project improvements. This evidence (documentation) must be maintained by CMS.

Maximum Deductible Amounts

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

For losses related to individual units in 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.

Special Endorsements

The requirements for endorsements for condo and PUD projects are as follows:

- Inflation Guard Endorsement, when it can be obtained;
- Building Ordinance or Law Endorsement, if the enforcement of any building, zoning, or land-use law would result in loss or damage, increased cost of repairs or reconstruction, or additional demolition and removal costs to rebuild after a covered loss event occurs.
- The endorsement must provide for contingent liability from the operation of building laws, demolition costs, and increased costs of reconstruction. The endorsement is not required if it is not applicable or the coverage is not obtainable in the insurance market available to the association; and

Property Insurance Coverage for Units in Project Developments (continued)

Special Endorsements (continued)

- Boiler and Machinery/Equipment Breakdown Endorsement, if the project has central heating or cooling. This endorsement should provide for the insurer's minimum liability per accident to at least equal the lesser of $2 million or the insurable value of the building(s) housing the boiler or machinery. In lieu of obtaining this as an endorsement to the commercial package policy, the project may purchase separate standalone boiler and machinery coverage.

Special Requirements for Condo Projects

Additional insurance policy requirements for condo projects are as follows:

- Any Insurance Trust Agreement is recognized.
- The right of subrogation against unit owners is waived.
- The insurance is not prejudiced by any acts or omissions of individual unit owners that are not under the control of HOA.
- The policy must be primary, even if a unit owner has other insurance that covers the same loss.

Named Insured

The table below provides the requirements regarding the name of the insured entity.

Coverage Type	Requirement for Named Insured
Condo projects	The policy must show the HOA as the named insured. If the condo's legal documents permit it, the policy can specify an authorized representative of the HOA, including its insurance trustee, as the named insured. The "loss payable" clause should show the HOA or the insurance trustee as a trustee for each unit owner and the holder of each unit's mortgage loan.
PUD common areas	The policy must show the HOA as the named insured.

See Mortgagee Clause for Property and Flood Insurance, for additional requirements that pertain to the mortgagee clause requirements.

Property Insurance Coverage for Units in Project Developments (continued)

Notices of Changes or Cancellation

The table below provides the notification requirements for notices of policy changes or cancellations.

Project Type	Requirement
Condo	The policy must require the insurer to notify in writing the HOA (or insurance trustee) at least 10 days before it cancels or substantially changes a condo project's coverage.

Additional Property Insurance Coverage

If CMS believes that a security property is exposed to hazards that fire and extended coverage do not protect against—such as toxic waste—it should contact Fannie Mae to determine whether additional coverage is necessary.

Unacceptable Types of Optional Coverage

Although certain property insurance policies that include optional coverage are allowed, Fannie Mae does not purchase or securitize mortgages in the following situations:

- The premium/fee for single-premium credit insurance policies or debt cancellation agreements is paid directly by the borrower or paid indirectly by financing the premium/fee into the mortgage loan amount.
- The premium/fee for single-premium mortgage insurance policies with a credit insurance feature is paid directly by the borrower or paid indirectly by rolling the credit insurance single premium into the cost of the mortgage insurance (whether or not it is identified as including a credit insurance premium).

Evidence of Property Insurance

Overview

CMS must follow the requirements below relative to documenting and retaining evidence of property insurance policies:

- The servicer should hold individual insurance policies for first mortgages, unless the servicer is covered by a mortgage impairment or mortgagee interest insurance policy or uses other evidence of insurance that Fannie Mae considers acceptable.
- The servicer must be given a copy of any insurance policy covering the common areas of the PUD project when the mortgage covers an individual unit in a PUD and coverage for the unit is provided under an individual policy.
- The servicer of a second mortgage does not need to keep the original policy in its possession if it is not responsible for paying the renewal premiums; however, it should retain in its files a copy of the insurance policy, any endorsements to it, and evidence of premium payments.
- When the borrower obtains property insurance, CMS must verify the actual existence of a valid policy that meets Fannie Mae's requirements. Information related to the policy should be passed on to the servicer.

The servicer may store any of the forms used as evidence of insurance in an electronic medium. However, the servicer must be able to provide a legible copy of any particular policy if Fannie Mae requests one.

Short-Form Certificates of Insurance

Instead of providing a full insurance policy for each property, some insurers issue a short-form certificate of insurance. CMS may accept a short-form certificate of insurance in lieu of an original policy if the certificate shows all of the necessary information and is signed by the insurer. In this case, a complete text of the full policy must be retained in the servicer's office.

Master or Blanket Policies

Many units in condo projects are covered by master or blanket policies instead of by individual policies. This also is true for some PUD units. In these cases, the servicer should be given a copy of the current master or blanket policy and a certificate of insurance showing that the individual unit that secures the mortgage loan is covered under the policy. As an alternative, CMS may obtain from an authorized representative of the insurer individual evidence of insurance for each unit. This evidence must:

- include the types and amounts of coverage provided; and
- describe any endorsements that are part of the master policy.

Flood Insurance Coverage Requirements

General Requirements

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

- has federally mandated flood insurance purchase requirements, or
- is located in the Coastal Barrier Resources System or Otherwise Protected Area. (See Properties Located in the Coastal Barrier Resources System or in an Otherwise Protected Area below for further detail.)

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

The following table describes when flood insurance is required.

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

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

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

Flood Insurance Coverage Requirements (continued)

General Requirements (continued)

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

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

Acceptable Flood Insurance Policies

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

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

Coverage for First Mortgages

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

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

Additional requirements for units in attached condo projects, and PUDs are detailed in Requirements for Project Developments below.

Coverage for Second Mortgages

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

Flood Insurance Coverage Requirements (continued)

Requirements for Project Developments

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

Project Type	Coverage Requirements
Condo	**Individual condo units:** Stand-alone flood insurance dwelling policies for an attached individual condo unit are not acceptable. A master condo flood insurance policy must be maintained by the HOA, subject to the coverage requirements below. (For detached units, refer to the requirements described in Coverage for First Mortgages above.) **Condo projects:** CMS must verify that the HOA maintains a Residential Condominium Building Association Policy or equivalent private flood insurance coverage for the subject unit's building if it is located in an SFHA. The policy must cover all of the common elements and property (including machinery and equipment that are part of the building), as well as each of the individual units in the building. The master flood insurance policy must be at least equal to the lower of • 80% of the replacement cost, or • the maximum insurance available from NFIP per unit (which is currently $250,000). If the condo project master policy meets the minimum coverage requirements above but does not meet the one- to four-unit coverage requirements (described in Coverage for First Mortgages), a supplemental policy may be maintained by the unit owner for the difference. The contents coverage for the building should equal 100% of the insurable value of all contents owned in common by association members. If the condo project has no master flood insurance policy or if the master flood insurance policy does not meet the requirements above, mortgages securing units in that project are not eligible for delivery to Fannie Mae.
PUD	**PUD units (attached and detached):** Fannie Mae requires the same flood insurance for individual PUD units that is required for other one- to four-unit properties (described in Coverage for First Mortgages above). A stand-alone dwelling policy may be maintained to meet these requirements.

Flood Insurance Coverage Requirements (continued)

Properties Located in the Coastal Barrier Resources System or in an Otherwise Protected Area	When CMS (or a flood zone determination company) determines that a property is located in the Coastal Barrier Resources System (CBRS) or in an Otherwise Protected Area (OPA), flood insurance is required and CMS must verify that the flood insurance policy meets Fannie Mae's requirements. A mortgage in a non-participating CBRS or OPA community is eligible only if the unit is not located in an SFHA and will require flood insurance to be eligible for delivery to Fannie Mae. Fannie Mae will accept flood insurance policies from either private insurance carriers or from the NFIP. The amount of flood insurance required must meet Fannie Mae's minimum coverage requirements for the appropriate property type. The carrier must meet Fannie Mae's minimum rating requirements for insurance underwriters.

Flood Insurance Coverage Requirements (continued)

Maximum Allowable Deductibles

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

Delivery Requirements

The following table describes the special feature code requirements applicable to flood insurance.

Structure Location and Status of Flood Insurance Coverage	Required Special Feature Code
• Some part of a principal and/or residential detached structure on the property securing the mortgage loan is located in an SFHA, and • Flood insurance coverage is in place on the principal and/or residential detached structure.	SFC 170 Flood Insurance — Special Flood Hazard Area
• No part of a principal or residential detached structure on the property securing the mortgage loan is located in an SFHA, but • Flood insurance coverage is in place on the principal and/or residential detached structure.	SFC 175 Flood Insurance — Not a Special Flood Hazard Area
• No part of a principal or residential detached structure on the property securing the mortgage loan is located in an SFHA, and • No flood insurance coverage is in place on the principal or residential detached structure. **Note:** In addition to these criteria, this special feature code also applies if there is a non-residential detached structure attached to the land for which any part is in an SFHA.	SFC 180 No Flood Insurance

Mortgagee Clause for Property and Flood Insurance

Mortgagee Clause

It is not required that Fannie Mae be named in the mortgagee clause, unless the coverage would be impaired by Fannie Mae not being named. If Fannie Mae is named, the clause should read: "Fannie Mae, in care of (insert servicer's name and address here)." This ensures that all matters related to the policy are referred directly to the servicer and not to Fannie Mae.

When Fannie Mae is not named in the mortgagee clause, CMS name, followed by the phrase "its successors and assigns," should be shown as the mortgagee. If CMS is not the servicer, the servicer's name should be specified. In all cases, the insurer should be instructed to send all correspondence, policies, and bills to the servicer (or to both the first and second mortgage servicers). If the mortgage is registered with MERS and is originated naming MERS as the original mortgagee of record, MERS must not be named as loss payee on any property insurance policy.

The table below provides additional requirements for mortgagee clauses.

Type of Mortgage	Mortgagee Clause Requirements
First mortgage on an individual single-family property	The policy must include (or have attached) a "standard" or "union" mortgagee clause (without contribution) in the form customarily used in the area in which the property is located. A mortgagee clause that amounts to a mere loss payable clause is not acceptable.
Second mortgage	The mortgagee clause in the property insurance policy for the first mortgage must be amended to recognize the existence of the second mortgage and to clearly set out Fannie Mae's interest in the policy coverage. CMS should inform the insurer about which mortgage servicer is responsible for payment of the insurance premium.
First mortgage secured by a unit in a condo project	If a unit owner maintains an individual policy (as indicated by the project's legal documents) or if an HO-6 policy is maintained for interior coverage, it must include the standard mortgagee clause as defined above. A mortgagee clause naming Fannie Mae or CMS is not required for a master project property insurance policy.

ADDITIONAL PROJECT INSURANCE

Liability Insurance

Projects Requiring Liability Insurance	Liability insurance is required for all condo projects, with the following exceptions: • condo projects reviewed under the Limited Review method, or • two- to four-unit condo projects that do not maintain commercial general liability insurance, but meet the following criteria: o the project is horizontal in nature (no vertical or stacked units); o there is documentable evidence acceptable to CMS that the project does not contain any common elements that would require liability coverage (for example, units are only separated by lot lines and a party wall); and o the association's legal documents do not require the maintenance of a general liability policy in the name of the HOA.
Liability Insurance Requirements	The HOA must maintain a commercial general liability insurance policy for the entire project, including all common areas and elements, public ways, and any other areas that are under its supervision. The insurance must also cover commercial spaces that are owned by the HOA The liability insurance policy must provide coverage for bodily injury and property damage resulting from the operation, maintenance, or use of the project's common areas and elements.
Amount of Coverage	The amount of coverage must be at least $1 million for bodily injury and property damage for any single occurrence. If the policy does not include severability of interest or separation of insureds in its terms, Fannie Mae requires a specific endorsement to preclude the insurer's denial of a unit owner's claim because of negligent acts of the HOA of other unit owners.
Cancellation/ Modification Requirements	The liability insurance policy for a condo must include a provision that calls for at least ten days' written notice to the HOA or insurance trustee before the policy can be canceled or substantially modified for any reason.

Fidelity/Crime Insurance

Projects Requiring Fidelity/Crime Insurance

Fidelity/crime insurance is required for all condo, with the following exceptions that do not require fidelity/crime insurance:

- condo projects reviewed under the Limited Review method,
- condo consisting of 20 units or less, or
- condo that would need fidelity/crime insurance coverage of $5,000 or less (based on the calculations described in the Amount of Coverage below).

Note: In states that have statutory fidelity/crime insurance requirements, Fannie Mae accepts those requirements in place of its own.

Requirements for Who Must Be Covered

The HOA must have blanket fidelity/crime insurance coverage for anyone who either handles or is responsible for funds that it holds or administers, whether or not that individual receives compensation for services, including coverage for a management agent. The insurance policy must name the HOA as the insured and the premiums should be paid as a common expense by the association or corporation.

A management agent that handles funds for the HOA should additionally be covered by its own fidelity/crime insurance policy.

Amount of Coverage

The HOA policy must cover the maximum funds that are in the custody of the HOA or its management agent at any time while the policy is in force. Fidelity/crime insurance is not required if the maximum estimated funds are less than or equal to $5,000.

A lesser amount of coverage is acceptable if the project's legal documents require, or another source acceptable to CMS verifies, that the HOA and any management company adheres to one or more of the following financial controls:

- Separate bank accounts are maintained for the working account and the reserve account, each with appropriate access controls, and the bank in which funds are deposited sends copies of the monthly bank statements directly to the HOA
- The management company maintains separate records and bank accounts for each HOA that uses its services, and the management company does not have the authority to draw checks on, or transfer funds from, the reserve account of the HOA
- Two members of the Board of Directors must sign any checks written on the reserve account.

Even then, the fidelity/crime insurance coverage must equal at least the sum of three months of assessments on all units in the project, unless this calculated amount is less than or equal to $5,000, in which case fidelity/crime insurance is not required.

End of document

Revision Summary

Date	Version	Description of Change
11/01/22	4.0	• Revised **Down Payment Assistance Programs** to list as permitted. • Revised **Ineligible Manufactured Housing Criteria** to add manufactured homes converted to storage units as ineligible.
12/01/21	3.9	• Revised **Homeownership Education and Housing Counseling** requirements. • Revised **Determining the Need for Federal Income Tax Returns** requirements.
07/15/21	3.8	• Revised **Verification of Deposits and Assets** documentation requirements. • Revised **License and Certification** to add Trainee appraisers are unacceptable to CMS. • Revised **Appraiser Trainees** to clarify Trainee appraisers are unacceptable to CMS. • Deleted **Supervisory Appraiser** as CMS requires state-licensed or certified appraisers.
06/23/21	3.7	Updated references to Letters of Explanation to clarify "Borrower(s) must write, sign, and date all Letters of Explanation themselves. The Lender or Broker may identify the subject matter only and not contribute to the letter's content."
02/18/21	3.6	• Updated references to Uniform Residential Loan Application (URLA) and 4506-T to 4506-C throughout guidelines. • Updated **Loan Application Sections** with new URLA descriptions. • Added **Loan Application-Additional Borrower Sections** with new URLA descriptions. • Updated **Retirement, Government Annuity, and Pension Income** requirements.
11/06/20	3.5	• Removed **Resale/Deed Restrictions** requirements. • Added **Loan Eligibility and Occupancy Types** section with requirements for eligibility based on type of deed restriction. • Updated Monthly Debt Obligations to add **Forbearance – Covid-19** requirements. • Added **Limited Cash-Out Refinance Transactions** requirements. • Revised **Cash-Out Refinance Transactions** to add "**Note:** Two-closing construction-to-permanent cash-out refinance transactions are not permitted."
05/06/20	3.4	• Revised **Housing Counseling** to remove HomeReady requirements. • Revised **No Cash-Out Refinance > Ineligible Transactions** to remove eligibility requirements for cash-out refinances. • Revised **Lease Requirements** with current FNMA guidance. • Revised **Verbal Verification of Employment > Military Personne**l to update url. • Added **Adoption Income** requirements. • Revised **Public Assistance Income** to add example of adoption income. • Revised **Project Review Methods** to current FNMA requirements. • Added **Waiver of Project Review** requirements. • Revised **Expiration for Project Reviews** to current FNMA requirements and remove FHA requirements. • Added **Requirements Applicable to All Properties in a Condo or PUD Project** requirements. • Added **Transactions Eligible for a Waiver of Project Review** requirements. • Added **Requirements that Apply When the Project Review is Waived** requirements. • Added **Project Review Requirements for High LTV Refinance Loans** requirements.

Revision Summary (continued)

Date	Version	Description of Change
05/06/20	3.4 (cont)	• Revised **Commercial Space and Mixed-Use Allocation** to increase commercial space allocation to 35%. • Added **Single-Entity Ownership** requirements. • Removed **Condo Project Manager (CPM)** requirements. • Revised **Florida — Attached Units in New and Newly Converted Condo Projects** to remove CPM. • Removed **FHA Approved Condo Review Eligibility** requirements.
12/18/19	3.3	• Revised **Transactions that Require Homeownership Education** requirements. • Deleted **Modified Mortgages** loan delivery requirements. • Revised **Calculating Monthly Qualifying Rental Income (or Loss)** requirements. • Updated **Method for Calculating the Income**
10/07/19	3.2	• Revised **Ineligible Properties** to remove Land Contracts. • Revised **Down Payment Assistance Programs** to list as not permitted. • Revised **Bankruptcy** to add Underwriting when the Credit Report Contains Inaccurate Bankruptcy Information. • Revised **Bankruptcy** to add Underwriting when a Bankruptcy Was Due to Extenuating Circumstances. • Revised **Student Loans** to clarify table is used when calculating a fully amortizing payment on a "deferred loan." • Revised **Collections and Charge-Offs Paid through Closing Transaction** to add credit report or supplement may be used in addition the payoff demand and must list the same information. • Revised **Uniform Collateral Data Portal (UCDP)** to remove reference to remove the *Market Conditions Addendum (Form 1004MC).* • Revised Exhibits for **Appraisals** to remove the *Market Conditions Addendum (Form 1004MC)* and requirements. • Removed the ***Market Conditions Addendum*** *(Form 1004MC)* and requirements.
07/25/19	3.1	• Revised **No Cash-Out Refinance > Eligibility Requirements** to remove PACE loan requirements. • Revised **No Cash-Out Refinance > Ineligible Transactions** to remove PACE loan exception requirements. • Revised **No Cash-Out Refinance > Ineligible Transactions** to add Proceeds are used to pay for energy efficient improvements, including the payoff of PACE liens. • Revised **No Cash-Out Refinance > Acceptable uses** to remove paying off PACE loan UPB. • Revised **Other Sources of Income > Employment Offers or Contracts** to update requirements for future employment. • Added **Financed Borrower-Purchased Mortgage Insurance** requirements

Revision Summary (continued)

Date	Version	Description of Change
07/12/19	3.0	• Revised **Multiple Properties Financed** to add two financed properties restriction for HomeReady loans. • Revised **Cash-Out Refinance Transactions > Eligibility Requirements** to align with FNMA handbook requirements. • Revised **Selection of the Appraiser** to add additional appraisal independence requirements. • Revised **Manufactured Home Property Eligibility Requirements** to add restriction for more than one dwelling on the site. • Revised **Condominium Homeowners' Associations** to add requirements when an HOA no longer operates as an HOA.
06/12/19	2.9	• Added **Texas Conversion (Refinance) Transactions** section and reference to the **Refinancing an Existing Home Equity Loan - Texas Conversion Transactions** section • Added requirements for **Collections and Charge-Offs Paid through Closing Transaction** • Added **Refinancing an Existing Home Equity Loan - Texas Conversion Transactions** with requirements for Texas Home Equity Conversion loans. • Removed **DU Refinance Plus** requirements throughout document. Program expired 12/31/2018.
03/18/19	2.8	• Removed 70% LTV restriction for properties listed for sale. FNMA removed this restriction in April 2017. • Revised **Hourly, Salary, and Commission Income (Non- Military)** to add requirements for borrowers that are in a Union • Revised **Age of Appraisal and Appraisal Update Requirements** to 240 days (formerly 12 months) • Revised **Rating Requirements** to add additional rating agency requirements and added Exceptions to Property Insurance Requirements • Revised **Exceptions to the Rating Requirements** and added **Conditions for Acceptable Reinsurance Arrangements** table.
01/04/19	2.7	• Added **Payoff of Installment Land Contract Requirements.** • Updated **Mortgage Insurance Coverage Requirements** and added LPMI and HomeReady requirement.

Revision Summary (continued)

Date	Version	Description of Change
12/12/18	2.6	• Revised **Subordinate Financing Requirements** with new FNMA requirements. • Revised **Properties Affected by a Disaster > Eligibility Requirements** with new FNMA Appraisal Waiver requirements. • Revised **Automobile Allowance** with new FNMA requirements. • Revised **Analysis of Borrower's Personal Income** with new FNMA requirements. • Deleted **Deductions Reported on IRS Form 2106 > Business Expenses** content to align with new FNMA requirements. • Revised **Commission Income** with new FNMA requirements. • Deleted **Unreimbursed Employee Business Expenses** content to align with new FNMA requirements.
12/06/18	2.5	• Revised **Non-U.S. Citizen** to add Non-U.S. citizens lawfully residing in the U.S. as a permanent or non-permanent resident alien are eligible with supporting documentation. Foreign Nationals, borrowers with Diplomatic Immunity and Non-U.S. citizens who have no lawful residency status in the United States are not eligible. • Added **Short Payoffs** section with definition and requirement that Short Payoffs are not eligible. • Updated **Income from Departure Residence** to correct percentage amount for Lease Agreements to 25%.
10/19/18	2.4	• Remove **Modification/Restructures** requirements to align with FNMA • Revised **Continuity of Income** to add requirements for borrowers transitioning to a lower pay structure. • Updated **Continuity of Income** Table to add VA benefits (not including retirement or long-term disability) • Updated **Employment-Related Assets as Qualifying Income > Example: Calculation of Net Documented Assets** to align with FNMA updates • Revised **Installment Debt** to add timeshare requirements. • Renamed **Property Inspection Waivers (PIW)** and **Property Fieldwork Waivers** to **Appraisal Waivers** throughout to align with FNMA and industry terminology. • Added **Rural High-Needs Appraisal Waiver** requirements • Revised **Lender Eligibility** with current FNMA requirements. • Revised **Manufactured Home Property Eligibility Requirements** to remove Co-op project requirements – not permitted under CMS guidelines • Revised **Payment of Mortgage Insurance Premiums** to remove split premium plans (CMS does not offer these)

Revision Summary (continued)

Date	Version	Description of Change
07/19/18	2.3	• Revised **Condo Section** to update Limited Review requirements for Investment Property. • Revised **Ineligible Properties** section to add "Single wide manufactured homes". • Revised **Rate & Term/ Limited Cash Out Refi** section to align with updated FNMA guidelines. • Revised **Ineligible Programs** section to clarify Refi Plus not Refi DU.
06/20/18	2.2	• Added Resale/Deed Restrictions to **General Property Eligibility** section.
05/31/18	2.1	• Revised **Ineligible Properties** to add Properties with more than one unit where one of more of the units is a manufactured home • Added **Documenting Rental Income from Vacation Rentals by Owner** requirements • Added **Lender Contributions** requirements • Revised **Asset Values** in the DU Underwriting Findings Report to align with current FNMA requirements • Deleted **Eligibility Requirements for Loans with Nontraditional Credit** section • Revised **Student Loans** to align to align with current FNMA requirements
04/08/18	2.0	• Revised Document Images requirements • Added Unacceptable Income Sources • Added Income from Departure Residence • Updated Unacceptable Sources of Reserves to add cryptocurrency • Revised Litigation list of minor matters
02/28/18	1.9	• Removed Manufactured Homes from Ineligible Properties. • Added Federal Income Tax Installment Agreements requirements. • Updated Guidance on Addressing Appraisal Deficiencies and Second Appraisals (added). • Added Detached condo project and removed Site condo project. • Updated Project review methods (removed site condos). • Revised Delivery Requirements. • Added Requirements for Review of Detached Condos and deleted Requirements for Review of Site Condos. • Appraisal Requirements from High-Balance Mortgage Loan Eligibility and Underwriting section since Field Reviews are no longer required. • Deleted PACE requirements as they are ineligible.
01/17/18	1.8	Added Manufactured Housing requirements.
12/21/17	1.7	• Added Income from Secondary Sources section. • Revised Verification of Secondary Employment Income and General Information on Liabilities. • Deleted DU Loan Casefiles: At Least One Borrower Has No Credit Score and Another Borrower Has a Credit Score.

Revision Summary (continued)

Date	Version	Description of Change
12/09/17	1.6	• Added the Frozen Credit Report and Income from Gambling sections. • Revised the Properties Financed, Non-Arm's Length Transactions, Future Employment, Debts Paid by Others, Program Expiration for DU Refi Plus, and the Condo and PUD Project Review Requirements sections.
10/27/17	1.5	• Revised the Non-U.S. Citizen, Multiple Properties Financed/Owned, Ownership Defined, Calculation of Reserves for Multiple Financed Properties, Texas Section 50(a)(6) Mortgage Legal Considerations > Mortgage Documentation, Debts Paid, and Property Inspection Waivers (PIW) sections. • Changed heading Types of Interested Party Contributions (IPCs) to Verification of Depository Assets. • Changed heading Employer Assistance to Verification of Non- Depository Accounts.
08/10/17	1.4	Added the **Mortgage Insurance Premiums** and **Inaccurately Reported Foreclosure** sections.
06/26/17	1.3	Added the Waiver Eligibility section. Deleted the DU Loan Casefiles: No Borrower Has a Credit Score section. Revised the following sections: • Non-Arm's Length Transactions • Cash Back to the Borrower • Foreign Credit Reports and Credit Scores • General Requirements for Credit Reports • Monthly Housing Expense
05/02/17	1.2	Added the following sections: • Student Loan Cash-out Refinance • Project Eligibility Waivers FNMA to FNMA Limited Cash-Out Refinances requirements • Debts Paid by Others section Revised the following sections: • Cash-Out Refinance – Acceptable uses • Modification/Restructures • Modified Mortgages • Properties with Solar Panels • Employment Documentation Provided by a Third-Party Employment Verification Vendor • Military Personnel • Verification of Deposits and Assets – Account numbers • Student Loans • Eligible and Ineligible Transactions sections • Decision Expiration Dates to 24 months
03/10/17	1.1	Added **Homeownership Education and Housing Counseling** section. Revised **Calculating Monthly Qualifying Rental Income (or Loss)** section.
02/28/17	1.0	New document.