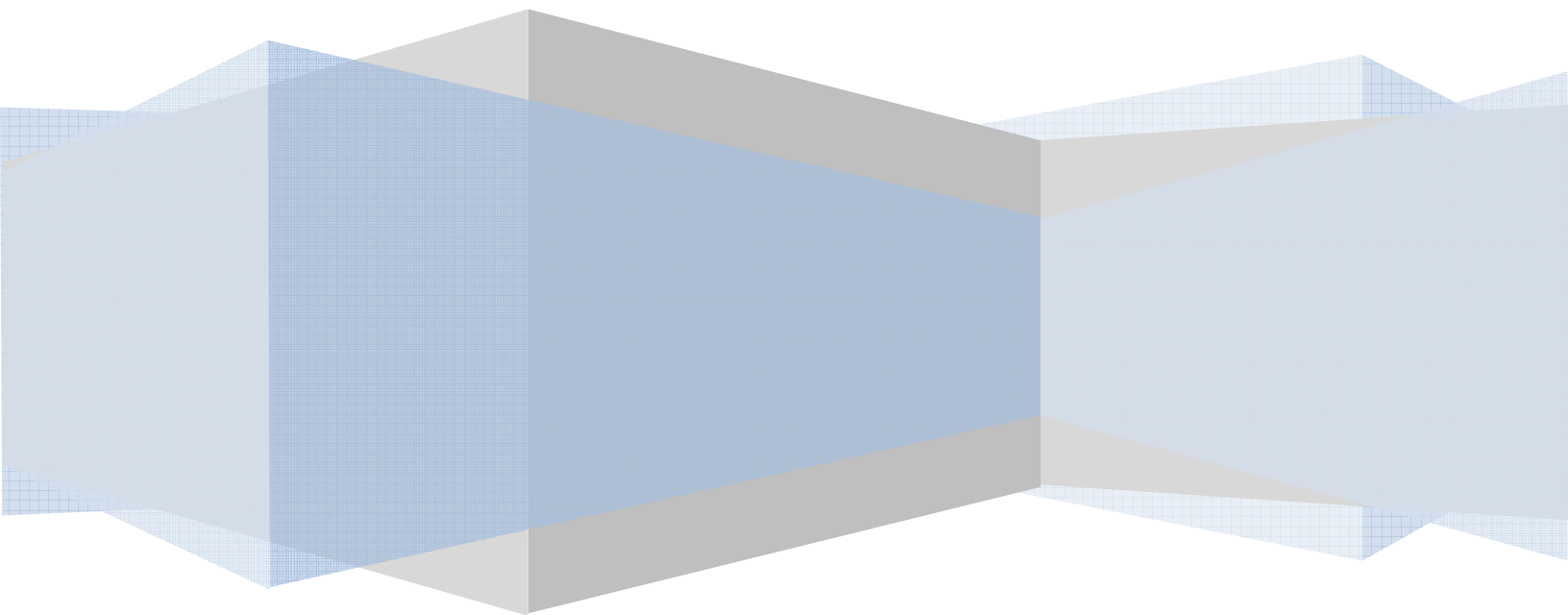

Veterans Home Mortgage VA Credit Policy



The Credit Policy Manual makes reference to “The Lender”. The Lender shall at all times refer to the institution or business, which is to ultimately fund or purchase the mortgage loan. Any outside business or entity involved, at any time, in the process of the originating, processing, underwriting, or closing of the mortgage must comply with The Lender’s credit policy as set forth in this manual.

Any discrepancies between this Credit Policy Manual and published Product Profiles will defer to whichever has the most recent revision date. This manual was last revised REVISION 02.21.2009.

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CHAPTER 1 – ELIGIBILITY REQUIREMENTS

INTRODUCTION

The Credit Policy Manual was developed to provide associates with a clear understanding of the elements involved in evaluating the credit worthiness and financial capacity of an applicant, and the adequacy of the proposed collateral.

Agency guidelines have been summarized and incorporated into the Credit Policy Manual by topic.

The Credit Policy Manual makes reference to “The Lender”. The Lender shall at all times refer to the institution or business which is to ultimately fund or purchase the mortgage loan. Any outside business or entity involved, at any time, in the process of the originating, processing, underwriting, or closing of the mortgage must comply with The Lender’s credit policy as set forth in this manual.

UNDERWRITING PHILOSOPHY

The Lender is engaged in the origination of investment quality loans. The Credit Policy Manual is to provide direction and consistency in determining the credit decision. The Lender’s intent is to describe the general underwriting philosophy of the company on mortgage loans, however is not all inclusive of all situations that may arise from loan to loan. In discussing this general approach we have presented the minimum guidelines considered necessary for prudent mortgage compliance underwriting, the essential requirement being that the terms of the loan be related to the probability of the borrower’s repayment and to the value and marketability of the mortgaged property.

The Lender believes that there is no singular characteristic within a loan file that indicates the quality of a loan. This concept is incorporated throughout these guidelines. While The Lender will not compromise quality, we are not simply a ratio or matrix driven company. We will underwrite the entire package, analyzing and weighing all aspects (i.e. loan to value ratio, collateral value, credit history, assets and in certain instances qualifying ratios). The Lender’s underwriters approve loans of investment quality risk. All loans will be reviewed with a common sense approach. Each loan is individually underwritten with emphasis placed on the overall quality of the loan. Although multiple risk factors are assessed, the underwriter will attempt to balance the evaluation between the borrower and the property.

As an innovative leader in the mortgage industry, The Lender expects to purchase loans that represent a marketable risk. The Lender will analyze the performance of a loan based on the collateral, credit characteristics and overall market conditions. Occasionally, The Lender may apply underwriting criteria, which is either more stringent or more flexible, depending on the economic conditions of the particular market. The borrower’s loan package must contain sufficient information to enable the underwriter to reach an informed and knowledgeable decision.

IMPLEMENTING CREDIT POLICY

It is the responsibility of all associates to become familiar with:

- Fair lending regulations; and
- The Lender’s stated credit policy;
- Laws and regulations that affect mortgage banking.

To assure all applicants of fair and equitable treatment, the underwriters are expected to exhaust all possibilities before denying a loan. All reasonable alternatives must be considered and presented to the applicant, as a counter offer, if it appears the loan may be approved under different terms than as submitted.

These efforts must be documented in the system notes or written documentation must be placed in the loan file. The consideration is to be applied consistently to all loan applications.

REGULATORY ISSUES

All associates who are involved in the mortgage origination process are expected to comply with all laws and regulations, which apply to our industry. Each associate is responsible for becoming familiar with, and practicing, the fair lending regulations set forth by the federal and state government.

Underwriters are especially cautioned to be conscious of the provisions for the Equal Credit Opportunity Act when evaluating an applicant's loan request. ECOA ensures that all persons have the same opportunity to obtain credit. A creditor cannot discriminate against an applicant on the basis of:

- Race;
- Color;
- Religion;
- National Origin;
- Sex;
- Marital Status;
- Family Status;
- Age;
- Receipt of income from a public assistance program; or
- The fact that the applicant has exercised any right under the Consumer Credit Protection Act.

GUIDELINE CHANGES

We strive to ensure the Credit Policy manual is current on all issues; however in the event that Credit Policy differs from specific investor and agency guideline changes, the most current release of the investor or agency guidelines will apply.

PRODUCT AVAILABILITY

Many of The Lender's available products are taken from negotiated commitments with investors. As a result of these commitments, The Lender's Product Summaries will define loan parameters and special underwriting considerations when necessary. When information is specified in the Product Summary which conflicts with existing Credit Policy, the Product Summary takes precedence over the Credit Policy Manual. It is essential that everyone become familiar with the Product Summaries and be cognizant of variances in:

- Documentation requirements;
- Eligible Property types;
- LTV and CLTV limits;
- Mortgage Insurance requirements;
- Occupancy limitations;
- Qualifying rates on ARM products;
- Qualifying ratios; and
- Subordinate financing restrictions.

SECTION 100.00 – GENERAL ELIGIBILITY ISSUES

100.01 – Applicant's Age

There is no maximum age limit for an applicant. The minimum age is the age that the mortgage note can be legally enforced in the state or other jurisdiction where the property is located.

100.02 – Co-Borrower/Co-Signer

The definition of co-borrower & co-signer is here for explanation purposes only. The Lender has made the decision that co-signed loans will not be accepted as we do require all borrowers be on title.

Co-borrowers take title to the property and obligate themselves on the mortgage and note. A co-signer has no ownership interest in the property (does not take title) but must execute the loan application and sign the mortgage note and will be liable for the repayment of the loan. The co-borrower or co-signer's income, assets, liabilities, and credit history are included in the determination of creditworthiness. The co-signer must have a principal residence in the United States and cannot be a party to the transaction such as seller, builder, real estate agent, etc.

VA Automatic Underwriters are only allowed to issue a credit decision on VA loans involving a veteran and his or her spouse if the spouse is not a veteran, or the spouse is a veteran who will not be using his or her entitlement on the loan.

The following loan cases must be pre-underwritten by a VA Automatic/LAPP Underwriter and submitted to the Department of Veteran Affairs for final approval:

- Veteran and one or more non-veterans (not spouse);
- Veteran and one or more veterans (not spouse) who will not be using their entitlement;
- Veteran and the veteran's spouse who is also a veteran, and both entitlements will be used;
- Veteran and one or more other veterans (not spouse), all of whom will use their entitlement.

Co-signers are not acceptable under any circumstances.

100.03 – Foreign Documentation

Documents received from foreign sources that are not in English must be translated into English by a University Foreign Language Department, Embassy Official, a recognized authority in translation, or an employee who is not involved in the loan transaction. A translation to English must be attached to each individual document. The name, address and telephone number of the translator must be indicated on the translation.

Funds received from a foreign source must be supported by evidence the funds were the applicant's prior to the transfer. Evidence of the current currency exchange rate must be provided as support for the amount converted to US dollars.

100.04 – Non-Borrowing/Non-Purchasing Spouse

The Lender will accept loan applications from married applicants whose spouse is not a part of the loan transaction. The non-borrowing spouse may be a purchaser and owner of the property, but not a borrower. The applicant and spouse will take title but the non-borrowing spouse does not disclose any financial information. Acceptability may vary based on the state law and must be confirmed with local Closing Manager.

The non-borrowing spouse will sign the security instrument if necessary under the applicable statutory or decisional law of the state to create a valid lien, pass clear title, and waive inchoate rights to property or assigned earnings. Contact compliance with any questions regarding specific state law.

100.05 – Residency Status

The Lender will purchase or securitize mortgages made to aliens who are lawful permanent or nonpermanent residents of the United States. We do not specify the precise documentation that a lender must obtain to verify that a permanent or nonpermanent resident alien borrower is a legal resident of the United States, rather, a lender should make a determination of the alien's residency status based on the circumstances of the individual case,

using whatever documentation it deems appropriate. Some products may limit LTV and occupancy based on residency.

100.06 – Trust Eligibility Criteria

Subject to the following criteria, an Inter Vivos Revocable Trust (“Trust”) is acceptable as a “borrower and property owner”. The Trust must be established by a natural person. It may be established solely by one individual or jointly by more than one individual. Each individual establishing a Trust is a Trustor/Grantor/Settler/Donor (the Settler); the terminology used will depend upon the applicable state. At least one of the individuals/Settler must be Primary Beneficiary and an occupying borrower whose income or assets were used to qualify for the loan. In addition, if no institutional trustee was appointed, this same individual/Settler must be a Trustee.

In order to consider the Trust as an eligible applicant, the following eligibility requirements must be met:

- The Trust must be established by a written document during the lifetime of the individual/Settler establishing the Trust, to be effective during his or her lifetime.
- The Trust must be one in which the individual/Settler establishing the trust has reserved to himself or herself the right to revoke the Trust during his or her lifetime.
- The individual/Settler establishing the Trust must be the primary beneficiary. If there is more than one individual/Settler, there may be more than one primary beneficiary. The income and/or assets of at least one of the individuals/Settlers establishing the Trust must be used to qualify for the mortgage and that same individual/Settler must occupy the subject property and sign the mortgage instruments.
- The Trust document must name one or more Trustees to hold legal title to, and manage, the property that has been placed in the Trust. The Trustees must include either:
 - at least one of the individuals/Settler establishing the trust, OR
 - An institutional Trustee that customarily performs trust functions in the relevant state and is authorized to act as Trustee under the law of such state.
- The Trustee must have the power to mortgage the subject property for the purpose of securing a loan to the party or parties who are the “borrower (s)” under the mortgage Note.
- Full title to the subject property (security) must be vested in the Trust(s); there may be no other owners.
- A copy of the Trust documents must be provided to the Underwriter when submitting the loan file. Underwriters are required to review the documents. Using the Trust documents, the Underwriter will complete the Underwriter’s Checklist for Inter Vivos Revocable Trusts to ensure the Trust conforms to investor and agency guidelines. The completed Underwriter’s Checklist for Inter Vivos Revocable Trusts must be a permanent part of the loan file.
- Settlement Agents must be instructed that the Mortgage Policy of Title Insurance must state that 1.) Title to the security property is vested in the Trustee(s) of the Trust and 2.) Take no exception with respect to the Trustee (s) holding title to the property or to the Trust.
- Copies of any Trust documents that the title insurance company required to make its determination regarding insurance coverage must be included in the loan file submitted to the Underwriting Department.
- The title insurance policy must assure full title to The Lender and must state that the title to the subject property is vested in the Trustee (s) of the Trust. The title policy must not take any exceptions with respect to the Trustee (s) holding the title to the subject property or to the Trust.
- IRS Form W-9 must be completed in the name of the Trust/Trustee (s) and must include either a Tax ID Number designated for the Trust or the Trustee’s Social Security Number.

Checklist for Inter Vivos Revocable Trusts

Borrowers: _____ Loan Number: _____

Note: An Inter Vivos Revocable Trust must be established, in writing, by a natural person(s) and may be established either solely or jointly (more than one Trustor and Primary Beneficiary.) The Trust MUST RUN to at least one of the Borrowers who also is named as a Trustor, Primary Beneficiary, and Trustee (unless an Institutional Trustee is appointed.)

1. Names of Inter Vivos Revocable Trust ("Trust"): _____
 _____ dated _____.

2. The Trust is created under the laws of the State of _____.

3. The subject property is located in the State of _____.
 (If the Trust state and the property state ARE NOT the same, STOP HERE: the Trust is not eligible.)

4. Trustor(s) / Grantor(s) / Settlor(s) / Donor(s): _____
 Primary Beneficiary(ies): _____
 (If at least one of the Borrowers IS NOT named as both a Primary Beneficiary and a Trustor, STOP HERE: the Trust is not eligible.)

5. Trustee(s): _____

(If at least one of the Borrowers IS NOT named as a Trustee and a Trustor and a Primary Beneficiary, STOP HERE: the Trust is not eligible UNLESS an Institutional Trustee has been appointed.)

6. At least one of the Borrowers who also is a Trustor and a Primary Beneficiary has reserved the right to REVOKE, alter or amend the Trust during his/her lifetime.
 _____ Yes _____ No (If NO, STOP HERE: the Trust is not eligible.)

7. The income and/or assets of at least one of the Borrowers who is both a Trustor and a Primary Beneficiary were used to qualify for the mortgage.
 _____ Yes _____ No (If NO, STOP HERE: the Trust is not eligible.)

8. At least on of the Borrowers who is both a Trustor and a Primary Beneficiary will occupy the property.
 _____ Yes _____ No (If NO, STOP HERE: the Trust is not eligible.)

9. Property is: _____ Primary Residence _____ Second Home (Investment Property is not eligible)

If Trust is acceptable, Loan Approval must request for a Title Policy with NO exception(s) with respect to the Inter Vivos Revocable Trust.

Comments:

Completed By:
 Date:

SECTION 101.00 – OCCUPANCY

101.01 – Owner Occupied Principle Residence

A principal residence is a 1-4 unit dwelling that will be the applicant’s primary residence. At least one of the applicants must occupy the dwelling as a principal residence within 60 days of closing. The following criteria define residency:

- Borrower occupies property as primary residence
- Property is occupied by the borrower for a major part of the year
- Property is convenient to the borrowers place of employment
- Property address on record for Federal income tax reporting and driver’s license
- Property possesses physical characteristics to accommodate borrowers immediate family

SECTION 102.00 – SECONDARY FINANCING

Secondary borrowing is acceptable as long as:

- The veteran is not placed in a substantially worse position than if the entire amount borrowed had been guaranteed by VA; and
- The requirements detailed below are met

The second mortgage must meet the following requirements:

- The lender must submit documentation disclosing the source, amount, and repayment terms of the second mortgage and agreement to such terms by the veteran and any co-obligors
- The second mortgage must be subordinated to the VA guaranteed loan, that is, the second mortgage must be in a junior lien position relative to the VA loan
- Proceeds of the second mortgage may be used for a variety of purposes, including but not limited to; closing costs or down payment to meet secondary market requirements of the lender; but it may not be used to cover any portion of a down payment required by VA to cover the excess of the purchase price over VA's reasonable value
- There can be no cash back to the veteran from the VA first mortgage or a second mortgage obtained simultaneously
- The veteran must qualify for the second mortgage which is underwritten as a additional recurring monthly obligation
- The rate on the second mortgage may exceed the rate on the VA guaranteed first; however, it may not exceed industry standards for second mortgages. "Rule of thumb" is that second mortgages are one or two percent above the market interest rates for first mortgages
- The second mortgage should not restrict the veteran's ability to sell the property any more than the VA first mortgage. That is, it should be assumable by the creditworthy purchasers.
- There should be a reasonable grace period before a late charge comes due or commencement of foreclosure proceeding in the event of default.

SECTION 103.00 – CONTRACT FOR DEED / LAND CONTRACT

A Land Contract or Contract for Deed is a contract in which the purchaser agrees to pay the seller specified amounts at defined intervals until the total purchase price is paid, at which time the seller transfers interest in the property to the purchaser.

Land contract transactions are acceptable within certain parameters:

- If the contract has been in place for less than twelve (12) months at the time of application, the transaction will be considered a purchase. The LTV ratio will be based on the lesser of the purchase price on the contract or the current appraised value. For a purchase transaction, the HUD-1 Settlement Statement must show the transaction as a purchase and the borrower may not receive cash back. A copy of the notarized land contract must be in the file.
- If the contract has been in place for twelve (12) months or more at the time of application, the transaction will be considered a refinance. The LTV ratio will be based on the current appraised value. For a refinance transaction, copies of the most recent twelve (12) months cancelled checks must be provided and the borrower may not receive cash back. A copy of the notarized land contract must be in the file.

CHAPTER 2 – VA FINANCING

SECTION 200.00 – INTRODUCTION

One of the benefits available to veterans is the receive up to 100% financing for the purchases or refinance of a home, combined with the ability to close on the mortgage for minimal cash out of pocket. VA guarantees the mortgage, thus providing lenders with a measure of protection in the event of a default. The Veterans Administration is responsible for developing guidelines and borrower eligibility requirements. The Lender offers financing on 1-4 unit dwellings, PUD's, and condominiums.

VA has delegated the authority to underwrite and close mortgages to The Lender as a VA Automatic Lender. The Lender participates in the VA Lender Appraisal Processing Program (LAPP) which allows a LAPP approved underwriter (SAR) to review appraisals on existing properties and to issue a Notice of Value (NOV).

It is the responsibility of the underwriter to be knowledgeable of VA guidelines in addition to those policies addressed within the Credit Policy Manual as the VA guidelines may vary from state to state for credit and appraisal review.

SECTION 201.00 – VA FUNDING FEE REQUIREMENT

The law requires that VA be paid a funding fee with guaranteed loans. The funding fee is not insurance and is not refundable. The funding fee may be financed (added to the loan), paid in cash or a combination of both.

VA may indicate an exception to the funding fee for veterans receiving VA compensation for service connected disabilities, or who receive retirement pay in lieu of compensation for a service connected disability, and loans made to surviving spouses of veterans who died in service or from service connected disabilities. Any exception to the funding fee will be noted on the Letter of Indebtedness issued by the VA.

201.01 – Funding Fees

As of 10/01/2007

VA Funding Fees – Purchases			
Transaction Type	Down Payment	Military	Reservist / National Guard
Initial use of entitlement	Less than 5%	2.15%	2.40%
Second or Subsequent use	Less than 5%	3.30%	3.30%
Initial use of entitlement or Second or subsequent use	5% but less than 10%	1.50%	1.75%
Initial use of entitlement or Second or subsequent use	10% or more	1.25%	1.50%
VA Funding Fees – Cash Out Refinances			
Transaction Type		Military	Reservist / National Guard
Initial use of entitlement		2.15%	2.40%
Second or Subsequent use		3.30%	3.30%
VA Funding Fees – Interest Rate Reduction Refinance Loan			
Transaction Type		Military	Reservist / National Guard
All Interest Rate Reduction Refinance Loans		0.50%	0.50%
VA Funding Fees – Assumptions			
Transaction Type		Military	Reservist / National Guard
All Assumptions		0.50%	0.50%

A number "5" in the "Entitlement Code" block of the COE indicates the veteran is using restored entitlement. Another indicator of previous use is when a loan number is shown in the box of the COE designated "Loan Number".

201.02 – Computing Funding Fee

The funding fee is computed as follows:

- The Funding Fee (fee) is calculated as a percent of the base loan amount before adding the fee to the base loan amount (except on IRRRL);
- On interest rate reduction refinancing loans, the funding fee is determined by completing VA Form 26-8923, Interest Rate Reduction Refinancing Worksheet;
- The down payment is computed on the property sales price. When a sales price is above the reasonable value of the property, as determined by VA, the portion of the down payment which reduces the loan amount to reasonable value may be considered down payment when calculating the funding fee. In cases involving partial entitlement, the down payment required to permit sale of the loan in the secondary market also counts toward the 5 or 10 percent down payment for funding fee calculation;
- On joint loans, each veteran pays the fee based on his/her portion of the base loan amount. For example, two veterans making a \$100,000 purchase with a 10 percent down payment will each pay a 1.25 percent funding fee on \$45,000; (\$90,000 divided by two). If one of the individuals is an eligible selected reservist, he/she will pay the higher fee on his/her portion of the loan. If one of the borrowers is not an eligible veteran or is exempt from the fee, the fee will not be collected for the portion of the loan attributable to that individual.

Note: For all VA loans, except the interest rate reduction refinancing loans, the Origination Fee and any permissible discount to be paid by the applicant is computed on the principal amount of the loan after the funding fee is added to the loan.

On IRRRLs, the funding fee and maximum loan amount including origination fee are calculated on the IRRRL Worksheet (VA Form 26-8923).

201.03 – Exemption from Funding Fee

A veteran with a service connected disability is exempt from paying the VA funding fee. The veteran's exempt status must be confirmed by:

- Submitting a properly completed Form 26-8937, Verification of VA Benefit Related Indebtedness, to the Finance Officer at the nearest VA regional office. When completed and returned by VA, the form will be checked in the appropriate box and signed to verify the veteran's exempt status; or

In lieu of VA verification, one of the following may be accepted as evidence of a veteran's exempt status:

- An award letter issued within one (1) year of the date of the loan application indicating the veteran is entitled to receive of VA disability compensation;
- For a veteran who elected service retirement pay in lieu of VA compensation, a copy of the original VA notification of disability rating and documentation of the veteran's service retirement income; or
- Indications on the certificate of eligibility that the borrower is entitled as an un-remarried or remarried surviving spouse.

The documentation used by the lender to determine a veteran's exempt status must accompany the certification of loan disbursement whenever a funding fee is not remitted, except when the borrower is an eligible surviving spouse.

If the veteran's exempt status cannot be verified prior to closing a loan, the fee should be remitted by the lender within 15 days after loan closing. The closing package should indicate that the veteran claims an exemption from the fee. Verification of the veteran's status will be confirmed by VA, if appropriate, the fee will be refunded to the lender to be applied to the outstanding loan balance if paid from the loan proceeds, or directly to the veteran, if paid in cash.

SECTION 202.00 – APPLICANT ELIGIBILITY

To be eligible for a mortgage guaranteed by the Veteran's Administration, the veteran must have served in the active military, naval or air service and, except for a service member on active duty, must have been discharged from active duty under conditions other than dishonorable.

The Armed Forces consists of the Air Force, Army, Coast Guard, Marine Corps, and Navy. Eligibility may be also established for certain other individuals, such as, the National Oceanic and Atmospheric Administration, merchant seamen with World War II service, and others (submit a VA 26-1880 to VA for determination of eligibility).

202.01 – Reserves and National Guard

Members of the Selected Reserve who are not otherwise eligible for VA home loan benefits are eligible for VA financing if the individual has completed six years of service in the Selected Reserve and:

- Received an honorable discharge from the service;
- Was placed on the retired list;
- Was transferred to the Standby Reserve or an element of the Ready Reserve other than the Selected Reserve after service in the Selected Reserve characterized as honorable service; or
- Continues to serve in the Selected Reserve.

Eligibility is also extended to:

- Individuals who were discharged from the Reserves or National Guard because of a service – connected disability before completing six years of service.
- The unmarried surviving spouse of a reservist who died from a service connected cause.

The Selected Reserve, the Ready Reserve, or other reserve components consist of units and individuals who participate actively in paid training periods and serve on paid active duty for training each year. This includes Air Force, Army, Coast Guard, Marine Corps and Navy as well as the Army National Guard and Air National Guard.

The funding fee charged to Reservists is higher than the fee charged to Armed Forces veterans. Funding Fees vary and must be verified by the Underwriter for accuracy and collection of the proper Funding Fee amount at closing.

202.02 – Surviving Spouse of an Eligible Veteran

The surviving spouse of an eligible veteran who dies as a result of service or service connected injuries may be eligible for a VA loan providing the spouse has not remarried. Also, the spouse of an active duty service member who is missing in action (MIA) or is a prison of war (POW) may be eligible.

The VA must issue a Certificate of Eligibility to indicate spouse's eligibility.

An unmarried surviving spouse who was a co-borrower under an existing VA loan shall be considered a veteran eligible for an interest rate reduction refinancing loan.

The surviving spouse must sign a statement certifying there has been no change in marital status since the eligible veteran's COE was issued, since the applicant's marriage would void the individual's eligibility for a VA loan.

202.03 – Co-Applicants/Joint Loans

The Lender is an approved VA Automatic Lender. VA does not allow joint loans (a co-applicant other than a spouse or multiple veterans) to be approved by Automatic Lenders. Unless the co-applicant is another eligible veteran, who will use their VA entitlement, only the veteran's portion of the mortgage will be insured. Normally, the guaranty on a portion of the loan will be insufficient to meet investor requirements of minimum 25% guaranty on the loan.

In case of 2 or more eligible veterans acting as applicants and contributing entitlement, the loan amount will be divided by the number of applicants (veterans). Both loan guaranty and the charge to each veteran's entitlement will be calculated individually based on the apportioned loaned amount. Loans under these circumstances must be pre-underwritten by The Lender but must be submitted for final approval by the Department of Veteran Affairs.

When the other veteran on the application is also the applicant's spouse, the loan may be processed as a normal VA automatic loan.

Joint loans:

"Joint loan" generally refers to a loan for which:

- a veteran and another person(s) are liable, and
- the veteran and the other obligor(s) own the security.

A joint loan is a loan made to:

- the veteran and one or more nonveterans (not spouse)
- the veteran and one or more veterans (not spouse) who will not be using their entitlement
- the veteran and the veteran's spouse who is also a veteran, and both entitlements will be used, or
- the veteran and one or more other veterans (not spouse), all of who will use their entitlement.

A loan involving a veteran and his or her spouse will not be treated as a "joint loan" if the spouse:

- is not a veteran, or
- is a veteran who will not be using his or her entitlement on the loan.

A loan to a veteran and fiancé who intend to marry prior to loan closing and take title as veteran and spouse will be treated as a loan to a veteran and spouse (conditioned upon their marriage), and not a joint loan.

To avoid confusion, the terms "veteran/nonveteran joint loan" and "2 veteran joint loan" are defined as follows:

Veteran/nonveteran joint loan: Common meaning: A loan involving one veteran and one nonveteran (not spouse).

For purposes of applying the principles explained in this section, this term will also be used to represent **any** other type of joint loan involving at least one veteran using his or her entitlement and at least one other person **not** using entitlement (can be a veteran or nonveteran, but not a spouse).

Examples:

- Three veterans using entitlement and one nonveteran.
- One veteran using entitlement and 4 nonveterans.
- Two veterans using entitlement and 2 veterans **not** using entitlement.

2 veteran joint loan: Common meaning: A loan involving 2 veterans who are not married to each other, both using their entitlement.

For purposes of applying the principles explained in this section, this term will also be used to represent **any** other type of joint loan involving only veterans, each of whom uses his or her entitlement.

It can include loans to:

- the veteran and the veteran's spouse who is also a veteran, if **both** entitlements will be used, or three, four, or more veterans, **all** of whom will use their entitlement.

Any person who uses entitlement on a joint loan must certify intent to personally occupy the property as his or her home.

Maximum number of units:

If a property is to be owned by two or more eligible veterans, it may consist of four family units and one business unit, plus one additional unit for each veteran participating in the ownership.

Thus, two veterans may purchase or construct residential property consisting of up to six family units (the basic four units plus one unit for each of the two veterans), and one business unit.

If the property contains more units than four family units plus one family unit for each veteran participating in the ownership and/or more than one business unit, the loan is **not** eligible for guaranty.

Joint loans that require VA prior approval:

Any joint loan for which the veteran will hold title to the property and any person **other than** the veteran’s spouse **must be submitted to VA for prior approval.**

Any loan for which the veteran and the veteran’s spouse will hold title to the property, whether or not the spouse also uses entitlement, may be closed automatically by a lender with automatic authority.

2 Veteran Joint Loans:

As with a non-joint loan, the potential maximum guaranty on a joint loan is calculated based on the total loan amount and cannot exceed \$60,000, even if the available entitlement of the veterans involved adds up to a greater amount.

Step	Action
1	<ul style="list-style-type: none"> • Divide the total loan amount by the number of borrowers.
2	<ul style="list-style-type: none"> • Multiply the result by the number of veteran borrowers who will be using entitlement on the loan. • There is usually only one veteran borrower, in which case the result of this Step is the same as the result of Step 1.
3	<ul style="list-style-type: none"> • Calculate the maximum potential guaranty on the portion of the loan arrived at in Step 2 (as if that portion was the total loan). • Note: The percentage and amount of guaranty is based on the loan amount including the funding fee portion when the fee is paid from loan proceeds.
4	<ul style="list-style-type: none"> • VA will guarantee the lesser of • the maximum potential guaranty amount arrived at in Step 3, or • the combined available entitlement of all veteran-borrowers. • If the result of Step 2 is greater than \$144,000, additional entitlement of up to \$24,000 may be added to each veteran’s entitlement for use on the loan, if needed.
5	<ul style="list-style-type: none"> • VA makes a charge to the veteran-borrowers’ available entitlement in the amount of the guaranty. • If more than one veteran is involved, VA divides the entitlement charge equally between them if possible, or, if only unequal entitlement is available, unequal charges may be made with the written agreement of the veterans.

Borrowers and Available Entitlement	Total Loan Amount	Vet’s Portion	Maximum Potential Guaranty on Vet’s Portion	Entitlement Charge
Vet \$36,000 Nonvet \$0	\$100,000	\$50,000	\$22,500	\$22,500
Vet \$36,000 Nonvet \$0	\$120,000	\$60,000	\$24,000	\$24,000
Vet \$27,500 Vet \$36,000 Nonvet \$0	\$108,000	Total for both vets \$72,000	Total for both vets \$28,800	\$14,400 \$14,400 Total=\$28,800

Vet \$25,000	\$201,000	Total for both vets	\$36,000	\$25,000
Vet \$11,000		\$134,000		\$11,000
Nonvet \$0				Total=\$36,000

202.04 – Credit Alert Interactive Voice Response (CAIVRS)

All applicants for a VA loan must be screened using the HUD Credit Alert Interactive Voice Response System (CAIVRS). The information provided by CAIVRS will be entered into Loan Analysis Worksheet. If CAIVRS indicates the applicant is presently delinquent, the applicant is not eligible for a new loan.

SECTION 203.00 – VA ENTITLEMENT AND LOAN GUARANTY

Each eligible veteran receives a set amount of entitlement to be used when applying for a mortgage loan. This entitlement decreases by the amount of guaranty issued by VA on any outstanding VA mortgages made to the veteran. A Certificate of Eligibility is provided by VA to verify the amount of entitlement available for guaranteeing the mortgage.

203.01 – Certificate of Eligibility

The Certificate of Eligibility indicates a set amount of entitlement to be used when applying for a mortgage loan. This entitlement decreases by the amount of guaranty issued by VA on any outstanding VA mortgages made to the veteran. A Certificate of Eligibility is provided by VA to verify the amount of entitlement available for guaranteeing the mortgage and is required on every loan (or an electronic version issued from VA's website).

203.02 – Requesting a Certificate of Eligibility

Updating the Certificate of Eligibility (COE) is required when:

- The applicant provides or has evidence of more than one COE;
- The loan application contains information contrary to the information provided by the COE;
- The loan file indicates a VA loan that may not be reflected on the COE.

203.03 – Multiple Certificates of Eligibility

If a veteran has more than one COE, all should be collected from the veteran. No one should have more than one COE, regardless of the number of periods of active duty. The duplicate COE(s) should be sent to VA with a completed VA 26-1880 to clarify which is accurate.

SECTION 204.00 – ELIGIBLE REFINANCE TRANSACTIONS

VA allows for regular refinances as well as providing for a “streamlined” process designed to reduce the veteran's interest rate.

When refinancing an existing VA loan to a new VA loan, only the existing COE or Electronic COE needs be furnished. In the case of a regular (rate & term or cash out) refinance, the previous entitlement used for subject property will be restored at the time guaranty is issued. An Interest Rate Reduction Refinancing Loan (IRRRL) re-uses the same amount of entitlement which is applied to the existing loan.

Borrower **must** be on the current mortgage being paid off and on title or on title of a property that was owned free and clear prior to being transferred to the borrower.

204.01 – Comparison of VA Refinancing Loans

The following table provides a quick reference for IRRRL's versus Cash-Out Refinances.

	IRRRL	Cash-Out Refinancing
Purpose	To refinance existing VA loans at lower interest rate	To pay off lien(s) of any type – can also provide cash to borrower
Interest Rate	Rate must be lower than on existing VA loan (unless existing loan is ARM)	Any negotiated rate
Monthly payment Amount	Payment must be lower than on existing VA loan (unless ARM being refinanced, term shortened or energy efficiency improvements included)	No requirement
Discount Points	Reasonable points can be paid – only two of these points can be included in the loan amount	Reasonable points can be paid – if paid from loan proceeds, do not exceed 100% loan limit
Maximum Loan	Existing VA loan balances plus allowable fees and charges plus up to two discount points plus the cost of any energy efficiency improvements plus the VA funding fee	100% of the reasonable value of the property indicated on the NOV plus the cost of any energy efficiency improvements plus the VA funding fee. Max loan is \$144,000, including funding fee.
Maximum Guaranty	Guaranty is at least 25 percent in all cases	Guaranty is at least 25 percent in all cases
Entitlement	The veteran re-uses the entitlement used on the existing VA loan – The IRRRL does not impact the amount of entitlement the veteran has in use	Must have sufficient available entitlement – if existing VA loan on the same property is being refinanced, entitlement can be restored for the refinance
Fees and Charges in Loan	All allowable fees and charges, including up to two discount points, may be included in loan	Allowable fees and charges and points may be paid from loan proceeds, subject to the 100% limit
Cash to Borrower	Not permitted	Borrower can receive cash for any purpose acceptable to the lender
Lien/Ownership	Must be secured by first lien – veteran must own property	Must be secured by first lien – veteran must own property
Refinance of Other Liens	Cannot refinance other liens – can only refinance the existing VA loan	Can refinance any type of lien(s)
Maximum Loan Term	Existing VA loan term plus 10 years, not to exceed 30 years + 32 days	30 years + 32 days
Occupancy	Veteran or spouse of active duty member must certify to prior occupancy	Veteran or spouse of active duty member must certify as to intent to occupy
Appraisal	No appraisal is required	Appraisal is required
Credit Underwriting	No underwriting is required except in certain cases	Full credit information and underwriting are always required
Automatic Authority	All lenders can close IRRRLs automatically, except if refinanced loan is 30 days or more past due, prior approval is always required	Only lenders with automatic authority can close these loan automatically

204.02 – Regular Refinances

Regular refinances are limited to an owner occupied primary residence and are subject to the same veteran occupancy requirements as purchases.

- The base loan amount for cash out transactions is limited to 100% of the VA reasonable value. The funding fee is then added to the base loan amount;
- The applicant needs to provide a statement to VA regarding the purpose of any cash-out on refinance;
- Free and clear properties are not eligible for a VA refinance;
- Normal disclosures and documentation is required;
- Standard or alternative documentation is allowed;
- All liens against the property are eligible for inclusion in the new mortgage;
- The maximum loan term is 30 years;
- An appraisal, credit package and borrower qualification are required;
- The borrower must have sufficient entitlement for VA to guaranty the loan;
- Required entitlement cannot exceed \$36,000 (or a total loan amount of \$144,000, with funding fee included);
- Subordinate financing allowed even exceeding logs. As long as first doesn't exceed 100% and 2nd subordinate.

Rate and term refinanced to payoff construction loans, installment sale land contracts and loans which were assumed by the veteran with an interest rate higher than the proposed interest rate may exceed the 100% LTV limit if the borrower does not receive cash back.

- No cash to applicant;
- Maximum loan is lesser of VA reasonable value or sum of loan balance plus allowable closing costs and discount points; or VA funding fee plus cost of any energy efficient improvement
- The Lender must be in a first lien position;
- Loan amount does not include prepaid;
- Loan amount does not include repairs or improvements to the subject property.

204.03 – Interest Rate Reduction Refinancing Loans (IRRRL)

VA streamline or Interest Rate Reduction Refinance Loans (IRRRL) are permitted when the property will be occupied as the applicant's primary residence. The new mortgage will finance the existing lien including current (30days) interest due, prepaid, allowable closing costs, up to 2 discounts points and the VA Funding Fee.

Note: Veterans may pay more than 2 discounts points, but any amount over the 2 discounts must be paid in cash and may not be financed.

For IRRRL loans, the funding fee and the maximum loan amount are determined by completing the VA Form 26-8923. Interest Rate Reduction Refinancing Loan Worksheet.

An interest rate reduction refinancing loan can be done only when the veteran has already used his/her entitlement for a VA loan on the property to be refinanced. If the original VA loan was assumed, the veteran owner must have substituted his/her entitlement for the VA loan in order to refinance. The loan must be a VA to VA refinance reusing the veteran applicant's entitlement.

The Lender will permit VA streamline refinances on non-owner occupied (investment properties). All associates must be aware of this policy and confirm occupancy and lien holder prior to any loan application.

The new loan may not exceed the sum of the outstanding balance on the existing VA loan plus allowable fees and closing costs, including discount (2% max) and funding fee (In the State of Texas the Discount Point can only be charged if being used to buy down the rate).. No lien other than the existing VA loan may be paid from the proceeds of the loan. Any secondary lien must be subordinated or paid in full by the veteran applicant's own funds.

The rate of interest on the new loan must be lower than the rate of interest on the loan being refinanced.

Generally no appraisal or credit underwriting are required, even in the instance of a recent bankruptcy. Even when there is no underwriting, approval of new credit will be required from the trustee in a Chapter 13 bankruptcy.

Loan payment is to be current at the time of application and at time of underwriting.

- Uniform loan application (FNMA-1003) and addendum (FNMA-1802a) will be required;
- Normal disclosures are required;
- A new VA case number is required;
- A reduction in interest rate is required, except when refinancing from an ARM to fixed rate loan;
- The new loan term will be the existing term plus 10 years not to exceed a maximum of 30 years;
- Energy efficient improvements may be financed into the new loan;
- Unused temporary buy down funds must be applied to the principal on the old loan before the new loan amount is calculated;
- Applicant may not receive more than \$500 cash back from the refinance transaction;
- Subordinate liens may not be financed into the new loan, but existing subordinate liens may be re-subordinate, with the new VA loan in first lien position;
- Existing lien must be a VA insured loan in the name of the Veteran/applicant;

- Veteran/applicant's name and LH or ID number on the COE must match the loan being refinanced;
- Changes in the borrower's name from the old note to the new note is permitted for the sole purpose of adding or deleting a spouse.

204.04 – Rate Reduction Refinance of an Adjustable Rate Mortgage

When refinancing an existing adjustable rate mortgage to a fixed rate loan, special underwriting criteria may apply. The combination of an increase in the interest rate from the ARM to a fixed rate loan along with additional costs such as closing costs, discounts, funding fees and energy efficient improvements may result in a significant increase in the veteran's monthly mortgage payment. When the principal and interest portion of the monthly PITI increase by 20% or more, the veteran must qualify for the higher loan payment.

The determination that the veteran qualifies will be based upon a fully completed, signed and dated application, an in file or tri-merged credit report and verification of income. Alternative documentation may be used, if available. Otherwise full documentation including a Verification of Employment and pay stubs or two years of personal federal income tax returns will be required.

The underwriter will indicate the applicant's qualification and loan approval on the VA Statement of Effect of Refinance, Loan Commander Notes and the Interest Rate Reduction Refinance Loan Worksheet.

A quick calculation to determine if qualifying is required, subtract the old PITI from the new PITI and divide the difference by the old PITI.

Example: Old PITI = \$650, New PITI = \$805.00
 $\$805 - \$650 = \$155$ divided by $\$650 = .238$ or 23.8%.
 Applicants will be required to qualify for new payment.

204.05 – Recently Listed Properties

- Owner Occupied properties must have been off the market for 1 month

SECTION 205.00 – SUBORDINATE FINANCING

For VA purposes, secondary borrowing refers to the veteran obtaining a second mortgage simultaneously with a VA-guaranteed first mortgage, both secured by the same property.

Secondary borrowing is acceptable as long as:

- The veteran is not placed in a substantially worse position than if the entire amount borrowed had been guaranteed by VA, and
- The requirements detailed below are met.

The second mortgage must meet the following requirements:

- The lender must submit documentation disclosing the source, amount, and repayment terms of the second mortgage and agreement to such terms by the veteran and any co-obligors.
- The second mortgage must be subordinated to the VA-guaranteed loan, that is, the second mortgage must be in a junior lien position relative to the VA loan.

Proceeds of the second mortgage may be used for a variety of purposes, including but not limited to:

- Closing costs, or
- A down payment to meet secondary market requirements of the lender.

But may not be used to cover any portion of a down payment required by VA to cover the excess of the purchase price over VA's reasonable value.

- There can be no cash back to the veteran from the VA first mortgage or a second mortgage obtained simultaneously.

- The veteran must qualify for the second mortgage which is underwritten as an additional recurring monthly obligation.

The rate on the second mortgage may exceed the rate on the VA-guaranteed first, however, it may not exceed industry standards for second mortgages.

- “Rule of thumb” is that second mortgages are one or two percent above the market interest rates for first mortgages

The second mortgage should not restrict the veteran’s ability to sell the property any more than the VA first mortgage; that is, it should be assumable by creditworthy purchasers.

There should be a reasonable grace period before:

- A late charge comes due, or
- Foreclosure proceedings are initiated in the event of default.

Second mortgages bearing unusual terms, interest rates, etc., are sometimes offered by parties such as:

- Federal, state, or local government agencies
- non-profit organizations
- private individuals
- a builder, or
- the seller.

Consult VA if it is unclear whether the terms of the second mortgage meet VA standards or if there may be a reasonable basis for VA to make an exception to the standards detailed in this topic.

Purchase of Property with Encumbrances

Generally, VA-guaranteed loans must be first liens. Any existing liens on the property must be paid off or subordinated to the VA loan.

A loan to purchase property subject to unpaid delinquent taxes, special assessments, prior mortgage indebtedness, or other obligations secured by effective liens that the veteran agrees to pay or which constitute encumbrances on the property is not eligible for guaranty if the loan amount plus these unpaid obligations exceeds VA’s reasonable value of the property.

SECTION 206.00 – MAXIMUM GUARANTY AMOUNT

The Veterans Benefits Act of 2004 was signed by the President on December 10, 2004. The law changes the maximum guaranty amount of \$60,000, for certain loans in excess of \$144,000, to an amount equal to 25 percent of the Freddie Mac conforming loan limit determined under section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act for a single family residence, as adjusted for the year involved.

To illustrate, the maximum guaranty for 2006 would be \$104,250. This is for 25 percent of the 2006 Freddie Mac conforming loan limit for a single family residence of \$417,000.

The maximum eligibility for each veteran is \$104,250 and the maximum loan amount with no down payment is \$417,000

HR3221 allows for an increase in the Maximum Guarantee amount in those eligible high cost areas based on data available from VA website http://www.homeloans.va.gov/docs/2009_county_loan_limits.pdf

Calculation determines the base loan amount prior to any financed funding fee. The financed funding fee may be added to any base loan amount, except that the total loan may not exceed \$240,000.

206.02 – Entitlement for Loan Guaranty Benefits

A Veteran is eligible for VA home loan benefits if he or she served on active duty in the Army, Navy, Air Force, Marine Corps, or Coast Guard after September 15, 1940, and was discharged under conditions other than dishonorable, according to the following guidelines:

ERA	DATES	MINMUM SERVICE REQUIRED	ENTITLEMENT CODE
WW II	9/19/40 TO 7/25/47	90 DAYS	CODE 1
PEACETIME	7/26/47 TO 6/26/50	181 DAYS	CODE 8
KOREAN WAR	6/27/50 TO 1/31/55	90 DAYS	CODE 2
POST KOREAN WAR	2/01/55 TO 8/04/64	181 DAYS	CODE 3
VIETNAM WAR	8/05/64 TO 5/07/75	90 DAYS	CODE 4
POST VIETNAM WAR	5/08/75 TO 9/07/80	181 DAYS	CODE 9
ENLISTED AFTER	9/07/80 TO 8/01/90	24 MONTHS	CODE 9
OFFICERS AFTER	10/17/81 TO 8/01/90	24 MONTHS	CODE 9

PERSIAN GULF	08/02/90-	90 DAYS	CODE 10
RESERVES	10/8/92-	6 YEARS	CODE 11

SECTION 207.00 – VA LOAN FEES AND CHARGES

207.01 – Closing Costs

The veteran may pay reasonable and customary costs for any of the following items:

- VA appraiser fees when incurred for a determination of reasonable value or for the cost of a second appraisal if the veteran has requested a reconsideration of value;
- VA Compliance Inspector fees when required by the VA appraisal;
- Recording fees and recording taxes or other charges incident to recordation;
- Credit report, including any cost of updating expired credit reports;
- That portion of taxes, assessments and similar items for the current year chargeable to the applicant/veteran and the initial deposits for the escrowed tax and insurance fund;
- Hazard Insurance policy premiums for the subject property;
- Survey costs when required by The Lender or the veteran, except that survey costs on condominiums must have prior approval of the VA Regional Office;
- Title examination and title insurance, including the cost of an environmental protection lien endorsement, if required by The Lender;
- On refinancing loans, a charge for Federal Express, Express Mail or a similar service will be acceptable when the saved per diem interest cost to the veteran will exceed the cost of the special handling;
- VA Funding Fee;
- One percent Loan Origination Fee. Costs covered by the 1 % flat charge including the following: lender's appraisal, lender's inspections (except on construction loans), loan closing or settlement fees, preparing loan papers, courier fees for conveying loan papers; attorney's services other than title work, photographs, postage and other mailing charges, amortization schedules, escrow fees, notary fees, commitment fees or marketing fees of any secondary purchaser of the mortgage and preparation and recording of assignment of mortgage to such purchaser, trustee's fees or charges, loan application or processing fees, fee for preparation of truth in lending disclosure statement, fees charged by loan brokers, tax services fees and any other fees, charges commissions or expenses not specified as an eligible closing cost by VA;
- Reasonable loan discount points.

207.02 – Allowable Fees

The VA home loan program involves a veteran's benefit. VA policy has evolved around the objective of helping the veteran to use his or her home loan benefit. Therefore, VA regulations limit the fees that the veteran can pay to obtain a loan.

Lenders must **strictly** adhere to the limitations on borrower-paid fees and charges when making VA loans.

The veteran can pay a maximum of:

- reasonable and customary amounts for any or all of the "Itemized Fees and Charges" designated by VA, plus
- a 1% flat charge by the lender, plus
- reasonable discount points.

Note: Some special provisions apply to construction, alteration, improvement and repair loans

The veteran may pay any or all of the following itemized fees and charges, in amounts that are reasonable and customary.

- The veteran can pay the fee of a VA appraiser and VA compliance inspectors.
- The veteran can also pay for a second appraisal if he or she is requesting reconsideration of value.
- The veteran **cannot** pay for an appraisal requested by the lender or seller for reconsideration of value.

- The veteran **cannot** pay for appraisals requested by parties other than the veteran or lender.
- The veteran can pay for recording fees and recording taxes or other charges incident to recordation.
- The veteran can pay for the credit report obtained by the lender.
- For Automated Underwriting cases, the veteran may pay the evaluation fee of \$50 in lieu of the charge for a credit report. For “Refer” cases, the veteran may also pay the charge for a merged credit report, if required.
- The veteran can pay that portion of taxes, assessments, and similar items for the current year chargeable to the borrower and the initial deposit for the tax and insurance account.
- The veteran can pay the required hazard insurance premium. This includes flood insurance, if required.
- The veteran can pay the actual amount charged for a determination of whether a property is in a special flood hazard area, if made by a third party who guarantees the accuracy of the determination.
- The veteran can pay a charge for a life-of-the-loan flood determination service purchased at the time of loan origination.
- A fee may **not** be charged for a flood zone determination made by the lender or a VA appraiser.
- The veteran can pay a charge for a survey, if required by the lender or veteran.
- Any charge for a survey in connection with a condominium loan must have the prior approval of VA.
- The veteran may pay a fee for title examination and title insurance, if any.
- If the lender decides that an environmental protection lien endorsement to a title policy is needed, the cost of the endorsement may be charged to the veteran.
- For refinancing loans only, the veteran can pay charges for Federal Express, Express Mail, or a similar service when the saved per diem interest cost to the veteran will exceed the cost of the special handling.
- Unless exempt from the fee, each veteran must pay a funding fee to VA.
- Additional fees attributable to local variances may be charged to the veteran **only** if specifically authorized by VA.

The lender may submit a written request to the RLC for approval if the fee is:

- normally paid by the borrower in a particular jurisdiction, and considered reasonable and customary in the jurisdiction.

Whenever the charge relates to services performed by a third party, the amount paid by the borrower must be limited to the actual charge of that third party.

Example: If the lender obtains a credit report at a cost of \$30, the lender may only charge the borrower \$30 for the credit report. The lender may **not** charge \$35, even if it believes that a \$5 handling charge is fair.

In addition, the borrower may **not** pay a duplicate fee for services that have already been paid for by another party.

Examples:

- An appraisal is completed on a property and paid for by a prospective purchaser, but the sale is never completed. A second purchaser applies for a loan before the validity period of the Notice of Value (NOV) expires. The lender uses the same NOV. The lender may **not** charge the second purchaser an appraisal fee if no second appraisal is ordered.
- A survey or flood zone determination, if the lender elects to use an existing survey or flood determination.
- In addition to the “itemized fees and charges,” the lender may charge the veteran a flat charge not to exceed 1% of the loan amount.
- Calculate the 1% on the principal amount after adding the funding fee to the loan, if the funding fee is paid from loan proceeds (except IRRRLs).

The lender’s flat charge is intended to cover all of the lender’s costs and services which are **not** reimbursable as “itemized fees and charges.”

The following list provides examples of items that cannot be charged to the veteran as “itemized fees and charges.” Instead, the lender must cover any cost of these items out of its flat fee.

- Lender’s appraisals
- Lender’s inspections, except in construction loan cases
- loan closing or settlement fees

- document preparation fees
- Preparing loan papers or conveyance fees
- Attorney's services other than for title work
- photographs
- interest rate lock-in fees
- postage and other mailing charges, stationery, telephone calls, and other overhead
- amortization schedules, pass books, and membership or entrance fees
- escrow fees or charges

Examples of items that cannot be charged to the veteran:

- notary fees
- commitment fees or marketing fees of any secondary purchaser of the mortgage and preparation and recording of assignment of mortgage to such purchaser
- trustee's fees or charges
- loan application or processing fees
- fees for preparation of truth-in-lending disclosure statement
- fees charged by loan brokers, finders or other third parties whether affiliated with the lender or not, and tax service fees.

The lender's maximum allowable flat charge of 1% of the loan amount is intended to cover **all** of the lender's costs and services which are not reimbursable as "itemized fees and charges." The lender may pay third parties for services or do as it wishes with the funds from the flat charge, as long as the lender complies with the [Real Estate Settlement Procedures Act](#) (RESPA).

The lender may **not** charge the borrower for attorney's fees. Reasonable fees for title examination work and title insurance can be paid, however, by the borrower. They are allowable itemized fees and charges.

VA does not intend to prevent the veteran from seeking independent legal representation. Therefore, the veteran can independently retain an attorney and pay a fee for legal services in connection with the purchase of a home. Closing documents should clearly indicate that the attorney's fee is **not** being charged by the lender, but is being paid by the veteran as part of an independent arrangement with an attorney.

Fees or commissions charged by a real estate agent or broker in connection with a VA loan may **not** be charged to or paid by the veteran-purchaser.

While use of "buyer" brokers is not precluded, veteran-purchasers may **not**, under any circumstances, be charged a brokerage fee or commission in connection with the services of such individuals. Since information on property available for purchase and financing options is widely available to the public from a variety of sources, VA does not believe that preventing the veteran from paying buyer-broker fees will harm the veteran.

A veteran obtaining a VA refinancing loan cannot use loan proceeds to pay penalty costs for prepayment of an existing lien.

A veteran purchasing a property with a VA loan cannot pay penalty costs required to discharge any existing liens on the seller's property.

The seller, lender, or any other party may pay fees and charges, including discount points, on behalf of the borrower.

VA regulations limit charges "made against or paid by" the borrower. They do not limit the payment of fees and charges by other parties.

Exception: Excessive seller concessions are prohibited.

For all types of VA loans, the loan amount may include the VA funding fee.

No other fees and charges or discount points may be included in the loan amount for regular purchase or construction loans.

Only refinancing loans may include other allowable fees and charges and discount points in the loan amount.

For “cash-out” refinancing loans, allowable fees and charges and discount points may be paid from cash proceeds of the loan, as long as total loan proceeds do **not** exceed **100%** of the reasonable value of the property.

207.03 – Seller Concessions

A seller concession is anything of value added to the transaction by the builder or seller for which the buyer pays nothing additional and which the seller is not customarily expected or required to pay or provide.

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

- payment of the buyer’s VA funding fee
- prepayment of the buyer’s property taxes and insurance
- gifts such as a television set or microwave oven
- payment of extra points to provide permanent interest rate buydowns
- provision of escrowed funds to provide temporary interest rate buydowns
- payoff of credit balances or judgments on behalf of the buyer

Seller concessions do not include:

- payment of the buyer’s closing costs
- payment of points as appropriate to the market (example: if the market dictates an interest rate of 7 1/2% with 2 discount points, the seller’s payment of the 2 points would not be a seller concession. If the seller paid 5 points, 3 of these points would be considered seller concession.

In some localities, builders or sellers offer concessions as a competitive tool. In extreme cases, the concessions may entice unwary and unqualified veterans into home mortgages they cannot afford. The concessions may disguise the veteran’s inability to qualify for the loan. Underwriters must review all Seller Concessions carefully to ensure this does not occur.

4% Limit

Any seller concession or combination of concessions which exceed 4% of the established reasonable value of the property is considered excessive, and unacceptable for VA-guaranteed loans. Do not include normal discount points and payment of the buyer’s closing costs in total concessions for determining whether concessions exceed the 4% limit.

207.04 – What Happens to Fees and Charges if the Loan Never Closes

The borrower’s out-of-pocket expenses for itemized fees and charges already incurred, such as appraisal and credit report, do not get refunded.

If the lender has already collected the 1% flat fee from the borrower, the lender must refund the fee. This applies to a loan that does not close for any reason, including the borrower going to another lender.

SECTION 208.00 – VA PROCESSING

The VA loan process has additional requirements, specific to the loan type.

208.01 – Assignment of VA Case Number

Both the VA case number and The Lender's loan number are assigned to the subject property. Case numbers or loan numbers do not transfer from one property to another. If a veteran's loan application is denied or withdrawn on a property, then a new VA case number, a new loan number, disclosures and full application are required when the veteran makes loan application on a new property. Example:

Veteran applies for a \$90,000 loan but property does not appraise for sufficient amount, the veteran withdraws from the loan application and contract and applies for a \$90,000 on a new property; the new application will require a new loan number and a new VA case number.

208.02 – Veteran Applicant Signatures

Original signatures are required on all documents. The veteran is not allowed to sign any blank document.

208.03 – Veteran Income Not Required

It is not necessary that the veteran applicant on the loan have income when the co-applicant/spouse has sufficient income to support the mortgage and other debts.

208.04 – Changes in Interest Rate or Discount

When the interest rate increases, or the veteran's discount point's increase, the loan must be resubmitted to underwriting. The 1003 and addendum (FNMA-1802a) must reflect the correct rate and points as the loan is closed. It is permissible for the veteran to initial the corrections.

208.05 – Nearest Living Relative

VA requires the name and address of the veteran's nearest living relative. This information must be provided in the loan file and will be entered into the VA Form 26-1820 prior to closing.

208.06 – VA Residual Income Requirements

In addition to the applicant's total debt ratio, VA gives serious consideration to the amount of the applicant's residual income. Residual income is the veteran's total discretionary income after deduction of all recurring expenses and long term obligations. VA has conducted studies to develop figures for the minimum amount of residual income necessary to support a family and pay for items such as food, clothing, medical care, etc. items that are deducted from the applicant's gross income to arrive at residual income must include:

- Long term obligations extending six months or more;
- Maintenance and utilities for the subject property;
- PITI for the subject property;
- Withholding for federal, state and local Income taxes;
- Withholding for Social security; and
- Withholding for Medicare.

Figures for determining withholding for taxes, social security and Medicare are to be taken from withholding charts issued by the appropriate government agencies.

208.07 – Number of Dependents

When determining the amount of income tax withholding for a married couple, use the charts for married persons. Each applicant's income is to be considered separately, with the number of dependents considered as follows:

- Each applicant will count themselves as a dependent.
- Children which are not from the current marriage will show as dependents for the respective parent.

- Children from the current marriage are to be considered as dependents for the applicant with the greatest income.

208.08 – Minimum Residual Income Requirements

When either the applicant or the spouse is an active-duty service person, the residual income figures can be reduced by five (5%) percent if there is a clear indication that the applicant or spouse will continue to receive the benefits resulting from use of nearby military-based facilities. This reduction may also be applied to retired military applicants when the property is located reasonably near a military base or installation with commissary privileges.

208.09 – Exceeding Ratios and Residual

VA qualifying ratios and residual income may be exceeded where significant compensating factors exist. In situations where the veteran's monthly housing expense will not be increasing, a high debt ratio (with residual exceeding requirement by more than 120%), or a shortfall in residual (with an acceptable debt ratio) will be acceptable provided the veteran has a history of no late payments in the past 24 months. The determination of the increase in shelter will be based on the average amount of mortgage or rent paid by the applicant in the previous 12 months

208.10 – Debt to Income Ratio

VA's debt-to-income ratio is a ratio of total monthly debt payments (housing expense, installment debts, etc.) to gross monthly income. It is a guide and, as an underwriting factor, it is secondary to the residual income. It should not automatically trigger approval or rejection of a loan. Instead, consider the ratio in conjunction with all other credit factors.

A ratio greater than 41% requires close scrutiny unless:

- The ratio is greater than 41% solely due to the existence of tax-free income (put notation regarding the tax-free income in the loan file or calculate an adjusted, smaller ratio based on "grossing up" of the tax-free income), or
- Residual income exceeds the guidelines by at least 20%

Loans closed automatically with ratio greater than 41%

Include a statement justifying the reasons for approval, signed by the underwriter's supervisor, unless income exceeds the guidelines by at least 20%. The statement must:

- Not be perfunctory, or
- List the compensating factors justifying approval of the loan.

208.11 – Status of Housing Availability

VA has eliminated mandatory assignment of government family quarters for other than "key and essential" personnel. The change has eliminated the need for active duty U.S. Army personnel to obtain DD Form 1747, Status of Housing Availability, before seeking off-base housing.

208.12 – Verification of VA Related Indebtedness

The Verification of VA Related Indebtedness (VA 26-8937) must only be completed by VA if Veteran receives disability income or is otherwise exempt from funding fee.

VA will utilize this form to verify disability benefits and to indicate when a veteran is exempt from the funding fee.

208.13 – Non-Taxable Income/Grossing Up

The term “gross-up” refers to a procedure that takes non-taxable income and increases it to the equivalent of taxable income. On VA loans the income used for qualifying is the residual income based upon the applicant’s net (after tax) income. However, the applicant’s total debt to income ratio should not exceed 41% without compensating factors. The “grossing up” of the applicant’s non-taxable income will have an effect on the total debt to income ratio.

The VA Automatic Underwriter may consider the effect of grossed up non-taxable income in calculating the applicant’s debt to income ratio. However, in such cases, the applicant must meet the VA residual income guidelines by using net income (before any grossed up amount). Please refer to Section 702.03 for factors. The underwriter must indicate on the Loan Analysis the use of grossed up income as a compensating factor for ratios that exceeded the normal 41%

208.14 – Amendatory Clause

Applicants and sellers are required to sign an amendatory clause on purchase of a residence to be financed by VA. The NBMC Amendatory Clause forms are to be utilized only when the executed sales contract does not contain the necessary language.

208.15 – Power of Attorney

VA restricts the use of a veteran’s Power of Attorney (POA). The restrictions are designed to protect a veteran’s loan guaranty entitlement and to reduce the complexities of loan papers executed by an attorney-in-fact of a veteran who is deceased or “missing in action” at the time the closing papers are executed.

A POA is not acceptable when the veteran’s status is Missing in Action (MIA) or Prisoner of War (POW). In these cases, the spouse must obtain a COE as a surviving spouse and be fully responsible for the obligation.

The POA may not be used for the purchase or refinance of property which is not the principal residence of the veteran. The veteran must personally occupy the dwelling.

If it is determined a POA will be accepted:

- The veteran must consent in writing to the transaction, authorizing the use of a specific amount of entitlement and a stated sales price and may be part of the veteran’s specific POA agreement (terms may also be a part of the sales contract if veteran has, personally, signed the sales contract);
- The file must contain evidence of the veteran’s consent, i.e., the veteran’s original signature on the executed sales contract and loan application;
- The veteran’s signature must be attested to by a commanding officer if active duty or notarized if a civilian; and;
- A VA loan will not be insured without positive evidence indicating that the loan instructions were executed when the veteran was alive. To comply with this requirement, The Lender must have certified as follows:
“The undersigned lender certifies that written evidence in the form of correspondence from the veteran or statement of his or her commanding officer (including statement of person authorized to act for said officer) affirmatively indicating that the veteran was alive and , if the veteran is on active military duty, not in a missing-in-action status on (date) was examined by the undersigned and that the said date is subsequent to the date the note and security instruments were executed on the veteran’s behalf by the attorney-in-fact”.

The “Alive and Well Statement” must be the original document issued by the military and must be a permanent part of the loan file. Certification by an associate or other individual will not be acceptable to replace the required original document. The Closing Agency may not certify to the “alive and well statement” unless able to furnish The Lender with documentation to support statement.

Note: VA will not require lenders to make the Alive and Well Certification in connection with IRRRL loans.

Note: If a lender experiences difficulty in obtaining verification that a service person in a combat area is alive and not in a missing-in-action status, the lender may request that VA obtain the necessary information on the lender's behalf.

208.16 – VA Loans In Disaster Areas

VA has specific requirements for loans secured by properties in a disaster area designated as such by either Federal or State authorities.

Prior to closing, it must be reconfirmed that the veteran's employment and income have not changed since the loan application. If it is determined that the veteran is no longer employed or that the family income has been reduced, the loan must be returned to underwriting for evaluation.

VA loans, closed prior to a Federal or State declaration of the property area as a disaster area, may be submitted for loan guaranty.

SECTION 209.00 – VA AUTOMATIC LIMITATIONS

Certain transactions and applicant circumstances do not permit the loan to be processed VA Automatic and will require prior approval from VA. However, if any loan must be submitted to VA for any reason, the loan must first be submitted to Underwriting for review. If the loan is acceptable, an approval will be issued subject to VA agency approval. Once this conditional approval is issued, Underwriting will submit the loan to VA. Under no circumstances may any loan be submitted to VA without previous underwriting approval.

The following loans require VA prior approval:

- Joint loans - loans with 2 or more (non-spouse) applicants; including two veterans who are contributing entitlement;
- Cases where the veteran is receiving VA paid non-service connected pension or disability;
- Situations where the veteran has been rated incompetent by VA as indicated on the Verification of VA Indebtedness.

209.01 – LAPP Property Eligibility

The appraisal of any property eligible to be the security for a VA loan can be processed under LAPP except:

- Master Appraisals
- Foreclosure Appraisals
- Those involving partial release of VA loan security
- Those involving HUD value determinations

SECTION 210.00 – ASSUMPTIONS

A veteran is personally liable for repayment of the mortgage unless a release of liability is obtained.

For loans that were committed to be made after March 1, 1988, the approval of the lender or VA must be obtained before a VA guaranteed loan can be transferred or assumed. An application for release of liability must be requested from the servicing lender or the VA office that guaranteed the loan.

If a buyer assumes all of the veteran's liabilities on the VA loan and meets VA's income and credit standards, the veteran may be released from liability.

Note: A release of liability does not restore a veteran's entitlement.

Applicants for assumption of a VA loan must be cleared through CAIVRS.

CHAPTER 3 – CREDIT

SECTION 300.00 – INTRODUCTION

The applicant's credit history must clearly document the ability and willingness to meet regularly scheduled financial obligations.

The total extent of an applicant's indebtedness has a direct bearing upon that individual's ability to repay the requested mortgage. An individual with an extensive amount of revolving and installment debts drawn to the limit, though current, could indicate that an applicant may not be able to make payments on the mortgage in a timely manner. Fully drawn credit lines, although current, represents a greater risk than non-fully drawn credit lines. The applicant's mortgage payment and total obligations must be at a manageable level.

In evaluating the applicant's credit history, the underwriting criteria must be applied consistently to each applicant regardless of race, color, religion, national origin, age, sex, familial status or handicap.

It is not the responsibility of an employee of The Lender to counsel any applicant on how to change the applicant's credit file. The employee is not to become directly involved in changing (cleaning up) the applicant's credit file. The applicant(s) must be directed to the repository that provided the credit information or to a consumer agency whose main objective is to counsel and assist consumers regarding their credit standing.

SECTION 301.00 – DOCUMENTING CREDIT

Documentation in the file must clearly support an applicant's ability to meet financial obligations in a timely, responsible manner. Although more weight is given to the applicant's payment experience within the past two years, the underwriter must always consider the applicant's entire credit history.

A Residential Mortgage Credit Report or a Merged Report must be obtained for all applicants where credit qualification is required. The original credit report, as well as all updates, corrections, and supplements must be included in the applicant's submission package. When the credit report fails to verify the applicant's payment history for mortgage, rental, or other significant debts, separate evidence of a satisfactory payment history must be developed.

The applicant's credit history may contain traditional trade lines. A trade line is defined as the type of credit obligation generally reported by a credit report indicating such information as date opened, high loan or credit amount, the current credit balance and the periodic payment history. The credit history may also contain non-credit or non-traditional references. These non-credit references are defined as continuing obligations, such as rent, utilities and insurance, which require a periodic payment at least quarterly. Non-credit payment references may appear on a credit report or may be verified by written verification.

Note: To be used to establish a minimum payment history, a non-credit payment reference must have existed for at least 12 months.

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Absence of a credit history is not generally considered an adverse factor. A minimum two (2) year history of the applicant, including residence, income, assets and credit must be developed. Lack of a credit history may result when:

- Recently discharged veterans have not had an opportunity to develop a credit history;
- Applicants have routinely used cash rather than credit;
- Applicants have not used credit since some disruptive credit event such as a bankruptcy or debt pro-ration through consumer credit counseling.

In these cases, it will be necessary to develop evidence of timely payments of non-installment obligations such as rent and utilities or other non-traditional credit.

SECTION 302.00 – CREDIT HISTORY

The applicant must have a credit history which indicates a reasonable ability and willingness to meet obligations as they become due.

Any or all of the following are indicators of an unacceptable credit history unless the cause of the problem was beyond the applicant's control:

- Incidents of more than one debt payments being more than 30 days late if the incidents have occurred within the last 12 months. This includes more than one late payment on a single account.
- Loss of security due to a foreclosure if the foreclosure has occurred within the last 36 months.
- Outstanding tax liens or delinquent Government debts with no satisfactory arrangements for payments, no matter what their age as long as they are currently delinquent and/or due and payable.
- A court-created or affirmed obligation (judgment) caused by nonpayment that is currently outstanding or has been outstanding within the last 12 months.
- Two or more rent payments paid 30 days or more past due within the last 3 years.
- Accounts which have been converted to collections within the last 12 months (utility bills, hospital bills, etc.).
- Collection accounts outstanding, with no satisfactory arrangements for payments, no matter what their age as long as they are currently delinquent and/or due and payable.
- Any debts written off within the last 36 months.

The following will not indicate an unacceptable credit history:

- "No history" of credit transactions by the applicant.
- A bankruptcy in which applicant was discharged more than 36 months before application.
- A satisfied judgment or foreclosure with no loss of security which was completed more than 12 months before the date of application.

Mitigating circumstances to establish the borrower's intent for good credit when the applicant provides documentation that may be considered if:

- The circumstances were of a temporary nature, were beyond the applicant's control, and have been removed (e.g., loss of job; delay or reduction in government benefits or other loss of income; increased expenses due to illness, death, etc.); or
- The adverse action or delinquency was the result of a refusal to make full payment because of defective goods or services or as a result of some other justifiable dispute relating to the goods or services purchased or contracted for.

SECTION 303.00 – OTHER FEDERAL DEBTS

Check HUD's Credit Alert Interactive Voice Response System (CAIVRS) to determine if the applicant is delinquent on a Federal debt. The Lender will clearly document both its CAIVRS identifying number and the borrower and co-borrower's CAIVRS access code near the signature line on the mortgage application form. No decision to deny credit can be based solely on the results of the CAIVRS inquiry. If CAIVRS identifies a delinquent Federal debt, the Lender will immediately suspend processing of the application.

The applicant will be notified that processing has been suspended and will be asked to contact the appropriate Federal agency, at the telephone number provided by CAIVRS, to resolve the delinquency. When the applicant provides the Lender with official documentation that the delinquency has been paid in full or otherwise resolved, processing of the application will be continued. An outstanding judgment obtained by the United States in a Federal Court (other than the United States Tax Court), which has been recorded, shall cause the applicant to be ineligible to receive a loan guarantee until the judgment is paid in full or otherwise satisfied. RHCDS loan

guarantee funds may not be used to satisfy the judgment. If the judgment remains unsatisfied or if the applicant is delinquent on a Federal debt and is unable to resolve the delinquency, the Lender will reject the applicant.

SECTION 304.00 – RESIDENTIAL MORTGAGE CREDIT REPORT

A Residential Mortgage Credit Report (RMCR) requires that information be accessed from at least two national repositories (data sources). The RMCR is a detailed account of the employment, credit history and residence history as well as public records of the individual.

The credit report must:

- Identify each applicant by name and verify the individual's social security number.
- Check that any social security number discrepancy must be disclosed by the Credit Reporting Agency.
- Provide a bureau score, accompanied by reason codes, for each applicant on the report.
- Be an original with no erasures, whiteout, or alterations.
- Provide the name, address and phone number of the reporting agency preparing the report.
- List all inquiries made in the last 90 days.
- Search all repositories for each locality where the applicant has lived for the past two years.
- Access no less than two national repositories and identify those which were accessed when compiling the report (acceptable repositories are Equifax, Experian, TransUnion, and Consumer Credit Assoc.).
- Attempt to verify all disclosed accounts and indicate if unable to verify certain references. The account information must contain the date the account was opened, high credit limit, current status, required payment amount, unpaid balance and payment history which lists a historical status of each account with the number of times past due.
- Contain a search at least two public record sources and disclose any discovered judgments, tax liens, bankruptcies or foreclosures.

When the credit reporting agency is unable to verify a social security number as belonging to the applicant, refer to the pre-funding guidelines.

For VA loans, the credit report must reflect the date of last activity (DLA) for all open revolving accounts.

304.01 – Three Repository Merged Credit Report

VA mortgages may utilize a three repository merged credit report in lieu of the Residential Mortgage Credit Report (RMCR). The credit report must contain all credit that is available in the repositories, be accurate and complete and provide an account of the credit, residence history and public record information of each applicant. The merged report must meet all of the requirements of a RMCR, with the exception of the applicant interview and confirmation of employment.

- The report must provide a bureau score, accompanied by reason codes, for each applicant.
- The report must include all of the information verified by the three repositories.
- Any social security number discrepancy must be disclosed by the repositories.
- Each individual trade line must identify the primary repository which provided the account information.
- The applicant is unable to provide documentation to support payment of collections, judgments or liens which reflect open balances on the merged report;
- The applicant indicates the accounts have different balances than what is shown on the report, but is unable to provide updated account statements; or
- The underwriter determines a RMCR is required to properly underwrite the mortgage.
- The faxed alternative documentation process was used.

Business Credit Report

304.02 – Unacceptable Credit Reporting Practices

It is not acceptable for the credit reporting agency to change information collected from the repositories. It is acceptable to delete duplications, to translate codes into plain language, and make appropriate adjustments to resolve conflicting information. The credit reporting agency may not:

- Restrict information collected to a period of time shorter than seven years.
- Delete lines of trade which pertain to an applicant's bankruptcy.
- Remove any derogatory information without written authorization of the creditor.
- Remove any public record information.
- Fail to report social security number discrepancies.

304.03 – Credit Reports on Non-Borrowing Spouses

VA requires a credit report (RMCR) on the applicant's spouse in community property states where the spouse will not be an applicant. The community property states where this will be required are:

Arizona, Louisiana, Texas, California, Nevada, Washington, Idaho, New Mexico, Wisconsin

If the property is located in a community property state, VA requires consideration of the spouse's credit whether or not the spouse will be personally liable on the note and whether or not the applicant and spouse choose to have the spouse's income considered.

If a married veteran wants to obtain the loan in his or her name only, the veteran may do so without regard to the spouse's credit only in a non-community property state.

304.04 – Separate Verifications of Credit

When the credit report does not contain a reference covering the most recent 12 months for the applicant's mortgage or rent payments, a direct verification will be required providing the mortgage payment history and/or rental payment history for the 12 months preceding the loan application, as required.

304.05 – Non-Traditional Forms of Credit

When an applicant lacks a traditional established credit history, then an alternative credit history must be provided using non-credit payment references. This non-traditional credit must cover a 12 month period and should adequately demonstrate the applicant's ability to successfully manage regularly scheduled financial obligations. Forms of non-credit payment references must document timely payment of

- Rental History
- Appliance rental or purchase
- Cable television bills
- Daycare expense
- Dealer financed auto loan
- Electricity bills
- Furniture rental or purchase
- Gas company bills
- Insurance premiums
- Jewelry purchases (store financing)
- Long term layaways
- Medical bills paid per payment agreement directly to the provider
- Owner financing on purchased goods
- Rental of current or previous residence
- Rent-to-own agreements
- Store financing
- Telephone Bills
- Personal Property Tax bills

In developing non-traditional credit, only those types of credit that require the mortgage applicant to make periodic payments on a regular basis should be considered (the payment schedule must call for payments at intervals that are no longer than every three months).

In order for the underwriter to consider verified non-credit payment references, the documentation must provide the following information:

- To whom the payments were made;
- The nature of the obligation (utilities, payment for purchases, insurance, etc.);
- When the account was opened
- The amount of the payment required or made;
- When the payments are due;
- A payment history;
- Any outstanding balance;
- The historical status of the account in a format that indicates the number of times and duration of times past due.

General reference letter without the above information are not sufficient documentation for establishing an acceptable credit reputation.

In addition, the underwriter must be provided with one or more of the following:

- Applicant's letter explaining the lack of credit history/use;
- Applicant's budget indicating provision for new mortgage debt, any other recurring debt and personal expenses;
- Evidence of homebuyer counseling.

When no credit history can be established, adherence to standard ratios will be required, unless the applicant has extraordinary compensating factors.

304.06 – Document Expiration Dates

Document expiration dates vary based upon whether the property is existing or under construction. The oldest document being considered determines the expiration date. Documents considered are the credit report, the most recent of a group of canceled checks provided to verify payment history, or individual written verifications of mortgage, rental or other debts, bank statements or investment account statements. That will include all documents provided for alternate documentation including pay stubs and bank account statements.

All asset verifications must be based upon current documentation; this includes the verification of assets for reserves. Expired documents must be fully updated and all information re-verified.

Existing construction: not older than 120 days from the date of the note.

- All pre-existing homes; or
- VA properties where construction began prior to the date of the appraisal.

Proposed or under construction: not older than 180 days from the date of the note.

- VA properties where construction had not been started at time of the appraisal.

304.07 – Credit Explanation Letters

Credit reporting agencies are required to report credit history for the past 7 years (bankruptcy and foreclosures may be 10 years); the credit report may contain derogatory history for the same period of time (past seven to ten years).

Outside of automated approvals, underwriters must provide justification for the underwriting decision. The underwriter always has the right to ask for additional documentation and/or an explanation for any issue which remains unclear or that may have an impact on the underwriting decision. The underwriter may require the applicant's explanation for derogatory credit that has occurred more than 24 months prior to application. Any letter of explanation must be provided directly from the applicant. Applicants must provide a written explanation of the circumstances surrounding the derogatory credit and must sign and date the letter.

Credit explanations must make sense and cannot conflict with other verified information or documentation in the file. When an applicant indicates unusual circumstances have contributed to serious delinquencies or derogatory credit, documentation to support those circumstances should be obtained if necessary to justify a decision to approve a loan with recent credit problems.

SECTION 305.00 – REVIEWING CREDIT HISTORY / ANALYSIS OF RISK

The applicant's attitude toward credit is a key factor when determining whether the individual is likely to repay debt. The applicant's credit history, explanation letters and other documentation must support a responsible attitude towards credit. The individual must clearly understand that when they incur debts, the debts must be repaid, even if it means personal sacrifice at times.

Reviewing the applicant's credit reputation must be based upon the entire credit history documented in the file. The underwriter must weigh the following factors in order to arrive at a conclusion that the applicant(s) credit history is acceptable.

- The type and amount of credit outstanding.
- How long the applicant has had credit.
- How the applicant uses the available credit.
- Any recent changes in the number of open accounts or overall amount of credit outstanding.
- The payment history and status of all accounts.
- Any recent inquiries shown on the credit report.
- Any public record or collection item.

305.01 – How to Analyze Credit

When evaluating an applicant's credit history, primary emphasis will be placed upon the manner in which the monthly housing expenses have been paid. Consideration will next be given to the timeliness with which installment loans, revolving accounts and other obligations have also been met.

The credit report must show the applicant has a history of paying obligations in a timely, responsible manner, and if, for some reason, payment was delayed, every effort was made to rectify the situation as soon as financially possible. This scenario represents a willingness to repay obligations.

Greater emphasis is to be placed upon the applicant's overall history of repayment, than upon isolated incidents of late payments which are not the result of an applicant's disregard for obligations. The underwriter must take into consideration that even the most creditworthy applicant occasionally may experience a problem, such as slow or lost mail, or a disputed bill.

The applicant's past repayment practices on obligations are the best indicator of their willingness to repay future obligations. Emphasis should be on the applicant's overall payment patterns rather than isolated occurrences of unsatisfactory repayment. Determine whether the applicant (and spouse, if applicable) is a satisfactory credit risk based on a careful analysis of the credit report and other credit data.

Rent and Mortgage Payment History

The applicant's rental history and any outstanding, assumed, or recently retired mortgages must be verified and rated. Housing expense payment history is often the best indicator of how motivated the applicant is to make timely mortgage payments in the future.

Absence of Credit History

For applicants with no established credit history, base the determination on the applicant's payment record on utilities, rent, automobile insurance, or other expenses that applicant has paid. Absence of a credit history is not generally considered an adverse factor. It may result when:

- Recently discharged veterans have not yet developed a credit history
- Applicants have routinely used cash rather than credit, and/or
- Applicants have not used credit since some disruptive credit event such as bankruptcy or debt pro-ration through consumer credit counseling. In those cases, develop evidence of timely payment of non-installment obligations such as rent and utilities since the disruptive credit event.

A poor credit history alone is a basis for disapproving a loan. If credit history is marginal, look to other indicators such as residual income.

Adverse Data

Reestablished credit: In circumstances not involving bankruptcy, satisfactory credit is generally considered to be reestablished after the veteran, or veteran and spouse, have made satisfactory payments for 12 months after the date the last derogatory credit item was satisfied. For example, assume a credit report reveals several unpaid collections, including some which have been outstanding for many years. Once the borrower has satisfied the obligations, and then makes timely payments on subsequent obligation for at least 12 months, satisfactory credit is reestablished.

Collections: Isolated collection accounts do not necessarily have to be paid off as a condition for loan approval. For example, a credit report may show numerous satisfactory accounts and one or two unpaid medical (or other) collections. In such instances, while it would be preferable to have collections paid, it would not necessarily be a requirement for loan approval. However, collection history and unpaid collection accounts should be considered open, recent credit. Borrowers with a history of collection accounts should have reestablished satisfactory credit in order to be considered a satisfactory credit risk.

Disputed Accounts: Lenders may consider a veteran's claim of bona fide or legal defenses regarding unpaid debts except when the debt has been reduced to judgment. Account balances reduced to judgment by a court must either be paid in full or subject to a repayment plan with a history of timely payments. For unpaid debts or debts that have not been paid timely, pay-off of these debts after the acceptability of applicant's credit is questioned does not alter the unsatisfactory record or payment.

Summary: The above guidance is not meant to address every possible scenario. Lenders should carefully review the complete credit history and use their judgment. For example, if an applicant has numerous unpaid collections, no matter when they were established, it's not unreasonable to question the borrower's ability and willingness to honor obligations. If the applicant and/or spouse are determined satisfactory credit risks in spite of derogatory credit information, the loan file should include an explanation from the applicant(s) and the lender's underwriter or the basis for the determination, if lenders are unsure about a particular situation, they should contact the appropriate VA Regional Loan Center.

305.02 – Debt Payoff/Pay Down

In each application, the underwriter must evaluate the loan request to determine if liquid assets are available to pay off debts for qualifying. The underwriter must consider debt payoff as an alternative in justifying each approval or denial of a loan request. In those cases, the applicant must have sufficient funds to meet down payments, closing costs, pre-pays, any required reserves and adequate funds to pay off any debt. Verification of

sufficient funds must be provided in the loan file. Consideration must be given to the type of debt being paid off, as well as the applicant's spending habits, to determine if debt payoff actually succeeds in decreasing the risk.

An applicant must not be asked or encouraged to pay off debts prior to underwriting the loan. The loan file should indicate those debts the applicant has elected to payoff and the underwriter will condition for evidence of payoff prior to or at loan closing.

305.03 – Paying Down Debt to Qualify

It is not acceptable for an applicant to "pay down" the balance on an installment or revolving debt to fewer than ten months remaining so that the debt will not count in the overall debt ratio.

On installment loans where the debt will not exceed ten months at closing, underwriting will not include the debt in ratio unless the payment is substantial and the applicant has limited cash reserves. The underwriter should state on the 1008, the Mortgage Credit Analysis Worksheet or the Loan Analysis why the debt was included, or excluded, from the qualifying ratios.

SECTION 306.00 – CREDIT AND LIABILITY DOCUMENTATION

306.01 – Alimony/Separate Maintenance

Alimony and separate maintenance are considered to be long term obligations. The applicant must provide proof of obligation arising from a divorce or legal separation.

306.02 – Automobile Leases

Automobile lease payments must be treated as an ongoing long term obligation, regardless of the remaining term on the lease. The current lease payment must be included in the applicant's long term obligations unless the applicant can provide conclusive evidence that:

- Another method of transportation has been secured (any new debt must be included in ratios); or
- An agreement, signed prior to mortgage loan closing, will renew the lease or purchase the vehicle (any new debt must be included in ratios).
- If the debt is fully paid, no payment will be counted.

306.03 – Bankruptcy

Petition under Chapter 7 of the Bankruptcy Code

The fact that a bankruptcy exists in an applicant's (or spouse's) credit history does not in itself disqualify the loan. A complete history on the facts and circumstances of the bankruptcy must be developed (documented).

If the bankruptcy was discharged more than two (2) years prior to the loan application, it may be disregarded.

If the bankruptcy was discharged within the last one (1) to two (2) years prior to the loan application, the following requirements must be met:

- The applicant or spouse has obtained consumer items on credit subsequent to the bankruptcy and has made the payments over a minimum of twelve (12) months with no late payments and
- The bankruptcy was caused by circumstances beyond the control of the applicant or spouse such as; unemployment, prolonged strikes, medical bills not covered by insurance, etc. and the circumstances have been verified with documentation. Under normal circumstances, a divorce will not be considered as an extenuating circumstance.

If the, bankruptcy (discharged within the last one to two years) was caused by failure of the business of a self-employed applicant, a loan approval will be considered based upon the following factors:

- The applicant has obtained a permanent position after the business failed;
- There is no derogatory credit information prior to the self-employment;
- There is no derogatory credit information subsequent to the bankruptcy; and
- Failure of the business was not due to the applicant's misconduct.

If the applicant or spouse has been discharged in bankruptcy within the past twelve (12) months, it will not be possible to determine the credit risk and the VA loan will not be approved.

Petition under Chapter 13 of the Bankruptcy Code

This type of filing indicates an effort to pay creditors. Regular payments are made to a court-appointed trustee over a 2 to 3 year period, or, in some cases, up to 5 years, to pay off scaled down or entire debts.

- If the applicant has finished making all payments satisfactorily, the lender may conclude that the applicant has reestablished satisfactory credit; or
- If the applicant has satisfactorily made at least 12 months worth of the payment and the Trustee or the bankruptcy judge approves of the new credit, the lender may give favorable consideration.

306.04 – Business Debts (Self-employed Applicant) Corporations

An applicant may be personally responsible for debts incurred for business related expenditures that appear on the applicant's credit report. The business debt will not be included in the applicants obligations if the applicant can provide 12 months canceled checks showing the business makes all the payments.

306.05 – Child Care

Only VA considers child care to be a long term obligation. No separate verification of the monthly expense is required. The amount used as an obligation is the amount disclosed at application by the veteran.

306.06 – Child Support

Court ordered child support is considered to be a long term obligation. The payment from the 1003, pay stub or other documentation in the file must be included in the debt to income ratio. In order to negate the payment the borrower must provide documentation that there are less than 10 payments remaining.

Voluntary child support is also considered a long term debt when disclosed by the applicant or when disclosed by documentation in the loan file.

Child support that is in arrears must be brought current. If a payment schedule has been established with the Court for the past due amount and a history of satisfactory payments is provided, the applicant will not be required to pay the past due amount in full. Both the payment for the past due child support and the regular court ordered support payment will be included in the applicant's income to total debt ratio.

306.07 – Collection Accounts

Collection accounts are not required to be paid off as a condition of mortgage approval. Please refer to Section 305.01 – How to Analyze Credit / Adverse Data for additional information pertaining to collection accounts and how they are to be treated.

306.08 – Consumer Credit Counseling Services (CCCS)

If the veteran, or veteran and spouse, have had adverse credit prior to entering a credit counseling plan and are now participating in a Consumer Credit Counseling plan, the following is required.

Twelve (12) months of satisfactory payment history must be provided; and
The counseling agency must approve the new mortgage loan transaction.

If the veteran, or veteran and spouse, have had good credit prior to entering credit counseling and have maintained a good credit history, but are currently participating in a Consumer Credit Counseling plan, such participation will not be considered as derogatory.

306.09 – Contingent Liability

The applicant may have a contingent liability based on co-signing a loan. If:

- There is evidence that the loan payments are being made by someone else, and
- There is no reason to believe that the applicant will have to participate in repayment of the loan, then
- The lender may exclude the loan payments from the monthly obligations factored into the net effective income calculation in the loan analysis

306.10 – Deed in Lieu of Foreclosure

A conveyance of a deed-in-lieu of foreclosure disclosed on a credit report or by the applicant is considered significant derogatory information and must be attributable to documented extenuating circumstances.

This derogatory information will be handled in the same manner as a foreclosure.

306.11 – Delinquent Housing (Mortgage or Rental)

An applicant's ability to successfully pay his or her monthly housing expense is traditionally the most critical piece of credit. All housing payments that are reported as over 30 days late are considered delinquent when evaluating an applicant's credit. In particular, payments for rent or mortgage that were paid over 30 days late, in the last 24 months, are considered a serious credit deficiency. An applicant with such late housing payments may be considered if the credit deficiency is mitigated by a usable bureau score of 720 or greater.

An applicant with an isolated housing payment delinquency (such as one 30 day late) may be considered for loan approval provided:

- The applicant provides a written explanation for the late payments that must indicate cause of the delinquency was beyond the applicant's control.
- If available, documentation to support the cause of the delinquency must be provided.
- The applicant must have demonstrated a prior satisfactory credit history over the last 24 months.

306.12 – Delinquencies – Installment

All installment accounts must be current. Installment debts are very similar to considering the individual's ability to repay these regularly scheduled, fixed payment an applicants housing expense when a debt.

One minor or isolated instance of an installment payment received no more than thirty days after the due date in the past 24 months should not prevent an applicant from being approved. The applicant however, must provide a satisfactory, written explanation for the late payment.

Multiple installment payments more than 30 days late or payments received 60 or more days after the due date are considered a serious credit deficiency. In order for the applicant to be considered for loan approval, the applicant must be able to show the delinquency occurred more than 24 months ago and was caused by extenuating circumstances beyond the applicant's control, circumstances that are not likely to reoccur.

Multiple installment payments paid more than 30 days after the due date, in the last 24 months, is considered unacceptable credit and will be considered a reason to deny the loan request.

Satisfactory credit is considered to be re-established after the veteran, or veteran and spouse, have made satisfactory payments for twelve (12) months after the date of the last derogatory credit item.

306.13 – Delinquencies - Revolving

All revolving loan accounts must be current. A minor or isolated 30 day late payment on a revolving account in the past 24 months will not prevent loan approval. The applicant must provide a satisfactory, written explanation for the late payment.

Repeated late payments to a substantial number of the applicant's accounts or any payments received 60 or more days past the due date, in the last 24 months, will be considered a reason to deny the loan request.

Late payments, 30 days or more, on revolving debt that occurred less than 24 months prior to loan application must have a written explanation from the applicant.

Satisfactory credit is considered to be re-established after the veteran, or veteran and spouse, have made satisfactory payments for twelve (12) months after the date of the last derogatory credit item.

306.14 – Delinquent Federal Debt-VA

If the applicant is presently delinquent on to:

- VA guaranteed mortgage
- HUD Section 312 Rehabilitation Loan
- Federal student loan;
- Federal Taxes; or
- Small Business Administration loan.
- Any Federal debt including, but not limited or Title I loan;

The applicant is not eligible unless the delinquent account is brought current, or

- The account is paid in full, or
- A satisfactory repayment plan has been made between the applicant and the Federal agency owed and an acceptable twelve (12) month payment history is provided.

As in the case of other delinquent obligations, a written explanation from the applicant regarding the delinquent debt will be required.

The overall analysis of the applicant's credit worthiness must consider the applicant's previous failure to make payments to the Federal agency in the agreed to manner.

306.15 – Defaulted Student Loans

If on a defaulted student loan, the applicant and the agency or financial institution have re-negotiated a repayment plan of the defaulted loan, copies of the last 12 months payments and Repayment Agreement will be acceptable. If a repayment plan has not been re-established, the defaulted loan must be paid in full prior to loan closing.

306.16 – Deferred Loans

When an applicant has projected liabilities where payments are to begin at a future date, such as a student loan, the first payment due date must be verified. When payments are scheduled to begin within 12 months of the date of closing on the subject mortgage, the payment must be included in total liabilities unless the applicant can provide written confirmation the debt has been deferred outside this time period.

Special deferments upon graduation are available for several years to doctors, teachers and other "in demand" professions. These situations require evidence of the applicant's ability to renew the deferment 12 months past closing.

306.17 – Employee Savings Plan Loans (401K, etc.)

Retirement contributions such as a 401k, including the repayment of debt secured by these funds, will not be considered as an obligation in determining the income to total debt ratio.

306.18 – Foreclosure/Primary Residence

The fact that a foreclosure exists in an applicant's (or spouses~ credit history does not in itself disqualify the loan. A complete history on the facts and circumstances of the foreclosure must be developed and documented.

If the foreclosure was discharged more than two (2) years prior to the loan application, it may be disregarded.

If the foreclosure was discharged within the last one (1) to two (2) years prior to the loan application, the following requirements must be met:

- The applicant or spouse has obtained consumer items on credit subsequent to the foreclosure and has made the payments over a minimum of twelve (12) months with no late payments: and
- The foreclosure was caused by circumstances beyond the control of the applicant or spouse such as unemployment, prolonged strikes, medical bills not covered by insurance, etc. and the circumstances have been verified with documentation. Under normal circumstances, a divorce will not be considered as an extenuating circumstance.

If the foreclosure (discharged within the last one to two years) was caused by failure of the business of a self-employed applicant, a loan approval will be considered based upon the following factors:

- The applicant has obtained a permanent position after the business failed
- There is no derogatory credit information prior to the self-employment;
- There is no derogatory credit information subsequent to the foreclosure, and
- Failure of the business was not due to the applicant's misconduct.

If the applicant or spouse has experienced a foreclosure within the past twelve (12) months, it will not be possible to determine the credit risk and the VA loan will not be approved.

If the foreclosure was on a VA loan, the applicant may not have full entitlement available for the new loan. The Certificate of eligibility must reflect sufficient entitlement to meet the required twenty-five (25%) percent guaranty on the new mortgage loan. The CAIVRS number must indicate the veteran (and spouse) has no federal debt or claim.

When the property was financed on a VA mortgage, consideration may be given to an applicants request for a mortgage once 2 years has passed and the file documents the foreclosure was due to extenuating circumstances and the applicant is not self employed. Extenuating circumstances will not be given consideration if the foreclosure resulted in the payment of a claim on a VA mortgage.

When a foreclosure occurred 3-5 years ago, all credit, since the foreclosure, must be rated satisfactory. Foreclosures which occurred more than 5 years ago may be disregarded if credit has been re-established and is rated satisfactory.

306.19 – Foreclosures on Second Homes or Investment Property

Consideration will not be given to waiving the three year waiting period, even with extenuating circumstances, when the applicant has had a foreclosure on an investment property or a second home. Applicants must wait the

full three years and must have re-established a satisfactory credit history. This restriction applies to all types of mortgage loan requests.

306.20 – Garnishment

A garnishment is an order to attach property or income to satisfy a creditor. Generally, a garnishment of wages will be indicated on an applicant's pay stub or verification of employment. It may also appear on the credit report.

Documentation to indicate the type of obligation, the amount of debt, the length of time required to repay the debt in full and the applicant's explanation for the garnishment will be required. The garnishment must be treated as a debt and included in debt-to income ratios unless the underwriter determines, that due to the underlying reason for the garnishment (such as a tax lien), the debt must be paid in full.

306.21 – Lawsuits

When an applicant discloses involvement in a lawsuit, or a pending law suit appears on the credit report, it is essential to determine the extent of the applicant's exposure. Details of the lawsuit must be obtained from the applicant's attorney that outlines:

- Whether the applicant is the plaintiff or defendant,
- The amount of the lawsuit and potential damages which may be awarded;
- The extent to which the applicant is covered by insurance against damages; and
- The amount of the applicant's potential out of pocket expenses.

When the applicant is the defendant, the applicant must have adequate insurance coverage and/or assets to cover the amount of potential liability in the event the lawsuit is lost. If the applicant does not have adequate resources, the loan may not be considered for approval until the lawsuit has been settled.

306.22 – Military Allotments

When reviewing the Leave and Earnings Statement (LES) for an active duty applicant, it is necessary to determine the purpose of any allotments to determine if the allotments reveal additional undisclosed debt or are merely reflecting payroll reductions for automatic payments. Only those allotments that meet the test for long term obligations must be included in qualifying ratio. Allotments for insurance, etc. are not considered long term debt.

306.23 – Military Advance Pay

When reviewing the Leave and Earnings Statement (LES) for an active duty application, it is necessary to determine any deductions for advance pay. Any repayments of advance pay which meets the test for long term obligations must be included in the qualifying ratio.

306.24 – Mortgage History

With the exception of automated approved loans, at minimum, a 12 month history of the applicant's mortgage history must be provided. VA will accept the standard written verification of mortgage or rent. An original verification form must be sent directly from The Lender's correspondent to the applicant's lender or landlord, and upon completion, be returned directly by the lender or landlord to correspondent.

If verified on the RMCR or the tri-merged report, a separate verification is not required. If a mortgage payment history is provided it must meet the following criteria:

- Be computer generated or typed, not handwritten,
- Identify the issuing lender or servicing agent,
- Clearly identify the Borrower and the mortgage,

- Show the total mortgage payment due,
- Show the due date of each payment,
- Show a 12 month history of the dates when payments were applied, and show the current outstanding principal balance.

Twelve (12) months of canceled checks must be obtained to support a satisfactory payment history, when the applicant is renting from a family member, the seller, real estate agent, or other interested parties to the transaction, or in transactions where there is an “identity of interest”.

Canceled checks must:

- Be legible
- Show the bank endorsement for deposit
- Show the date of bank endorsement
- Identify the servicer as payee
- Be copied, front and back

306.25 – Mortgages

Currently Owned Real Estate Non-Income Producing: The monthly mortgage payment on all non-income producing real estate owned by the applicant must be included in long term obligations. The payment must include taxes and insurance (PITI). If owned free and clear, a monthly amount for taxes, insurance and HOA dues must be counted as a debt.

Rental Properties: Rental losses are treated as long term obligations.

Applicants Current Residence: When the applicant will not have sold or leased his or her current residence by the time of closing, the full mortgage payment (Pill) plus and HOA dues must be included in long term obligations. If the residence is leased, the gross rents must be reduced to allow for maintenance and vacancy before the outstanding mortgage payment is subtracted to determine net rental income or loss

The veteran is permitted to use gross rental income to directly offset the outstanding mortgage payment on his or her current residence.

306.26 – Mortgages - Relocating Applicant

When the applicant is being relocated by an employer, the payment on the mortgage secured by the applicant’s previous residence may be excluded from ratios provided a copy of the buyout, relocation, or purchase agreement is provided and one of the following circumstances exist:

- The applicant has executed a buyout agreement offered by his or her employer (or relocation company); or
- The employer has agreed in writing to be responsible for payments on the mortgage loan until the property is sold.

306.27 – Projected Liabilities

When an applicant has projected liabilities where payments are to begin at a future date, such as a balloon note, or a ninety day note, the first payment due date must be verified. When payments are scheduled to begin within 12 months of the date of closing on the subject mortgage, the payment must be included in total liabilities unless the applicant can provide written confirmation the debt has been deferred outside this time period.

306.28 – Real Estate Expense

When an applicant owns property free and clear, expenses related to the property must be included in the applicant’s long term debt before calculating ratios. Monthly property related expenses include: taxes, insurance,

maintenance, homeowners association dues, assessments and ground rents (leasehold payments). If these expenses are already included in calculations used to determine net rental income or losses, they do not need to be shown as a separate obligation. These expenses must be specifically included in obligations when the property is not rented.

306.29 – Rental Loss

If net rental income is a loss, the amount of the loss must be included in the applicant's total obligations.

306.30 – Revolving Accounts

Revolving accounts are credit cards or lines of credit (such as overdraft protection on a checking account) where the balance fluctuates and the payment amount is based upon a percentage of the outstanding balance. In the absence of a verified or stated payment amount according to the credit report, a payment will be calculated at 5% of the outstanding balance, but not less than \$10.

306.31 – Installment Accounts

All installment accounts with ten payments or more remaining will be included in long term obligations for qualifying purposes. Payments less than 10 months remaining that are of such size as to impact applicant's ability to make the mortgage payments will be counted in the qualifying ratios.

Deduct significant debts and obligations from total effective income when determining ability to meet the mortgage payments. Significant debts and obligations include:

- Debt and obligations with a remaining term of 10 months or more, that is, long-term obligations, and
- Accounts with a term less than 10 months that require payments so large as to cause a severe impact on the family's resources for any period of time.

Example: Monthly payments of \$300 on an auto loan with a remaining balance of \$1500, even though it should be paid out in 5 months, would be considered significant.

Debts assigned to an ex-spouse by a divorce decree will not generally be charged against the veteran borrower. This includes debts that are now delinquent.

306.32 – Tax Liens

Tax liens are of a great concern to The Lender, as the potential for additional liens against the subject property would increase our risk as a lender. The applicant must explain the reasons for the tax lien (Federal, state, or local).

Applicants will be required to pay off any Federal, State, or Local Tax Liens and provide the release of lien prior to loan closing - NO EXCEPTIONS!

306.33 – Term Notes

When an applicant has a term note with interest only payments, the interest must be included in total obligations. Additionally, if the applicant will not have sufficient liquid assets remaining after closing to repay the obligation, a monthly principal reduction must be calculated and added to the applicant's monthly obligations. If the note becomes due and payable within 12 months of closing, the applicant must be able to either:

- Pay the note in full or support sufficient payments to retire the debt; or
- Provide the terms under which the note can be renewed and be able to qualify under those terms.

Computing the monthly principal reduction will be based upon the remaining term of the note.

306.34 – Debts Owed to Relatives

When an applicant has been renting from a relative, or has debts, including any mortgage, which are owed to a relative, canceled checks must be obtained to support a satisfactory repayment history and to establish the amount of the monthly payment. Since an applicant's ability to repay debt is demonstrated by the manner in which current debts are paid, confirmation that the applicant has been able to successfully meet a sizable obligation is essential to evaluating the applicant's ability to manage the proposed monthly housing expense.

306.35 – Margin Loans/Stock Accounts

Loans secured by stock are acceptable as assets to close and reserves. A margin loan from a stock broker is also an acceptable source of funds for down payment and reserves. This allows the applicant to withdraw funds from the brokerage account without having to sell the stock. Typically, no debt service is calculated on the margin loan since the underlying value of the stock is at least twice the amount of the margin loan. The stock could be sold at any time if needed to pay off the loan. If payments are required on the loan, they are to be included in the total obligations ratio.

306.36 – Repossessions

Repossessions are considered to be major derogatory credit. A minimum period of two years must have elapsed between the date of the repossession and the date of the application and a 24 month satisfactory, re-established credit history must be documented.

When the repossession was a result of documented extenuating circumstances, a minimum period of 12 months re-establishing credit and finances must have elapsed.

A repossession is considered derogatory credit. When a repossession is an isolated incident and applicant has no other derogatory credit, extenuating circumstances may be considered without seasoning or time period.

306.37 – Employment/Job Related Expense

Employment related expenses must be documented. Such costs may include but are not limited to dependent care, significant (or unusual) commuting costs, tools or job specific costs, etc.

Employment related expenses must be included in total debts when qualifying the applicant(s).

306.38 – Short Pays at Loan Payoff

A "short pay" is defined as the proceeds a bank, mortgage lender, or private mortgage insurer accepts as payoff that is less than the total principal and interest due on the loan. A short pay may occur when a property is sold as a "pre-foreclosure" sale or at a sale that, due to lower property values, does not net sufficient proceeds to cover the payoff of the mortgage loan. There may be other reasons why a borrower negotiates a short pay with a lender.

The evidence of a short pay on the applicant's credit will be viewed in the same manner as a foreclosure or deed in lieu of foreclosure. The applicant must have reestablished a satisfactory credit history. The time period the applicant must wait before obtaining a new loan will be the same as for foreclosures.

306.39 – Rent Payments

With the exception of automated approvals, at a minimum, 12 months of rental history must be verified. If the credit report does not contain a reference covering the most recent 12 months of the applicant's rent, then a direct verification must be sent to the landlord.

Canceled checks to cover the most recent 12 month period application will be acceptable. The canceled checks must:

- Be legible.
- Show the bank endorsement for deposit.
- Show the date of bank endorsement
- Identify the landlord as payee
- Be copied, front and back

306.40 – NSF / Non-Sufficient Funds

Underwriters may require explanations for any NSFs found on an applicant's bank statements, but generally will not require an explanation for an isolated incident.

An isolated incident may be that loan file where there is no evidence of problems with cash flow (such as late payments on credit accounts) and there is one or more NSF shown on the applicant's bank statements in the past 60 days.

When review of the loan documents indicates cash flow difficulties and there are 2 or more NSFs in the last 60 days, the applicant's written explanation will be required.

306.41 – Compensating Factors

Compensating factors may affect the loan decision. These factors are especially important when reviewing loans which are marginal with respect to residual income or debt-to-income ratio. They cannot be used to compensate for unsatisfactory credit.

Valid compensating factors should represent unusual strengths rather than mere satisfaction of basic program requirements. For example, the fact that an applicant has sufficient assets for closing purposes, or meets the residual income guideline, is not a compensating factor.

Valid compensating factors should logically be able to compensate (to some extent) for the identified weakness in the loan. For example, significant liquid assets may compensate for a residual income shortfall whereas long-term employment would not.

Compensating factors include, but are not limited to the following:

- Excellent credit history
- Conservative use of consumer credit
- Minimal consumer debt
- Long-term employment
- Significant liquid assets
- Sizable down payment
- The existence of equity in refinancing loans
- Little or no increase in shelter expense
- Military benefits
- Satisfactory homeownership experience

SECTION 307.00 – EXTENUATING CIRCUMSTANCES

When considering extenuating circumstances which apply to a bankruptcy, foreclosure, or deed-in-lieu of foreclosure, a different level of scrutiny is applied than when reviewing delinquencies.

What is considered to be a reasonable excuse for a period of bad credit, such as a short term layoff, illness, or similar incident, is not considered to be the caliber of financial hardship which should result in a bankruptcy, foreclosure, or deed-in-lieu of foreclosure. The criteria which is applied to extenuating circumstances requires the occurrence of a catastrophic event which resulted in extreme financial hardship from which the applicant(s) could

not recover considering the income and debt load at that time. Specifically, events must have caused either a long term loss of income which was not preventable or massive debt which the applicant was not able to pay. Applicants must provide evidence of the events as well as an explanation.

An applicant who experienced financial difficulties due to extenuating circumstances in the past may present less risk than that indicated by his or her credit score or other loan file documentation.

If there is a question about an applicant's specific circumstances which is not addressed below, please contact our Regional Underwriting Center.

307.01 – Examples of Extenuating Circumstances

Examples of situations which are considered to be extenuating circumstances and qualify for special consideration when evaluating a bankruptcy, foreclosure, or deed-in-lieu of foreclosure are:

- The death of a primary wage earner.
- Loss of employment due to business closings and reductions-in-force which resulted in substantial unemployment in the area, document with a copy of the Warren Act notice.
- A primary wage earner suffered a serious long term illness or injury which resulted in a loss of income.
- The uninsured extended illness or injury of an immediate family member which resulted in massive medical bills.

307.02 – Situations That Do Not Qualify as Extenuating Circumstances

An applicant may be faced with a temporary financial hardship or an unrecoverable financial hardship that does not fit the description of extenuating circumstances (that warrant special consideration when evaluating a past bankruptcy, foreclosure, or deed-in-lieu of foreclosure). Examples of situations that do not qualify as extenuating circumstances are:

- A failed self-employed business venture;
- The loss of a job in an area which is not experiencing high levels of unemployment or plant closures;
- An applicant's divorce;
- The applicant was taken advantage of by a friend, relative, or spouse;
- The applicant was out of town or out of the country and relied upon someone else to pay their bills; or
- An individual moved or relocated (for whatever reason) and was unable to sell their home or other property.

307.03 – Financial Mismanagement

When an applicant has experienced significant adverse or derogatory credit caused by financial mismanagement, the file must meet all of the following criteria:

- Evidence on the credit report and other credit documentation that the applicant has re-established an acceptable credit reputation for 1) at least a four year period; and 2) the applicant has the minimum number of trade-line or non-credit payment references to meet guidelines.
- Evidence on the credit report and other credit documentation that all of the applicant's credit is current.
- Evidence that the applicant's credit history, in the most recent 48 months, shows no new public records for bankruptcy, foreclosure, unpaid judgments or collections, no payments 60 days or more past due, and not more than two payments 30 days past due.
- An underwriting analysis on FHLMC Form 1077 or other file document relating the applicant's explanation and indicating the underwriter's reasonable conclusion that the applicant has re-established an acceptable credit reputation.

SECTION 308.00 – RE-ESTABLISHING CREDIT

An important aspect of lending to an individual whose has experienced a period of flawed credit is the re-establishment of an excellent credit history. A minimum period of twelve (12) months is necessary to determine whether the individual has successfully recovered from their financial difficulties.

Recently opened credit accounts do not support a re-establishment of credit, as the payment history is too new to evaluate.

Re-establishment of credit is considered for applicants who have a proven track record, i.e., applicants who had a prior history of 24 to 36 months of excellent credit and experienced a period of difficulty but who have regained their prior status.

Re-establishing credit must require a conscious effort on behalf of the individual to make timely payments. Payroll deduction loans do not prove the applicant has the ability to actively manage monthly payments. Alternative forms of credit or nontraditional credit documentation may not be used to re-establish credit that was traditional and unsatisfactory. At a minimum, the applicant must be able to demonstrate an ability to manage monthly housing expenses and payment of housing related utilities.

The period of flawed credit must be fully explained and the circumstances must be isolated and not likely to occur. This section does not address chronic flawed credit. An applicant who has had prior credit problems for extended periods of time cannot use the 12 months of recent credit to compensate for chronic flawed credit.

SECTION 309.00 – REVIEWING QUALIFYING

An applicant's past performance for meeting obligations and accumulating savings will be given primary consideration when determining whether the applicant is an acceptable risk. The underwriter must consider:

- Will the applicant's monthly housing expense and other long term obligations represent an affordable portion of the individual's income?
- How will an increase in monthly housing expense affect the applicant's ability to pay the mortgage?
- Are there recent changes in the applicant's financial situation (a raise, new car payment, etc.) which will affect the ability to repay the mortgage?

309.01 – Applicant's Qualifying Ratios

It is essential that the applicant's monthly housing expense and other long term obligations represent an affordable percentage of the applicant's stable monthly income. When qualifying ratios are exceeded, the loan must contain sufficient compensating factors to offset the higher ratios.

309.02 – An Increase in Obligations

The underwriter must evaluate the applicant's ability to successfully manage an increase in monthly housing expense. The manner in which the applicant uses personal funds, which includes savings as well as spending, is a good indicator of the individual's ability to manage this increase. A history of regular savings of an amount similar to the proposed increase in monthly housing expense or a substantial accumulation of savings would indicate the applicant has the ability to manage the personal finances.

On the other hand, an applicant with limited or no savings, who will be increasing monthly housing expense, and who has not shown an ability to manage a similar level of expenses may represent a greater credit risk.

SECTION 310.00 – QUALIFYING THE APPLICANT

For purposes of qualifying an applicant for a mortgage, ratios are calculated to determine what percentage of the applicant's income will be spent on the proposed monthly housing expense and total of all obligations.

310.01 – Monthly Housing Expense

The applicant's monthly housing expense consists of:

- Principal and interest payment.
- Monthly escrow for real estate taxes, hazard insurance, and flood insurance.
- Monthly payment of mortgage insurance premiums.
- Homeowners Association dues.
- Ground rents (leasehold payments).
- Special assessments.
- Payments on subordinate financing.

The applicant is responsible for Payment of all of these items, whether placed in escrow with The Lender or paid by the applicant. Even when the applicant will not escrow for taxes and insurance, those figures must still be included with the principal and interest (PITI) in the calculations for the Purpose of qualifying the applicant.

310.02 – Total Monthly Obligations

An applicant's total monthly obligations are the total of the applicant's monthly housing expense (PITI) and long term liabilities. The applicant's long term liabilities include all installment loans, revolving accounts (including charge accounts, overdraft protection, and lines of credit), real estate loans (including real estate taxes, hazard insurance and Homeowners Association Dues on other real estate) stock pledges, alimony, child support, and all other debts of a continuing nature.

310.03 – Long Term Obligations

Long term obligations are those fixed term obligations that extend beyond a specified number of months and include continuing obligations, such as automobile leases and negative rental income. Long term obligation must be included in the applicant's total debt for the purpose of calculating qualifying ratios.

310.04 – Qualifying Ratios

Qualifying ratios were developed by the agencies and investors as a framework for evaluating an applicant's ability to repay their obligations.

Ratio Guidelines

Ratio guidelines have been established and may be exceeded with automated underwriting approval. On a manual underwrite, the underwrite is strongly encouraged to follow the manual underwriting ratios shown below

<u>Qualifying Ratios</u>	<u>Housing</u>	<u>Total Debt</u>
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VA

Standard

*must meet residual requirements

41%

CHAPTER 4 – INCOME

SECTION 400.00 – INTRODUCTION

This section discusses our requirements for assessing income stability, determining the adequacy and continuance of income, and deciding which sources of income are acceptable for a salaried or commissioned borrower. These guidelines also apply to borrowers who rely on income received from trusts, capital gains, royalties, real estate or other miscellaneous earnings that are not the result of the borrower's employment (including those borrowers who have less than 25% ownership in a business).

400.01 – Income History

A borrower must have a history of receiving stable income from employment or other sources and a reasonable expectation that the income will continue to be received in the foreseeable future (usually for the next 3 years). Typically, when a borrower has been generating income for two or more years from full-time work with an employer(s), the lender does not need to look further into the income history of the borrower.

400.02 – Stable Earnings

Income from employment should be from related fields if the applicant has held several jobs. Not all types of employment offer year round employment with one employer, such as the building trades or farm workers. The evaluation of stable earnings must be based upon whether the applicant is able to consistently generate a similar amount of income. If the income is stable, the next step is to develop an income figure from the verified information which represents dependable earnings as a basis for repayment of the loan.

Special attention must be given to additional compensation in the form of overtime, bonus, commission, or from secondary sources so that the income used to qualify is truly representative of what the applicant will continue to earn. Variances in earnings from these sources must be carefully evaluated to determine if income is stable.

Employment should be stable in most cases with at least a two-year history in the same job or in the same line of work. Self-employed borrowers must have been in business for at least two years.

Frequent job changes without advancement or in a different line of work must ensure consistent or increasing income levels and likelihood of continued stable employment.

The applicant must explain in writing any employment gaps that exceed one (1) month (unless relieved by automated underwriting findings).

For a borrower employed by a relative or closely held family business, the supporting documents must be adequate to support the loan decision. Documentation required would be similar to that required of a self-employed borrower. A VOE signed by a family member is not acceptable.

400.03 – Continuance of Income

The applicant's income should continue for a sufficient period of time to be a reliable source for repayment of the mortgage. Evaluation of the applicant's history of employment, ability to generate similar income consistently, number of years in the same field of employment, specific educational background, and sources of any additional compensation must indicate the income can be expected to continue.

The applicant may be required to provide evidence at loan closing that there have been no changes or decreases in the income used to qualify.

SECTION 401.00 – DOCUMENTING INCOME

The documentation requirements stated in this chapter are not necessarily the minimum requirements for establishing income. **Automated approvals may give documentation relief and the underwriter must follow the feedback certificate and document according to that, first.** The underwriter has the responsibility to obtain any additional information required to establish the applicant's income.

All loan types require that a full two year history of employment be documented on the application.

401.01 – Alternative Documentation

Alternative documentation for employment requires in most circumstances, the applicant to provide a copy of the most recent two (2) years W-2 form, a pay stub covering the most recent 30 day period (at time of application) and a verbal verification of employment for the preceding two years by The Lender (automated feedback certificate may reduce these requirements). The W-2 should be the employee's copy. The pay stub:

- May not be handwritten, but must be typed or computer generated;
- Must clearly identify the employer;
- Must clearly identify the applicant as the employee;
- Reflect gross earnings for both the pay period and year-to-date;
- Should identify the pay period.

When the pay stub does not reflect gross earnings, social security taxes, withholding tax or other deductions that may indicate the applicant is a salaried employee, the use of alternative documentation is not acceptable.

If less than 25% of the applicant's income is derived from commissions, overtime or bonus, the income may be verified using alternative documentation. The file must provide the following:

- Applicant's most recent IRS W-2 form; and
- Pay stubs for the most recent 30 day period (prior to application date) indicating year to date figures; and
- Employee telephone verification verifying two prior years employment with employer and substantiating the likelihood of continued overtime, bonus or commission income.

If more than 25% of such borrower's income is derived from overtime or bonus income, Lender must obtain copies of such borrowers IRS W-2 Form(s) for the two-year period prior to the loan application, such borrower's payroll statement(s), including year-to-date income figures, for the payroll period ending no more than 30 days prior to the loan application, and telephone confirmation from such borrowers employer(s) verifying employment for the two-year period prior to the loan application and substantiating the likelihood of continued overtime/bonus income.

When commission income exceeds more than 26% of the applicant's total income, full documentation including one to two years personal tax returns, will be required as determined by the automated underwriting certificate.

Note: Pay stubs must support a minimum 30 day period. Depending upon how the applicant is paid and when the loan application is taken, more than one pay stub may be required. Example: An application taken in January with a pay stub dated January 16th will require more than one pay stub to indicate a 30 day period.

Payroll ledgers or other forms of verification may not be substituted for the applicant's pay stub. Alternative documentation will not be used when all of the required information cannot be provided.

When alternative documentation or tax returns are used, the applicant will be asked to sign an IRS Form 4506T. Since the form is date sensitive, the applicant may be required to sign more than one time, with a final form 4506T obtained at loan closing.

401.02 – Written Verification of Employment

VA will all accept the standard written verification of employment (VOE) to document the two year history. An original VOE form must be sent directly from The Lender's correspondent to the applicant's employer, to the attention of personnel or payroll. Upon completion, the VOE must be returned directly from the employer to The Lender's correspondent. A written verification of employment is required in any of the following circumstances:

- The applicant is paid hourly (full or part-time) and the employer must provide the number of hours worked, if not provided on pay stub(s);
- The employer must comment on the likelihood of continuance of overtime or bonus.

A current YTD pay stub is required for all forms of employment, in addition to the written verification of employment. When the applicant does not receive a pay stub, or the paystub is handwritten; a payroll ledger must be obtained which has been signed and dated by the employer.

401.03 – Income Tax Returns

Income tax returns may be necessary to document income. The applicant's complete individual federal income tax return for the most recent two years must be provided with all schedules and attachments. The applicant should sign the signature page of all tax returns to indicate the forms provided are a true and correct copy of those documents filed with the IRS.

It is not acceptable for the applicants to provide only a portion of their tax returns.

The applicants will be required to sign an IRS Form 4506T which enables The Lender to obtain information on tax returns directly from the IRS. **The Lender may, in its sole discretion, request IRS verification on all files requiring tax returns.** The following is a list of some of the types of income and expenses where tax returns will be needed (The list may not include all instances when tax returns are required):

- Auto Allowance (if needed to qualify);
- Commissioned earnings;
- Contract employee;
- Dividend income;
- Employed by a family owned business;
- Employee business expenses (not reimbursed);
- Interest income;
- Minister (if needed, case by case basis);
- Partnership income;
- Rental income;
- Royalties;
- Seasonal employee;
- Truck Driver (over the road/long haul);
- Self-employed applicant;
- Union employee.

401.04 – Reviewing Employment Documentation

The income documentation must be reviewed to confirm that the information is consistent throughout the file and supportive of the income necessary to qualify. The pay stub should clearly identify the applicant, and should show no sign of any alterations.

Inconsistencies and discrepancies that cannot be supported with further documentation must be reviewed with Underwriting Managers, or Credit Policy. When misrepresentation is suspected the file must be moved to Underwriting Manager for review.

When an applicant is a salaried employee, the pay stubs should indicate withholding for federal income tax, state income tax (where applicable), social security and Medicare. If there is no withholding, the applicant may be paid

as a contractor and must be treated as self-employed. If an applicant is paid a salary, the pay checks should be for the same amount each time. If the gross wages are not consistent and the variance is not clearly identified on the pay stub, an explanation must be obtained. The pay stub should be reviewed to determine any payroll deduction for debts, such as 401(k), ESOP, or credit union loans, salary advances, garnishments or child support.

W-2s must have all appropriate sections completed, including the employer ID number. The name and address of the employer and the employee should correspond to the pay stubs, 1003, VOE or other file documentation. Variances may be as simple as a change of ownership of the employer, but any variances must be clarified in the loan file. Incomplete W-2s must be reviewed thoroughly and the missing information must be confirmed and documented in the file. The earnings shown should be consistent with other verified information.

Written VOEs should not contain any alterations or evidence of alterations. Any corrections must be initialed by the individual completing the VOE.

Note: If documentation contained in the file clearly supports the corrections, such as a correction in year to date earnings supported with a W-2 for that year, it is not necessary to return the VOE for initials on the correction.

When reviewing the information on the VOE, earnings must be supported by other documents in the file.

SECTION 402.00 – CALCULATING INCOME

An applicant's income base income can be calculated in a variety of ways. For qualifying purposes, the income must be converted to a monthly rate of pay. When performing income calculations, it is essential to review the applicant's pay stub, W-2 and the rate of pay indicated on any VOE to confirm that current earnings support the income used to qualify.

402.01 – Calculating Variable Forms of Income

Qualifying income of a fluctuating nature, such as bonus, overtime, commission earnings, seasonal employment, foster care pay, or rental income is obtained by averaging the applicant's income, typically over the last 24 months (unless given documentation waiver by automated approval). The monthly income figure, obtained by averaging, must then be compared to the applicant's current year to date earnings. Any decline in income must then be investigated.

There may be situations where normal calculations will not apply to the income the applicant receives. Some employment fields, such as health care professionals, do not work a forty-hour work week, but continue to pay overtime or other fluctuating income. Calculating the income for such employment may require a VOE, in addition to a pay stub and W2s, to provide an explanation of earnings pattern.

Credit should not be given for both a 40 hour work week and overtime, in such cases. It may be that an average of the applicant's total income would give a more accurate picture of the applicant's earnings. The overall strength of the applicant, the stability of income and the likelihood of the continuance of the income must be considered when using variable forms of income.

When averaging income using an applicant's W2, credit should be given for income which has been deferred into a 401(k), 403 (b), or 501(c)(18) savings plan. These types of voluntary income deferrals are found on the W2 or the pay stub. This income would be available to the applicant to meet obligations, if the applicant desired, and should be included in qualifying income. These voluntary deductions may help to clarify situations when the wages on the VOE do not match the figure on the W2 for gross wages.

402.02 – Source of Income

Income may derive from a variety of sources such as salary, bonus, commissions, self-employment and/or other sources.

All income sources will be reviewed with regard to the borrower's ability to service the total debt obligation.

Income from such sources as seasonal type work of less than 12 months duration, commissions, overtime, bonuses, and unemployment compensation must be computed as the estimated annual amount of such income for the upcoming 12 months. Consideration should be given to whether the income is dependable based on verification by the employer and the applicant's history of such income over the previous 24 months.

402.03 – Non-Taxable Income

In considering income that is not subject to Federal income tax, the amount of tax savings attributable to the nontaxable income may be added for use with the repayment ratios. Adjustments for other than the applicable tax rate are not authorized. The Lender must verify that the income is not subject to Federal income tax and that the income (and its non-tax status) is likely to continue. The Lender must fully document and support any adjustment made.

An applicant who receives non taxable income has a greater spending power than someone who is paying taxes on their earnings. A person receiving \$1,000 a month in non taxable income has \$1,000 to spend. On the other hand, an individual who is employed receiving gross wages of \$1,000 would see his/her take home pay reduced by payroll taxes. To equalize this tax difference, for qualifying purposes, the non taxable income must be "grossed up".

All tax exempt income will be grossed up, except where bond programs, investor or agency criteria have specifically disallowed grossed up income. The grossed up income must be identified on the loan application, transmittal summary, or MCAW, or loan analysis.

The payer of the income must provide documentation indicating the amount of benefit the applicant is currently receiving, define the benefit and, where possible, indicate the income is likely to continue.

The following is a list of sources of non taxable income, but may not contain all such sources:

- Accident and health insurance proceeds;
- Child support payments;
- Clergy housing allowance;
- Damages awarded for physical injury or sickness;
- Federal Employee's Compensation Act payments;
- Food Stamps;
- Foster care payments;
- Government cost of living allowances;
- Interest on state or local obligations (tax free bonds);
- Military allowances (quarters, rations and variable housing allowance);
- Social Security Income;
- Veteran's benefits (do not confuse with military retirement);
- Welfare benefits;
- Worker's compensation.

VA will permit the applicant's income to be grossed up for the purpose of calculating the debt ratio. This process may be used to lower the debt ratio for the veterans who meet the residual requirements and clearly qualify for the requested VA loan.

The veteran's current tax status as indicated on the pay stub or current tax charts may be used to determine the amount of increase or gross up.

Do not add non taxable income to taxable income before grossing up.

The applicant's net income will be used to determine qualification based on residual income. Grossing up is not allowed when calculating residual income.

SECTION 403.00 – TYPES OF INCOME

403.01 – Alimony / Separate Maintenance

Income in this category may be considered as effective if such payments are likely to be consistently received for the first three years of the mortgage. The borrower must provide a copy of the final divorce decree, legal separation agreement, or voluntary payment agreement, *as well as* evidence that payments have been received during the last twelve months. Acceptable evidence of payment regularity includes cancelled checks, deposit slips, tax returns, and court records. Periods less than twelve months may be acceptable, provided the payer's ability and willingness to make timely payments is adequately documented by the lender. Automated underwriting approval findings may also indicate less than 12 months also acceptable.

403.02 – Auto Allowance

Generally, automobile allowances are paid to cover specific expenses related to an applicant's employment. If it is documented that the auto allowance is not for auto expenses such as gas, oil, tires and other maintenance and that the applicant does not have such auto expenses in connection with the job, then it is appropriate to use such income to offset a corresponding car payment.

To the extent that an automobile allowance is documented to exceed the actual automobile expenses (payment, gas, oil, and other maintenance), the excess income may be used as effective income.

Documentation may include such items as the applicant's personal tax returns or a letter from the employer's payroll or human resources department (on company letterhead).

403.03 – Bonus

For bonus income to be considered as stable income, the written Verification of Employment (VOE) must support a two year history of receipt plus reasonable prospects of its continuance, with the exception of waivers by the automated underwriting findings. The VOE must not state categorically that such income is not likely to continue.

Bonus income used to qualify will be calculated using a 24 month average.

Large variances in the amount of bonus income must be questioned, especially if there has been a decrease in the amount of bonus income. Information may be requested to clarify the bonus structure and how often the bonus is paid. A signing bonus paid to a new employee would generally not be considered continuing income for qualification purposes. In situations where the applicant is paid an annual bonus and is requesting loan approval subject to receipt of the bonus income for funds to close, the file must indicate if the entire bonus will be used as assets to close. Bonus income used for closing will not be used as effective income to support monthly obligations.

403.04 – Capital Gains

Income received from a capital gain is generally a one-time transaction; therefore, it should not usually be considered as part of the borrower's stable monthly income. However, if the income reflected on Schedule D- *Capital Gains and Losses* 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 and losses – the recurring gains may be considered in determining the borrower's stable monthly income – as long as the borrower provides evidence that he or she owns additional property or assets that can be sold if extra income is needed to make future mortgage payments.

403.05 – Child Support

Income in this category may be considered as effective if such payments are likely to be consistently received for the first three years of the mortgage. The borrower must provide a copy of the final divorce decree, legal separation agreement, or voluntary payment agreement, *as well as* evidence that payments have been received during the last twelve months. Acceptable evidence of payment regularity includes cancelled checks, deposit slips, tax returns, and court records. Periods less than twelve months may be acceptable, provided the payer's ability and willingness to make timely payments is adequately documented by the lender. Automated underwriting approval findings may also indicate less than 12 months also acceptable.

403.06 – Clergy

Ministers are individuals duly ordained, commissioned or licensed by a church or church denomination. Ministers or other members of the clergy are generally considered self-employed unless exempted by IRS from self-employment taxes. An exception from the IRS must be provided, when applicable.

The applicant may have elected to have social security and federal income taxes withheld from paychecks, but it is not mandatory.

Rental or housing allowance received may be considered income for qualifying the applicant. Written documentation, such as a VOE provided by the church, must be obtained showing receipt of this income. The applicant's pay stub should also reflect receipt of the housing allowance. If the applicant is newly employed, obtain a copy of the church budget (in lieu of a check) showing funds have been allocated for housing allowance. Housing allowance for ministers is non-taxable income and may be grossed up for qualifying. On VA loans, the amount of non-taxable income may be grossed up to determine the income to debt ratio.

The church may budget for educational, medical insurance, life insurance, retirement, etc. to be paid on behalf of applicant; however, these items will not be considered as qualifying income, unless exempted by the IRS. The housing allowance, although not subject to federal income taxes, is subject to self-employment taxes. Gross income on Schedule SE of the applicant's 1040 should include housing allowance paid.

403.07 – Commission

Commission income must be averaged over the previous two years. The applicant must provide the last two years personal tax returns along with a recent pay stub. Un-reimbursed business expenses must be subtracted from gross income. Individuals whose commission income shows a decrease from one year to the next require significant compensating factors to allow for loan approval.

Applicants with commission income received between one and two years may be considered favorably provided the underwriter is able to justify the acceptance and can document the likelihood of continuance or if automated findings provide a waiver for one year documentation.

Commissions earned less than one year are not considered effective income. An exception may be made in those situations where the applicant's compensation was changed from a salary to commission within a similar position with the same employer. An applicant may also qualify when that portion of earnings not attributable to commissions would still be sufficient to qualify the applicant for the mortgage.

403.08 – Contractor/Consultant

All independent contractors will be treated as a self-employed. Two years personal tax returns and a year to date profit and loss will be required, with the exception of a waiver from the automated findings. When the applicant's pay stubs do not show withholding for taxes, social security and Medicare, the applicant is paid 1099 income. Please refer to the self-employed chapter for additional information on review of tax returns.

403.09 – Disability

All disability benefits must be verified with a photocopy of the award letter. The letter must indicate the amount and length of time the benefits will be received. If the disability is short-term, verification of the applicant's anticipated return to work should be obtained. Must continue for a minimum of 24 months.

VA considers disability income in a similar manner to Conventional and FHA criteria; however, if VA has declared the veteran incompetent or the veteran's income is from a VA paid non-service connected disability/pension, the loan must be referred to VA for prior approval. All prior approval loans must be submitted to Underwriting. If approved, the Underwriting Department will submit the loan to VA.

403.10 – Dividends and Interest

Interest and dividend income may be used, provided that documentation (Schedule E tax returns or account statements) supports a two-year history of receipt and is expected to continue to be received for the next three years. This income must be averaged over the last two years. The lender must verify the borrower's ownership of the assets on which the interest and/or dividend income was earned. If the borrower is using liquid assets to close, only the interest generated by the funds remaining will be given consideration as qualifying income.

Example: Applicant has \$100,000 in CD's; \$40,000 will be used for closing, leaving \$60,000. \$60,000 earning 5% interest is \$3,000 per year. The past 2 years tax returns show earnings of \$5,163 and \$4,796 which supports roughly 5% earnings on \$100,000 each year. You would use the \$3,000 or 60% of the average income for the last 2 years (2987) \pm 12 for a monthly figure. If tax returns show interest from notes receivable, exclude this income from interest calculations and follow guidelines for "Note Receivable".

403.11 – Employment (Wages and Salary)

Salaried Income

The following documentation is required:

- Form RD 1910-5, "Request for Verification of Employment," (or the equivalent HUD/FHA/VA or Fannie Mae form), and the most recent paycheck stub.
- OR -
- Paycheck stubs or payroll earnings statements covering the most recent 30-day period, and W-2 tax forms for the previous 2 tax years, and a telephone verification of the applicant's current employment.

Please refer to Recently Discharged Veteran for exceptions to the two year employment rule in addition to the guidelines stated above.

403.12 – Family Owned Business

Self-Employment Income

The borrower must have been self employed for a minimum of two years. Self Employment of less than two years, but more than one year may be considered. The borrower must be in the same line of work as they were for at least two years prior to becoming self employed. The income from self employment must be comparable to the borrower's salaried wages. An applicant is considered self-employed when income is derived from a business in which they maintain a majority ownership (25% or more) interest or can otherwise exercise control over the business activities

Underwriting the self-employed loan applicant has always been especially challenging. Not only must the underwriter make sense out of complex tax returns, profit and loss statements, balance sheets and other related

documentation, the underwriter must be able to use sound reasoning and judgment when deciding which "rules" to apply and when.

The SFHGLP requires the Lender to determine:

- The self-employed applicant's adequate and dependable income. This income figure is used to determine the applicant's qualification to repay the requested loan.
- The self-employed applicant's annual income and adjusted annual income. These income figures are used in the determination of an applicant's eligibility for the RHS loan guarantee.

SFHGLP regulations recognize that an applicant's qualifying income may be different than the applicant's eligibility income. This distinction is important to remember when determining how to apply the different rules.

Determining Type of Business Structure - Income from a sole proprietorship, partnership, partially owned or wholly owned corporation or income received by independent contractors is considered to be self-employed income. The type of business in which the borrower has ownership will determine how to verify income.

Sole Proprietorship - A sole proprietorship has a single owner who is not incorporated. The sole proprietor has complete control over the business, but also has unlimited liability for business losses and debts. The sole proprietor will file a Schedule C with Form 1040.

Partnership - A partnership is a legal form of business, which has two or more partners. General partners have unlimited personal liability for the debts and losses while limited partners are only liable for the amount of their investment in the partnership. The partners control the partnership and the amount of control each partner has is addressed in the partnership agreement. In addition to an individual Form 1040, the partnership will file a Schedule K-1 with Form 1065.

Corporation - A corporation, usually, is a state-chartered business entity that is separate from its owners. The corporation, not the stockholder, is liable for the business debts and losses and the stockholder's personal liability is limited to the amount they have invested in the corporation. The corporation files a Form 1120.

S-Corporation - An S Corporation is a state chartered business, which is generally smaller than a Corporation, and limited to 35 stockholders. The S corporation, not the stockholders, is liable for the business debts and losses. The S corporation will file a Schedule K-1 with the Form 1120S.

A self-employed borrower must submit the last two years, business and personal federal tax returns with all schedules, a year-to-date Profit and Loss Statement and Balance Sheet, and this requirement will vary with Investor.

As an alternative, the lender may obtain IRS-issued transcripts of the borrower's tax returns, as long as the transcripts include the information from all of the applicable schedules.

The tax return documentation should be complete and include all appropriate schedules, such as Schedule C (Profit or Loss from Business), Schedule F (Farm Income and Expenses), and/or Schedule D (Capital Gains and Losses).

The self-employed applicant also should submit current documentation of the business's income and expenses, including profit and loss and balance statements. Depending on the facts of the individual application, the lender may require more documentation in order to determine the self-employed applicant's income.

In all cases, the lender must obtain sufficient documentation to support its determination regarding the viability of the business and the self-employed applicant's income. Only after the lender receives adequate documentation may the self-employed applicant's qualifying income be accurately calculated.

When an applicant is employed by a family owned business, a written verification of employment, copies of the applicant's personal income tax returns, W-2s for the past two years and a current pay stub to support the figures shown on the written VOE will be required. Verified income must be supported by actual earnings. Recent raises

must be supported by pay stub and year-to-date earnings. If the business is very small and uses handwritten paychecks (no YTD earnings stated), it may be necessary to obtain a copy of a payroll ledger signed by the owner or the business's accountant for confirmation of income.

If the applicant is a new hire, previous employment in the same or related field must be verified.

403.13 – Foster Care Income/Court Ordered Custody

Foster care income may be considered if it is recurring and likely to continue. A two (2) year history of past receipts is required. The income must be averaged over a two (2) year period.

Foster care income may be considered as qualifying income if underwriting is able to document a two year history of providing foster care services under a state or county sponsored program. Income received for a minimum two year period will be considered likely to continue, Income from foster care should be averaged over two years. Document earnings through a letter from the administering agency. Foster care earnings are non-taxable and may be grossed up.

There are circumstances outside of a divorce involving parental custody where the court has ordered custody of a child (not foster care) and a child custody payment is made(such as from social services); such income may be considered stable if it has been received a minimum of 12 months. The age of the child in custody will be considered in determining the reasonable continuation of the income.

403.14 – Foreign Income

Please refer to Residency Status when considering residency and source of income. Please review the following:

When the applicant is a US citizen or Permanent Resident Alien:

Employed in the United States by a foreign corporation, the income may be used to qualify when documented by a VOE evidencing a two year earnings history. The earnings must be in US dollars (or converted to US dollars) and the employer must confirm that the income is protected from any exchange rate fluctuations.

Employed abroad by a US company or a foreign company, the personal tax statement filed with the IRS will be required to indicate the income earned outside the US Tax returns indicate US Dollars and have been adjusted for any exchange rate fluctuations. The income may be used to qualify. Please refer to the specific product summary for details, but in most instances the applicant is eligible for a loan on a second home, a primary residence occupied by immediate family and investment property.

When the applicant is a Non-permanent Resident Alien:

Employed in the United States by a foreign corporation, the income may be used to qualify when employment, residence and credit have been verified for a minimum two year period. Please refer to the specific product summary for details, but the applicant should be eligible for loans on a primary residence only.

Employed abroad by a foreign company, the income is ineligible for qualifying.

403.15 – Government Assistance Programs

Income from government assistance programs, such as food stamps or welfare, may be used as qualifying income provided such income has a reasonable likelihood of continuing for at least three (3) years. The applicant should provide a copy of a benefits awards letter as evidence of eligibility. VA educational benefits may not be considered as qualifying income. Non taxable assistance payments may be grossed up.

403.16 – IRA/KEOGH Distributions

Once an individual reaches 59½ years of age, he/she may become eligible to receive distributions from his/her personal or business retirement funds, such as IRAs or KEOGHs, to which they have contributed.

If an account has been set up for regular distributions, the amount of the distribution may be acceptable qualifying income provided the payments would continue for a minimum of 3 years. Obtain a letter from the administrator of the account to verify the terms of the distribution. Document receipt of the funds and the current balance of the account.

Note: Do not use the same assets to determine interest income.

403.17 – Military (Active Duty)

Obtain a current Leave and Earnings Statement (LES) and a Statement of Service (needed to obtain a Certificate of Eligibility) from the commanding Officer. The Estimated Time of Separation (ETS date) must indicate service to continue more than 12 months from date of closing.

If the applicant's separation date is 12 months or less from closing, continuance of income must be documented by one of the following methods:

The applicant must have re-enlisted (provide documentation); or

The applicant must state he or she intends to re-enlist and provide a statement from the Commanding Officer confirming there is no reason the applicant would not be permitted to re-enlist.

VA only will accept a valid offer of civilian employment for qualification in situations where the applicant will be discharged within 12 months of closing.

Salary plus VHA, clothing allowance and rations may be used to qualify.

The applicant must obtain authorization to live off base (DD-1747) to be able to use quarters allowance to qualify unless the local VA office has determined no base housing is readily available, or the applicant is stationed in an area without base housing, such as overseas assignment, or is a recruiter.

Additional income such as flight pay and pro-pay may be used if verified as continuing income (hazard pay will not generally be confirmed as continuing).

403.18 – Mortgage Differential Payments

Payments received from an employer or government agency to supplement mortgage payments may be added to qualifying income; they may not be used to offset the mortgage payment. Obtain written documentation to support the amount received and the duration of the payments. If the payments are set up on a declining scale, the smallest amount received will be the amount used for qualifying purposes. The mortgage differential payments must continue for no less than three years.

403.19 – Notes Receivable

Income from notes receivable is evidenced by a copy of the executed note and proof the applicant has received the payments on a consistent basis for the past 12 months. This proof may be in the form of bank statements or deposit slips for the last 12 months, or the applicant may provide tax returns. When reviewing tax returns, Schedule B will show receipt of interest payments and the applicant may declare capital gains (Schedule D), if gains were realized on the sale of an asset. If the interest received supports regular receipt of payments, exclude any related interest or capital gains calculations from any self-employed income calculations and credit the applicant with the full payment as qualifying income (averaging tax returns may give credit only for interest and not principal payments received). Continuance of income must be for no less than one-third the term of the loan.

403.20 – Overtime

The use of overtime income for qualifying is acceptable when the applicant has a two year history of receipt of overtime and documents a likelihood of continuance of overtime, with the exception of documentation waivers by the automated underwriting engine. The VOE must not state categorically that such income is not likely to continue.

If the VOE or alternative documents itemize the amount of overtime hours, an average of the hours multiplied by the current overtime hourly rate will be used. If the number of overtime hours is not available from the employer, an average of earnings will be used. A current pay stub and two years W-2's must be reviewed to confirm actual income figures. Overtime received for periods of less than two years, but at least 18 months may be acceptable provided the underwriter adequately justifies and documents the reason for using the income for qualifying purposes. An earnings trend must also be established for overtime income.

If the overtime income shows a continual decline, the underwriter must provide a sound rationalization for including the overtime income for applicant qualifying.

Overtime earnings that are guaranteed or required by the employer as a normal work week (such as a required work week of 45 hours with 40 hours at standard pay and 5 hours at time and one-half) will be considered as effective income without any time period or seasoning when verified and documented by the employer.

Overtime earnings less than 18 months but at least 12 months may be considered on a case by case basis. File documentation and applicant's current pay stubs must strongly support the use of such income in qualifying. The underwriter must consider all the risks inherent in the file and indicate that layering of risks has not occurred. The underwriter must provide written justification for considering overtime earnings less than 18 months on both the underwriting analysis and in Loan Commander's note pad. This requirement is waived with automated underwriting findings requiring less documentation.

403.21 – Partnership Income

A partnership is a legal form of business, which has two or more partners. General partners have unlimited personal liability for the debts and losses while limited partners are only liable for the amount of their investment in the partnership. The partners control the partnership and the amount of control each partner has is addressed in the partnership agreement. In addition to an individual Form 1040, the partnership will file a Schedule K-1 with Form 1065.

When an applicant is a limited partner with less than 25% interest, as in a law or accounting firm, and partnership income is needed to qualify in addition to wages received, the applicant must provide 2 years personal tax returns with the Schedule K-1 for the partnership. The K-1s must be reviewed to determine whether there are capital contributions being made. If there are capital contributions, the partnership agreement must be obtained to determine the amount of further required contributions. The earnings will be decreased by the amount of capital contributions and the income averaged over two years.

When an applicant owns 25% or more of a partnership or is a general partner, partnership returns will be required and the applicant will be treated as self-employed.

403.22 – Pension/Retirement

Pension or retirement benefits may be verified through a benefits award letter or separate verification from the plan administrator. Monthly payments and the term of the payments must be verified. If the monthly benefit will continue for more than three years, the income can be used for qualifying. Receipt of the income can be verified from tax returns, W-2 forms, 1099 forms or, if direct deposit, from copies of the applicant's recent bank statements, but does not have to be verified in the case of Social Security Income when the borrower is of retirement age.

If the applicant is receiving military retirement and VA disability, the payments are remitted on a combined check, but the amounts are broken out on the veterans' annual statement. The VA benefit must not be counted twice. VA disability is non-taxable and may be grossed up.

When the veteran is receiving VA paid non-service related pension, the loan cannot be processed on an automatic basis and must be submitted to VA for prior approval. Underwriting must review and approve the loan before submitting to the agency.

403.23 – W2 Professional Salaried Income

A Physician or Attorney who has graduated out of school within the past two years and has not been employed in their profession long enough to establish a two year history within that profession. A verbal verification must confirm along with any documentation needed to evidence history of school, such as a diploma or transcripts.

403.24 – Projected Income

VA will permit the use of projected income for qualifying only for a veteran who will be retiring from the military within the next 12 months, and if the veteran can provide a valid offer of local civilian employment. Written verification must include start date, position; salary, etc, and the work must have some direct relationship to the applicant's military experience or educational background.

403.25 – Recently Discharged or Retired Veteran

Short term civilian employment is acceptable if the lender can establish a satisfactory relationship between the applicant's current employment and the training received and duties performed while in the military. The employer should provide a statement that the veteran is performing his job satisfactorily and that probability of continued employment is favorable. Employment in a field unrelated to skills obtained in the military is not acceptable income.

403.26 – Rental Income

If the VA applicant will be renting property not secured by the new VA loan and not a property the veteran currently occupies, the following must be obtained:

- Documentation of cash reserves of at least three (3) months mortgage payments (PITI).
- Individual income tax returns, signed and dated, plus all applicable schedules for the previous two (2) years, which show rental income generated by the property.

If there is little or no prior rental history on the property, the following must be obtained:

- A one year lease to support anticipated rents;
- Document the date of purchase of the property;
- Provide evidence regarding the local rental market (appraiser can provide); and
- Evidence the veteran has prior experience managing rental units or other background involving both property maintenance and rental.

If the VA applicant will be renting a currently owned house occupied prior to the new loan, the debt on the home may be offset by gross rent received, if sufficient to meet the debt and ONLY if there is no indication that the property will be difficult to rent. A one year lease must be obtained to support anticipated rents. This rental income may not be included in effective income,

403.27 – Rental Income - Subject Investment Property

If the veteran can document a prior history of successfully managing rental property or other collection activities, VA will permit use of 75 percent of the verified prior rent collected on the units (existing construction) or 75 percent of the appraiser's opinion of the property's fair monthly rental (proposed/new construction). The applicant must have six (6) months PITI in reserves.

There must be evidence that indicates the applicant has a reasonable likelihood of success as a landlord; i.e. previous landlord experience, property is in a area of other rentals, etc. The full PITI payment is used in determining the total debt ratio and the veteran must occupy one unit of the subject property.

403.28 – Reservist/National Guard

VA requirements for reservist are the same as for active duty.

403.29 – Room and Board

Room and board received for the applicants residence may not be considered for qualifying income.

403.30 – Seasonal Employment

Income from seasonal employment may be considered if the applicant has worked the same job "in season" for the past two years and expects to be rehired for the next season. A verification of employment (VOE) and the last two years (2) W-2's are required.

Income from such sources as seasonal type work of less than 12 months duration, commissions, overtime, bonuses, and unemployment compensation must be computed as the estimated annual amount of such income for the upcoming 12 months. Consideration should be given to whether the income is dependable based on verification by the employer and the applicant's history of such income over the previous 24 months.

Seasonal employment is acceptable as qualifying income if the applicant has worked in the same line of work for the past two years and the current employer confirms on the VOE that the applicant will be re-hired. If the applicant's income is from multiple employers two years tax returns must also be obtained as support for income. Seasonal income should be averaged over the 24 month period being reviewed.

Seasonal employees may receive unemployment compensation during the "off season".

403.31 – Second Job

Note: Second jobs may take the form of seasonal employment, such as a referee for football games or running snow removal equipment. Such employment is considered uninterrupted and may be used in qualifying if the applicant has worked the same type of job for the past two years and expects to be re-hired during the next season.

To use income from a source other than the applicant's primary employment as qualifying income, the income must have continued for a period of two years, with the exception of automated findings.

403.32 – Shift Differential

Shift differential is paid as an incentive to employees who work shifts, such as evenings, nights or weekends. When considering a shift differential as stable qualifying income and the shift differential is a permanent component of an applicant's income, the amount may be considered without a history of receipt. If the shift differential varies periodically, a minimum one year history is required. The employer must confirm the applicant will continue to receive the income. Receipt of shift pay must be supported by the current pay stub as well as by the prior year's earnings shown on the VOE or W-2s.

403.33 – Social Security - Retirement

Social Security and Pension income can be verified with an award letter, tax returns or bank statements. Survivor benefits can also be used to qualify provided that they continue for at least three (3) years.

Social security benefits are payable to retirees as early as age 62 (Or age 60 if a surviving spouse). If the applicant is eligible due to age, it is sufficient to document receipt of Social Security benefits through a benefits award letter, SSA 1099, or bank statements if an automatic deposit references the social security number of the recipient/applicant. Monthly income is the gross benefit before Medicare is deducted.

403.34 – Social Security -- Surviving Spouse and Child or Payments to Family Members

Family members may be eligible to receive social security benefits after the disability, or retirement of a primary wage. Obtain a copy of the benefits awards letter (benefits must be payable to our applicant) and evidence of the Ages of the dependents. Payments must continue for no less than three years.

403.35 – Temporary Employment

Temporary employment will be considered when the applicant works through an agency (or agencies) and has demonstrated this to be a stable form of income. The applicant's work history must be verified for two years and the applicant must have worked steadily as a temporary employee for a minimum of 18 months. Income will be averaged over the two year period, but not less than 18 months. Obtain W-2s for 2 years plus a current pay stub.

Note: No consideration will be given to the income of an individual who is not employed through a temporary agency and whose sole employer states the applicant's employment is "temporary".

403.36 – Tips

The applicant must have a two year history evidencing receipt of tip income. The applicant must provide two years of personal income tax returns, together with a current pay stub. Tip income will be averaged over a two year period. If the tip income is not reported on the pay stub or tax returns, then the income may not be used for qualifying.

403.37 – Trailing Spouse

When the subject property is being purchased as the result of relocation of the primary wage-earner and the secondary wage-earner has an established history of employment, is expected to return to work and there is a reasonable prospect for securing employment in a similar occupation in the new area, the trailing spouse income will be considered as a compensating factor. The underwriter must address the availability of such possible employment and must note on the 1008, MCAW and in Note Pad what income was considered and how the compensating factor was used.

403.38 – Truck Drivers

The above guidelines apply to VA loans, except that income will be averaged for two years, but not less than 12 months.

403.39 – Trust Income

Trust income may be used if the trust is non-revocable and the income will continue for at least three years. A photocopy of the Trust agreement or the Trustee's statement confirming the amount, frequency and duration of the payments should be obtained to verify the income and continuance of the income.

Trust income may be used as the applicant's qualifying income.

- Obtain a copy of the trust agreement or the Trustee's statement confirming the amount, frequency and duration of payments to the applicant.
- All trust income must be from a non-revocable trust, made for the benefit of the applicant
- Disbursements must continue for a minimum of three years.
- Two years personal tax returns must be provided.
- Income will be averaged for the two year period.

403.40 – Unemployment Compensation

Usually income derived from unemployment compensation cannot be considered due to the limited duration.

Unemployment compensation will be used as qualifying income when the applicant is employed in a seasonal type of job or field where temporary periods of unemployment are typical. Develop a two year history using tax returns and average this income over 24 months. In this situation, the applicant's regular income would also be averaged. Unemployment income can not be used for qualifying where the applicant underwent long periods of unemployment (i.e., greater than 26 weeks) due to factors other than seasonal employment.

403.41 – Union Member

If a union member such as a plumber, electrician, merchant marine, or sheet metal worker is continuously employed by one employer, normal methods of calculating hourly or salary income will be used. Standard alternative documentation or VOE's will suffice.

Union members, who at the direction of their union local, may work for a number of employers will have the union local verify how long the applicant has been a member and their current rate of pay.

To determine income, obtain 2 years tax returns and/or W-2s from all employers and year to date income. Develop an average number of hours worked and apply the present hourly rate of pay to determine qualifying income. The tax returns and W-2'S must support the income developed. Applicants may also receive unemployment compensation which is typically shown on the tax returns and which can be included in the average of income.

403.42 – VA Benefits

VA benefits (other than educational benefits) may be used as qualifying income if continuance is likely. The amount must be verified by a benefits awards letter or a VA distribution form. VA benefits are non-taxable and are not grossed up in determining residual. The applicant must meet VA residual guidelines. Non-taxable income may be grossed up to determine the income to debt ratio.

403.43 – Workers Compensation

Workers Compensation benefits differ by state and benefits are usually reevaluated annually.

A consistent and diligent effort must be made to obtain adequate information to allow the use of the income as qualifying income. Any workers compensation used must be documented in file and should, at minimum include the physician's statement, the awards letter, and evidence of receipt of the funds. The justification for workers compensation income used must be indicated on the 1008 transmittal, the VA loan analysis.

Temporary income benefits are paid for injuries which are expected to medically improve, usually for a term of two years, or such time as the employee can return to work. The workers compensation benefit will be used as qualifying income, unless the employee will be returning to work at a set time in the immediate future. If the employee will be returning to work, the employer must confirm the position and rate of pay.

A second type of workers comp is paid for permanent disability (which affects ability to perform previous job, but does not prevent the individual from working) until such time as the applicant can be trained for a new occupation.

This type of benefit usually continues for 5-8 years from the date of injury as a supplement to income and can only be used as qualifying income if it will continue for three years after closing.

- Lifetime workers compensation benefits are paid for a catastrophic injury such as loss of sight, hearing, or loss of limb.
- Death benefits are also available for the surviving spouse and minor children. The duration of this income is determined by state law and may be considered as qualifying income if three years continuance is established.
- Lump Sum benefits are also paid to workers in lieu of temporary or permanent disability payments and are considered as savings.

On VA loans, the non-taxable amount may be grossed up to determine the debt to income ratio.

Note: Diligence on the part of Underwriting must be made to obtain the amount of income, the terms under which the money is paid and evidence the income can reasonably be expected to continue.

403.44 – Lottery Income

In order to consider income from the applicant's winning a lottery, the file must document the following:

- Income must have been received for no less than a two year period prior to application;
- Income must be expected to continue for a period not less than three years from loan closing;
- Funds for closing and/or down payment must come from applicant's assets currently verified; and
- The source of funds for closing and/or down payment must be verified and cannot involve any gift funds

SECTION 404.00 – SPECIAL INCOME CRITERIA

404.01 – Maternity Leave

If an applicant, on maternity leave at the time of application for a mortgage, indicates the intent to return to work, the income must be treated as continuous and stable. Standard or alternative documentation of employment income is allowed.

404.02 – Payroll/Leasing Company Employees

Businesses may utilize a payroll services company. Verification of income through the use of pay stubs and W-2s from the payroll service will be acceptable. The loan file documentation must indicate the confirmation of the employer and the specific payroll service used.

Businesses may also lease permanent position employees from an employment firm. The applicant may work for the employment firm with pay stubs and W2s indicating the employment firm, but physically the employee is leased to another company. This is an acceptable form of income. The file must document the applicant's circumstances.

404.03 – Unacceptable Forms of Income

Certain types of income may not be given consideration for qualifying the applicant. These are:

- Educational benefits, such as VA benefits, scholarships, etc.;
- Gifts, regardless of duration or amount;
- Lump sum payments such as inheritances, or lawsuit settlements (may be verified as assets to close);
- Payments which are received for purchase or reimbursement of specified items;
- Retained earnings;
- Secondary income which will continue for less than three years;

- Taxable forms of income which the applicant does not declare on federal tax returns;
- Unverifiable income;
- Value of a company furnished automobile; and
- Value of employment benefit packages which are not received as cash wages.
- Lump sum payments of lottery earnings that are not ongoing.

404.04 – VA-Short Term Employment to Offset Debts

VA permits the use of short term employment to offset intermediate term debt. If the applicant has income with a twelve month history, such as overtime or bonus, which cannot be used as qualifying income, or when secondary income such as child support will not continue for the required period of time, VA will permit the use of this income to offset debts with six to twenty-four monthly payments remaining. When considering secondary income for this purpose, the number of months the income will continue must be equal to or greater than the number of payments remaining on the debt.

SECTION 405.00 – SELF-EMPLOYED APPLICANT

An applicant that owns 25% or more of any business is considered to be self-employed. The following documentation is required for all self-employed applicants, with the exceptions of any waivers provided by the automated underwriting engine:

- Signed individual federal income tax returns, including all applicable schedules, for the most current two years;
- Signed business federal income tax returns for the, last two years, including all applicable schedules, if the business is a corporation, an S corporation, or a partnership;
- A year-to-date profit and loss statement and balance sheet, regardless of the business structure, if the loan application is dated more than 120 days after the end of the business tax year;
- A balance sheet for the previous two years, if the business is a sole proprietorship that has significant business assets, employees other than the owner or his/her spouse, and regularly prepares separate business financial statements; and
- The applicant's written permission to request copies of his/her tax returns for the past two years from the IRS should they later be required for quality control purposes (IRS Form 4506T). If > 60 days from application, another 4506T is signed at closing.

405.01 – Length of Self-Employment

Income from self-employment is considered stable if the applicant has been self-employed for two years or more. Automated underwriting findings may waive the requirement to supply evidence of two year history. If an applicant who has been self-employed for less than two years must have a two year history of previous successful employment in the same occupation (or a related field) in order to be eligible for financing. In such cases, the applicant must be able to document a reasonable probability of success based upon market feasibility studies and pro forma financial statements for his or her business.

The income from an applicant's self-employment of less than one year will not be considered as effective income.

SECTION 406.00 – SELF-EMPLOYED BUSINESS STRUCTURES

Knowledge of the business structure owned by a self-employed applicant will assist associates in evaluating the stability of the business and the degree of the applicant's involvement. There are four principal business structures - sole proprietorship, partnership, corporation, and S corporation.

406.01 – Sole Proprietorship

A sole proprietorship is an unincorporated business owned by an individual. The individual owner has unlimited personal liability for all debts 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 business obligations. The success of this type of organization depends solely on the individual who owns it. Death of the owner would terminate the business and place the assets in probate, delaying the disposition of assets to creditors and heirs. Business income or loss is reported on Schedule C of the individual owners tax return.

406.02 – Partnership

A partnership is formed when two or more individuals establish a business and share profits, losses, and responsibility for running the business. Each partner agrees to act in accordance with the partnership agreement. In a general partnership, each partner is personally liable for the debts of the entire business and is responsible for the actions for every other partner. A general partnership is dissolved immediately upon the death, withdrawal, insanity, or insolvency of any of the partners, although the personal liability to partnership creditors exists even after the partnership is dissolved.

In a limited partnership, the limited partners have no right to participate in the management and operation of the business. The limited partner's liability is limited to the amount invested in the partnership. A limited partner's death, withdrawal, insanity, or insolvency does not dissolve the partnership.

Partnerships file a tax return with the IRS for information purposes. Income from the partnership flows to the individual partner's tax returns. The partners pay taxes on their proportionate share of net partnership income. Partnerships, both general and limited, are subject to a tax code provision called the "at risk" provision. The partner is not allowed to deduct more in losses than the amount "at risk" in the partnership. The amount "at risk" equals the sum of the capital plus undistributed earnings, plus any amount for which the partner is personally liable.

406.03 – Corporation

A corporation is a state-chartered business that is owned by stockholders. A corporation has perpetual existence unless otherwise stipulated in the articles of incorporation. A stockholder is not personally liable for the debts of the corporation. However, controlling shareholders are frequently required to personally guarantee any financing the corporation obtains from banks or other creditors. Although legal control of the corporation rests with its stockholders, the responsibility for day-to-day operations is delegated to a board of directors and officers of the company. Corporations must file corporate tax returns to report their income or losses. A stockholder, if employed by the corporation, will receive W-2 income. A stockholder may also receive dividend income.

406.04 – S Corporation

An S corporation is a corporation with no more than 35 stockholders. It must be a domestic corporation with only one class of stock. All stockholders must be individuals or estates. The S corporation cannot belong to an affiliated group of corporations. Stockholders elect to be taxed as an S corporation. Shareholders include in their personal tax returns, their pro rata share of ordinary income, capital gains, tax preference items, and other components of taxable income. In many respects, shareholders are taxed similarly to partners in a partnership. S corporation status avoids double taxation while providing limited liability protection to shareholders of the corporation.

SECTION 407.00 – SELF-EMPLOYED INCOME ANALYSIS

The Self-Employed Income Analysis (The Lender's format as found at the end of this section) will assist the associate in arriving at the applicant's qualifying income. This form must be a part of any application package submitted for underwriting. An average monthly income must be developed using at least two full years of the applicant's tax returns. When a year-to-date profit and loss statement is used, the income must be consistent with previous year's earnings. If the applicant has provided three years tax returns, income for all three years may be used to establish an average income. Because self-employed income may change each year, an average better approximates the applicant's long-term earnings ability. Projected income is not acceptable for

qualifying purposes. Either the schedule analysis method or the adjusted gross income method may be used to analyze income.

The financial statements and tax returns, for the self-employed applicants business, must be reviewed to confirm that the business will continue to generate the income the applicant needs to qualify for the requested mortgage. If the applicant's individual tax returns confirm sufficient income and the business tax returns and financial statements indicates that it is a viable company, it is not necessary to investigate the business any further. However, if the applicant needs (and has the legal right) to draw additional income from the business, the business must be capable of providing additional income for the applicant's use.

The applicant's earnings trend must be established. Annual earnings that are level or increasing are acceptable. However, a continuing decline in income over two or three years would be a reason to carefully consider and possibly decline the application, even if the applicant's current income and debt ratios meet established guidelines.

Evaluation of the self-employed applicant's individual tax returns will vary depending on which of the income analysis methods used.

407.01 – Schedule Analysis Method of Evaluating Returns

The schedule analysis method evaluates only the income from self-employment and ignores other income documented on the applicant's individual tax returns. Other income may be considered when it is properly documented and summarized separately on the loan application. This method eliminates the need to review un-allowed losses and saves the time required to review each line of the applicant's tax return to determine increases or decreases to the adjusted gross income. The following schedules to the IRS Form 1040 or supplemental forms are used to analyze a self-employed applicant's income under the schedule analysis method:

Schedule C (Profit or Loss from Business). This form is used to determine the business income from a sole proprietorship. Certain adjustments to the net profit or loss shown on this form will be made to arrive at the income available to the applicant. Depletion and depreciation will be added back, while the 50% meals and entertainment exclusion must be deducted.

Schedule D (Capital Gains and Losses). A onetime capital gain or loss will not be considered in determining income available to the applicant. However, if the applicant's business has a frequent turnover of assets that produce recurring gains or losses, the capital gain or loss must be considered. The applicant's tax returns for the past three years will be reviewed to develop average earnings.

Schedule E (Supplemental Income and Loss). The income or loss is taken from Schedule K-1 of the of the US Partnership Return (IRS Form 1065). If the business is a partnership, the income or loss is the sum of ordinary income (or loss) and guaranteed payments. If the business is an S corporation, the income or loss is the sum or ordinary income (or loss) and other income (or loss). Income from partnerships and S corporations must also be analyzed for un-allowed losses. (See discussion of un-allowed losses" under the AGI method, Schedule E).

Schedule F (Farm Income and Expense). This form is used to determine any business income from farming. Depreciation will be added back to the net profit or loss to arrive at the income available to the applicant.

Employee Business Expenses (IRS Form 2106). This form is used when an applicant, who receives wages from a business, has business expenses. Actual business expenses paid by the applicant will be deducted from income. If the business reimbursed the applicant for expenses, the amount reimbursed would have been reported as part of the applicant's W-2 income.

Wage and Tax Statement (IRS Form W-2). If the self-employed applicant is paid a salary by a corporation, the income is reported on a W-2.

Once the stable, continuing self-employment income has been determined by adjusting and totaling the income from the sources above, the partnership or corporate tax returns, as applicable, will be reviewed, if additional income is needed to qualify.

407.02 – Adjusted Gross Income Method of Evaluating Tax Returns

The AGI method for determining a self-employed applicant's income relies on the adjusted gross income reported on the applicant's individual tax returns. The income is either increased or decreased based on analysis of specific lines on the applicant's tax return (IRS Form 1040) or related schedules attached to it.

- **Wages, salaries If a self-employed applicant reports W-2 wages, the associate must investigate.** It could mean the applicant operates a corporation and pays himself or herself a salary. It could also mean the applicant's spouse is employed. If so, the spouse's income should be subtracted from the adjusted gross income. If the spouse's income is needed to qualify, the spouse's income must be verified directly with the employer.
- **Taxable interest income (from Schedule B).** This income will be included if it has been received for the last two years. Assets to support the continued income must be verified. The income cannot be used to qualify if the assets will be used as a source of the down payment or closing costs.
- **Tax-exempt interest income.** This income will be included if it has been received for the past two years and is expected to continue. Assets to support the continued income must be verified. The income cannot be used to qualify if the assets will be used as a source of the down payment or closing costs.
- **Dividend income (from Schedule B).** This income will be included if it has been received for the past two years and is expected to continue. Assets to support the continued income must be verified. The income cannot be used to qualify if the assets will be used as a source of the down payment or closing costs.
- **Taxable refunds of state and local income taxes.** This income must be deducted from the AGI since it is not recurring income.
- **Alimony received.** This income will be included if it will continue for at least three years and has been received for at least one year at the time of loan application.
- **Business income or loss (from Schedule C).** Depreciation and depletion will be added to the AGI and the 50% exclusion for meals and entertainment must be deducted from the AGI. Expenses related to business use of the home will be added back to AGI.
- **Capital gain or loss (from Schedule D).** In most cases, a capital gain is a nonrecurring event. Therefore, an adjustment to the AGI is required to neutralize the transaction. Subtract the amount of any gain or add the amount of the loss. However, if the capital gain income can be documented by a minimum of three years tax returns and there is evidence that the applicant will continue to acquire assets to generate capital gains, the income will be used to qualify.
- **IRA distributions.** This income will be included if it will continue for at least three years. My nontaxable portion must be added to the AGI. Non-recurring lump sum distributions will not be used to calculate income and must be subtracted from the AGI. Assets to support the continued income must be verified.
- **Pensions and annuities.** This income will be included if it will continue for at least three years. Any nontaxable portion must be added to the AGI.
- **Rents, royalties, Partnerships, estates, trusts, etc. (from Schedule E).** Depreciation or depletion related to income (or loss) from rents and royalties must be added to AGI. However, if a deductible rental loss is less than the actual loss, then it is an "un-allowed" loss that may affect the applicant's income.

Income from partnerships and S corporations must be determined by analyzing the K-1 for the corresponding partnership or S corporation. Subtract income (and add back losses) from Section II of Schedule E to neutralize the amount reported. For a partnership add back ordinary income (or subtract ordinary loss) and guaranteed payments to partner from Schedule K-1 (IRS Form 1065) to the AGI. For an S corporation add back ordinary income, or subtract the ordinary loss from Schedule K-1 (IRS Form 11208). If the income exceeds actual distributions to the partner or shareholder by a material amount, a partnership or corporate resolution or other satisfactory evidence is required to verify that the applicant has access to the additional income. Income from partnerships and S corporations must also be analyzed for ‘un-allowed’ losses.

Income from estates and trusts can be included, but since it can be complex in nature, the applicant must document the amount, frequency of receipt, and continuity for the past three years. Losses from estates and trusts must be analyzed for un-allowed losses.

An ‘un-allowed’ loss is an actual loss that could not be deducted from income for tax purposes. An ‘un-allowed loss carryover’ is an ‘un-allowed’ loss from previous years that may reduce income for tax purposes in the current tax year. The associate must determine whether there are any ‘un-allowed losses’ to deduct from income or ‘un-allowed loss carryovers’ to add back to income. Information necessary to calculate these amounts are on the Passive Activity Loss Limitations (IRS Form 8582).

- **Farm income or loss (from Schedule F).** This is the profit or loss from farming. Any depreciation shown on Schedule F must be added to the AGI.
- **Un-employment compensation.** This will be considered as acceptable income if there is a documented two-year history of its regular receipt. This is particularly true when the unemployment compensation supplements regular seasonal employment. If unemployment compensation cannot be documented as regular income, it must be deducted from AGI.
- **Social security benefits.** This income will be included if it will continue to be received for at least three years. The nontaxable portion of these benefits must be added back to the AGI.
- Most of the income adjustments shown on the IRS Form 1040 must be added back to the AGI. These adjustments include IRA deductions, the self-employed health insurance deduction, Keogh retirement plans, penalties on early withdrawal of savings, and alimony paid. Any alimony paid must also be included as a monthly debt.
- **Employee business expenses (IRS Form 2106).** These are actual expenses that should be deducted from AGI. However, depreciation will be added back.
- **Depreciation and amortization (IRS Form 4562).** Amortization will be added back to AGI, but depreciation will not since the adjustment would already have been made from Schedule C, E or F of the IRS Form 1040.

Once the stable, continuing self-employment income has been determined by making adjustments to the AGI on the applicant’s individual tax return, the associate will determine whether additional income from the business will be used in determining the applicant’s financial ability to repay the mortgage debt by evaluating partnership and corporate tax returns, if applicable.

407.03 – Evaluating Corporate Tax Returns

The Self-Employed Income Analysis will be used to determine the applicant’s share of corporate income available for the applicant’s personal use. The applicant’s percentage of ownership can usually be determined from the ‘compensation of officers’ section of the corporate tax return. If this information is not provided, the associate must obtain other evidence of the applicant’s ownership before this income can be considered. Before using the applicant’s share of corporate income to qualify the applicant, the associate must verify the applicant’s right to the income by obtaining a corporate resolution or other comparable document that establishes that right.

If the corporation operates on a fiscal year other than a calendar year, the associate must make time adjustments to relate the corporate income to the individual tax return, which is on a calendar year basis.

The following items must be considered when evaluating income from US Corporation Income Tax Returns (IRS Form 1120) to develop the correct “adjusted” business income:

- **Taxable income.** This is the corporation’s net profit for tax purposes. It must be reduced by the corporation’s total taxes to determine after-tax income.
- **Depreciation.** This non-cash expense must be added back to the corporation’s after tax income.
- **Depletion.** This non-cash expense must be added back to the corporation’s after-tax income.
- **Mortgages.** Notes, bonds payable in less than one year. This amount, which is found on the corporation’s balance sheet, must be deducted from the corporation’s after tax income. This amount is not available for distribution because the funds are required to meet the next years obligations.

Once the adjusted business income has been developed, it must be multiplied by the applicant’s percentage of ownership in the business. The associate will then subtract any dividend income from the business that the applicant reported on his or her individual tax return to arrive at the total income available to the applicant for qualifying purposes.

After the income available to the applicant for qualifying purposes has been determined, the associate will reevaluate the corporation’s overall financial position, using the Comparative Income Analysis (FNMA Form 1088). An applicant’s withdrawal of funds may have a negative impact on the corporation’s cash flow. When this occurs, it may not be possible to confirm the stability of income available for debt repayment.

407.04 – Evaluating S Corporation Tax Returns

The Self-Employed Income Analysis will be used to determine the applicant’s share of the S Corporation’s adjusted business income that will be available for the applicant’s personal use. The applicant must provide a corporate resolution or other satisfactory evidence that he or she has access to the income. The income or loss for an S Corporation (IRS Form 1120S) is transferred to Schedule E of the individual owner’s US Income Tax Return (IRS Form 1040). The primary source of income for an owner of an S Corporation comes from W-2 wages, which can be traced to the “compensation of officers” line on IRS Form 11208.

Depreciation and depletion from the S Corporations tax returns will be proportionately added back to the applicant’s income since they are non-cash expenses. However, they must first be reduced by the applicant’s proportionate share of the S Corporation’s total obligations payable in less than one year. (This will help determine whether the business will be able to meet its short term obligations).

Once the adjusted business income available to the applicant has been determined, the associate will reevaluate the S corporation’s overall financial position, using the Comparative Income Analysis (FNMA Form 1088). An applicant’s withdrawal of income from the business may result in negative cash flow of the business. When this occurs, it may not be possible to confirm the stability of income available for debt repayment

407.05 – Evaluating Partnership Tax Returns

The Self-Employed Income Analysis will be used to determine the applicant’s share of the partnership’s adjusted business income that will be available for qualifying the applicant. The applicant must provide a partnership resolution or other satisfactory evidence that the income is available for the applicant’s personal use. Both general and limited partnerships use the US Partnership Return of Income (IRS Form 1065) and the Partner’s Share of Income, Credits, Deductions, etc. (Schedule K-1) for filing income tax returns for the partnership. The partner’s share of income is carried over to Schedule E of his or her US Income Tax Return (IRS Form 1040). The applicant’s Proportionate share of depreciation and depletion will be added back to the applicant’s income since these are non-cash expenses. However, they must first be reduced by the applicant’s proportionate share of the partnership’s total obligations payable in less than one year. (This will help determine whether the business will be able to meet its short term obligations).

Once the adjusted business income available to the applicant has been determined, the associate will reevaluate the partnership's overall financial position, using the Comparative Income Analysis (FNMA Form 1088). An applicant's withdrawal of income from the business may result in negative cash flow of the business. When this occurs, it may not be possible to confirm the stability of income available for debt repayment.

407.06 – Evaluating Profit and Loss Statements

Year-to-date income from a business will be used to qualify an applicant if the income is consistent with the previous year's earnings for the business. If year-to-date income is significantly higher than previous year's earnings, year-to-date financial statements must be audited to be used in averaging income. If un-audited financial statements or other verifiable evidence is unavailable, significantly higher year-to-date earnings must be treated as a compensating factor, but will not be used to calculate income.

The Self-Employed Income Analysis will be used to determine the portion of a business' year-to-date income that will be used in qualifying the applicant. The applicant's proportionate share of depreciation and depletion will be added back to net profit since these are non-cash expenses. However, they must first be reduced by the applicant's proportionate share of the business' obligations due in less than one year since this income is required to meet short term obligations.

407.07 – Evaluating the Balance Sheet

The balance sheet provides a picture of the financial position of the business on a specific date. The total assets of the business are equal to the total liabilities and owners equity. Although the assets are stated in terms of dollars, only cash represents actual money. Retained earnings is not an asset of the business. Rather it is the amount of earnings that have been reinvested in the business since the business was established. Those reinvested earnings are reflected in the assets of the business.

Assets are items of value owned by the business. Assets may be divided into two categories, current assets and fixed assets.

- Current assets are assets which are expected to be converted into cash within the current operating cycle (in most cases the current year). Current assets normally include cash, marketable securities, accounts receivable, and inventories;
- Fixed assets are assets which are not expected to be converted into cash within the current operating cycle, for example, plant and equipment;
- Liabilities are amounts owed by the business to creditors;
- Liabilities may be classified as current liabilities or long term liabilities;
- Current liabilities are liabilities which must be paid within the current operating cycle. Current liabilities consist of accounts payable, short term notes payable, current maturities of long term debt, accrued income taxes and other accrued expenses.
- Long term liabilities are those obligations not payable during the current operating cycle.

The current ratio is computed by dividing current assets by current liabilities. The current ratio provides the best single indicator of the extent to which claims of short-term creditors are covered by assets that are expected to be converted to cash in a period roughly corresponding to the maturity of the claims.

A current ratio of less than 1.0 may indicate that net income from the current period will be required to pay current obligations. When the current ratio is less than 1.0, cash flow from non-cash expenditures, such as depreciation, depletion, and amortization, will not be used to qualify the applicant.

CHAPTER 5 – ASSETS

SECTION 500.00 – INTRODUCTION

The applicant must have sufficient liquid assets available to pay the down payment and the costs associated with obtaining the mortgage, meet any required investment criteria, and retain sufficient reserves following closing, as needed. An applicant's ability to accumulate assets provides insight into the individual's ability to successfully manage personal finances. Assets must be verified for reserve, closing costs and down payment.

500.01 – Required Funds

At the time the loan is submitted to underwriting for final approval, it must contain verification of adequate funds for closing and required reserves. If the applicant is liquidating assets for funds to close, the file should clearly indicate which assets will be liquidated. The final loan application must provide an accurate estimate of the funds required from the applicant to close the transaction. Incomplete or inaccurate figures in the details of the transaction may result in problems or delays at closing.

SECTION 501.00 – DOCUMENTING ASSETS

When documenting assets, the loan file must provide conclusive evidence the applicant has adequate funds available to close the loan and comply with any requirements for cash reserves. When the underwriter has concerns about the adequacy or source of funds which have been documented, it is both the underwriter's right and responsibility to request additional documentation to resolve any concerns regarding available funds.

501.01 – Alternative Documentation

All loan types require conclusive documentation of sufficient funds to close the loan and meet reserve requirements (where applicable). The Lender's policy is to utilize alternative documentation whenever possible. The borrower may receive documentation relief from automated underwriting findings. Additional documentation may be required to support the source of funds for any increases in account balances or new accounts.

Alternative Documentation of assets requires the applicant to provide all pages of account statements evidencing all transactions for the most recent 60 day period. The account statement must meet the following criteria, unless otherwise stated in automated underwriting system:

- Account statements may be originals, computer generated or certified photocopies.
- Computer generated statements must be signed and dated by the preparer.
- Computer generated statements must provide starting and ending balances together with all activity for the period covered.
- Computer generated statements require the name of the issuing bank and must indicate the name and title of the individual preparing the print-out.
- The entire statement must be copied.
- Identify the issuing institution (depository or broker/dealer).
- Identify the account owner(s) (applicant).
- Identify the account number (if applicable).
- If depository, show all transactions on the account (deposits and withdrawals) for a sixty day period.
- If stocks or securities, identify the stocks and/or securities and the dates acquired and/or sold.
- Account statements must show any outstanding loans, if applicable
- Show the period covered and ending balance or cash value.

501.02 – Written Verification of Deposit (VOD)

All loans may use the standard written verification of deposit (VOD) with no alterations or white out. An original VOD form must be sent directly from the correspondent to the applicant's depository institution (or brokerage), and upon completion, be returned directly from the depository institution to correspondent.

A VOD should be obtained when the applicant's account is a "passbook savings" account or other account that does not provide a statement or sufficient information to allow alternative documentation.

SECTION 502.00 – ACCESS TO FUNDS

File documentation must indicate the applicant has immediate access to the funds in the verified account or additional documentation must be provided to support liquidation of an asset.

- Account statements or Verification of Deposits, provided for funds needed to close or meet reserves, must indicate the applicant as the account holder.
- Applicant must indicate amount of funds to be withdrawn from a 401K, ESOP, SEP or other employee savings plan.
- Funds to be received from an employer, trust fund or other source must be documented with letter from the provider or other similar supporting document.
- Applicant must indicate what assets are to be liquidated, the amount of funds to be received and provide a supporting document indicating sufficient funds are available.

When assets are to be liquidated, the underwriter must condition the loan for proof of liquidation and evidence of the net proceeds (as required by automated approval) from the account in a dollar amount adequate to close the mortgage, or to combine with amounts verified as already in the bank equaling sufficient funds for closing.

The underwriter cannot assume assets are available unless written verification is obtained. Currently, only verified assets are printed on the final loan application in the assets column and only those assets, as verified, will be considered by Underwriting.

SECTION 503.00 – DETAILS OF THE TRANSACTION (URLA)

It is essential the final loan application provide an accurate reflection of the funds required from the applicant to close the transaction. Incomplete or inaccurate figures in the details of the transaction are not acceptable. Cost estimates must accurately reflect the applicant's cost. The completed application must present a realistic picture of the amount of cash the applicant will need to close on the loan. The 1003 must contain the appropriate information. It is not acceptable to refer to other loan documents, such as the Good Faith Estimate (GFE).

503.01 – Applicants Minimum Investment

When an individual is purchasing or refinancing real estate, the amount of required funds to close is the difference between the moneys needed to complete the transaction and the mortgage amount:

- Add the sales price (or payoff if a refinance)
- Plus all closing costs (origination fee, credit report, appraisal, etc.)
- Plus the prepaid (the escrow reserve for taxes, insurance, mortgage insurance, prepaid interest through month end and the initial premiums for mortgage insurance and hazard and flood insurance)
- Plus the cost of repairs (except streamline refinances)
- Less verified earnest money deposit
- Less credit for any equity due the applicant (value of the lot, etc.)
- Less seller or lender paid financing concessions
- Equals moneys necessary to complete the transaction
- Less the mortgage amount
- Equals cash required to close from applicant

When an applicant will be paying off debts for qualifying purposes, adequate funds must be documented to complete debt payoff in addition to funds required for closing and any required cash reserves.

503.02 – Required Reserves

Funds which the applicant has invested in a 401k or similar employee savings plan do not need to be liquidated. Credit will be given for the amount the applicant is vested, less the balance of any outstanding loans. Reserve requirements are shown below. Unless stated otherwise, the requirement is based on a specific number of months of the proposed PITI.

- VA – No reserves required with the exception of documenting automated findings

503.03 – Seller Contributions (Financing Concessions)

No limitations on seller contributions for normal and reasonable closing costs.

503.04 – Sales Concessions

VA defines a seller concession as anything of value added to the transaction by the builder/seller for which the buyer pays nothing additional and which the seller is not customarily expected or required to pay or provide.

Such concessions include, but are not limited to:

- Payment by the seller of the buyer's VA funding fee,
- Prepaid taxes and insurance,
- Gifts such as a television set or microwave oven,
- Extra discount points paid to provide permanent interest rate buy downs,
- Escrowed funds to provide temporary interest rate buy downs, or
- The payoff of credit balances on behalf of the buyer.

Any concession or combination of concessions which exceed four (4) percent of the established reasonable value of the property is considered excessive for VA loan purposes. Normal discount points and payment of the buyers closing costs will not be considered a concession for purposes of determining if total concessions are within the established limit, It is not acceptable to exceed the 4% limitation.

503.05 – Non-Arms Length Transactions

A non-arms length transaction is defined as one where the seller and the purchaser have a relationship outside the purchase of the property. The relationship must be disclosed on the sales contract. Examples are where a parent is selling a house to child or an employer is selling to an employee. In such cases, the funds needed for down payment and closing costs cannot be co-mingled in joint accounts. The assets must be inaccessible to all parties in the transaction, except the purchaser. It is necessary to document that the purchaser has adequate personal assets to complete the transaction.

SECTION 504.00 – SOURCE OF FUNDS / ASSETS TO CLOSE

Funds used as down payment, closing costs, prepaid, and any required reserves, must not only be adequate to close the mortgage transaction, but must be adequately documented. The file must clearly indicate the applicant's source of funds. Additional documentation may be required when:

- An account has been opened within the 90 days prior to application unless the balance in the account, or the account statements, clearly shows the current balance to be only the result of deposits of the applicant's normal paychecks.
- No average balance is indicated on the VOD (account statements or a transaction history covering a 60 day period must be obtained).
- Account balances indicate an increase in the average balance that exceeds one month take home pay for the applicant.

- Deposits appearing on the applicant's account statements exceed the applicant's normal take home pay.
- Checking accounts have only deposit activity and no withdrawals. The applicant must explain how the normal day to day living expenses are being paid.

504.01 – 1031 Exchange

The 1031 Tax Deferred Exchange (1031 Exchange) feature provides borrowers with an additional means for obtaining down payment funds. A tax deferred exchange allows the borrower to exchange the "like kind" (residential to residential) property as long as the acquired property is of greater or equal value to the relinquished property.

Proceeds from an IRS Exchange are acceptable. An IRS 1031 Exchange allows a borrower to place proceeds from the sale of a property into an escrow account to be held and used toward the purchase of another like kind property. The following documentation must be provided in order to verify funds from the 1031 Exchange at closing:

- HUD 1 from both properties
- Statement from the Accommodator verifying available funds
- Exchange agreement

504.02 – Bank Account

In addition to the above requirements, when using computer generated printouts, a correspondent must indicate on the print-out that the forms are provided in lieu of original or certified true bank statements which the applicant could not provide. The correspondent must sign and date the statement.

504.03 – Bridge Loan

A bridge loan is an acceptable source of funds, as long as it is secured by a valid second lien against the applicant's previous residence:

- It must have regularly scheduled payments or a payment must be estimated for amount and term of the loan;
- If the bridge loan payment is not monthly (or there is no scheduled payment) the payment must be converted to a monthly amount for qualifying purposes;
- The bridge loan may not be secured by the subject property;
- If it is a short term loan, it must be renewable; and
- The applicant must be qualified using the bridge loan payment, the previous mortgage payment, the new loan and other debts.

The underwriter will review a copy of the note or approval letter from the financial institution or other entity providing the bridge loan and issue an approval subject to receipt of executed bridge loan documents for the payment and dollar amount specified.

504.04 – Cash

"Cash" is considered to be any of the following:

- Funds on deposit in the Borrower's checking, savings, money market or certificate of deposit account or other depository account.
- A gift that is from a Related Person of the Borrower, that does not have to be repaid and is documented.
- A gift of Equity from a Related Person is allowed provided it meets the requirements.
- A gift or grant from An Agency that does not have to be repaid, is given pursuant to an established program
- Proceeds of a loan fully secured by the Borrower are owned assets.
- Proceeds from the sale of the Borrower's assets.
- A cash deposit toward the purchase, the source of which is verifiable.

- Funds disbursed from a trust if documented.
- Funds on deposit in an Individual Development Account (IDA) and matching funds provided by An Agency.
- Funds on deposit in a Community Savings System that are deposited by the borrower and documented.

None of the following is considered to be cash:

- Proceeds of a personal or unsecured loan.
- A gift that must be repaid in full or in part.
- A cash advance on a revolving charge account or unsecured line of credit.
- Cash for which the source cannot be verified (cash on hand).

504.05 – Cash Advance on Credit Card

Cash advances may be used for funds to close. The increased balance due to the advance must be considered when determining a monthly payment on that account.

504.06 – Cash Saved at Home

Cash saved at home is an eligible source of funds. The funds must be deposited at a financial institution, and the applicant must provide evidence of an ability to accumulate such savings. No seasoning is required on the deposited funds.

Underwriting will review inquiries in the last 90 days and new trades on credit report to ensure funds were not borrowed.

The asset verification process requires the applicant to explain how such funds were accumulated and the amount of time taken to do so. The Underwriter must determine the reasonableness of the accumulation of the funds based on the applicant's income stream, the time period the funds were saved, spending habits, and history of using financial institutions. Underwriters must indicate on the MCAW or VA Loan Analysis, the reasoning behind the decision to accept the cash funds.

504.07 – Collateralized/Secured Loans

Funds to complete a loan transaction may be borrowed on a secured or an unsecured basis. However, when the sale price exceeds the established value, the difference must be paid from the veteran's personal funds and may not be borrowed.

504.08 – Commission From Sale of Subject Property

When the applicant will receive commission from the sale of the property being purchased, the file must clearly document the applicant's right to those funds and the amount the applicant will be receiving.

Technically, the commissions are unearned until the loan is closed. The applicant is entitled to the commission funds but such funds are not to be used in the subject loan transaction.

The HUD1 must indicate the applicant has paid the down payment and closing costs and prepaids, if applicable, from his or her own funds. A check must be issued by the Closing Agent for the amount of commission funds due the applicant. The check must not be net of funds needed to close. A copy of the Closing Agent's check will be required as an approval condition by underwriting.

504.09 – Corporate Funds

An applicant may use corporate funds for money to close if the following conditions are met:

- The applicant owns at least 51% of the stock in the corporation.

- A current balance sheet is provided indicating sufficient cash assets.
- Funds are verified on deposit for the corporation.
- Verification of receipt of the funds by the applicant, prior to closing.
- The file contains a letter from the corporation's CPA stating the company is capable of disbursing the funds without impairing the operation of the company.
- A copy of the Corporate Resolution indicating the applicant will be permitted to withdraw funds from the corporation.

504.10 – Currency Conversions

When an applicant's funds are from a foreign source, the funds must be deposited in a Bank in the United States, and verified. The verified funds will be the result of currency being converted from the foreign source to US dollars. Evidence of the currency exchange rate is required to support the amount of funds converted to US dollars.

504.11 – Earnest Money Deposit

Earnest money deposit must be fully documented by cancelled check, certified funds or money order. If documents are less than 90 days old verify borrower had funds available to make transaction. Copy of deposit documentation from realtor or seller is not acceptable documentation. If deposit funds cannot be verified the amount of deposit must be deducted from verified assets in the loan file.

Verification of earnest money deposit is a prior to closing requirement and may never be required at closing.

Underwriter is to condition AC-Earnest money verified in the amount of \$_____.

504.12 – Employee Savings Plans (401K)

Many employers offer savings plans as a benefit to their employees where the employer matches a specified percentage of the employee's contributions. When considering these accounts to meet cash reserve requirements, only the applicant's vested portion, less the balance of any outstanding loans, will be considered towards meeting reserve requirements. Examples of these accounts are 401K and ESOP savings plans.

- The value of the account must be documented by the applicant's most recent statement.
- Funds to close may be in the form of a withdrawal or a loan against the account.
- When the applicant is withdrawing funds to close, the proceeds check must evidence sufficient net proceeds (after penalty for early withdrawal, and federal withholding) to close the loan and meet reserve requirements when the proceeds are combined with other verified liquid assets.
- When borrowing against an employee's saving account, a copy of the loan agreement and proceeds check must be obtained.

504.13 – Gambling or Lottery Winnings

Winnings from gambling or the lottery are acceptable for funds to close and must be documented by a statement of earnings from the casino or lottery commission.

A W-2G must be issued to the recipient of lottery and gambling winnings; therefore, records can be accessed to document source of funds.

504.14 – Gift (Including Gift of Equity)

An applicant, purchasing or refinancing a primary residence, may receive a gift to be used towards down payment, prepaid items, closing costs, financing costs and any required cash reserves or a gift may be in the form of equity at closing.

Gift funds are not allowed on refinances.

504.15 – Gift From a Relative

A gift is acceptable if the donor is:

- A relative of the applicant;
- The applicant's employer or labor union; a charitable organization;
- A governmental agency or public entity that has a program to provide home ownership assistance to low and moderate income families or first time homebuyers; or
- A close friend with a clearly defined and documented interest in the applicant, evidenced by joint assets, joint debts, joint leases or other evidence as may be provided by the applicant,

A gift from any other source is considered an inducement to purchase and requires a reduction to the sales price.

A gift letter is required and must:

- Specify the dollar amount of the gift;
- Be signed by the donor and the applicant;
- State no repayment is required;
- Provide the donor's name, address, and telephone number; and
- State the relationship to the applicant.

The gift letter must contain language asserting that the funds given to the homebuyer were not made available to the donor from any person or entity with an interest in the sale of the property including the seller, real estate agent or broker, builder, loan officer, or any entity associated with them.

The loan file must document the transfer of the funds from the donor to the applicant. Acceptable procedures include:

- If the gift funds are in the homebuyer's account, the underwriter must document the transfer of the funds from the donor to the homebuyer by obtaining a copy of the canceled check or other withdrawal document showing the withdrawal is from the donor's personal account, along with the homebuyer's deposit slip or bank statement that shows the deposit; or
- If the funds are not deposited to the applicant's account prior to closing, obtain verification that the gift funds are received from the donor for the amount of the gift. Verification may be any of the following:
 - Cashiers check or Bank Check together with a copy of the donor's withdrawal slip;
 - Certified check drawn on the donors account with evidence of withdrawal from donor's account;
 - Cash together with a copy of the donors withdrawal slip;
 - Bank Receipts which indicate a wire of funds from the donors account to the applicant's account or the closing agent's account for benefit of the applicant.

Note: In all cases, the investors and the agency require evidence of the donor's withdrawal or remittance of the gift funds.

If the donor borrowed the gift funds and, thus, cannot provide the documentation from his or her bank or other savings account, the donor must provide evidence that those funds were borrowed from an acceptable source, i.e. not from a party to the transaction including the mortgage lender. "Cash on hand" is not an acceptable source of the donor's gift funds.

Funds from gifts from any source are not to be included as cash reserves.

504.16 – Gift from an Employer, Church, Municipality or Non-Profit

If the applicants source of funds is a gift or grant from an employer, a municipality, nonprofit religious organization or nonprofit community organization, the loan file documentation must: provide a copy of the legal agreement that specifies the terms and conditions of the gift or grant. The legal agreement must:

- Establish that the funds are provided by the employer, municipality, or nonprofit;
- Establish that the organization has a formal gift program;
- Indicate that the funds are a gift or grant to the applicant that does not have to be repaid;
- Identify the donors mailing address'
- Include an indication of how the funds will be transferred.

Included in the mortgage file must be evidence of the transfer of the funds that clearly shows receipt of the specific check providing the donated hinds, such evidence may be a copy of the donors canceled check or a settlement agent's statement or HUD1. This requirement may be waived by automated approval. Refer to documentation matrix.

Examples of documentation that may be used include copies of the grant program materials, award letters, or terms and conditions provided to the applicant. The gift or grant should be shown on the closing statement.

504.17 – Government Bonds

Government bonds should be valued at their purchase price unless the redemption value can be determined and verified. The actual receipt of funds must be documented.

504.18 – Grant

A grant is treated like a gift when considering it as funds to close. An acceptable donor may be a church, municipality or nonprofit (charitable) organization. An award letter on the agency's letterhead must be provided that will:

- State the amount of the gift or grant;
- State no repayment is required;
- Establish that the organization has a formal gift (grant) program; and
- Specify how the funds will transfer.

At closing receipt of the grant must be documented by canceled check or the HUD-1 clearly evidencing receipt of funds. A copy of the legal agreement specifying the terms and conditions of the grant must be obtained. Please be aware that grants which result in a lien against the property for recapture upon sale are considered "soft seconds" and are underwritten using secondary financing criteria,

A government agency or public entity which offers down payment assistance is acceptable as a source of funds.

504.19 – Inheritance

Funds received through an inheritance may be treated as the applicant's own funds. Receipt of funds should be evidenced by a letter from the executor of the estate or a copy of the will, plus a copy of the proceeds check.

504.20 – Lawsuit or Insurance Settlement

When an applicant anticipates receiving a lump sum settlement as the result of a lawsuit or insurance claim, the applicant must provide a copy of the settlement agreement, judgment, or letter from an attorney providing the amount of the applicant's portion of the settlement. The receipt of funds must be documented with a copy of the settlement check and deposit slip. These funds are considered as the applicants own funds.

Funds already on deposit in the applicant's account must be supported by bank statements and evidence of settlement such as a settlement agreement, letter from the settlement attorney, claims statement, court order, etc.

504.21 – Relocation Benefits

Benefits provided by an applicant's employer to offset relocation expenses are considered acceptable funds for closing and will be treated as the applicant's own funds to meet minimum investment requirements. When an applicant will be using these funds to close, the following guidelines will apply:

- The property must be an owner occupied primary residence.
- The applicant must provide a copy of the relocation policy and evidence he or she is eligible for the stated benefits.
- The applicant must provide a copy of the request for funds anticipated for closing, and
- A copy of the check from the employer.

Relocation assistance in the form of a reimbursement from the employer, that is to be received after closing, will not be counted as available funds to close. The reimbursement funds may be given consideration when meeting reserve requirements.

504.22 – Relocation Equity Buyout

A corporation relocation buyout of an applicant's current home is acceptable when documented by sufficient evidence. Such evidence may include combinations of the following to the satisfaction of underwriting:

- Copy of executed relocation agreement;
- Fully executed offer to purchase, agreement with the applicant's employer or a third party relocation company (TPRC);
- Evidence of an assigned sale with guaranteed purchase by the employer or TPRC should the assigned sale fail to close;
- Evidence of the equity advance received from the employer or TPRC; or
- HUD 1 or other closing statement as evidence of settlement between the applicant and the employer, TPRC or third party buyer.

504.23 – Rent Credit (Equity)

The portion of a rental payment which exceeds fair market rent can be applied towards the applicant's down payment if there is a valid lease purchase agreement in effect; however, this amount may not exceed the amount of the credit as specified in the lease. The applicant must provide a copy of the lease purchase agreement along with copies of canceled checks or money orders for the past 12 months. The appraiser is to develop a figure for fair market rent. Documentation must be provided to support the applicant's own five (5%) percent down payment, including any allowable credit for payments made above the fair market rent.

504.24 – Pension Plan

Typically an applicant does not have access to funds in pension plan. These accounts can be accessed only when the applicant quits or retires; therefore, pension plans are not considered as assets for closing or reserves.

504.25 – Salary Advance

VA permits the use of military advance pay for funds to close; however, the applicant must qualify with the additional debt repayment.

504.26 – Sale of Assets

Documentation to support proceeds from the sale of an asset, including personal property, must be a valid Bill of Sale, receipt or settlement statement that clearly:

- Identifies the applicant as the seller of the property;
- Identifies the property which was sold;
- Show the net proceeds to the seller;
- Show the disposition of all liens against the property, if any;
- Is signed by the buyer and the seller, or their authorized agents.
- Provides the buyers name, address and telephone number

The loan file must provide written evidence to support liens paid in full or transferred to the purchaser of the asset.

Proceeds received from the sale of an applicant's assets, including personal property, will be acceptable as long as the applicant can provide:

- Evidence of ownership of the asset; i.e. copy of car title, insurance policy, appraisal, etc.
- Documentation which supports the value of the asset, such as published value or estimates or an appraisal by a qualified appraiser;
- Conclusive evidence the items have been sold and ownership transferred, such as a bill of sale or a statement from the purchaser; and
- Evidence of receipt of the purchase proceeds, such as a deposit slip or bank statement.

Only the lesser of the documented value or actual sales price may be considered as funds to dose. The item(s) in question must be sold to a party outside of the loan transaction.

Note: Evidence that the applicant owned the property being sold required. Further, the transaction must make sense, i.e., sufficient collateral sold obtain the net proceeds.

504.27 – Sale of Real Estate

Proceeds from the sale of real estate must be documented with:

- A copy of the fully executed settlement statement (HUD-1).
- The HUD-1 must be a certified copy of the final, fully executed document.
- The amount of net proceeds to the seller (who must be the same person as our applicant), must be of an adequate amount to close the loan and meet any cash reserve requirements when combined with the applicant's verified assets.

504.28 – Sale of Real Estate – Joint Ownership

When an applicant is relying upon funds to close from the sale of jointly-owned property, and the co-owner of the property being sold is not an applicant on the loan, it is necessary to verify the applicant's percentage of ownership and the resulting proceeds from that sale.

The proceeds from the sale of a jointly-owned property must be verified with a certified copy of the HUD-1 and a copy of the applicant's proceeds check.

504.29 – Savings as a Source of Funds

The ability to accumulate savings reflects well upon the applicant's ability to meet financial responsibility. An applicant with little or no savings history may have difficulty meeting future financial needs, especially where the proposed monthly housing expense will be increasing.

Funds saved for loan closing must be supported by periodic deposits as evidenced by bank statements or deposit slips. A 60 day history is required on all funds. If the applicant is taking funds from a non-depository account, account statements completing a 60 day history on those funds must be provided in addition to evidence of proceeds from that account.

Accumulated savings should be proportionate to the applicant's stated income. Account statements should support an applicant's assets as they relate to income.

When assets are disproportionate to the applicant's income, the underwriter will be justified in requiring documentation and explanation of source of funds.

504.30 – Savings Bonds

Savings bonds must be valued at their purchase price unless the redemption value can be determined and verified

When the bonds have not been redeemed at time of underwriting, the loan file must contain a list of bonds owned by the applicant, stating face value and serial number, An associate of NBMO or an official of the applicants bank must sign the list and certify they personally reviewed the bonds and the owner of the bonds is the applicant.

The actual receipt of funds from redemption of the bonds must be documented by use of the Bank issued 1099 or other official documentation.

504.31 – Stocks

The value of stocks may be verified by a current statement from the stockbroker or a photocopy of the stock certificate along with a dated newspaper stock list. The actual receipt of funds from the sale of stock must be documented.

504.32 – Sweat Equity

Sweat equity is normally not permitted for use as funds to close. Exceptions may be requested on a case by case basis from the National Underwriting Department.

504.33 – Tax Refunds

Many applicants rely heavily upon their tax refunds to have sufficient funds to close. The underwriter must determine if an applicant's tax returns have been properly filed. If a potential tax liability is evident due to an incorrectly filed return, the tax refund will not be acceptable as a source of funds to close a loan. (An example of a filing error may be where married couples each file as "Head of Household"). To utilize tax refunds for closing, the following documentation will be required:

- Copy of the filed tax return together with any documentation reflecting an "EZ" or "Rapid" refund, signed and dated by applicant and
- A copy of the deposit slip or certified printout indicating deposit of the tax refund (source of funds documentation).

504.34 – Trade Equity

Trade Equity may be utilized when the property trade is between the borrower and a seller. The trade transaction file must contain:

- A current appraisal on the borrower's property being traded; and
- An appraisal on the property being acquired; and
- A closing statement on the borrower's property evidencing the net proceeds available.

The following applies to trade equity from the borrower(s) existing manufactured home.

- If owned 12 months or more, prior to the application date, 90% of the retail value based on the NADA manufactured housing appraisal guide, or
- If owned less than 12 months, prior to application date, the lesser of:

- 90% of the retail value, or
- The lowest price at which the manufactured home was sold during the 12 month period preceding the application date.

Note: Any costs resulting from the removal of the home or any outstanding indebtedness secured by liens on the home must be deducted from the maximum equity contribution. The trade equity must be documented by a lien search in the appropriate records to verify ownership and liens. The seller of the new manufactured home must provide proof of title transfer and satisfaction of liens on the traded home.

504.35 – Unsecured Loan

The use of unsecured loans as funds to close is acceptable for VA financing as long as the applicant is able to qualify with the additional payment. The loan may not be provided by a party to the transaction.

504.36 – Unverifiable Source of Funds

When the applicant is unable or unwilling to provide documentation supporting a satisfactory source of funds, the funds in question will not be acceptable for consideration when determining available funds for closing.

504.37 – Life Insurance Cash Value

Cash value on a life insurance policy may be used as the applicant's assets for down payment and closing. The cash value life insurance verification must be provided and must meet the following:

- Must be a computer generated or typed statement from the insurance company (not handwritten).
- Must identify the life insurance company.
- Must identify the policy owner(s) (applicant).
- Must show the period covered and the ending cash value.
- Must show any outstanding loans.

CHAPTER 6 – APPRAISALS

SECTION 600.00 – PROPERTY AND APPRAISAL OVERVIEW

The Lender will extend first lien financing for the purpose of purchasing or refinancing one-to-four family residential real estate. The property must constitute an acceptable form of collateral for the requested mortgage. The security for the mortgage may be single family detached or attached, a townhouse or PUD, a condominium, or a two-to-four family dwelling.

Please refer to Product Summaries for specific product criteria. The information contained in the Product Summary will take precedence over the information found in the Credit Policy Manual.

On properties to be insured by VA, the VA office with jurisdiction over the subject property may have local property criteria that differs from the information contained in this manual. The Regional Underwriting Department is responsible for being aware of these local differences and for indicating in the loan file the local policy that dictates an exception to any of the policies contained in this manual. For appraisal or property information not contained in this section, please contact your Regional Underwriting Center.

600.01 – Ineligible Properties

The following are the types of ineligible properties:

- Commercially Zoned Properties
- Condotels
- Cooperatives
- Houseboats
- Industrially Zoned Properties
- Multi-family Dwellings containing more than 4 units
- Properties rates in fair or poor condition without repairs to bring to average condition
- Properties subject to hazardous conditions
- Properties that do not have full utilities meeting all standard and local code.
- Properties utilized as a place of worship
- Tax Shelters
- Timeshares
- Unimproved Land
- Working Farms
- Properties in Lava Zones 1-3
- All properties under 600 square feet

If the appraisal indicates a “fair” or “poor” condition, the appraisal is unacceptable. The appraisal may be appraised with the condition as “average” and made subject to the repairs that will bring it to acceptable (“average” or “good”) condition. The appraiser must list necessary repairs. A final inspection will be required to be performed by the appraiser prior to funding.

600.02 – Types of Appraisals & Requirements

Building Sketch

For detached, 1 Unit properties, end Planned Unit Development (PUD) units and units in detached Condominium projects (site condominiums), the exterior sketch of the improvements must include the dimensions and calculations the appraiser used to determine the size of the subject property.

For Condominium Units and interior PUD units, an interior perimeter sketch is acceptable. Appraisers may rely on the dimensions and estimates for gross living area as shown on the plat or exhibits to the condominium or

PUD documents, or may provide legible photocopies of floor plans or individual unit plats that include the dimensions and calculations.

For 2-4 unit properties, the sketch must also include each unit's layout and entries.

Location Map

The location map must locate the subject property and all comparable properties (including sale, rental, and listing comparables, as applicable). This map may be a photocopy of a printed street map showing the location of the subject property and comparable properties in the relation to major streets and influences such as parks and schools.

Photographs of Comparable Sales

One clear color or black and white photograph of the front of each comparable sale is required. Each photograph must be an original (produced by photography or electronic imaging) or facsimile, be appropriately identified, and be illustrative of the comparable sale. If an original photograph of a comparable sale cannot be obtained, a clear copy of the photograph of the comparable from a multiple listing service (MLS) is acceptable. The appraisal report must reasonably justify using the MLS source.

If black and white photographs of the comparables are used, the appraiser must note on the appraisal report any information that would have been evident in color photographs but is not apparent in black and white images and could adversely affect the market value or marketability of the mortgaged premises.

Exhibits

The Exhibits are summarized in the following chart:

Exhibits for Appraisals and Inspections	Forms 70, 70B, 72 and 465
Inspection Types	Interior & Exterior
Photographs of subject property	Front view, Rear view, Street scene
Photographs of comparable sales	Front view, Rear view, Street scene
Building sketch or interior	Required
Location map of subject property	Required
Location map of comparable properties	Required

600.03 – Appraisal and Inspection Report Forms

Form 70 – Uniform Residential Appraisal Report

Form 70 is designed to report the results of an appraisal of a 1-unit property to include a unit in a PUD, a unit in a detached condominium project (site condominium) or a 1-unit property with an accessory unit. The form may not be used for an appraisal of a Manufactured Home or a unit in a condominium project. An interior and exterior inspection of the subject property is required.

Form 70B – Manufactured Home Appraisal Report

Form 70B – Manufactured Home Appraisal Report is designed to report an appraisal of a 1-unit Manufactured Home, including a Manufactured Home in a Planned Unit Development (PUD). A Manufactured Home located in a condominium project requires the appraiser to inspect the project and complete the project information section

of the Form 465, Individual Condominium Unit Appraisal Report, and attach it as an addendum to form 70B. The Manufactured Home Appraisal Report is also designed to report an appraisal of a 1-unit Manufactured Home that is located in a cooperative project; however, mortgages secured by a cooperative are not eligible for sale.

Form 72 – Small Residential Income Property Appraisal Report

Form 72 is designed to report the appraisal results for a 2 to 4 unit property. An interior and exterior inspection of the subject property is required.

Form 465 – Individual Condominium Unit Appraisal Report

Form 465 is designed to report the results of an appraisal of a 1-unit property in a condominium project, excluding units in detached condominium projects (site condominiums). An interior and exterior inspection of the subject property is required.

600.04 – Addenda Required

The appraiser or the Seller may determine that the appraisal or inspection report must be supplemented by addenda. When addenda is required it must be the form approved by Freddie Mac/Fannie Mae as of the date of the appraisal. All addenda must be attached to the appraisal or inspection report and incorporated into the report by reference.

600.05 – As Is Appraisals

Generally, an appraiser will issue the Uniform Residential Appraisal Report (URAR) indicating a property value that is based upon property in an “as is” condition. In most instances the “as is” appraisal will indicate no repairs; however, if the appraiser identifies items found to be in a below average condition, the underwriter must investigate the extent and/or impact of such conditions.

The underwriter must order such inspections, documentation or information as need to ascertain the full condition of the subject property. The underwriter will require appropriate action be taken to correct or repair any property conditions that pose a structural risk to the property or a health or safety hazard to the occupants.

SECTION 601.00 – UNIQUE PROPERTIES

Unique properties offer a challenge. The key to successful lending is being able to demonstrate there is a demand for the specific type of property. This requires an appraiser to provide three very similar comparable sales (at least two should be the same type of construction, the additional comps must appeal to the same buyer) which are within reasonable proximity to the subject and are recent sales. The primary concern is whether sufficiently similar, recent sales can be located which will establish a value. If the comps are so dissimilar or dated that any value conclusion reached by the appraiser is unreliable, the property will not be eligible for financing.

601.01 – Dome Homes

Dome homes are acceptable properties if located in an area with other similar types of construction and the property is homogenous with the neighborhood. The appraisal should indicate the property is in an area of proven marketability and the dwelling meets all standards for construction. The Appraiser must provide “like” comps.

601.02 – Earth Sheltered Homes

Earth sheltered homes are acceptable properties if located in an area with other similar types of construction and the property is homogenous with the neighborhood. The appraisal should indicate the property is in an area of proven marketability and the dwelling should be constructed to resist moisture and must meet all standards for construction. Earth sheltered homes are not acceptable in the following areas:

- Coastal areas where wind driven seas present a flood hazard;
- Any flood prone area; or
- Areas having high water tables.

601.03 – Leasehold Estates

Property involving a less than fee simple ownership (i.e., leaseholds, cooperatives, and ground rental arrangements) is **not** eligible for appraisal without prior VA approval of the specific legal arrangement or project. Submissions to the VA Regional Loan Center Office (Dept. 262A) must include:

- Details of the ownership arrangement
- Copies of leases or other instruments creating the estate, and
- Recommendations of the VA office of jurisdiction

601.04 – Log Homes

Log homes are acceptable properties if located in an area with other similar types of construction and the property is homogenous with the neighborhood. The appraisal should indicate the property is in an area of proven marketability and the dwelling meets all standards for construction. The appraiser must provide a minimum of one log home comparable, preferably two.

601.05 – Manufactured Homes

A Manufactured Home must have the following characteristics:

- The Manufactured Home must be built on a permanent chassis in compliance with the National Manufactured Construction and Safety Standards Act by the Department of Housing and Urban Development (HUD)
- A “HUD Certification Label” must be permanently affixed to each transportable section of the Manufactured Home evidencing compliance with Federal Manufactured Home Construction and Safety Standards. If the certification label has been removed, compliance may be evidenced using the HUD data plate located near the main electrical panel or in another readily accessible and visible location. The HUD label number(s) appear on both the HUD data plate and the “certification label(s).”
- The Manufactured Home must be a 1-unit dwelling that is legally classified as real property.
- The stabilizing devices must comply with the manufacturer’s design or a design by a licensed (registered) professional engineer. Stabilizing devices refer to all components of the anchoring assemblies, and any other equipment, materials, and methods of construction that support and secure the Manufactured Home to the ground.
- The Manufactured Home must be affixed to a permanent foundation for the site conditions, home design features, and the loads the home was designed to withstand in accordance with the manufacturer’s instructions or a design by a licensed (registered) professional engineer. The foundation must meet all local, State or federal codes, as applicable.
- The Manufactured Home must be at least 12 feet wide and have a minimum of 600 square feet of gross living area.
- The manufactured Home must have been built on or after June 15, 1976.

A Manufactured Home must meet the following requirements:

- The Manufactured Home must be a 1-unit dwelling comprised of a multiple sections (a “multi-wide manufactured home”), “single-wide” is not allowed.
- The wheels, axels, and towing hitches must be removed from the manufactured home
- The Manufactured Home must be permanently attached to the land and the land must be owned by the borrower in fee simple, unless the Manufactured Home is located in a condominium project. A mortgage secured by a Manufactured Home located on a leasehold estate is not eligible.

- A multi-wide Manufactured Home may be located on an individual lot, in a sub-division, or PUD.
- The Manufactured Home must be permanently connected to a sewage disposal system such as a public sewer or a septic tank, and to other utilities that meet local, State and federal requirements.
- The mortgaged premises must conform to all applicable use restrictions and must be zoned for residential use, and not commercial or business uses.
- The square footage and room dimensions must be acceptable to typical purchasers in the market area.
- The Manufactured Home must be permanently attached to the site, connected to the utilities and any additional improvements, modifications or repairs that affect the habitability of the Manufactured Home must be completed.
- Any structural modifications to an existing Manufactured Home must be approved by a licensed professional engineer or the local, State or federal authority.

Other types of factory-built housing

- Other types of factory-built housing not subject to the National Manufactured Construction and Safety Standards Act, such as modular or panelized housing are not included in the definition of Manufactured Homes. Mortgages secured by one of those types of factory-built housing are acceptable as long as property eligibility requirements are met.
- Existing homes must be affixed to a permanent foundation for no less than one year.
- The appraisal must use other manufactured homes for all comparable sales if possible; if not, “stick-built” homes may be utilized.

601.06 – Mixed Use Property

The criteria for Mixed-Use Properties are as follows:

- The property must be a one-family property occupied by the applicant as a principal residence.
- The mixed use of the property must represent a legal, permissible use of property in accordance with local zoning requirements.
- The applicant must be both the owner and operator of the business.
- The property must be primarily residential in nature.
- The market value of the property must be based upon residential use and characteristics, rather than any business use or special business-use modifications that were made.
- The property must not require a significant expenditure to convert the property to use solely as a residence.

Examples of acceptable business use are: an in home day care facility, a beauty or barber shop, a specialty store, or a doctor’s office. The business use of the home may not modify the dwelling in such a manner which would adversely affect it’s marketability as residential property. A mixed use property must be located in a primarily residential area.

In addition to the criteria noted above, the nonresidential use must be subordinate to the property’s residential use and may not exceed 25% of the total floor area.

601.07 – Modular Homes

Modular homes are defined as factory built, off-site. Other descriptions include panelized, prefabricated or sectional housing. The factory built house is delivered to the subject property in sections. Upon delivery to the site, the sections are put together and the property takes an appearance and characteristics of a site-built residence. Modular housing must assume the characteristics of site built housing and comply with all local zoning and building codes. The appraiser should use similarly constructed properties as comparable; however, if sales are not available, the appraiser may use site built housing if an explanation is provided for why this was done, and adjustments are made to reflect any market preference for site built housing.

601.08 – Rural Property/ Excess Land

A rural area is defined as relating to the country or anything beyond suburban areas. It is not uncommon for a rural area to have residential properties with relatively large sites and one or more outbuildings. The rural area may have mixed-use properties, vacant buildings or agricultural use properties.

There is no VA limitation on the amount of acreage which may be financed on rural properties if similar comparable sales support the acreage as common for the area. However, excess land is unacceptable for inclusion in value. Excess Land is defined as the area by which the plot exceeds the area of a readily marketable real estate entity. This occurs when the subject is considerably larger than typical lots in the neighborhood and the excess is capable of separate use. For example, if the subject property has 10 acres, and the comparables have similar acreage, but are not limited to strictly residential use, then a market has not been demonstrated for residential property with the same amount of land as the subject.

Zoning may be residential/agricultural. The residential use of the property must represent the “highest and best use” of the property.

The appraisal must indicate that the subject property maintains the characteristics of residential property, such as:

- Must be primarily residential;
- Must not be used for agricultural, farm, ranch or commercial use.
- Must be readily accessible by a roadway;
- Outbuildings are of minimal value to the overall property value;
- Must be serviced by adequate utilities.
- Must be available for year-round occupancy.

The underwriter’s knowledge of the area and comments provided by the appraiser will determine if the amount of land included in the transaction is typical for the area.

601.09 – Limited Access Properties (Flag Lots)

Unusual shaped lots, known as “Flag Lots” have limited access. Such lots usually have an easement created across other land to provide vehicular access to the property. The subject property, in a flag lot, has no portion of the property fronting onto a road.

The appraisal must address the site and view, and the impact on the property’s marketability and accessibility. The land value must be clearly justified. Unless marketability can be supported, the property will be ineligible for a mortgage.

SECTION 602.00 – THE APPRAISER

The Lender relies upon qualified real estate appraisers to provide an estimate of the fair market value of the subject property based upon research of current market data for use by the underwriter in making a risk decision. The Lender does not have an Approved Appraisers List, however does have a published Exclusionary List that must be checked for each file underwritten that requires an appraisal.

602.01 – VA Appraisers

VA appraisers are approved by the Veteran’s Administration and listed on VA’s fee panel of appraisers

When a loan file has been transferred from another lender, the Staff Appraisal Reviewer (SAR) must underwrite the unexpired appraisal; verify that the appraiser’s license/certification and LAPP number are current before issuing the Notice of Value (NOV). If the transferred appraisal includes a NOV issued by the previous lender, the SAR must still review the appraisal and concur with the value. The NOV must be signed by the Staff Appraisal Reviewer.

The Notice of Value (NOV) may be signed by one SAR, while the credit package may be signed by a different underwriter. LAPP will recognize the SAR signing off on the credit package as the Staff Appraisal Reviewer of record on the loan.

Underwriters must be aware of any unacceptable performance by appraisers and provide such information to the Regional Underwriting Manager or to Credit Policy Department.

Documentation of the specific violation of the regulations and/or policies of the VA will be required. The Regional Underwriting Manager, Senior Credit Policy Officer, Quality Control Manager, FHLMC and FNMA will review the documentation and determine the appropriate course of action.

602.02 – Responsibilities of the Appraiser

The Lender's approved appraisers are expected to provide complete and accurate appraisals in a prompt fashion. Appraisers of VA properties are expected to provide complete and accurate appraisals and to prepare such appraisals in the manner dictated by the policies and regulations of the specific government agency. The appraiser must never work in cooperation with others to arrive at a requested value. When completing an appraisal, the appraiser must:

- Prepare the appraisal using the Uniform Standards of Professional Appraisal Practice;
- Prepare an objective and unbiased appraisal report;
- Obtain and utilize complete and accurate data by thoroughly researching the market using reliable independent data sources to locate recent, similar sales which provide a true indication of the subject's market value;
- Personally inspect the interior and exterior of the subject property as well as the exteriors of the comparable sales;
- Consider any market forces, economic trends, or environmental hazards on the subject's site, or in the vicinity, and note these factors on the appraisal.
- Note conditions that potentially influence or affect the value or marketability of the subject property; and
- Adjust the value of the comparable sales to accurately reflect the differences in the market place for the differences between the subject and the comparable sales.

602.03 – Unacceptable Appraisal Practices

It is the responsibility of The Lender to deliver loans to our investors containing appraisals which evidence a sound investment; it is therefore, The Lender's responsibility to monitor the quality of these appraisals to ensure the appraisers who provide appraisal services to The Lender do not engage in unacceptable appraisal practices. Unacceptable appraisal practices include:

- Failure to adhere to fair lending practices in the appraisal process;
- Failure to comment on adverse negative factors with respect to the neighborhood, subject property, or proximity of the subject property to adverse influences;
- Inclusion of inaccurate or incomplete data about the subject neighborhood, site, improvements or comparable sales;
- Use of comparable sales when the appraiser did not inspect the exterior of the property, at the very least, by completing a drive-by inspection;
- Failure to use comparable sales that are the most similar available sales compared to the subject property in terms of location, age, design, size, and amenities;
- Use of data, especially comparable sales data, that was provided by parties with a financial interest in the sale or financing of the property without confirmation by a disinterested third party;
- Failure to make adjustments when the market clearly indicates a reaction to a difference between the subject property and the comparable, or using excessive adjustments which do not reflect the market reaction to the differences;
- Reaching a value conclusion which is not supported by available market data;

- Development of a value based upon sex, color, race, religion, handicap, national origin, or familial status of either the prospective owners, occupants of the property or the present owners, or occupants of properties in the vicinity of the subject property or that is based on any other factor that local, state, or federal law designates as being discriminatory;
- Use of unsupported assumptions, personal opinions or perceptions about market forces or other factors that may or may not affect the use or value of the property;
- Failure to apply the same appraisal standards to those properties sold under an affordable housing program or located in areas undergoing rehabilitation;
- Failure to review required documentation including but not limited to sales contract, plans, specifications, or property inspection before determining appraised value;
- Failure to comply with all VA requirements when appraising property for a VA Insured Loan.

SECTION 603.00 – APPRAISAL REQUESTS AND DOCUMENTATION

The appraisal is critical to the lending process. The lender does not see the property which will serve as the collateral for the mortgage, therefore, the underwriter must rely completely upon the appraisal as a means of evaluating risk. It is essential the underwriter be able to interpret the facts and observations provided by the appraiser in order to make an informed decision on the loan.

603.01 – Properties Eligible for VA Lender Appraisal Processing (LAPP)

Single family (one unit) existing dwellings, 2-4 unit family dwellings, and manufactured homes may be processed under the Lender Appraisal Processing Program (LAPP).

New construction not yet completed. The correspondent must provide plans and specs. With the loan file to include:

New construction, that is complete except for buyer preference items, may be processed under LAPP Buyer preference items include:

- Range, dishwasher, disposal, interior paint, wall paneling and paneling trim, counter tops, sinks and lavatories that cannot be installed until the countertop is installed, carpeting and floor covering in those rooms where floor covering, floor-mounted toilets, wallpaper, light fixtures, air conditioner compressors and fences.

Items that are not considered to be customer preference items include:

- Central heating and air conditioning systems (except compressors), bath tubs, toilets, showers, water heaters, kitchen cabinets and cabinet finish, interior woodwork, except wall paneling, exterior siding, and roofing or any earlier state of construction such as framing, windows, rough electrical, and rough plumbing. Driveways and walks should be completed and are not considered buyer preference items.

Prior to requesting a LAPP appraisal on a condo project, project approval by VA must be confirmed. Evidence of condo project approval must be sent to underwriting, with the appraisal. Underwriters who have received the LAPP designation from VA are responsible for reviewing the VA appraisal and issuing a Notification of Reasonable Value (NOV). The LAPP underwriter is referred to as a Staff Appraisal Reviewer (SAR). The SAR is responsible for any approval, cancellation or transfer of the VA appraisal. The SAR underwriter must:

- Review the appraisal for acceptable value and compliance with VA's minimum property requirements;
- Have knowledge of the property's flood status prior to issuing the NOV (a flood certificate will be required); and
- Promptly issue the NOV within the time frame specified by the local VA field office.

Underwriters or Staff Appraisal Reviewers are not empowered to decline VA appraisals. When the appraisal or property is determined to be unsatisfactory or an unacceptable risk, the appraisal must be sent to VA with the SAR's recommendation. The VA will then issue a denial on the property or will issue a CRV.

603.02 – Converting an FHA Appraisal to VA

A Direct Endorsement Statement of Appraised Value will not be accepted by VA. Appraisers not approved by VA will not be eligible for conversion to VA.

603.03 – Reconsideration or Changes in Value

The procedures for requesting for a reconsideration of value on VA are similar to FHA. When the loan is processed under LAPP, the value may not be increased by more than 2% over the original value, regardless of the appraiser's conclusions. Increases exceeding 2% must be submitted to VA for issuance of a CRV.

On a MCRV, before any request for reconsideration of value of more than 5% can be considered, a Fee Appraiser must Field Review the property. This will also apply to any second or subsequent requests.

The Underwriter is not empowered to decrease value on VA appraisals. When it is determined that the value is unsupported, the appraisal must be sent to the VA with a letter of explanation. VA will review the appraisal, determine value and issue a Certificate of Reasonable Value.

603.04 – Appraisal Expiration Dates

Appraisals on existing construction are valid for six months. Appraisals on proposed construction are valid for a period of one year and on new construction never-occupied are valid for 6 months.

603.05 – Statement of Limiting Conditions

The appraiser may not make any changes, deletions, or additions to this form. An executed copy of this form must be attached to each individual appraisal. Additionally, the appraiser must check the box in the Reconciliation section on page 2 of the URAR, and indicate the date of the current 1004B which is attached.

603.06 – Required Appraisal Documents

The type of financing and the number of units dictate the appropriate appraisal forms and required supporting exhibits for completion by the appraiser.

603.07 – Owner of Record

Effective for mortgage applications taken on or after May 1, 2005, when a new appraisal is required, the Seller must verify:

For Purchase Transactions:

- The property seller listed on the sales contract is the Owner of Record of the subject property, or
- If the transaction involves the sale of land separate from the dwelling, the property seller listed on the sales contract for the land is the Owner of Record for the land.

For Refinance Transactions:

- The Borrower is an Owner of Record of the subject property

For transactions that involve the payoff of a land contract, the property seller is the vendor on the recorded land contract and the Owner of Record of the subject property; and the Borrower is a vendee on the recorded land contract.

Seller must retain documentation evidencing the verification in the mortgage file. Such documentation may include, but is not limited to; the appraiser's analysis and conclusions in the appraisal report, a property sales history report, a copy of the recorded deed, a copy of a property tax bill, or the title commitment or binder indicating the legal ownership of the property.

603.08 – Electronic Imaging/Appraisal Software

Appraisers are permitted to use computer software programs which are designed to reproduce the URAR, including those programs which have the capability of expanding areas of the form set aside for narrative comments. Any expansion may not result in the Sales Comparison Analysis being separated so that it appears on two pages. The sequence of information may not change from that which appears in the preprinted forms.

Electronic signatures will be acceptable. The appraiser must be responsible for the security measures taken to insure that no misuse of the electronic signature occurs. When a PDF file or email, appraisal is used in conjunction with underwriting paperless files the underwriter must upload the appraisal to attach to the Loan Queue file.

603.09 – Photographs

Photographs of the subject property and the comparable sales must provide a clear image of the completed improvements. The photos must be originals which are produced either by photography or electronic imaging.

When the appraiser is not able to provide a clear photo of a comparable sale, the appraiser should provide a copy of the photo from the multiple listing services (MLS), if available, in addition to the actual photograph to assist the underwriter in assessing the similarity of the properties. An example where this would apply is when a comp is a rural property which has considerable acreage and a wooded lot, making it impossible for the appraiser to get a better picture without trespassing. The appraiser must also provide an explanation why the picture from the multiple listing services was used.

603.10 – Inspections Required By Underwriter

Underwriters may require, as a condition of approval, a property inspection as deemed appropriate by the underwriters including but not limited to an inspection from an appraiser, pest company, engineer, or other inspector such as roofer, electrician, etc. If the requirement for an inspection or certification is the result of a recent event, such as a roof inspection required as a result of a hurricane or hail storm, the inspection or certification must occur and be dated after the event. The underwriter must be made aware of any potential need for repairs, such as property damage found as a result of any required inspection.

The underwriter required inspections must be no more than 90 days old at time of loan funding. If any inspection report is over 90 days old, the closer must confer with underwriting to resolve the situation.

Closers are accountable for the review of appraisal conditions, inspections, certifications and purchase contracts for any repair items. The closer is responsible for assuring that no loan is funded until all repair conditions, including new or additional repairs discovered as a result of underwriter conditions or/and required inspections have been completed and reviewed.

603.11 – Inspections for New Construction

A satisfactory final inspection is required when the appraisal is subject to repairs or completion per plans and specifications. Photographs are required when, at the time of original appraisal, the home was not substantially complete to show completed as originally appraised. The original appraiser should complete this inspection, VA Form 26-1859.

603.12 – Repairs

Photos are not typically required for repairs unless the physical appearance of the property is altered. The completion certificate must be dated after completion of the work and prior to loan closing unless an approved escrow has been established. It must clearly state that all repairs (conditions of the appraisal) have been satisfactorily completed, in a workmanlike manner. The repair inspection must be signed by the original appraiser.

603.13 – Lender Certified Repairs

When The Lender is required to certify repairs (per the appraisal), an on-site inspection must be made by the Account Executive, Branch Manager or other designated employee or other responsible party. Photographs must be made of the repaired site and placed in loan file with a written, signed and dated report itemizing each repair item inspected and approved. The name and signature of the associate making the inspection must be legible.

SECTION 604.00 – APPRAISAL AND PROPERTY STANDARDS

The appraiser is responsible for determining the condition and value of the subject property. The appraiser and underwriter are responsible for the review of the property to assure The Lender that the property criteria of the investor or insuring agency are met. VA is specific about the minimum property standards.

The underwriter must confirm the appraisal's support of value and obtain, if necessary, additional comparables or explanations, or whatever may be necessary to establish a fair market value. Just because an appraiser has provided an explanation does not mean it automatically makes the issue acceptable. The underwriter must evaluate the appraiser's explanation in terms of risk. Explanations must make sense and provide justification for the appraiser's conclusions. If the loan is foreclosed upon, sale of the property is the means of recouping any loss, so the value must be supported and the property must be marketable.

The Lender requires properties to be safe, sound and sanitary. Any deficiencies noted by the appraiser which affect these basic requirements must be corrected.

For items not mentioned within this Credit Policy, refer to VA Lenders Handbook.

604.01 – Appraisal Description, Analysis and Adjustments

The appraisal report must be completed in a manner that correctly depicts or describes the neighborhood, site and improvements. The following sections correspond to Form 70, URAR, but all of the requirements and guidelines also apply to the other appraisal report forms unless otherwise stated in this section.

Subject Section

- This section of the report must clearly identify the subject property by providing a complete property address and legal description. If a legal description is lengthy, the appraiser may attach it as an addendum to the report.
- Identify the "property rights appraised" as either a fee simple or leasehold.
- The appraiser must complete the section, including the data sources used to verify the listing and sale price information.

Contract Section

- The sales price, contract date and loan charges paid by the property seller, or the financing and sales concessions made by the property seller, must be stated in the sales contract. The mortgage originator must provide the complete contract for sale for the subject property to the appraiser with each appraisal request. The appraiser must have the necessary and appropriate data sources for the area in which the subject property is located. If the appraiser cannot obtain the complete contract for sale for the subject property and all information needed to perform the analysis, the appraiser should decline the appraisal assignment.
- The appraiser must analyze and report his or her conclusions on any current contract for sale for the subject property, any offerings or listing for sale for the subject property as of the effective date of the appraisal, and,

if such information is available in the normal course of business, the sales history of the subject property and comparable sales.

Neighborhood Section

- The neighborhood section of the report must contain an accurate description of the subject neighborhood and the factors that influence market value and marketability in the neighborhood. The information presented in the neighborhood section must be consistent with, and support, the conclusions reached by the appraiser throughout the appraisal report. For example, if the subject property is a residential mixed-use property, such as a storefront, then neighborhood analysis must demonstrate that the neighborhood is primarily residential and that storefront/mixed-use properties are acceptable residences in the neighborhood.
- Unfavorable factors revealed in the neighborhood section require the appraiser to address the impact of those factors on value and marketability. If the appraisal report demonstrates that there is a viable market for housing in the neighborhood or that the neighborhood is undergoing revitalization, the unfavorable factors do not necessarily make the mortgage ineligible for sale.
- An appraiser may use a block-by-block analysis in neighborhoods that have undergone significant deterioration or abandonment in the past, but are now undergoing an evident revitalization effort, to demonstrate that there is a viable market for housing. In this analysis, the appraiser should describe the extent of revitalization efforts under way, the demand evidenced for renovated housing and the boundaries of the revitalized area being used as the subject neighborhood. This analysis must be consistent with the data presented and support the conclusions reached by the appraiser throughout the report.
- If the appraiser has selected comparables from a competing neighborhood, the appraiser must identify the competing neighborhood in this section or an appropriate addendum and describe why it is comparable to the subject neighborhood. The appraiser should explain why the competing neighborhood is a more relevant source of comparables than the subject neighborhood, as of the effective date of the appraisal.
- The appraiser must certify that the estimate of market value in the appraisal report is not based on the race, color, sex, handicap, familiar status, religion or national origin of:
 - Prospective owners or occupants of the subject property, or
 - Present owners or occupants of the properties in the vicinity of the subject property
- In addition, the appraisal must not improperly take into consideration the:
 - Property modifications made to accommodate handicapped persons
 - Age or location of a dwelling, or
 - Age of the neighborhood or census tract where the dwelling is located
- No mortgage will be accepted that is supported by an appraisal report that makes reference to the race, color, religion or national origin of any person, or the age or racial composition of the neighborhood.

Site Section

Property characteristics – This section must accurately describe the physical characteristics of the site, site improvements and available utilities, and must fully analyze any locational factors affecting the site.

- Zoning – the appraisal report must accurately state:
 - The zoning classification (if classified), and
 - Whether the use of the subject property complies with the reported classification
 - The use of the mortgage premises must conform to applicable zoning and use restrictions and enable the mortgage to qualify as a home mortgage. The Lender may purchase a home mortgage secured by property that does not conform to applicable zoning and use restrictions, if the property is a legal use (commonly referred to as legal nonconforming use). The appraiser must comment on any adverse effect of any nonconforming use when estimating the market value and marketability of the property.
 - Zoning requirements cannot be the basis for classifying a project as a Planned Unit Development (PUD) or condominium project.
- Utilities
 - The utilities serving the subject property must meet community standards. In addition, the comparable sales should have utilities similar to the subject property. When differences in utilities exist between the subject property and the comparable sales, any adjustments or lack of adjustments made to the comparable sales for significant differences must be explained in the

comments area or on an attached addendum. In addition, the appraisal report must evaluate the effect these differences have on the subject property's value or marketability.

- Streets
 - The subject property must have legally appropriate ingress and egress. The streets serving the subject property must be maintained in a manner that generally meets community standards. In addition, the comparable sales should have street maintenance similar to the subject property. When differences exist between the ownership or maintenance of the subject property's streets and the comparable sale's streets, adjustments or lack of adjustments made to the comparable sales for the differences must be explained in the comments area or on an attached addendum. In addition, the appraisal report must evaluate the effect these differences have on the subject property's value or marketability.
- Additional Parcels
 - When the subject property includes two or more adjoining parcels of real estate, the site description must accurately describe the land and any improvements included in each of the parcels. In addition, the comparable sales should have adjoining parcels similar to the subject property. When differences in sites exist between the subject property and the comparable sales, any adjustments or lack of adjustments made to the comparable sales for significant differences must be explained in the comments area or on an attached addendum. In addition, the appraisal report must explain the effect these differences have on the subject property's value or marketability.
- Flood Hazard
 - The appraisal report must indicate whether the dwelling on the subject property lies within a "Special Flood Hazard Area" (SFHA) as identified by the Federal Emergency Management Agency (FEMA) through the National Flood Insurance Program (NFIP).
 - The flood zone, flood map number and map date must also be stated.
 - The appraiser need not complete this section if the flood zone is determined by another party, such as a non-appraiser on the staff of the Seller, a surveyor or a specialized flood zone determination company. If the flood zone determination is not made by an appraiser, the resulting flood zone documentation must contain at least the flood hazard information required in the appraisal report and must be attached to the appraisal report.
 - The seller warrants that any flood zone determination made on or after June 1, 1995, by a party other than the seller is guaranteed by the flood zone determination maker to be accurate, in accordance with federal law. The seller, however, remains responsible for the accuracy of any flood zone determination made by the seller or a party other than the seller.
 - Any flood zone determination made by any party on or after January 2, 1996, must be documented by a completed FEMA Standard Flood Hazard Determination, FEMA Form 81-93, in accordance with federal law. The SFHDF may be used in printed, computerized or electronic format. If an electronic format is used, the exact format and layout of the SFHDF are not required, but all fields and elements not identified as optional on the SFHDF are required.

Impact of Contaminated Sites, Hazardous Substances and other adverse conditions

The appraiser must consider any known Contaminated Sites or Hazardous Substances that affect the property or the neighborhood in which the property is located. The appraiser must also note the presence of contaminated Sites or Hazardous substances in the appraisal report, make appropriate adjustments to reflect any impact on market value and comment on the effect they have on the marketability of the subject property.

Examples of matters about which the appraiser must note and comment include but are not limited to:

- Any presence of asbestos, urea-formaldehyde or any similar insulation in the dwelling
- Proximity of the property and/or its neighborhood to a contaminated site
- Proximity of the property to ground water contamination, chemical or petroleum spills or other hazardous substances that are expected to impact the area for more than one year
- Proximity of the property to areas that may affect the value or marketability of the property including, but not limited to, the following:
 - Industrial sites
 - Waste or water treatment facilities

- Commercial establishments (other than retail establishments that serve the residential neighborhood)
- Airport approach paths
- Floodplains
- Landslide areas

Improvements Section

- The appraisal report must contain an accurate description of the improvements and any factors that may affect the market value or marketability of the subject property.
- An unusual floor plan, such as a home with tandem bedrooms or a bathroom off the kitchen, does not make a property ineligible for financing. The appraiser should address whether an unusual floor plan or similar obsolescence is also found in other properties in the neighborhood, and to the extent possible, comparables used should also have similar obsolescence in order to demonstrate marketability and support value.
- A 1-unit detached property may have an incidental accessory unit that is incidental to the overall value and appearance of the subject property. Examples of such properties include a dwelling with a unit above a detached garage, a dwelling with a guest apartment, or a detached PUD with a basement unit. The appraiser must describe the accessory unit, and analyze any effect on the value or marketability of the subject property.
- When the subject property does not conform to its neighborhood in terms of type, design, age, and the materials and techniques used in its construction, the appraiser must evaluate the effect the nonconformance has on the property's value and marketability. The appraisal must not improperly take into consideration the age of the dwelling.
- Other requirements and conditions relating to the improvements are the following:
 - The property must be habitable as a year-round residence
 - The appraiser must note if the subject property is dissimilar to competing properties in the neighborhood and address the impact on marketability

Sales Comparison Approach

- The sales comparison approach is considered to be the most reliable approach to value. Therefore, a Seller must place primary emphasis on this approach when reviewing and judging the acceptability of each appraisal report.
- Each comparable sale must be analyzed for similarities and differences between it and the subject property. The appraiser must make appropriate adjustments for differences, and indicate the dollar amount of the adjustments to reflect the value of the differences to the market. Comparable sales must be adjusted to the subject property, except for sales and financing concessions that must be adjusted to the market at the time of the sale.
- The appraiser should try to select at least two comparable properties that bracket the subject property in terms of identifiable characteristics; the third comparable should be similar to that of the subject property. Through the adjustment process, the superior comparable adjusts downward to the subject property and the inferior comparable adjusts upward. The comparable property most similar (of the three comparables) to the subject property required few, if any, adjustments. In choosing comparable for bracketing purposes, the appraiser should select properties that best support the subject property as its final market value.
- The appraiser must analyze pending and recent sales of comparable properties. At least three verified, closed (settled) sales of comparable properties must be analyzed with adjustments made for significant differences between the comparable sales and the subject property.
- The three comparable sales listed in the report must be:
 - Similar to and located near the subject property
 - Properties whose closing (settlement) occurred before the effective date of the appraisal of the subject property
 - Recently sold. If the sale of a comparable property occurred more than 12 months before the date of the appraisal, the appraiser must justify in the appraisal report the use of the comparable property
- Additional comparables, in the form of closed sales, sales under contract or current listings, may be used to support the appraiser's adjustments and conclusions, address change in the market, support the use of older comparables in stable neighborhoods or support the use of distant or less similar comparables in rural areas.

- Additional comparables are not always needed, but may contribute significantly to understanding unusual situations, such as limited markets, neighborhoods with little turnover of property and areas with a variety of distinct property types. For example, if the subject property is mixed-use, such as a storefront residence, then additional comparable sales may be needed to support the appraiser's conclusion that the property use is primarily residential, the value is based on residential use and there is a ready acceptance of such properties as residences.
- Comparables may be taken from a competing neighborhood if:
 - The appraiser has established that the neighborhoods are comparable and compete for the same buyers, and
 - Comparables taken from the competing neighborhood are better indicators of current market trends in the subject neighborhood than the existing comparables available in the subject neighborhood.
- For properties located in existing established subdivisions, PUD's or ground lease communities and for unit in existing Condominium Projects, the appraisal report may use three comparable sales from within that subject project or subdivision. However, if the subject property is in a controlled market (such as a new subdivision or project, a newly-converted project or an area where the property seller owns a substantial number of units), at least one comparable sale must be outside the influence of the developer, builder or property seller. Resales from within the subject project or subdivision may be used to meet this requirement. When comparable sales from outside the subject project or subdivision are used, they must also be outside the influence of the subject property's developer, builder or property seller.

If a comparable sale is over six months old, an explanation must be provided. Comparables can never be more than one year old, even with an explanation. The comparable selection should include at least one sale outside the subdivision or project and one sale from within the subdivision or project. The third sale may be either.

Sale and Listing history

- The appraiser must research, verify, analyze and report:
 - Any current agreement for sale for the subject property
 - Any offerings for sale of the subject property in the twelve months prior to the effective date of the appraisal
 - Any prior sales or transfers of the subject property for the three years prior to the effective date of the appraisal
 - Any prior sales or transfers of each comparable sale for the year prior to the date of sale of each comparable sale
- The Seller's review of the acceptability of each appraisal report should include an analysis of the sale and listing history. The Seller must confirm that the sale price trend in relation to the appraiser's estimate of value is reasonable and representative of the market.
- For purchase transactions, the Seller should analyze the appraisal report and the current contract for sale for the subject property
- For both purchase and refinance transactions, the Seller's underwriting analysis of the appraisal report should include any current listing or offering for sale for the subject property, the sales history of the subject property and comparable sales, and the current ownership of the subject property
- To reduce the Seller's risk of liability resulting from fraudulent or inaccurate appraisal reports, the Seller should analyze the subject property and comparable sales and evaluate the time elapsed between the date(s) the property was acquired and the date(s) resold, or the date of the current resale contract, if applicable. If the sales history of the subject property or comparable sales indicates current or prior sale prices may be excessive, and resale dates occurred shortly after the property seller's acquisition of the property, the appraisal report should provide evidence to support a rapidly appreciating real estate market, significant improvements that resulted in a corresponding increase in the property value or a previous sale that was below market value due to a distress or tax sale.

Reconciliation

- The data and information presented in the appraisal report must support the appraiser's estimate of market value. The appraiser must explain how the final value conclusion was determined, and the rationale must be consistent with the comments, conclusions and assumptions stated throughout the appraisal report.

- The reconciliation must contain any conditions of the appraisal on which the final estimate of value is based.

Comments section

- Any additional features; necessary repairs or modernization; or physical, functional or external inadequacies must be reported in the "comments" sections of the appraisal report or detailed in the addenda to the appraisal report.
- Repairs that affect the safety, structural integrity, mechanical systems or habitability of the improvements must be repaired. Cosmetic repairs, those that do not affect the safety, structural integrity, mechanical systems or habitability need not be repaired as long as:
 - The appraiser has made any necessary adjustments to the comparables
 - The appraisal is not made subject to repairs and
 - The appraiser has addressed whether the condition affects the value or marketability of the property
- Examples of cosmetic repairs include: worn floor coverings, minor cracks in windows, minor holes in interior walls or interior doors, etc.
- If the appraiser notes that additions or alterations were made without required permits, the appraisal report should also contain comments on the quality and appearance of the work. In addition, the appraiser should note special energy-efficient items and adverse environmental conditions.
- If the property has been modified to accommodate mixed use, the appraiser should address whether the modifications affect the property's marketability as a residence and whether the cost to restore the property to solely residential use will affect its value.

Cost approach

- The cost approach to value is required for appraisals of Manufactured Homes. It is not required for appraisals of attached PUD or Condominium Units.
- The Seller may request the appraiser to develop and report the cost approach to value when not required for the transaction. The appraiser must develop and report the result of any approach to value that is applicable and necessary for an appraisal report, even if the Seller did not request it. The approach may be appropriate especially when appraising properties that are:
 - New or proposed construction
 - Under renovation
 - Unique because of their styles or construction methods, or
 - Have functional obsolescence not typical for the market
- When the cost approach to value is developed, the appraiser must make proper adjustments for any items detrimental to stability or marketability, such as physical, functional and external depreciation that are not typical for the market.
- Appraisal reports that rely primarily on the cost or income approaches to value in order to estimate market value are unacceptable.

Income approach

- The income approach to value is required for appraisals of 2- to 4-unit properties. The Seller may request the appraiser to develop and report the income approach to value when not required for the transaction. The appraiser must develop and report the result of any approach to value that is applicable and necessary for an appraisal report, even if the Seller did not request it.
- Appraisal reports that rely primarily on the income or cost approaches to value in order to estimate market value are unacceptable.

PUD units

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

Condominium Units

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

Manufactured Homes

Additional appraiser qualifications

In addition to the appraiser qualifications, the Seller must determine that the appraiser demonstrates the knowledge and experience to perform quality appraisals for Manufactured Homes. The appraiser must:

- Have adequate experience and must have previously completed real property appraisals of Manufactured Homes
- Have adequate education and/or training related to the appraisal of Manufactured Homes
- Understand the unique features that affect the quality of Manufactured Homes and the factory construction techniques for Manufactured Homes
- Understand the manufacturers' and federal, State and local requirements for the installation of Manufactured Homes
- Be knowledgeable concerning the local Manufactured Home market, and
- Have access to appropriate data sources to establish an opinion of value. Traditional appraisal data sources may not provide sufficient quality Manufactured Home data for the appraiser to develop a supportable and well-documented appraisal. Although the MLS and public records information remain an important source of data, the appraiser must develop other sources such as Manufactured Home retailers and builders experienced in the installation of Manufactured Homes. The N.A.D.A. Manufactured Housing Appraisal Guide and Marshall & Swift Residential Cost Handbook may also be used to provide support for the appraiser's quality adjustments and value conclusions.

Contract for sale provided to appraiser

- If the transaction is a purchase or "no cash-out" refinance that involves the conversion of interim construction financing to permanent financing, the Seller must provide the appraiser with:
 - A complete copy of the executed contract for sale of the Manufactured Home and the land, or if the Manufactured Home and land have separate contracts, the executed contract for each is required. If the Borrower has owned the land for 12 months or more, a copy of the executed contract for the land is not required.
 - For a new Manufactured Home, the Seller must provide the appraiser with a copy of the manufacturer's invoice and the Manufactured Home Purchase Agreement. For a purchase transaction or any transaction that involves the conversion of interim construction financing to permanent financing, the appraiser must analyze the contract for sale and other documents for the transaction, including for new Manufactured Homes, the manufacturer's invoice and Manufactured Home Purchase Agreement.

Appraisal requirements

The appraiser must, at a minimum:

- Perform a complete visual inspection of the interior and exterior areas of the Manufactured Home
- Inspect the neighborhood
- Inspect each of the comparable sales from at least the street
- Research, verify, and analyze data from reliable public and/or private sources
- Develop an opinion of the market value of the Manufactured Home based on the sales comparison approach to value. Non-realty items, such as insurance, warranties or furniture must be excluded from the value conclusion.
- Develop the cost approach to value as support for the sales comparison approach
- Report his or her analysis, opinions, and conclusions on Form 70B, Manufactured Home Appraisal Report
- Match the manufacturer's serial number(s) and the HUD Certification Label number(s) on the dwelling to the number(s) on the contract for sale, manufacturer's invoice, and any other documentation provided. If the numbers do not match, the appraisal report must clearly state that the Manufactured Home is not the same dwelling referenced on the contract for sale or other applicable documentation.

- Complete the Form 70B in its entirety

Sales comparison approach

- The appraiser must state the specific number of manufactured home sales and listings as well as the respective price ranges that were used in the analysis.
- The appraisal report for the Manufactured Home must contain at least two comparable Manufactured Home sales of similar configuration (i.e., multiwide comparable sales for a multiwide subject property) and similar quality.
- The appraiser may use either site-built housing or a different type of factory built-housing as the third comparable sale if the appraiser explains the reason for selecting the comparable and makes and supports the appropriate adjustments in the appraisal report. More than three comparable sales may be used if needed to adequately support the appraiser's opinion of value.
- If the Manufactured Home is in a controlled market (such as a new subdivision or project, a newly converted project or an area where the property seller owns a substantial number of units), at least one comparable sale must be outside the influence of the developer, builder or property seller. Resales from within the subject project or subdivision may be used to meet this requirement. When comparable sales from outside the subject project or subdivision are used, they must also be outside the influence of the subject property's developer, builder or property seller.
- The appraiser must not create comparable sales by combining vacant land sales with the contract purchase price of the Manufactured Home. If the appraiser is unable to develop an appraisal based on at least two comparable sales of similar Manufactured Homes, the Mortgage is not eligible for sale.

Cost approach

- The cost approach and sales comparison approach are complementary for the valuation of manufactured housing and must support the final value conclusion.
- A detailed cost approach to value based on published sources and supported by market data is required for all Manufactured Home appraisals. It must, at a minimum, provide the information indicated on Form 70B and provide sufficient information and data to allow the Seller and other reviewers to replicate the cost figures and calculations.
- The cost figures must come directly from a published cost service without modification by the appraiser.
- The appraiser must report the source of the cost data and the effective date of cost data.
- The appraiser must provide a quality rating from the cost service used. The appraiser's quality rating must be based on objective criteria.
- The appraiser must provide his or her opinion of site value supported by a summary of comparable land sales or other methods used for estimating site value.

Income Approach

- The income approach to value is not required; however, the appraiser must consider the income approach to value and develop it if applicable and necessary to develop a credible report.

Completion certificate

- If the appraisal is performed before the Manufactured Home is delivered and installed on a permanent foundation, the Seller must obtain a completion certificate or appraisal update from the appraiser. The certificate or update must report the appraiser's analysis of previously unavailable information, and provide certification that the conditions of the appraisal have been satisfied. Form 442 or a comparable form with an interior inspection may be used.

2- to 4-unit properties

- In addition to the other requirements and guidelines set forth in this chapter, the following requirements and guidelines are applicable to completing Form 72, Small Residential Income Property Appraisal Report, for 2- to 4-unit properties.

Comparable rent data

- At least three rental comparables must be analyzed in the "comparable rental data" section. These rental comparables must:

- Have current rental information
 - Be units similar to and located near the subject property
- The rental comparables are usually not the same comparable properties used in the sales comparison approach. The appraisal report should state that the units and properties selected as rental comparables are comparable to the subject property (both the units and the overall property) and should accurately represent the rental market for the subject property unless otherwise stated in the report.

Subject's rent schedule

- This section contains the subject property's current actual rents and the estimated market rents. The estimated market rents for the subject property must be supported in the appraisal report and be consistent with the data presented throughout the report.

Sales comparison approach

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

Leasehold estates in ground lease communities

For leasehold estates in ground lease communities, the appraiser must:

- Include in the neighborhood section a description of the amenities and common property
- Comment on the monthly unit charge of the subject property and the comparable properties, if the comparable properties are from competing ground lease communities, and
- Consider and analyze how the ground lease affects value and make the appropriate adjustments to the comparable sales

Energy-efficient properties

- An energy-efficient property uses cost-effective design, construction, materials, equipment and site orientation to conserve energy, consistent with the climate of the area in which the property is located. Items that contribute to the energy efficiency of a property include, but are not limited to, the following:
 - Insulation with adequate R-values installed in ceilings, exterior walls and roofs; around hot water heaters; under floors that cover unheated areas; and surrounding ducts and pipes that are not air-conditioned
 - Caulking and weather stripping
 - Double- or triple-paned windows
 - Window shading or landscaping for solar control
 - Storm doors and windows
 - Automatic setback thermostats
 - Heating, cooling and lighting systems and appliances designed to be energy-efficient
 - Solar systems for water heating, space heating and cooling
 - Wood-fired heating systems (using outside combustion air)
 - Building designs that minimize energy use, such as reduced window areas and earth sheltering
- The appraisal report must list the energy-efficient items in the subject property and note their contribution to the value for the Mortgage to receive the special underwriting.

- The appraisal or inspection report must be signed by an appraiser approved by the Seller. A Seller may not accept a mortgage if the appraisal or inspection report is made for anyone other than the Seller or mortgage originator. The appraiser must be impartial and unbiased. The appraiser may not have any present or contemplated future interest in the subject property. In addition, neither current nor future employment or compensation for performing the appraisal or inspection may be contingent on the results reported by the appraiser.

Seller Warranties

- With respect to each appraisal or inspection report, the Seller represents and warrants that:
 - All information known to the seller that may affect the estimate of value or marketability has been provided to the appraiser in conjunction with the appraisal or inspection request
 - It has reviewed the mortgage and has concluded that the mortgaged premises is adequate security for the mortgage.
 - The report complies with the applicable requirements in this chapter
 - The report is of professional quality and supports all of the appraiser's assumptions, data, analyses, rationale and conclusions that were relied on in estimating the value and addressing the marketability of the mortgaged premises
 - The information in the report is accurate, internally consistent, written in clearly understandable language, fully supported and sufficiently documented
- Deficient appraisal or inspection reports will be considered a breach of the Seller's warranty as to the acceptability of the mortgage. In addition to reviewing the appraisal or inspection report submitted, the Seller may make property inspections and/or other investigations to assure property eligibility and proper underwriting of the mortgage offered for sale.

Market Value Definition

- An appraisal report must be based on the following definition of market value:
 - The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, 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 considers his 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.
- Adjustments to the comparable must be made for special or creative financing or sales concessions. No adjustments are necessary for those costs which are normally paid by sellers as a result of tradition or law in a market area; these costs are readily identifiable since the seller pays these costs in virtually all sales transactions. Special or creative financing adjustments can be made to the comparable property by comparisons to financing terms offered by a third-party institutional lender that is not already involved in the property or transaction. Any adjustments should not be calculated on a mechanical dollar-for-dollar cost of the financing or concession but the dollar amount of any adjustments should approximate the market's reaction to the financing or concessions based on the appraiser's judgment.
- The market value estimate of the subject property must not include value assigned to furniture or any other personal property

Detrimental Conditions

- On appraisal or inspection reports, the appraiser must note the presence of detrimental conditions, such as expansive soils, underground mines or subsidence in the immediate area of the subject property. In addition, the appraiser must note any evidence of dampness, infestation or abnormal settlement observed on the subject property and call for correction of the observed condition or professional inspections to determine the

seriousness of the condition. The appraiser must also consider the effect of such conditions in estimating the subject property's market value and/or any effect on marketability.

- For any appraisal report that is made subject to inspections or conditions due to detrimental conditions, the Seller must include in the mortgage file evidence of corrective action as called for by the inspector or appraiser (such as an exterminator's certificate, engineer's report or satisfactory completion certificate) dated before the delivery date of the related mortgage.

Maximum Financing

- For any appraisal report, the Seller must consider the appraiser's indication of the trend of property values in the area in which the subject property is located with respect to offering financing to the maximum loan-to-value (LTV) ratio.

Statement of Assumptions and Limiting Conditions, and Appraiser's Certifications

- The Statement of Assumptions and Limiting Conditions, Appraiser's Certification and Supervisory Appraiser's Certification are incorporated into each appraisal and inspection report form. Modifications or deletions to these are not permitted. However, additional certifications that do not constitute material alterations to the report, such as those required by law or those related to the appraiser's continuing education or membership in an appraisal organization, are permitted.

Owner of Record

- Effective for mortgage applications taken on or after May 1, 2005, when a new appraisal is required, the Seller must verify:
 - For purchase transactions:
 - The property seller listed on the sales contract is the Owner of Record of the subject property or
 - If the transaction involves the sale of land separate from the dwelling, the property seller listed on the sales contract for the land is the Owner of Record for the land.
 - For refinance transactions, the borrower is an Owner of Record of the subject property
 - For transactions that involve the payoff of a land contract, the property seller is the vendor on the recorded land contract and the Owner of Record of the subject property; and the borrower is a vendee on the recorded land contract.
- Seller must retain documentation evidencing the verification in the mortgage file. Such documentation may include, but is not limited to, the appraiser's analysis and conclusions in the appraisal report, a property sales history report, a copy of the recorded deed, a copy of a property tax bill, or the title commitment or binder indicating the legal ownership of the property.

604.03 – Negative Time Adjustments

Negative time adjustments made in the sales comparison approach of an appraisal indicate declining values and should be commented on by the appraiser and reviewed carefully by underwriting.

The appraiser must provide written justification for time adjustments before the underwriter issues the final statement of appraised value. The underwriter must determine that the time adjustments are applicable to the local VA jurisdiction.

604.04 – Comparables

The appraiser is to provide a 36 month history of any prior sales of the subject and comparables, including sales price and any other available data. The underwriter must question any property which resold in a short time for a much higher price. Very often, these circumstances involve substantial rehabilitation, and the appraiser should furnish details.

When reviewing comparable sales, the amenities must be similar comps should be from within the same project and one should be from a competing project, but in the same market area. Ideally, 2 of the comps.

On refinance loans, the appraiser must provide comparables that support the subject property value. The comparables should “bracket” the value of the subject property, for example if the subject is valued at \$120,000, it would be inappropriate for the adjusted value of all comparables to be less than \$120,000. At least one of the comparables should be of a higher value.

Properties in rural areas or with acreage must have comparables with similar locations or property size. On non-conforming loans, the maximum acreage allowed is ten (10) acres. At least two (2) comparable must be provided to support the market value.

604.05 – Property Located in Areas Affected by Natural Disasters

It is the responsibility of each associate, correspondent and Account Executives to be aware of natural disasters occurring in the areas served by the correspondent of A.E. The underwriting and closing of loans is dramatically affected by hurricanes, earthquakes, flooding, hail storms, forest fires, tornadoes, mud slides or other natural disasters.

For properties in areas that have sustained damage, the Lender’s Drive by Inspection Certification, is to be completed on all loans in the pipeline that have not closed, where appraisals have been performed prior to the date of the natural disaster.

The following additional criteria must be met:

- If the loan has not been underwritten, the underwriter will require the Lender’s Certification form as a “PTD” condition.
- Any damage noted will require an inspection by the appraiser to determine the extent of damage and affect on value.
- Approved loans on property that has incurred damage will be returned to the Regional Underwriting Department for review.
- No fee will be charged to the applicant for the Lender’s Inspection.
- Properties where the Lender Certification indicates no damage” will require an acknowledgment and Hold Harmless Letter from the applicant(s) at loan closing.

*If conditions exist that are conducive to damage, such as high water marks on the side of the building, standing water or other questionable factors, the issue should be brought to the attention of the Regional Underwriting Department. The underwriter will determine what additional inspections may be needed. If additional guidance is required, the underwriter will contact the Credit Policy Department.

Please refer to additional VA requirements below.

604.06 – Purchase & Refinances/Damage Sustained

On properties that have sustained damage and the applicant desires to close on the loan prior to completion of repairs, the following criteria must be met:

- The underwriter must review the estimate for repairs and any request for an escrow, prior to loan closing.
- No escrow may be released without a final inspection by an appraiser or Compliance Inspector. All escrow agents must be advised that a release of escrow must be presented in writing from either an underwriter or operations personnel. No funds are to be released without written approval.
- When approving a loan, the underwriter must condition the approval to collect all repair inspection fees at loan closing.
- The title company must provide an endorsement to insure against mechanic’s and material men’s liens Any additional fee for the endorsement will be the responsibility of the applicant.

Other scenarios may result from loan applications on damaged properties. Please contact your Regional Underwriting Department for assistance in determining the proper course of action. In addition, The Production Support Group or the Credit Policy Department may be contacted for assistance.

Please refer to additional VA requirements below.

The veteran cannot be charged any disaster-related inspection fees or repair costs.

If any local law requires the property to be inspected and approved by the local building inspection authority, a copy of the appropriate local report(s) must be provided.

If there is an indication that the property, despite repairs, will be worth less at the time of loan closing than it was at the time of appraisal, then the VA fee appraiser must update the original value estimate. The payment of the appraiser's fee for that service will be a contractual matter between buyer and seller. If the property value has decreased, the loan amount must be reduced accordingly.

Prior to closing, it must be verified that the veteran's employment and income have not changed since the loan application. Should it be determined that the veteran is no longer employed or family income has been reduced, the underwriter must be notified and must evaluate the change(s) prior to closing the loan.

In order to be eligible for VA guaranty, properties appraised on or before the date of a Presidential declared disaster, and not closed prior to that date, will require an inspection and the following certifications:

- Lender Certification: "This is to affirm that the property which is the security for VA loan number _____ has been inspected to ensure that it was either not damaged in the recent disaster or has been restored to its pre-disaster condition or better." The certification must be signed by a closing CSM, providing the date signed and title of individual.
- Veteran Certification: I have inspected the property located at _____ and find its condition now to be acceptable to me. I understand that I will not be charged for any disaster-related expenses and now wish to close the loan". The certification must be signed and dated by the Veteran.

The inspection made on behalf of The Lender must be in the loan file. If the property is inspected by an associate, a written report and photographs will be required. Loan Summary Sheet (VA Form 26-0286) must be annotated "Lender and Veteran Disaster Certifications Enclosed".

604.07 – Value Conclusion and Appraiser Signatures

The market value is determined by evaluating the sales comparison approach, the cost approach and the income approach (when applicable). The value is then noted in the lower right hand corner of the appraisal above the appraiser's signature.

The underwriter must condition for a certification of completion when the appraisal is made subject to repairs or completion. Required repairs should not include cosmetic items which do not affect the value or marketability of the property. Repairs should generally be limited to those items which affect the structural integrity of the dwelling or pose a health or safety hazard to the occupants.

The appraisal must be signed by the member of the fee panel who was assigned by VA to complete the appraisal.

604.08 – Burglar Bars

The use of burglar bars is permitted; however, they should meet local code requirements, which typically require that at least one window in each room be equipped with a keyless quick release latch in rooms which have no door to the outside.

604.09 – Common Use Agreements

A common use agreement provides for the sharing of repair and maintenance costs and ingress/egress access for completion of repairs and maintenance. Where common and customary, common use agreements will be

required where common use areas exist, such as walls, driveways, etc., which are shared by adjacent properties. The rights of each owner must run with the land and pass to successors in title.

DE underwriters and VA Automatic underwriters must be aware of the requirements of the local office with jurisdiction over the subject property. Generally, the agencies will require common use agreements.

604.10 – Disaster Areas

As a result of a national disaster such as flooding, hurricanes, tornadoes, fires, earthquakes, etc., the federal government will designate the affected area to be a Presidential Declared Disaster Area. In such designated areas, the following is required:

- If an appraisal was completed on a property within the affected area prior to the date of the disaster, the appraiser or another designee will be required to re-inspect the property prior to closing.
- The designee must provide an addendum to the appraisal identifying property defects which could affect the health or safety of the occupants.
- The appraiser must address any effect the disaster had on the value marketability of the subject.

When the re-inspection evidences damage to the property, the loan must be resubmitted to underwriting to re-evaluate the adequacy of the collateral.

604.11 – Earthquakes Fault Lines

The title insurance policy issued for The Lender may not take any exception to natural fault lines, including those determined by a survey.

604.12 – Encroachments

When there is a minor encroachment, a “hold harmless” letter must be executed by the borrowers at closing and title insurance coverage must be obtained for the encroachment. Examples of acceptable encroachments are: When the improvements of the adjoining property do not exceed one foot over the lot line, provided the encroachments do not touch any buildings or interfere with the use or enjoyment of the subject’s improvements; hedges or removable fences belonging to the subject or adjoining property; or when the driveway encroaches on adjoining property by one foot or less, provided there is a minimum clearance of eight feet between the buildings on the subject property and the property line affected by the encroachment.

604.13 – Environmental Hazards

The presence of hazardous wastes, materials containing asbestos, urea, formaldehyde insulation, radon gas, or other toxic substances on or near the subject property, must be noted on the appraisal as a hazardous condition. The appraiser must comment on the effect the hazard may have on the property’s value and marketability. The value must be adjusted to reflect market reaction to the hazard.

Properties affected by an environmental hazard are acceptable if the appraiser can demonstrate the impact of the hazard is measurable and support value with the use of comparable sales from both the affected area and a similar competing area without the negative influence.

The appraiser should comment on any conditions which may be affected by the hazard, such as a well, septic or public water facility. When there is a concern, the underwriter must condition for appropriate tests to determine whether there is any contamination. If there is contamination, the property will not be eligible for financing.

The applicant must execute a “hold harmless” letter at closing which addresses the nature of the hazard.

Note: Lead paint hazards that may exist in properties built before 1978 have come under the jurisdiction of the Environmental Protection Agency (EPA). The EPA now requires notification to all purchasers of the possible hazard of lead paint and purchasers are to be offered a period of time to allow for home inspections.

604.14 – Excess Property/Land or Buildings

(Excess land is addressed rural properties.)

When a property contains what appears to be excess property or buildings, such as mother-in-law suites, carriage houses, or other property, the appraiser must address the effect on value, conformity to local custom and zoning. The comparables provided by the appraiser must have similar features or line adjustments in the comparable grid on page two of the appraisal. The appraisal must support the market value as determined by the appraiser. The underwriter must confirm the appraisal's support of value. Also see, Reconsideration or Changes in Value.

604.15 – Flood Insurance

Flood insurance is required by law for all mortgage loans originated or serviced by a Federal insured institution when any portion of the improvements of the secured property lie in a Federal Emergency Management Agency (FEMA) declared Special Flood Hazard Area (SFHA). If the improved property is located in a SFHA requiring flood insurance and the flood insurance is not available for the community it does not participate in the Flood insurance program. The property is not eligible for financing with The Lender. There are no exceptions to waivers to this requirement.

The office of Federal Emergency Management Agency (FEMA) may determine a building site is no longer designated a Special Flood Hazard Area (SFHA). FEMA will issue a Letter of Map Amendment (LOMA) for an individual site or a Letter of Map Revision (LOMR) for same areas (or subdivisions) to show changes to flood plains, flood ways or flood elevations.

Flood insurance must be required if any portion of the improvements lie within a SFHA. When a portion of the security property lies in a SFHA but the improvements do not, flood insurance may or may not be required.

604.16 – Heat and Air Conditioning

All properties must be provided with a safe, adequate active heat source. Space heaters must be inspected by a licensed heating company, who must certify the heaters are properly vented and conform to local code.

Air conditioning, if installed, must provide a safe cooling system. The Lender has no specific requirements for window air conditioners as they are considered personal property.

604.17 – High Pressure Gas and Liquid Petroleum Transmission Lines

The Lender and VA fee appraisers should be aware of recorded easements which indicate the presence of high-pressure gas or liquid petroleum transmission lines. Pipeline companies can provide information concerning locations of pipelines, easements and compliance with Federal regulations. Loans to be insured by VA must meet the following requirements before a loan can be closed and funded:

- No part of any residential structure can be located within a pipeline easement. My detached improvements which are in, or partially in, a pipeline easement will not receive value in the appraisal process or in the reasonable value determination on a VA CRV or NOV.

If a residential structure is or will be located outside the pipeline easement, but within an area that extends 220 yards on either side of the centerline of the transmission line, the CRV, MCRV or NOV will be conditioned with the following:

- For high-pressure gas pipelines, a statement from an authorized official of the pipeline company must be submitted certifying compliance with Federal Regulations 49 CFR.

- For liquid petroleum pipelines, a statement from an authorized official of the pipeline company must be submitted certifying that the pipeline complies with 49 CFR. Section 195 and all amendments thereto.

604.18 – Lot Dimension Variances

When the lot dimensions noted on the appraisal differ substantially from the survey, the appraiser must be contacted to determine whether the variance warrants a change in value. If the value has changed, the appraisal must be resubmitted to underwriting before the loan may close.

A substantial variance in lot size is considered to be a difference of more than 2% on the length of the frontage of the property or more than 6% of the length of any other dimension.

604.19 – Private Road, Alley or Common Drive

When a single family property accesses a public road by means of a private road, alley, or common drive which is not part of the subject's land, a permanent, recorded ingress/egress easement which runs with the land will be required. The private road must be maintained in an all weather condition.

A private road maintenance agreement, except for properties located in California or Oregon, must be provided by either a homeowners association or by a joint maintenance agreement executed by all parties with land adjacent to the private road:

- The maintenance agreement must be recorded and binding to successors in title.
- It must require the road be maintained in an all weather condition

604.20 – Structural Damage

When the appraisal appears to indicate the property has suffered structural damage, the appraiser must either reject the property or require a satisfactory structural engineer's report. The report must be prepared by a licensed registered professional engineer and must be dated prior to any repairs. A final inspection evidencing satisfactory completion of all recommended repairs by the original engineer will be required.

Structural damage is not limited to the foundation alone and may involve the root load bearing walls, etc. It is ultimately the underwriter's responsibility to accept the property with repairs, or to reject the property. The Regional Underwriting Manager must review the appraisal and sign the loan approval or denial.

The borrower is to be provided with a copy of the initial engineer's report, any interim and final inspection reports and a copy of the warranty. The borrower must sign a statement acknowledging receipt of these items. The borrower must sign a Hold Harmless letter acknowledging that neither VA or The Lender warrants the property or the repair.

VA's requirements are similar to FHA; however, properties with structural deficiencies should be rejected by the LAPP SAR and forwarded to VA. The veteran must then request VA to reconsider the property with an engineer's report and any recommended repairs.

604.21 – Termite Report Statement

In areas prone to infestation, Termite and other Wood Destroying Insect Reports may be required. The common and customary use of such inspections typically follows climate and geographic patterns.

In addition to termites, the report will indicate the presence of other forms of wood destroying organisms, such as fungus, water damage due to poor drainage, etc., as well as the presence of other insects or pests. All problems noted on the inspection report must be addressed; the date of the termite report may not exceed 30 days at time of funding.

When the termite report indicates:

- Active infestation, evidence of treatment must be provided.
- Damage from previous or current infestation, the damage must be repaired, it is essential to determine the extent of the damage by contacting the inspector if the report is unclear. Correction of minor damage may be evidenced by a paid work order listing the repairs.
- Structural damage, a structural engineer's report will be required to determine the needed repairs.

On VA new or proposed construction, where soil poisoning was used, the National Pest Control Association (NPCA) Form-99a, Subterranean Termite Soil Treatment Builders Guarantee and Form NPCA-99b, New Construction Subterranean Termite Soil Treatment Record will be used. The licensed pest control company must complete NPCA-99b. The form must be used as an attachment to the builders form, NPCA-99a. The builder is responsible for distributing the completed forms and for providing copies to The Lender. If a state has more stringent record keeping requirements than the NPCA-99b, then VA will accept use of the state form in lieu of the NPCA99b, however, the state form must be attached to the NPCA-99a.

On all VA loans, the underwriter must review and approve termite/pest control reports that list repairs or "conductive conditions" prior to funding. Closers are responsible for obtaining "clear or approved" pest inspection reports before loan funding.

604.22 – High Tension Transmission Lines

No dwelling or other improvement which may become the security for a VA guaranteed loan can be located within the transmission line easement. Any detached improvements that are in, or partially in, a high voltage electric transmission line easement will not receive value in the appraisal process or in the reasonable value determination on a CRV or NOV.

604.23 – Zoning

The appraiser is responsible for reporting the specific zoning classification for the subject property on the Uniform Residential Appraisal Report. The appraiser is required to provide a statement indicating if the improvements represent a legal use; a legal, non-conforming use or an illegal use under the zoning regulations; or state if there are no local zoning regulations.

For a one to four unit family property or a unit in a PUD project that represents a legal but non-conforming, use of the land, the appraiser's analysis must reflect any adverse effect that the non-conforming use has on the value and marketability of the property. Further, it must be determined (and documented) that the property, if partially or completely destroyed, can be rebuilt as the same structure. Example: A single family residence with an added mother-in-law suite, complete with kitchen and garage may be a legal, but non-conforming use of the property. The loan file must indicate that the property as it exists (at loan underwriting) can be rebuilt as the same structure.

Note: If the property represents an illegal use under the zoning regulations, it is ineligible for financing.

604.24 – Zero Lot Line

An acceptable maintenance easement must be provided for the zero lot line side of the dwelling which provides for space from the subject's wall to perform repairs and maintenance of that wall. The easement must be recorded and binding of all successors in title.

A building constructed on or to a property line shall be separated from the adjoining building by a wall extending the full height of the building from the foundation to the ridge of the roof; the wall can separate row type townhouses or semi-detached units.

There must be adequate space between buildings to permit maintenance of the exterior walls.

604.25 – Underground Fuel Tanks

Home heating oil tanks are not regulated by federal law. The Environmental Protection Agency (EPA) has established guidelines concerning abandoned, underground home heating fuel oil tanks,

If a tank is to remain on the property, the following procedures are recommended:

- Tank should be emptied of any fuel oil or water. Contents should be treated as contaminated and should be removed by a specialist in the removal of contaminated materials.
- All piping and spouts should be disconnected and removed.
- Vent line should be plugged or capped, preferably below ground level.
- Tank should be filled with sand, concrete, foam or other inert material that will not interact with the metal from which the tank is constructed.

If a tank is to be removed, the following procedures are recommended:

- Tank should be removed by a professional who will remove and dispose of the tank in an appropriate manner. (Homeowner remains responsible for the tank until disposed tank is accepted by a scrap or salvage yard).
- The hole should be examined for any contaminants (visual check) and then filled with clean soil.

When an appraisal indicates an underground fuel tank, the Underwriter must review the local guidelines with the appraiser and with local environmental officials to determine if removal or other procedure should be required.

The Lender will accept the procedures authorized by the local environmental authorities for the removal or disposal of underground fuel oil tanks.

A release of oil or other contaminants into the soil is regulated by law. If any evidence of soil contaminants is indicated, the property is not eligible for financing.

SECTION 605.00 – SEWAGE SYSTEMS

605.01 – Cesspools

Cesspools may be acceptable if all of the following occur:

- All appraisal comparables must have the same system (cesspools);
- The cesspool must be common and customary for area; and
- The cesspool must be acceptable to and inspected by local governmental authority such as health department, environmental department, etc.

605.02 – Community Sewage Systems

- A community sewage system is a central system which is owned, operated, and maintained by a private corporation or non-profit property owners association.
- HUD no longer maintains a list of approved systems. The appraiser must note on the URAR the name of the community system(s). The lender is responsible to ensure the community system(s) are licensed and adequate to service the property.

605.03 – Septic Systems

An individual septic system must be located on the subject property. The property owner is responsible for maintenance as well as compliance with the regulations imposed by state or local health authorities.

An individual septic system may be acceptable in areas where soil conditions are satisfactory for the proper installation and usage and public or community systems are not available. The property must be connected to a public or community sewage system where available and if costs are feasible (3% or less of the value of the property). The individual septic system must be located on the subject property.

Individual septic systems on new construction will require inspection. Sewage systems must be inspected by an engineer who holds a current State License which authorizes them to perform such inspections. The inspection must be performed in accordance with state or local health authority standards and requirements and the laboratory used must be State certified and meet EPA standards.

On existing property, if the home is not occupied and the systems have not been in use for 30 days or more, an inspection of the sewage system must be made by a State licensed sanitation or civil engineer, A State licensed contractor for sewage disposal systems or a member of a qualified inspection service to determine if the sewage disposal system was operating in a satisfactory manner at the time of the inspection and if the sewage system is considered adequate to dispose of all domestic wastes in a manner which will not create a nuisance or endanger the public. If the system has not been in use for thirty days, a dye test is recommended.

SECTION 606.00 – WATER SUPPLY SYSTEMS

606.01 – Community Water System

A community water system is a central system which is owned, operated, and maintained by a private corporation or non-profit property owners association.

On both new and existing construction, the following additional information is required:

- A license to operate from the appropriate governing body (health department or other local state agency).
- Rates must be reasonable for the service provided when compared to similar properties.
- Is a central system, owned, operated, and maintained by a private corporation or a non-profit property owners association.

Note: Some VA offices require that community Water Systems be approved by the local VA office and be issued an ID number.

606.02 – Individual Wells

- An individual well must be located on the subject property.
- The property owner is responsible for maintenance as well the regulations imposed by state or local health authorities.
- A Chemical analysis will be required when there is a history of ground water contamination in the area.
- In all cases, when an inspection or water test is required, it may not be dated more than 90 days prior to the date of loan funding.

Individual wells are acceptable only in areas where public or community utilities are not readily available. Local field offices may impose more stringent requirements than shown below. The basic criteria is:

- The water must be tested for the presence of bacteria and chemicals (including lead) with results within an acceptable range. The test should be conducted by the local health authority, in some areas where a local health authority is not available; a state EPA approved laboratory test may be acceptable (check with your Regional Underwriting Department).
- The well must have adequate water pressure.

606.03 – Individual Springs/Cisterns as a Water Source

In some locations water sources other than a public system, a community system or a well may have approval of the local VA office. It will be the responsibility of the Regional Underwriting Department to be familiar with local conditions and agency requirements.

In order for a spring to be used as a source of water by a property, the local VA office must have approved the use of the spring. VA will normally require, at minimum, both a water analysis and evidence that the spring is enclosed to prevent contamination.

606.04 – Shared Wells

Properties that are served by individual water sources must be connected to a public or community water system whenever feasible. When a public or community water system is not available or connection is not feasible and the property shares a well with another property, the following are required:

- A satisfactory well agreement must be submitted. At a minimum, the well sharing agreement must 1) make reasonable and fair provisions for maintenance and repair of the systems and sharing of costs to do so; 2) include a permanent easement that allows access for maintenance and repair; 3) be recorded in the local deed records and 4) be binding on the signatory parties and their successors in title..
- The well must be capable of providing a continuing supply of safe and potable water to each property simultaneously so that each dwelling will be assured of a sufficient quantity for domestic purposes.

VA considers community or shared wells as water systems in which the individuals share in the responsibility for the operation and maintenance of the system.

Note: Some local VA offices limit the number of persons allowed to share in a well; require that water meters be placed on behalf of each shareholder; and/or that cost of sharing be disclosed.

SECTION 607.00 – CONDOMINIUMS AND PLANNED UNIT DEVELOPMENTS

A Condominium is a form of ownership in which the interior space of a unit is individually owned in fee simple title, but owners have an undivided interest in the land, common areas and facilities within the project. While maintenance of the interior of a unit is the individual unit owner's responsibility, the common areas and facilities are maintained and managed by a Homeowner's Association (HOA) of which the unit owners are members. In an established project, the unit owners control the HOA, while in a new construction project, the builder or developer generally controls it.

A Planned Unit Development (PUD) is a project consisting of individually owned parcels of land, together with common areas and facilities that are owned and maintained by a HOA of which the unit owners are members. Each owner has a non-exclusive easement allowing access to the project's common areas. In some cases, the unit owner may have an exclusive easement over a part of the common areas (i.e. parking space).

607.01 – Condominium Projects with 2 to 4 Units

No restrictions are placed on high rise condominiums other than the requirement that VA must approve the project.

607.02 – Manufactured Homes in Condominium Projects

A Manufactured Home within a condominium project will not be eligible for financing.

607.03 – High Rise Condominiums

Any project consisting of four or more stories will be considered a High-Rise Condominium. Units in a high-rise project must be common and typical for the neighborhood. The appraiser must provide recent comparables sales from competing high-rise projects to support the marketability of the collateral.

607.04 – Loft Condominiums

While there are a variety of definitions for Loft Condominiums, they are typically viewed as units with an open floor plan consisting of large, non-partitioned space within a converted factory or warehouse. Traditional loft characteristics include high ceilings, exposed ductwork and large windows which help to create a feeling of air and space. Due to the unique nature of loft-style condominium projects in some areas, the appraisal report must demonstrate that there are not marketability issues associated with this style of housing.

607.05 – Planned Unit Developments

In a PUD, the Homeowners Association owns and is obligated to maintain the common areas and facilities within the development for the common use and benefit of the unit owners. While individual unit ownership is not in common with other unit owners, each unit owner has an automatic, non-severable interest in the HOA. Each unit owner must pay mandatory assessments to the HOA.

A project review is not required for PUD projects.

SECTION 608.00 – ENERGY EFFICIENT PROPERTIES

An energy efficient property is one that uses home design, site orientation, construction materials and equipment to both conserve nonrenewable fuels (energy) and to reduce the cost of nonrenewable fuels. Special energy savings items should be recognized in the appraisal.

There are two different loan scenarios where energy efficiency can make a difference:

- qualifying ratios for all loan types may be increased when the subject home is documented to be energy efficient and
- an VA loan amount may be increased above the appraised value or sales price to cover cost of energy efficient improvements.

Mortgage loans are available to applicants wanting to purchase or refinance a principal residence and incorporate the cost of energy efficient improvements into the mortgage.

608.01 – VA Energy Efficient Mortgages (EEM)

EEMs are loans to cover the cost of making energy efficiency improvements to a dwelling. They can be made in conjunction with:

- a VA loan for the purchase of an existing dwelling, or
- a VA refinancing loan secured by the dwelling.

Acceptable energy efficiency improvements include, but are not limited to:

- solar heating systems, including solar systems for heating water for domestic use
- solar heating and cooling systems
- caulking and weather-stripping
- furnace efficiency modifications limited to replacement burners, boilers, or furnaces designed to reduce the firing rate or to achieve a reduction in the amount of fuel consumed as a result of increased combustion efficiency, devices for modifying flue openings which will increase the efficiency of the heating system, and electrical or mechanical furnace ignition systems which replace standing gas pilot lights
- clock thermostats
- new or additional ceiling, attic, wall and floor insulation
- water heater insulation
- storm windows and/or doors, including thermal windows and/or doors
- heat pumps, and vapor barriers.

Requirements:

- Funds for energy efficiency improvements are considered part of the total loan, which must be secured by a first lien.
- If the labor is to be performed by the veteran, the loan increase will be limited to the amount necessary to pay for materials.
- A loan for existing property may be increased by up to \$6,000 for energy efficiency improvements at the option of the lender and veteran at any time up to loan closing without VA's prior approval.
- The lender must determine that the proposed weatherization and/or energy conservation improvements are reasonable for the particular property.
- The lender must evaluate the veteran's ability to pay the increased loan payments caused by addition of energy efficiency improvements.
- For energy efficiency improvements that will increase a loan amount by more than \$6,000, the amount of the increase must be supported by an increased valuation in an equal amount.

Borrower Notice on the NOV:

Information on EEMs is provided to a veteran who applies for a loan which requires a NOV (that is, a loan for a home purchase or cash-out refinance). The NOV includes the following notice to the veteran:

"The buyer may wish to contact a qualified person/firm for a home energy audit to identify needed energy efficiency improvements to the property. In some localities, the utility company may perform this service. The mortgage amount may be increased as a result of making energy efficiency improvements such as: Solar or conventional heating/cooling systems, water heaters, insulation, weather-stripping/caulking, and storm windows/doors. Other energy related improvements may also be considered."

The mortgage may be increased by:

- up to \$3,000 based solely on the documented costs
- up to \$6,000 provided the increase in monthly mortgage payment does not exceed the likely reduction in monthly utility costs, or more than \$6,000 subject to a value determination by VA.

UNDERWRITING CONSIDERATIONS:

Energy efficiency improvements up to \$3,000:

The resulting increase in loan payments will normally be offset by a reduction in utility costs.

Energy efficiency improvements more than \$3,000, up to \$6,000:

The lender must make a determination that the increase in monthly mortgage payments does not exceed the likely reduction in monthly utility costs. Rely on locally available information provided by utility companies, municipalities, state agencies or other reliable sources, and document the determination.

Energy efficiency improvements over \$6,000:

Lenders should exercise discretion and consider

- whether the increase in monthly mortgage payments exceeds the likely reduction in monthly utility costs, and
- whether the veteran's income is sufficient to cover the higher loan payment.

A VA Certificate of Commitment issued before the decision to make energy efficiency improvements over \$6,000 must be returned to VA for a determination that the applicant still qualifies.

Energy efficiency improvements in conjunction with an IRRRL:

If the monthly payment (PITI) for the new loan exceeds the PITI of the loan being refinanced by 20% or more, the lender **must** certify to having determined that the veteran qualified for the higher payment.

Documentation Required with closed Loan Package:

Energy efficiency improvements up to \$3,000:

Evidence of the cost of improvements such as a copy of the bid(s) or contract itemizing the improvements and their cost.

Improvements more than \$3,000, up to \$6,000:

Evidence of the

- cost of improvements such as a copy of the bid(s) or contract itemizing the improvements and their cost, and
- the lender's determination that the increase in monthly mortgage payments does not exceed the likely reduction in monthly utility costs

Improvements over \$6,000:

- Documentation of VA's valuation of the energy efficiency improvements, and
- for prior approval loans, the Certificate of Commitment must reflect the additional amount.

IRRRL with significant increase in payments:

If the cost of the improvements causes the new loan payment (PITI) to be 20% or more higher than the old payment (on the loan being refinanced), then include the lender's certification that it has determined that the veteran qualified for the higher payment.

How to calculate Guaranty and Entitlement Use:

Step	Action
1	Calculate guaranty on the loan without the portion attributable to the energy efficiency improvements.
2	Calculate guaranty on the energy efficiency improvements portion by applying the same percentage used in Step 1.
3	Add the results of Steps 1 and 2 to arrive at guaranty on the entire loan.

NOTE:

The veteran's entitlement will **only** be charged the amount arrived at in Step 1; which is based upon the loan amount **before** adding the cost of the energy efficiency improvements.

Funding Fee Calculation:

Calculate the funding fee based on the full loan amount including the cost of the energy efficiency improvements.

Improvements Not Completed Prior to Closing:

If the energy efficiency improvements are not completed before closing, the lender may establish an escrow or earmarked account and close the loan.

- A formal escrow is not required.
- Only the amount needed to complete the improvements must be withheld.
- Check the appropriate block in item 23 [VA Form 26-1820, Report and Certification of Loan Disbursement](#).
- No additional documentation concerning the escrowed/earmarked funds must be submitted when reporting the closed loan.

Generally, the improvements should be completed within six months from the date of loan closing.

- Provide written notification to VA when improvements are completed and the escrow funds are disbursed, and
- assure the funds are properly applied to the costs of improvements.

If, after a reasonable time, the lender determines that the improvements will not be completed:

- apply the balance of the escrowed/earmarked funds to reduce the principal balance on the loan, and
- provide written notification to VA that this has been done.

Reimbursement from IRRRL Proceeds:

The veteran generally may not obtain cash proceeds from an IRRRL.

Note: There is **one** exception. Up to \$6,000 of IRRRL loan proceeds may be used to reimburse the veteran for the cost of energy efficiency improvements completed within the 90 days immediately preceding the date of the loan.

Temporary Interest Rate buydowns:

As a marketing tool, builders, sellers, or lenders will sometimes establish and fund escrows to temporarily reduce a borrower's loan payments during the initial years of the mortgage. The borrower may also fund such an escrow for herself/himself as a financial management tool.

VA will guaranty loans involving temporary interest rate buydowns, if otherwise eligible.

A temporary interest rate buydown can be used in conjunction with **any** type of VA-guaranteed loan except a GPM.

Escrow Requirements:

Funds must be safely escrowed with an independent third-party escrow agent beyond the reach of prospective creditors of the builder, seller, lender, and the borrower.

The escrow agent must make payments directly to the lender or servicer. The funds may be used **only** for payments due on the note. The funds may **not** be used to pay past due monthly loan payments. If the loan is foreclosed or prepaid, the funds must be credited against the veteran's indebtedness.

Escrowed funds may **not** revert to the party that established the escrow. If the property is sold subject to, or on an assumption of the loan, the escrow must continue to pay out on behalf of the new owner.

Underwriting Requirements:

The loan application may be underwritten based on the first year's payment amount if there are strong indications that the income used to support the application will increase to cover the yearly increases in loan payments.

- Routine cost of living increases **cannot** be used for this purpose.
- Increases resulting from confirmed future promotions or wage percentage increases guaranteed by labor contracts (for example, teachers, auto workers) may be given favorable consideration.

The assistance payments must run for a minimum of one year. Scheduled reductions in the assistance payments must occur annually on the anniversary of the first mortgage payment.

The reduction in the assistance payments may be accomplished through:

- annual payment increases in equal or approximately equal amounts, or
- equal annual increases in the interest rate.

The loan application must be underwritten based on the **full** payment amount if there are no strong indications that the income used to support the application can reasonable be expected to keep pace with the increases in loan payments.

The buydown arrangement can be considered a compensating factor.

If the residual income and/or debt-to-income ratio is marginal, the buydown plan (used to offset a short-term debts), along with other compensating factors, may support approval of the loan.

Provide a detailed statement signed by the underwriter explaining reasons for approval

The terms of the buydown arrangement are **not** limited to specific criteria such as a minimum or maximum number of years for application of the assistance payments.

It is the lender's responsibility to review and determine the acceptability of the buydown.

Lenders must provide the veteran-borrower with a clear, written explanation of the buydown agreement.

A copy of the buydown and escrow agreements must accompany the loan submission.

608.02 – Energy Efficient Mortgage Funding Fee and Guaranty

VA will guarantee an energy-efficient mortgage in the same proportion as a loan not including energy efficient improvements. However, the charge to the veteran's entitlement will be based upon the loan amount before adding the cost of energy efficient improvements:

Example: If a veteran has full entitlement and applies for a loan of \$80,000 plus \$6,000 in energy efficiency improvements, VA will guarantee 40% of the full loan amount of \$86,000. The dollar amount of the guaranty will be \$34,400, but the charge to the Veteran's entitlement will be only \$32,000.

The funding fee must be calculated on the full loan amount, including the cost of the energy efficient improvements.

SECTION 609.00 – ESCROWS

The use of completion escrows for repairs or improvements is dictated by VA and will be limited to those instances where it is impossible to complete the required work prior to closing the loan. The lack of a final inspection delays the insurability or sales ability of the loan and is not to be considered lightly.

When the applicant or seller fails to complete repairs within the specified time frame of the escrow agreement, The Lender may choose to either complete the repairs or apply the funds to the outstanding principal balance.

609.01 – Escrows for New Construction

Escrows are allowed but limited to those improvements where completion is prohibited due to winter weather conditions (such as final grade, sod or seeding, pouring concrete for walks & patios, etc.) On a case by case basis:

- The repairs or improvements must be a requirement of the appraisal or included in the terms of the sales contract.
- The completion cost of the repairs or improvements is limited to 3% of the lesser of the sales price or appraised value.
- All repairs must be completed within a maximum of 120 days, but no later than May 31. (Extensions beyond these terms must be approved by National Underwriting Department).
- Escrows are not permitted on refinances.
- Escrows and escrow agreements must be completed in accordance with agency guidelines.

609.02 – Escrow for Repairs or Improvements Existing Construction

Requirements for establishing a repair escrow are:

- The safety and soundness of the dwelling and ability to inhabit the dwelling cannot be adversely affected by the incomplete items.
- Copies of bids or contracts must be provided to establish the amount of funds to escrow.
- Funds equal to 150% of the cost to complete the repairs or improvements must be withheld by the escrow agent and an escrow account established.
- Escrows for VA loans must be completed in the agency described manner.
- All improvements must be completed the specified time frame and a final inspection (evidencing completion of all escrow items) must be performed by the original appraiser prior to disbursement of the escrow funds.

Escrows for repairs are limited to those items where completion is prohibited due to weather conditions:

- The repairs or improvements must be a requirement of the appraisal or included in the terms of the sales contract.
- All repairs must be completed within a maximum of 120 days, but no later than May 31. (Extensions beyond these terms must be approved by Regional Underwriting Center.
- Funds escrowed must be 1-1/2 times (150%) the estimated or contracted cost of the repairs.
- Escrows are not permitted on refinances.

Although VA typically limits repair escrows to weather-related items, an exception is permitted for the Energy Efficient Mortgage program. Evidence the improvements are completed must be forwarded to VA once escrow funds are disbursed. If repairs are not completed within the specified time frame, the funds will be used to reduce the principal balance of the mortgage.