Silvergate

Non-QM Mortgage Program

Purchase Eligibility Guidelines

Effective Date: June 22, 2020

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1 General Purchase Eligibility

1.1 Overview

These guidelines are designed to provide direction and consistency for correspondent lenders wishing to originate investment-quality non-qualified mortgage ("Non-QM") loans for sale to Silvergate Bank's ("Silvergate") Correspondent Lending Division ("SCL").

1.2 Closed Loans Only

A loan will only be purchased by SCL after the loan has been closed by the Correspondent and SCL has reviewed and approved the complete file, including credit, appraisal, closing, and collateral documents.

1.3 Ability to Repay (ATR)

For mortgage loans made for a personal, family, or household purpose covered by the federal Truth in Lending Act (TILA), the ATR rule requires lenders to demonstrate they have made a good faith determination based on verified third-party records that the Borrower has sufficient income and assets to repay the loan according to its terms, generally considering the following eight criteria:

- Current or reasonable expected income or assets;
- Current employment status;
- Monthly payment on the covered transaction;
- Monthly payment on any simultaneous loan;
- Monthly payment for mortgage-related obligations;
- Current debt obligations, alimony, and child support;
- Credit history; and
- Debt-to-income ratio.

All loans considered for purchase by SCL must meet ATR rules. Certain loans may be exempt from TILA or otherwise exempt from the ATR. If SCL chooses to purchase such a loan (e.g., investment property), it will only do so if the Borrower appears able to afford the loan based on prudent underwriting standards.

1.4 Manual Underwriting Requirement

Comprehensive underwriting is required by the Correspondent on every loan to ensure and document compliance with ATR requirements and to make a well-informed credit/lending decision. The Correspondent's underwriting approval and evidence of its determination that the Borrower meets ATR requirements must be included in the loan file.

1.5 QM Review

Loans that are eligible for Fannie Mae or Freddie Mac approval are ineligible for sale to SCL as a Non-QM loan. Loans must be submitted through either Fannie Mae's Desktop Underwriter or Freddie Mac's Loan Prospector to ensure the Borrower does not qualify for a qualified mortgage (QM). AUS findings must be either "Refer" or "Approve/Ineligible," otherwise, the Correspondent must provide a completed Non-QM Loan Eligibility form.

In certain respects, the parameters of SCL's Non-QM programs, as defined in these guidelines, differ from those of the Federal National Mortgage Association (FNMA), including but not limited to:

- DTI ratios,
- Maximum loan amounts,
- Reserve requirements,
- Minimum FICOs,
- Aggregate loan amounts, and
- Self-employed documentation.

Loan Program Types

- Conventional 5/1 Libor ARM and 5/1 Libor ARM interest only (based on 1-year Libor index; 5-2-5 interest rate caps; floor rate equals the margin).

1.6 Qualifying Rate (ARMs)

Qualify at the greater of the start rate or fully indexed rate (i.e., current index + margin) for income ratio calculations. The same rule applies to the interest-only programs (using the same criteria mentioned above), but it will be amortized over the remaining period after the interest-only period.

1.7 Fannie Mae Guideline Reference

For underwriting purposes, if a topic or guideline is not specifically addressed in these guidelines, the applicable topic/guideline will default to standard Fannie Mae underwriting guidelines as defined in the Fannie Mae Selling Guide, Part B: Origination Through Closing (https://www.fanniemae.com/content/guide/selling/b/index.html).

1.8 Zero Fraud Tolerance

SCL has a zero-tolerance policy as it relates to fraud. Correspondents should follow their own established fraud and identity procedures on every loan to prevent and detect fraud (including, but not limited to, Social Security number verification, verbal verifications of employment, processing of 4506-T, etc.). Loans containing fraudulent documentation or information will immediately be declined. If there is a determination of originator involvement, the originator will be made inactive and any reports required by the federal Bank Secrecy Act will be filed. SCL will pursue Borrower fraud to the fullest extent of the law.

1.9 Fair Lending Policy

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

1.10 Points and Fees

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

1.11 Higher-Priced Mortgage Loan (HPML) Eligibility

Higher-priced mortgage loans are considered as eligible for purchase by SCL provided all required disclosures are provided, and compliance with the HPML appraisal rule is met. For all HPMLs, an escrow account for property taxes and insurance must be established and funded for a minimum of 5 years.

1.12 HOEPA High-Cost (Section 32) Loans Not Eligible

High-cost (Section 32) mortgage loans, as defined by applicable local, state, federal, and secondary market regulations, are not eligible for purchase.

1.13 Ineligible Loan Features

The following features are not allowed:

- Pre-payment penalties (with the exception of investment properties),
- Negative amortization,
- Balloon payments, and
- Loans closing with CEMA (NY).

1.14 Vesting

Ownership must be fee simple in name of individual(s) or inter vivos revocable trust. (LLC prohibited) Exception: DSCR and Investment loans can close under an LLC.

1.15 Inter Vivos Revocable Trust

Inter vivos revocable trusts, also known as living trusts, are eligible for purchase under certain conditions. Please refer to Fannie Mae requirements for anything not addressed in this section.

- The trust must be established by one or more natural persons, solely or jointly. The primary beneficiary of the trust must be the individual(s) establishing the trust. If the trust is established jointly, there may be more than one primary beneficiary if the income or assets of at least one of the individuals establishing the trust will be used to qualify for the mortgage.

- The property may be a primary residence, second home or investment property.
- The trustee must have the power to hold legal title to and mortgage the property. This must be specified in the trust.

1.16 Trust Agreement Requirements

The Seller must obtain copies of the trust or trust certification and include them in the loan file submitted for purchase. The copies must be certified by an attorney or the grantor/trustor/settlor. The title company must also be supplied with copies of the trust.

A review of the trust agreement is required to ensure the agreements meets all the following requirements:

- The trust is established by one or more natural persons, solely or jointly. The person establishing the trust is known as the “Settlor,” “Trustor,” or “Grantor,” referred to below as “Settlor.”
- The trust is effective during the Settlor’s lifetime.
- The Settlor is the primary beneficiary of the trust. If there is more than one Settlor, there can be more than one primary beneficiary.
- The Settlor is the trustee or one of the co-trustees.
- The trustee has the power to mortgage the subject property for the purpose of securing a loan to the party (or parties) who are the Borrowers on the note.
- The trustee is not required to obtain written consent from the beneficiaries to mortgage the subject property if written consent has been provided.
- There is no unusual risk or impairment of lender’s rights, such as distributions required to be made in specified amounts other than net income.
- The trust is valid under federal, state, and local law.
- If the trust agreement requires more than one trustee to borrow money or purchase, construct, or encumber realty, the Seller must confirm that the requisite number of trustees have signed the loan documents.

1.17 Power of Attorney

Loans closed via a power of attorney (POA) are reviewed on a case-by-case basis.

1.18 Guideline Exceptions

Exceptions to published guidelines may be considered on a case-by-case basis without regard to Borrower’s race, color, religion, national origin, sex, handicap, or marital status. Loans with exception requests should exhibit strong compensating factors. Exception requests should be submitted in writing. SCL’s decision to allow or deny any exception request relates only to whether

SCL will purchase a loan and does not bind a Correspondent with respect to the underlying decision to extend credit.

1.19 Minimum/Maximum Loan Amounts

Minimum loan amount is $50,000 and maximum loan amount is $2,000,000. See Program Matrices for sub-limits based on credit score and loan-to-value (LTV) ratio.

1.20 Assumability

Loans may be assumed by a qualified Borrower after the initial fixed-rate term.

1.21 Ineligible States

Properties located in the following geographic regions are not eligible for purchase by SCL:

- New York;
- Texas (cash-out refinancing only; all other transactions are acceptable);
- U.S. territories; and
- In all cases, state-specific regulations supersede SCL guidelines.

1.22 Non-Arm's-Length Transactions

A non-arm's-length transaction is a transaction between family members (related to the Borrower by blood, marriage, adoption, or legal guardianship), co-workers, friends, or anyone associated with the transaction, such as the listing agent, builder, mortgage lender, or broker. Non-arm's-length transactions may be eligible for purchase under this program at the sole discretion of SCL. If a non-arm's-length transaction is approved for purchase, SCL may require a second appraisal or other value validations be provided.

1.23 Ineligible Property Types

Ineligible properties include but are not limited to:

- Leasehold properties,
- Co-ops,
- Condotels,
- Timeshares,
- Income-producing enterprises (farms, bed & breakfasts, assisted living),
- Manufactured homes,
- Log homes, and
- Properties over 5 acres are case by case, not to exceed 20 acres.

1.24 Loans to One Borrower

Loans to one Borrower from SCL may not exceed five (5) properties and/or $3,000,000.

Maximum Financed Properties – Borrowers are allowed up to a total of fifteen (15) financed residential properties with all lenders, including subject property.

2 Non-Warrantable Condominiums

Non-warrantable condominiums are allowed with the following parameters:

Condominium Project Questionnaire – A completed questionnaire is required.

Commercial Space – Commercial space acceptable in projects up to 40%.

Completion Status – The project, or the subject's legal phase along with other phases, must be complete. All common elements in the project or legal phase must be 100% completed. At least 50% must be sold or under a bona-fide contract.

Delinquent HOA Dues – No more than 20% of the total units in the project may be 60 days or more past due on HOA dues.

Investor Concentration – Investor concentration up to 60% is allowed. Higher percentages may be considered on investment property transactions when an established history of a high percentage of rental units in the condo project can be demonstrated.

HOA Control – The developer may be in control of the condominium association provided the Master Agreement provides for the homeowners to take control upon either a predetermined percentage of unit sales or within a defined time period.

Litigation – Projects involved in litigation are acceptable if the pending lawsuit(s) are not structural in nature, do not affect the marketability of the units, and:

- Potential damages do not exceed 25% of the HOA reserves; or
- Documentation is provided by the insurance carrier or the attorney representing the insurance carrier that the insurance carrier has agreed to provide the defense and the association's insurance policy is enough to cover the litigation.

Single-Entity Ownership – Single entity may own up to 30% of units in the project.

3 Income Qualifying

3.1 Adequate and Stable Income

Income and employment analyses are key elements of the underwriting process and must be used to determine whether the Borrower's ability to repay is reasonable. Income documentation provided by the Borrower must be reviewed and verified for this purpose. Additionally, the income must be considered stable, likely to continue, and sufficient to enable the Borrower to repay the debt in a timely manner.

Declining income sources should be closely reviewed to determine if the income may be used for qualifying purposes. An explanation for the decline should be obtained. In instances where there is sufficient information to support the use of the income, the most recent lower income must be used for qualification.

Employment should be stable with at least a two (2)-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 (2) consecutive years.

The Borrower(s) must explain in writing any employment gaps that exceed one (1) month. Borrowers must be currently employed.

3.2 ATR Documentation

Maintaining documentary evidence of compliance with the ATR standards is of critical importance. The loan file must document the Borrower's ability to repay or the loan will be ineligible for purchase by SCL.

3.3 Debt-to-Income Ratio Requirements

The debt-to-income (DTI) ratio is calculated by dividing the Borrower's total monthly obligations by the Borrower's total monthly qualifying income. SCL does not utilize a separate housing expense ratio (i.e., front-end ratio), but rather rolls up all debts as defined by ATR rules. The allowable DTI ratio is 45% or 50% with 12 months reserves.

LTV	Maximum DTI
60% or below	45% or 50% with 12 months reserves

Note: First-time homebuyers are limited to a 43% DTI when using one of SCL's Alternative Documentation (Alt-Doc) programs.

3.4 Residual Income Requirement

Loans with DTI ratios of ≤ 43% require no residual income. Loans with DTI ≥ 43.01% require residual income. Residual income is defined as the cash flow remaining after all monthly obligations have been paid. The requirement = 0.0045 (0.45%) of the unpaid principal balance of the mortgage (i.e., UPB x 0.0045 = required residual income).

4 Income Documentation Option (Full-Doc)

4.1 Salaried Borrowers

Portfolio Program Matrices

Salaried income from employment should be from related fields if the Borrower has held multiple jobs. In some cases, an employer does not offer year-round employment for a certain position, such as the building trades or farm workers (seasonal income). The evaluation of stable earnings must be based upon whether the Borrower(s) is able to consistently generate a similar amount of income from the employers listed.

If the income is determined to be stable, the next step is to develop an income figure from the verified information that 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 other acceptable sources, so that the income used to qualify is truly representative of what the Borrower will continue to earn. Variances in earnings from these sources must be carefully evaluated to determine if income is stable.

For salaried Borrowers, pay stubs covering at least one (1) month's year-to-date (YTD) earnings, along with the most recent two (2) years' W-2 statements are required to verify their income.

Second-job income will require receipt of pay stubs covering at least one (1) month's YTD earnings and most recent two (2) years' W-2 statements. For qualifying purposes, the second-job income will be based on a two (2)-year average of the W-2s.

Follow FNMA guidelines with regard to commission, bonus, or overtime income greater than 25% of base income. In general, we will require YTD pay stubs and W-2s covering the most recent two (2)-year period or a written verification of employment (VOE).

Please reference the "Employment and Other Sources of Income" section of the *Selling Guide: Fannie Mae Single Family* for additional information regarding income documentation and qualification guidelines.

4.2 Self-Employed Borrowers

Self-employed Borrowers are identified as any individual(s) who has a 25% or greater ownership interest in a business. The following factors must be considered when analyzing a self-employed Borrower:

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

Self-employed Borrowers must have been in business for at least two (2) years to be considered for qualification.

Self-employed Borrowers will be required to provide the most recent two (2) years' personal tax returns (all schedules) and two (2) years' business tax returns, if applicable (i.e., Partnership, LLC, S-Corporation, or C-Corporation). In addition, the following is required:

- If more than 120 days has passed since the filing of the latest Schedule C or business tax return, a dated YTD unaudited profit and loss (P&L) statement;
- Evidence of the existence of the business for the past two (2) years (i.e., a Certified Public Accountant (CPA letter); and
- A signed 4506-T and 1040 tax transcripts covering the most recent two (2) years (not required for business returns).

4.3 Fixed Income

This applies to income sources such as Social Security (including dependent's Social Security), disability payments (temporary or permanent), VA disability, retirement/pension, or alimony/child support. If this income is used for qualification of the Borrower(s), evidence of income and probability that it will continue for at least three (3) years past the application date must be provided.

Note: Borrowers who are on a temporary leave from their current job for reasons such as maternity or parental leave, short-term disability, and other temporary leave types that are considered acceptable by law, and/or the Borrower's employer will be considered for eligibility on a case-by-case basis, subject to Fannie Mae guidelines for temporary leave income as defined in Fannie Mae's Selling Guide, B3-3.1-09, Other Sources of Income.

If the fixed income source is verified as non-taxable income, it may be adjusted or "grossed-up" by 125%, provided that:

- Only the net income will be used for determining disposable/residual income; Medicare and insurance payments are to be omitted;
- The Borrower(s) clearly benefits as a result of income being grossed-up to qualify; and
- The Borrower's net income (before gross-up) is sufficient to pay all debts.

Non-taxable income that is not allowed to be grossed up includes:

- Foreign-earned income,
- Foster care income, and
- Housing allowance.

4.4 Capital Gains and Losses

Capital gain or loss that is a one-time transaction will not be considered as a gain or loss in determining the income available to the Borrower(s). However, if the Borrower's business has a constant turnover of assets that produce recurring gains or losses, the capital gain or loss may be considered in line with the following:

- An average of the gains or losses for the last two (2) years as disclosed on the Borrower's income tax form 1040, Schedule D, will be used to calculate the income.
- When the income from this source represents a substantial portion of the Borrower's income, the Borrower's tax returns for the past two (2) years must be reviewed (regardless of documentation type) to determine an accurate estimated of average earnings. For example, an asset sold during the year might be an income-producing asset, which could result in a reduction in future income.
- Borrowers must have an asset base in order to use capital gain or loss on an ongoing basis.

4.5 Farm Income

Net farm income reported on the Borrower's income tax return (Schedule F) is eligible with the addition of depreciation, pension, amortization, and depletion.

Note: Farm income cannot be generated by the subject property as income-producing farm properties are ineligible for purchase.

4.6 Interest and Dividend Income

Interest and dividend income may be used for qualification if it has been verified through two (2) years' tax returns as a stable source of income, and if additional verification is obtained as proof that the funds are still on deposit in the financial institution and/or investment portfolio account. Income must be proportionately reduced if funds are used for closing in a purchase money transaction.

4.7 Military Income

Income verified for clothing allowance, quarters allowance, hardship or hazard pay may be included as stable income if there is a likelihood of continuance. Basic Allowance for Housing (BAH) and Basic Allowance for Subsistence (BAS) may be grossed up to 125% due to their non-taxable status. Other allowances may also be grossed up to 125% if documentation is provided evidencing the allowance is non-taxable.

4.8 Note Income

Note income is eligible for qualification, so long as a complete copy of the note (all pages) is provided, outlining the terms and conditions of repayment. The repayment period must extend at least three (3) years past the application date of the loan.

4.9 Rental Income

In order to use rental income for qualification, all applicable transactions (2–4-unit primary residences and all investment properties) will require a rental income analysis to determine a positive or negative cash flow. Rental income on a second-home transaction is not allowed. One of the following is required to support leases or rental income on the application:

- Rent Survey Form 1007 or Form 1025 (only required for subject property); or
- Federal income tax returns (1040s) with Schedule E.

Actual rents must be documented with copies of the signed lease agreements. Net cash flow for properties, other than the subject property, will be calculated using Schedule E from the Borrower's federal tax returns (1040s) for the past two (2) years.

A positive cash flow will be added to gross income; negative cash flow will be added to total liabilities and used to qualify the Borrower(s).

Room rents will not be considered as income for qualifying purposes.

A loan for an investment property generating a negative cash flow will be closely scrutinized and should present adequate purpose for the Borrower's circumstances.

Rental income received from a family member may not be used as income without copies of a minimum six (6) months' cancelled rental checks provided by the tenant/family member.

Income received from rental properties will be calculated using one of the following methods:

Owned at least one (1) year – For properties owned for one or more tax years, cash flow can be calculated in one of the following manners:

- 75% of actual rents, established by copies of signed leases; or
- Net income from 1040 tax return Schedule E, plus depreciation.

Owned less than one (1) year – For properties owned less than one tax year, cash flow must be based on 75% of the lesser of actual the actual or market rents.

Rental income from a new investment property purchase transaction can be used to qualify using 75% of the current lease (must document proof of the security deposit) minus the full PITIA (principle, interest, taxes, insurance, and association dues). If there isn't an existing lease, 75% of the appraiser's opinion on the appraisal minus the full PITIA will be used.

4.10 Short-Term Rental Income

One of the following is required to support leases or rental income on the application:

- Rental Survey Form 1007 or Form 1025(only required for subject property); or
- Federal income tax returns (1040s) with Schedule E (follow Agency guidelines).

*** Must provide proof that short-term rentals are allowed in the municipality (city website/appraiser).**

Note: The above applies to standard program only.

4.11 Restricted Stock (RSUs)

SCL will only consider restricted stock that was awarded in prior two (2) years and became unrestricted (vested) in the current year. The vesting schedule must indicate the income will continue for a minimum of three (3) years at a similar level to the prior two (2) years. Continuance is based on the vesting schedule using a stock price based on the fifty-two (52)-week low for the most recent twelve (12) months' reporting at the time of closing.

RSU income is calculated using a two (2)-year average. If RSU income is declining, proof of stability must be provided, and the most conservative average used for qualifying.

The following documentation is required:

- Copy of the vesting schedule, and
- Most recent W-2 and pay stub.

Private stock is not eligible; employer must be a publicly traded entity.

4.12 Trust Income

Trust income may only be derived from an irrevocable trust or a revocable trust where a Borrower who is the beneficiary has also established the trust. In order to verify trust income, a complete copy of the original trust agreement showing the terms and conditions of the income that will be received must be provided.

In lieu of the copy of the trust agreement, a certification letter from the trust administrator may be obtained, outlining the total income paid to the Borrower, method of payment, duration of the trust and any non-taxable portion is required. Receipt of this income must be verified to continue for at least three (3) years past the date of the application.

Except for what is stated in these guidelines, the product will default to Fannie Mae manual underwriting guidelines for acceptable sources of income for qualification purposes. Please reference the "Employment and Other Sources of Income" section of the *Selling Guide: Fannie Mae Single Family* (Section B3-3.1) for additional information regarding trust income.

5 Alternate Income Documentation Option (Alt-Doc)

5.1 Overview

Portfolio Program Matrices

The Alt-Doc program is for both self-employed and salaried/salary-plus commission Borrowers. Any of our Alt-Doc options are intended only to minimize the amount of documentation that is required for a qualified Borrower and should in no way be construed as "stated income."

Borrowers utilizing Alt-Doc options may have a Standard Documentation Co-Borrower on the loan. Any Alt-Doc Borrowers on a loan will cause the loan to be considered Alt-Doc for pricing and review purposes.

Note: Borrowers classified as investors (e.g., day traders; real estate investors who do not have ownership in a company, etc.) are **not** considered self-employed for the purposes of SCL's Non-QM program. They are ineligible for Alt-Doc options and must qualify under a Full-Doc program. If the Borrower's primary source of income is from rents disclosed on Schedule E, the loan must be submitted under our Full-Doc program. Rents received as a secondary income source will be acceptable with the documentation outlined in Sections 5.1.1–5.1.2.

5.1.1 Rents Received as Secondary Source of Income on Alt-Doc

Option 1 – Copy of current lease agreements for all properties you are utilizing for rental income. Provide three (3) months' proof of receipt of rental income. A 25% vacancy factor will be used. If rental deposits are not going into a separate bank account, they must be backed out of the bank's statement calculation and analyzed as a separate income source.

Option 2 – Copy of current lease agreements for all properties you are utilizing for rental income. Provide one (1) or two (2) years of Schedule E to support either the one (1) or two (2) years (12/24 months) bank statement income provided. Any other 1040s or schedules provided will cause the loan to become ineligible for alternative documentation and will have to be submitted for review as a Full-Doc loan.

If deposits are not able to be validated and sourced, the full PITIA of the rental unit must be included in the qualifying DTI ratio.

5.1.2 Short-Term Rentals

If the subject property is leased on a short-term basis utilizing an online service such as Vrbo®, gross monthly rents can be determined by using a twelve (12)-month lookback period and either twelve (12) monthly statements, or an annual statement provided by the online service to document receipt of rental income. If documentation can't be provided covering a twelve (12)-month period, property will be considered unleased.

5.2 12- or 24-Month Bank Statement Program (Alt-Doc)

Portfolio Program Matrices

The bank statement program is available to any Borrower with a 25% or greater ownership in a business. Borrowers must have a **50% ownership interest in a business** to submit business statements for qualifying. Twelve (12) or twenty-four (24) months of statements are reviewed to verify the business income stated on the loan application (1003).

The bank statement option is designed for Borrowers with an established self-employment history **(minimum of two (2) years in the same business)**. Stability is a critical component in evaluating the Borrower's continuing ability to meet his/her obligations. Borrower(s) must provide evidence of the existence of the business for at least two (2) years. Acceptable documentation includes a copy of the business license, business credit report, CPA letter, or confirmation from the State's Corporation website.

Note: Any tax returns provided will cause the loan to become ineligible for Alt-Doc programs and will have to be submitted for review as a Full-Doc loan.

The self-employed Borrower(s) must provide the most recent, consecutive twelve (12) or twenty-four (24) months' bank statements (all pages and statements must be within ninety (90) days of note date). Only sole proprietors and minimum 50% business owners may use business bank statements when utilizing the 12- or 24-month bank statement option, and a combination of business and personal statements is prohibited. Remaining owners (excluding spouse) who are not on the loan must provide a signed and dated letter acknowledging the transaction and confirming that the Borrower has access to the account for income purposes. **A consistent pattern of withdrawals exceeding deposits on a monthly basis or evidence of a decline in earnings may result in disqualification.**

Deposits coming from sources other than the business must be deducted from the 12- or 24-month total. Examples include but are not limited to:

- Deposits from Social Security,
- Transfers from another (non-business) account,
- Tax refunds,
- Rental income, or
- Income deposited from a known employer.

Non-sufficient funds (NSF) or overdraft protection activity in the past 12 months must be explained by the Borrower. Excessive NSF or overdraft activity may disqualify the Borrower from using the bank statement program as these are an indicator of cash flow and money management issues.

Silvergate will adhere to the following tolerances with an acceptable letter of explanation from the Borrower:

- No more than three (3) occurrences in the last twelve (12) months. An occurrence is defined as one or more checks returned the same day.
- Zero (0) NSFs/overdrafts are allowed in the last three (3) months.

Deposits that are larger than typical for the account may be included with a satisfactory explanation from the Borrower(s). Supporting documentation may be required.

If personal statements are utilized, 100% of the eligible deposits can be used for qualifying.

Each Borrower has a different situation and each loan needs to be weighed on its own merit. Steps must be taken by the underwriter to evaluate the reasonableness of the expenses incurred based on industry averages.

If business statements are utilized, a business narrative must be provided detailing the description of business, number of employees, equipment for business that is owned or leased, type of client base, and location of business. This narrative will be used to determine if this method appears reasonable for the type of business.

To determine business expenses, please use one of the following options:

Option 1: Fixed Expense Ratio

Fixed Expense Ratio of 70% – 30% of total business-related deposits can be used for qualifying purposes. This does not include non-business-related deposits or any transfers. Please also account for Borrower's percentage of ownership and either divide by twelve (12) or twenty-four (24) months to determine monthly qualifying income. **Examples of business that would fall into this category include but are not limited to: retail products, food service/restaurants, manufacturing, construction/contracting or any business with a large amount of fixed expense/staff or general overhead.**

Fixed Expense Ratio of 50% – If the Borrower is in a service-related business or owns a business with limited overhead such as, but not limited to: **consulting, accounting, legal, counseling, therapy, financial planning, insurance, information technology, or home-based businesses.** 50% of total business-related deposits can be used for qualifying purposes. This does not include non-business-related deposits or any transfers. Please also account for Borrower's percentage of ownership and either divide by twelve (12) or twenty-four (24) months.

Option 2: Third-Party Prepared P&L Statement

If the type of business operates more efficiently or typically has a materially different expense factor (higher or lower than Option 1 fixed expense ratio), then the P&L may be applied. The P&L statement must be prepared and signed by a third-party tax professional (defined as a CPA, tax attorney, enrolled agent, or paid tax professional [PTIN]).

- P&L statement covering either the same one (1)-year or two (2)-year period as the bank statements (within 90 days).
- P&L gross earnings should be within 15% of bank statement gross deposits (minus any disallowed deposits) to be considered reasonable validation of income.

- The lower of the net income from the P&L or total deposits from the bank statements will be used to determine the Borrower's monthly income (averaged over twelve (12) or twenty-four (24) months depending on program). Qualifying income is determined by multiplying the Borrower's ownership percentage by the lower of the two factors above (net P&L income or total deposits). **The minimum expense factor with a P&L is 20% for service business, 40% for product business.**

Note: If you use Option 1 (Expense Ratio) and supply a P&L (Option 2) in the file, the lowest income stream will be applied.

5.3 12- or 24-Month 1099 Program (Alt-Doc)

Program Matrices

The 12- or 24-month 1099 program is available to any Borrower who is paid via 1099 and files taxes as self-employed or independent contractor. Borrowers must have a 50% ownership interest in a business to submit business statements for qualifying. Twelve (12) or twenty-four (24) months of 1099s are reviewed to verify business income stated on the loan application (1003).

The 1099 program option is designed for Borrowers with an established self-employment history (minimum of two (2) years in the same business). Stability is a critical component in evaluating the Borrower's continuing ability to meet his/her obligations. Borrower(s) must provide evidence of the existence of the business for at least two (2) years. Acceptable documentation includes a copy of the business license, business credit report, CPA letter, or confirmation from the State's Corporation website.

Note: Any tax returns provided will cause the loan to become ineligible for Alt-Doc programs and require it to be submitted for review as a standard/Full-Doc loan.

The 1099s may be obtained to replace one (1) or two (2) calendar years of personal or business bank statements. The 1099s must be validated with a wage and income transcript from the IRS.

Evidence of YTD earnings via YTD bank statements must also be received. All other bank statement program requirements apply.

1099 Gross Income Calculation – (total gross 1099 income + YTD bank statement income) / total number of applicable months. Unallowable deposits will be subtracted from banks statements.

> **Example**: Income from 1099s of past two (2) years is $180,000. YTD bank statements = total allowed deposits of $80,000 through June for a total of $260,000. Then $260,000/30 = $8,666.67 per month (P&L or expense ratio will still be required when utilizing business bank statements.)

Only sole proprietors and minimum 50% business owners may use business bank statements to validate YTD income when utilizing the 1099 option, and a combination of business and personal statements is prohibited

For Borrowers who are paid W-2 and 1099 and it is necessary to combine income for qualifying, you may use traditional qualifying for W-2s and validate the 1099 income following the 1099 income standards.

Refer to the matrices for 12- or 24-month bank statement program to determine max LTV, loan amount and minimum credit score. If using one (1) year of 1099, then follow parameters listed under twelve (12) months.

5.4 Limited Program (Alt-Doc)

Portfolio Program Matrices

The Limited/Alt-Doc program is available to self-employed, salaried, wage earner, and/or commissioned Borrowers. Borrowers who work for family members are not eligible for the Limited program.

Self-Employed Borrower(s) must provide the most recent year tax return (personal and business, if applicable), a YTD P&L and/or a paystub showing YTD income. In addition, evidence of the existence of the business for at least two (2) years is required. Acceptable documentation includes a copy of the business license, business credit report, CPA letter, or confirmation from the State's Corporation website.

Commission/Salary + Commissions Borrowers must provide the most recent year tax return and the most recent paystub showing YTD income.

All other Salaried Borrowers must provide the most recent year W-2 and the most recent paystub showing YTD income. In addition:

- The most recent two (2) months' personal bank statements must be provided, to validate required reserves.
- A processed 4506-T, IRS transcripts required for one (1) year, in line with W-2.
- A written VOE is required. The VOE must reflect income for the single-year period shown on the single-year tax return/W-2. The VOE must also reflect the total amount of time the Borrower has been employed with that entity.

5.4.1 Asset Depletion Eligibility

Asset depletion can be used to supplement other income to help lower the DTI ratio and meet ATR requirements, subject to certain limitations.

Eligible assets include cash or cash equivalents and marketable securities (i.e. certificates of deposit, money market accounts, savings, stocks and bonds (70% of the remaining value), and mutual funds.

Ineligible assets include equity in real estate and private (not publicly traded) stocks.

Retirement assets may only be used for asset depletion if the Borrower is retirement age (at least 59½).

All assets considered for asset depletion must be verified through an account statement from the most recent 60-day period.

The amortization period used to calculate depletion of the asset will be based on a 5% factor. For example, if an asset value is $1,000,000, the amount of the asset than can be used to supplement income is $50,000 annually, or $4,166.67/month ($1,000,000 x 5% = $50,000).

If asset depletion is used to support ATR determination, the asset depletion calculations must be clearly documented in the file.

6 Asset Reserves

6.1 Overview

The Borrower must have adequate liquid assets available to pay the down payment and the costs associated with obtaining the mortgage, meet any required investment criteria, and provide required reserves following closing.

A Borrower's ability to accumulate assets provides insight into the Borrower's ability to successfully manage personal finances. Assets from acceptable sources must be verified for down payment, closing costs, prepaid items, and reserves.

6.2 Minimum Reserve Requirements

Loan Amount	Required Reserves
$50,000 – $1,500,000	Nine (9) months' verified PITI
$1,500,001 – $2,000,000	Twelve (12) months' verified PITI

When calculating reserves for investment/non-owner-occupied properties, PITI plus additional property expenses must be used:

- Principal and interest;
- Hazard, flood, and mortgage insurance premiums (if applicable);
- Real estate taxes;
- Any special assessments;
- Any homeowner's association dues;
- Any subordinate financing payments.

Borrowers with additional financed properties are required to document an additional two (2) months' PITIA for each property in addition to the reserves on the subject property.

6.3 Documentation of Assets

Assets can be cash in the bank, stocks, bonds, IRAs, 401Ks, mutual funds or retirement accounts. For stocks and bonds, 100% of the value of the assets may be considered for reserves and won't be required to be liquidated. For vested retirement funds, 60% of the value may be considered for reserves if the Borrower is not yet of retirement age (59 ½); if the Borrower is at least retirement age, 70% may be utilized, and liquidation is not required.

For most asset types, documentation should include all pages of the most recent two (2) months consecutive statements or the most recent quarterly statement. If the account has not been seasoned 90 days, the funds used to open the account will need to be sourced.

If the Borrower(s) is not of retirement age, they must document that they have unrestricted access to all retirement-based funds used for closing costs, down payments, and post-closing reserves.

Significant disparities between the current account balance and the opening balances may require additional explanation, as will large or irregular deposits.

Proceeds from a cash-out refinance transaction on the subject property may be used to meet reserve requirements.

6.4 Down Payment

The greater the down payment, the less risk the proposed loan will have. On owner-occupied transactions (including second homes), a minimum of 10% of the purchase price must come from the Borrower's own funds. Non-owner-occupied transactions require a 20% down payment from the Borrower's own funds.

6.5 Business Funds

Use of business funds/assets may be considered acceptable for the down payment, closing costs, and post-closing reserves when a Borrower is self-employed and 100% owner of the business. The Borrower must be identified as an owner of the account, and:

- No more than 50% of the business funds can be used for the down payment and closing costs; any unused balance may be utilized to meet reserve requirements; or
- A letter from a CPA must be obtained verifying that the withdrawal/use of funds for the transaction will not have a negative impact on the business.

6.6 Unacceptable Asset Sources

The following sources of funds may not be used in the calculation of assets:

- Proceeds from unsecured loans or personal loans;
- Gifts that must be repaid in full or partially;
- Sweat equity;
- Cash-on-hand, also known as mattress money;
- Cash advances from a credit card or other revolving account;
- Salary/bonus advances received against future earnings;
- 1031 Tax Deferred Exchange proceeds on owner-occupied property or second home;
- Seller-funded down payment assistance programs;
- Funds for closing disaster relief loans or grants;
- Commission from the sale of the subject property;
- Assets from margin accounts;
- Gift of equity; and
- Funds that have not been vested.

7 Borrowers

7.1 General Definition

A Borrower is a credit applicant who will have ownership interest in the subject property, sign the security instrument, and sign the mortgage or deed of trust note. If two or more individuals own the property jointly, and are jointly and severally liable for the note, all are considered Borrowers.

7.2 Customer Identification Program

The U.S. Patriot Act requires banks and financial institutions to verify the name, date of birth, address, and identification number of all Borrowers. Correspondents must ensure the true identities of all Borrowers have been documented.

7.3 U.S. Citizens

United States citizens are eligible for financing.

7.4 Permanent Resident Aliens

A permanent resident alien is a person who is not a U.S. citizen, but is legally able to maintain permanent residency in the U.S. Permanent resident aliens are eligible. The Borrower must provide the Department of Homeland Security evidence as follows:

- Alien Registration Receipt Card I-151 (referred to as a "green card") that does not have an expiration date on the back but has been issued for 10 years; or
- Alien Registration Receipt Card I-551 that has an expiration date on the back (Conditional Resident Alien Card) and is accompanied by a copy of the filed USCIS Form I-751 (petition to remove conditions); or
- Non-expired foreign passport that contains a non-expired stamp (valid for a minimum of three (3) years), reading "Processed for I-551 Temporary Evidence of Lawful Admission for Permanent Residence. Valid until mm-dd-yy. Employment Authorized."

The U.S. Citizenship and Immigration Services website is: https://www.uscis.gov/forms.

7.5 Non-Permanent Resident Aliens (with U.S. credit)

Non-permanent resident aliens who are authorized to live and work in the U.S. on a temporary basis are eligible with one of the following visa classifications:

- A-1, A-2, A-3
- E-1, E-2, E-3
- G1–G-5
- H-1
- L-1
- NATO
- O-1
- R-1
- TN (NATFA)

The Borrower must provide a copy of their passport and unexpired visa. In lieu of this, the Borrower can provide an I-797 Notice of Action form with valid extension dates and an I-94 form (Arrival/Departure Record). Borrowers who are unable to provide evidence of lawful residency status in the U.S. will not be eligible for financing.

7.6 Non-Occupant Co-Borrowers

Non-occupant Co-Borrowers must be disclosed on the initial loan application, cannot be added at a later date to qualify, and must be related to the primary Borrower on the loan.

7.7 First-Time Homebuyers

Borrowers are considered first-time homebuyers (FTHB) when there is no evidence of the Borrower(s) owning a residential property in the prior three (3) years. FTHBs generally must fulfill specific requirements in addition to the conditions stipulated for experienced homebuyers (refer to Program Matrices for details).

8 Occupancy Types

8.1 Primary Residence

A primary residence is a 1–4-unit property occupied by the Borrower as their principle residence (may also be referred to as owner-occupied). To qualify as a primary residence, the transaction must meet each of the following criteria:

- Property is located in the same general area as the Borrower’s employment;
- Borrower intends to occupy subject property as their principal dwelling; and
- Property possesses physical characteristics that accommodate the Borrower’s family.

8.2 Second Home

A second home is a dwelling occupied by the Borrower in addition to the Borrower’s primary residence (may also be referred to as a vacation home). Second homes are eligible for financing and are restricted to one-unit dwellings only. Typically, second homes should meet the following criteria:

- Be located a reasonable distance (i.e., at least 50 miles) from the Borrower’s primary residence or be in a resort area;
- Must be occupied by the Borrower for some portion of the year;
- Suitable for year-round occupancy;
- Borrower must have exclusive control over the property; and
- Must not be subject to any timeshare arrangements, rental pools, or other agreements that require the Borrower to rent the subject property or give control of the subject property to a management firm.

8.3 Investment Property

An investment property is a 1–4-unit non-owner-occupied property. To be acceptable, it must not be one of the ineligible property types spelled out in Section 1.23, Ineligible Property Types.

9 Purchase Transactions

9.1 Purchases

A purchase transaction is one that allows a buyer to acquire a property from a seller. A copy of the fully executed purchase contract and all attachments or addenda are required. The lesser of the purchase price or appraised value of the subject property is used to calculate the LTV.

Note: The Borrower may not be on title prior to the loan closing. The seller that is on title (the vested owner of record) must be the individual who executes the sales contract.

Additionally, the seller must be on title prior to when the settlement statement and closing documents are executed.

9.2 Owner-Occupied Residency Requirement

A property will not be considered a primary residence unless at least one of the Borrowers occupies all or part of the subject property within sixty (60) days of the note date and will occupy the subject property as their primary residence for at least twelve (12) consecutive months from the note date.

In addition:

- The homeowner's insurance policy must show the same mailing address and subject property address. **Note**: If the Borrower uses a P.O. Box, and occupancy cannot be verified, a formal occupancy inspection is required.
- If the subject property is a two-to-four-family property, the appraisal must indicate the unit the Borrower intends to occupy in the property, and the information indicating the unit to be owner-occupied must be consistent with all documentation in the file.
- If the Borrower currently owns other properties (not being sold as part of the subject transaction), the Correspondent must review to determine that the Borrower's intent to occupy the subject property is reasonable. The loan file must contain supporting documentation.
- The purchase agreement must show the Borrower's intent to occupy the subject property.
- The Borrower may not receive any cash back on a purchase transaction other than out of pocket fees, provided gift fund requirements are met.

9.3 For-Sale-By-Owner (FSBO)

FSBO transactions must be closed through escrow with an executed real estate sales contract in the file.

9.4 Gift Funds

Gift funds from immediate family members are acceptable on owner-occupied transactions if a minimum of 10% of the purchase price comes from Borrower's funds. Investment transactions require 20% from Borrower's own funds.

9.5 Sweat Equity

Gifts of "sweat equity" are not allowed.

9.6 Seller Contributions

Seller contributions to purchase transactions are restricted as follows:

- Contributions cannot exceed 6% of the purchase price for owner-occupied/second-home transactions; and
- Contributions cannot exceed 3% of the purchase price for investment/non-owner-occupied transactions.

9.7 Property Flips

When the subject property is being resold within 180 days of its acquisition by the seller, and the sales price has increased more than 10%, the transaction is considered a "flip." To determine the time period, the acquisition date (the day the seller became the legal owner of the property) and the purchase date (the day both parties executed the purchase agreement) should be used.

Flip transactions are subject to the following requirements:

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

Flip transactions must comply with the HPML appraisal rules in Regulation Z. The full Regulation Z revisions can be found at http://www.consumerfinance.gov/regulations/appraisals-for-higher-priced-mortgage-loans.

A second appraisal is required in the following circumstances:

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

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

9.8 Secondary Financing

Only institutional secondary financing is acceptable for purchase transactions. (SCL does not provide secondary financing.) Existing subordinate financing may remain in place as long as it is re-subordinated and not a reverse mortgage or home equity line of credit (HELOC).

9.9 Departing Residences

If the Borrower's current primary residence is pending sale but will not close with title transfer prior to the new transaction, both the current and proposed mortgage payments (PITIA) must be used in qualifying for the new loan.

If the Borrower is converting a current primary residence to a second home, both the current and proposed mortgage payments (PITIA) must be used in qualifying for the new loan.

If the Borrower is converting a current primary residence to an investment property, rental income from the newly converted property can be used to qualify, using75% of the current lease minus the full PITIA. All of the following must be obtained to confirm leasing of the property:

- Fully executed lease agreement,
- Security deposit from the tenant, and
- Bank statement showing the deposited security funds.

10 Refinance Transactions

10.1 General Refinance Requirements

Rate/term and cash-out refinance transactions are allowed.

10.2 Rate/Term Refinance

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

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

- Existing first mortgage payoff;
- Closing costs and prepaid items (interest, taxes, insurance) on the new mortgage;
- The amount of any subordinate mortgage liens used in their entirety to acquire the subject property (regardless of seasoning);
- The amount of a HELOC in first or subordinate lien position that was used in its entirety to acquire the subject property (regardless of seasoning);
- Any subordinate financing that was not used to purchase the subject property provided;

- For closed-end seconds, the loan is at least one (1) year seasoned as determined by the time between the note date of the subordinate lien and the application date of the new mortgage; and
- For HELOCs and other open-ended lines of credit, the loan is at least one (1) year seasoned and there have been less than $2,000 in total draws over the past twelve (12) months prior to the application date.

If the most recent first mortgage transaction on the property was a cash-out refinance within the last six (6) months, the new mortgage can only be rate/term refinance. It is not eligible for cash out. Note date to note date is used to calculate the six (6) months.

On rate/term transactions, the Borrower may only receive cash back in an amount that is the lesser of 2% of the new mortgage balance or $2000.

10.3 Cash-Out Refinance

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

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

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

- Existing first mortgage payoff;
- Closing costs and prepaid items (interest, taxes, insurance) on the new mortgage;
- The amount of any subordinate mortgage liens that are being paid off; or
- Cash in hand reflected on the HUD-1 or Closing Disclosure as appropriate.

A signed letter from the Borrower disclosing the purpose of the cash out must be obtained on all cash-out transactions. The purpose of the cash out is also reflected on the loan application.

Delayed financing transactions (initiation of a cash-out refinance immediately after a cash purchase) are permitted.

10.4 Cash-Out Limits

See guideline matrix for LTV restrictions. Cash-in-hand limited to $300,000 on all programs.

10.5 Seasoning

SCL has no seasoning requirement for rate/term or cash-out refinances. Refer to Section 12, Property Appraisal Requirements for value determination guidance.

10.6 Properties Listed for Sale

Refinances for properties currently listed for sale are not eligible. To be eligible for a refinance, properties previously listed for sale must have been off the market and the listing canceled at least one (1) day prior to the application date of the loan.

A copy of the canceled listing is to be included in the file and a current multiple listing service search is to be performed to verify that the property is not currently listed by a different realtor. The loan file must also contain evidence that the Borrower is occupying the property, as well as an explanation letter of the Borrower's intent to occupy, reason for listing the home, and why they are now refinancing.

Note: Investment and second-home properties do not require these two documents.

10.7 Benefit to the Borrower

Refinances must provide a bona fide benefit to the Borrower(s) for primary and second-home transactions. When determining the benefit on a transaction, one of the following items should exist to support the benefit to the Borrower(s):

- Lower principal and interest payment,
- Lower interest rate,
- Pay-off of a balloon payment,
- Consolidation of debt,
- Resolution of loss mitigation actions,
- Pay-off of a tax lien,
- Cash-out proceeds to the Borrower(s) in excess of the costs and fees to refinance,
- Pay-off of a construction loan, or
- Pay-off of property taxes.

On a loan where the only benefit is monthly savings, closing costs and fees must be considered and recouped within state-specified timeframes, as applicable. Originators must adhere to any state-specific or federal benefit to Borrower compliance requirements. The benefit to the Borrower must be calculated based on the qualifying housing payment.

10.8 Refinance in Texas

Cash-out refinances in Texas are not eligible.

10.9 Inherited Properties

Inherited properties are allowed as both rate/term and cash-out transactions. If the subject property was inherited less than twelve (12) months prior to application, the transaction is considered a cash-out refinance and is subject to the following requirements:

- Equity owners must be paid through settlement. A written agreement signed by all parties stating the terms of the buyout and property transfer must be obtained;
- Subject property has cleared probate and property is vested in the Borrower's name; and
- Current appraised value is used to determine LTV.

10.10 Buying Out a Co-Owner's Interest

A transaction resulting from a divorce settlement and/or dissolution of a domestic partnership, wherein the Borrower(s) is required to buy out the interest of the other owner may be considered a rate/term refinance if the following apply:

- The subject property was jointly owned by the parties for at least twelve (12) months prior to the funding of the new loan, with documentation to evidence this;
- There is a fully executed written agreement or court-approved divorce decree that references the terms of the property settlement and proposed disbursement of refinance proceeds;
- The Borrower(s) who will be acquiring sole ownership of the subject property may not receive any of the funds from the refinance.

11 Credit Standards

11.1 Mortgage/Rent

0 x 30 in past twelve (12) months as evidenced by a credit report, twelve (12) months of canceled checks, or an institutional verification of mortgage (VOM) or verification of rent (VOR). Twelve (12) months of canceled checks or bank statements must be obtained if the Borrower is making payments to an individual or interested party. Properties owned free and clear are considered 0 x 30.

11.2 Credit Report

A credit report is required for every Borrower on the loan application who will sign the note. The credit report should provide merged credit information from the three (3) major national credit repositories. A valid Social Security number (SSN) or Individual Taxpayer Identification Number (ITIN) is required for all Borrowers on the loan. The credit report should include verification of all credit references provided on the loan application and must certify the results of public record searches for each city where the Borrower has resided in the last two (2) years. Either a three (3)-bureau merged report or a residential mortgage credit report is required.

11.3 Age of Credit Report

The credit report and other credit documentation may not be more than ninety (90) days old at the time of loan closing.

11.4 Credit Scores

Each Borrower must have valid credit scores from at least two (2) of the three (3) repositories: Experian (FICO), TransUnion (Empirica), and Equifax (Beacon).

The Borrower's representative credit score is determined by the following:

- If all three (3) scores are reported for the individual Borrower, the middle score would be used for that Borrower.

- If only two (2) scores are reported for the individual Borrower, the lower of the two (2) scores will be used.
- If there are multiple Borrowers on a loan application, the primary wage earner's credit score will be used as the representative credit score. A minimum credit score of 680 is required for all Borrowers.

11.5 Trade Lines

All programs require:

- Two (2) active trade lines reporting for at least twenty-four (24) months with activity in the last twelve (12) months; or
- At least three (3) trade lines reporting for twelve (12) months with activity in the last twelve (12) months.

The account must have activity in the last twelve (12) months and may be open or closed. Current housing (rental history or a mortgage) not reporting on credit report may be considered an open trade if supported by cancelled checks and/or VOM.

For primary-residence and second-home transactions, only the primary wage earner must meet the minimum trade-line requirement. For investment property transactions, all Borrowers on the loan must meet the requirement.

11.6 Fraud Alerts

The three credit repositories have developed automated messaging to help identify possible fraudulent activity on a credit report. Examples include Initial 90-day Fraud Alerts, Extended Fraud Alerts, Active Duty Alerts, and HAW K Alerts. All fraud alerts must be fully resolved for the loan to be eligible for purchase.

11.7 Inquiries

Recent inquiries may indicate that the consumer has actively been seeking credit. A signed letter of explanation from the Borrower or creditor is required for all inquiries within the most recent 120 days to determine whether additional credit was granted as a result of the Borrower's request.

11.8 Disputed Credit Accounts

All disputed accounts appearing on the Borrower's credit report must be taken into consideration with all other debt unless the Borrower can prove otherwise.

11.9 Derogatory Credit

The credit history of the Borrower(s) should be reviewed to determine whether there are any major indications of adverse or derogatory credit. Adverse or derogatory credit information does not necessarily mean the Borrower's credit is not acceptable. The Borrower's overall credit history should be evaluated to determine the level of risk.

11.10 Installment and Revolving Debts

Past-due consumer debts can be no more than thirty (30) days past due at time of closing. Rolling late payments are considered delinquent for each late occurrence.

11.11 Timeshare Accounts

For credit review purposes, timeshare obligations are considered installment loans.

11.12 Litigation

Any litigation involving the Borrower, including bankruptcy, foreclosure, deed-in-lieu, pre-foreclosure, short sale, judgments, tax liens, collection accounts, and charge-offs must be evaluated separately and meet the program requirements. All derogatory credit that will impact the Borrower's title must be paid off at or prior to closing. Title must ensure the first lien position without exception.

11.13 Consumer Credit Counseling

Borrowers who have participated in consumer credit counseling are eligible provided that at least twelve (12) months have passed since the completion of the program.

11.14 Bankruptcy

Bankruptcies must be seasoned at least twelve (12) months. This applies to all chapters (7, 11, and 13). Refer to the rate sheet for adjustments for bankruptcies that are seasoned less than thirty-six (36) months.

11.15 Foreclosure/Deed-in-Lieu/Short Sale/Modification

The waiting period is twelve (12) months from finalization to the date of the loan application. Refer to the rate sheet for adjustments for seasoned less than 36 months.

11.16 Judgment, Tax Lien, Collection, or Charge-Offs

Judgments and tax liens must be paid off at or before closing. Collections or charge-offs may remain open when they are:

- Less than twenty-four (24) months old with a maximum balance of $2,000;
- Twenty-four (24) months old with a maximum balance of $2,500 per occurrence; or
- Medical collections.

Charge-offs and collections that exceed the above balances must be paid in full.

11.17 Requirements for Letters of Explanation

A written letter of explanation may be needed to address information reported in the credit profile. Explanation letters must address the matter sufficiently and be signed by all Borrowers acknowledging the accuracy of the information. A copy of the written explanation must be included in the loan file.

A letter of explanation may be required for reasons including but not limited to the following situations.

11.17.1 Profile Inconsistencies

The information contained in the credit report must be examined for consistency with other file documentation, including the Borrower's address history, employment information, and name variations. Discrepancies must be adequately explained and questionable explanations researched.

11.17.2 Social Security Number Discrepancies

Any inconsistency in Social Security numbers reported must be fully explained.

11.17.3 Questionable Credit Activity

An explanation letter may be required to address reported activity that could indicate the credit is not being successfully managed. Instances of questionable credit activity may include but is not limited to a profile that includes recently opened revolving accounts that are at or near their limits, or Borrowers that are overextended or overly reliant on the use of revolving credit combined with a consistently delinquent payment history.

11.17.4 Credit Inquiries

A written statement addressing all credit inquiries made within the prior one hundred and twenty (120) days (other than an inquiry related to the subject loan) is required and must state that no additional credit accounts were obtained by the Borrower other than those reflected on the credit report or the mortgage application. If additional credit was obtained, a verification of that debt must be provided and the Borrower must be qualified with the monthly payment.

11.17.5 Adverse and Derogatory Credit

A written explanation is required to explain the circumstances causing adverse or derogatory credit addressing the following items:

- The explanation is consistent with the adverse information;
- The explanation establishes a credible cause for the late payments;
- The Borrowers represent an acceptable credit risk and exhibit the ability and willingness to repay the mortgage; and
- How the problem has been resolved and is not likely to recur.

11.18 Extenuating Circumstances

The Borrower must provide a letter of explanation to address the nature of the events that led to extenuating circumstances, including bankruptcy or foreclosure-related actions. The letter must prove that the Borrower had no reasonable options other than to default on their financial obligations.

Derogatory information that was the result of extenuating circumstances must be supported with appropriate documentation and an explanation regarding the relevance of the documentation.

Examples of documentation that can be used to support extenuating circumstances include documents or official records that confirm the event (such as a copy of a divorce decree, notice of job layoff, job severance papers) or that illustrate factors that contributed to the Borrower's inability to resolve the problems that resulted from the event (such as a copy of insurance papers or claim settlements, property listing agreements, lease agreements, tax returns).

11.19 Liabilities

11.19.1 Installment Debt

Installment debt is a monthly obligation with fixed payments and terms. Payments on installment loans must be included in the Borrower's debt-to-income ratio. Payments can be excluded if there are ten (10) or fewer monthly payments remaining to pay the debt in full. If the payment is substantial and exceeds 5% of the Borrower's qualifying income, the originator should review the overall transaction to ensure the remaining payments will not impact the Borrower's ability to handle the new mortgage payment. Installment debt paid in full prior to closing can be excluded from the debt-to-income ratio. Supporting documentation, such as a credit supplement or direct verification from the creditor, must be obtained as evidence the debt has been paid in full.

11.19.2 Revolving Debt

Revolving debt is open-ended debt in which the principal balance may vary from month to month. The minimum required payment as stated on the credit report or current account statement should be used to calculate the debt-to-income ratio. If no payment is stated on the credit report, the greater of $10 or 5% of the current balance should be included in the debt-to-income ratio calculation.

Revolving accounts are allowed to be paid off prior to or at closing in order to exclude the payment from the debt-to-income ratio. Supporting documentation, such as a credit supplement or direct verification from the creditor, must be obtained as evidence the debt has been paid in full.

11.19.3 Business Debt

A business debt is a financial obligation of a business and can be the sole responsibility of the business or be personally secured by the business owner, making that person also liable for the debt. If the debt is reflected on the Borrower's personal credit report, the Borrower is personally liable for the debt and it must be included in the debt-to-income ratio. Debts paid by the Borrower's business can be excluded from the debt-to-income ratio with any of the following supporting documentation:

- Most recent six (6) months' canceled checks drawn on the business account;
- Tax returns reflecting the business expense deduction; or
- Business bank account statement showing assets remain after funds to close and reserve requirements are with a balance greater than or equal to the balance of the debt.

If the debt is less than six (6) months old, the payment must be included in the debt-to-income ratio.

11.19.4 Alimony and Child Support

Monthly alimony, child support, or separate maintenance fees must be included in the Borrower's debt-to-income ratio. The file should contain supporting documentation as evidence of the obligation, such as a final divorce decree, property settlement agreement, signed legal separation agreement, or court order.

11.19.5 Home Equity Line of Credit

For HELOCs, whether deferred, in forbearance, or in repayment, the actual documented payment (documented in the credit report, in documentation obtained from the lender, or in documentation supplied by the Borrower) must be utilized to determine the monthly payment for the debt in the Borrower's qualifying debt ratios. If the payment currently being made cannot be documented or verified, then 1% of the outstanding balance must be used.

11.19.6 Student Loans

When a monthly student loan payment is provided on the credit report, that amount may be used for qualifying purposes.

If the credit report does not reflect the correct monthly payment, the monthly payment that is on the student loan documentation (the most recent student loan statement) may be used to qualify the Borrower.

If the credit report does not provide a monthly payment, it must be determined using one of the options below:

- If the Borrower is on an income-driven payment plan, student loan documentation may be obtained to verify the actual monthly payment is $0. The Borrower may then qualify with a $0 payment.
- For deferred loans or loans in forbearance, the following must be calculated:
    - A payment equal to 1% of the outstanding student loan balance (even if this amount is lower than the actual fully amortizing payment); or
    - Fully amortizing payment using the documented loan repayment terms.

12 Property Appraisal Requirements

12.1 General Appraisal Responsibilities

A completed appraisal report is required on all loan transactions to assess the adequacy of the property as collateral for the mortgage requested. The correspondent lender is responsible for all of the following:

- The accuracy and completeness of the appraisal and its assessment of the marketability of the property;

- Underwriting the completed appraisal report to determine whether the subject property presents adequate collateral for the mortgage;
- Ensuring that the appraiser uses sound reasoning and provides evidence to support the methodology used for determining the value;
- Compliance with the ECOA Valuations Rule, which requires notifications to Borrowers (1) of their right to receive copies of appraisals within three (3) days of application, and (2) that copies of appraisals and other written valuations be delivered to them on the earlier of (a) promptly upon completion, or (b) three (3) business days before closing;
- Ensuring that the appraiser provides an accurate opinion, an adequately supported value, and an accurate description of the property;
- Ensuring that the appraiser provides their license or certification on the appraisal report;
- Complying with the Appraiser Independence Requirements published by Fannie Mae/Freddie Mac and the requirements of the TILA and Regulation Z with respect to valuation independence;
- Disclosing to the appraiser any information about the subject property of which it is aware that could impact the marketability of the property;
- Providing the appraiser with the ratified sales contract and other financing or sales concessions associated with the transaction;
- Ordering and receiving the appraisal report for each mortgage transaction; and
- Ensuring the appraiser does not use unsupported assumptions or use race, color, religion, sex, handicap, familial status, or national origin for any party in the transaction, or impermissible demographics of the community in which the property is located, as the basis for market value.

12.2 Uniform Residential Appraisal Report (URAR)

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

- Uniform Residential Appraisal Form (FNMA Form 1004);
- Small Residential Income Property Appraisal Report (FNMA Form 1025);
- Individual Condominium Unit Appraisal Report (FNMA Form 1073);
- Single Family Comparable Rent Schedule for all one (1)-unit investment properties (FNMA Form 1007); and
- Operating Income Statement for 2–4-unit investment properties (FNMA Form 216).

12.3 Number of Appraisals and Special Requirements

The number of appraisals required are as follows:

≤ **$1,500,000** – One (1) full appraisal with at least three (3) comps sold within past six (6) months;

> $1,500,000 – One (1) full appraisal with at least three (3) comps sold within past six (6) months and field review or Clear Capital CDA. If tolerance is greater than 10%, a second full appraisal is required.

Appraiser should comment about lack of comps if not available, and a field review or Clear Capital CDA will be required if comps are insufficient.

All transactions require a new appraisal. For properties purchased or refinanced within the past six (6) months, the lesser of the purchase price/appraised value at the time of the last refinance or current appraised value will be utilized to determine subject property value.

Note: If transaction is a rate/term refinance, the new appraised value may be used.

If the property valuation has increased by 10% or more in the past seven (7) to twelve (12) months, a second appraisal is required. If a property has been "flipped" within one hundred and eighty (180) days, a second appraisal is required. The requirement for a second appraisal will be waived if the following criteria are met:

- The loan is a non-HPML transaction;
- The LTV is < 40%; and
- The loan amount is < $1,000,000.

12.4 Appraisal Report Content

The following items must be contained in the appraisal report:

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

those cases, the appraiser's analysis must reflect and include comparable sales that are similarly affected.

- Certification and statement of limiting conditions signed by the appraiser.

12.4.1 Subject Property Analysis

The subject property should conform to the neighborhood in terms of age, design, and materials used for construction. The appraiser should describe any unacceptable or unusual items that will impact marketability and where appropriate, make adjustments for the specified items in the estimate of market value.

Acceptable marketability is supported by at least average ratings for quality, construction, condition, and appeal of the property (fair and/or poor ratings are not acceptable under this program).

12.4.2 Living Area

Living areas of the subject property should be typical for the marketing area. The appraisal should use comparable sales of similar size to demonstrate the marketability of the property.

Condo units and/or attached properties with less than six hundred (600) square feet and detached properties with less than seven hundred (700) square feet of living area will require additional analysis to determine if their size is common and customary in the subject market. These will be considered on a case-by-case basis.

12.4.3 Design

The appraiser should assess the design and overall appeal of the subject property and evaluate whether similarly designed properties exist and are readily marketable in the subject area.

12.4.4 Outbuildings

Small outbuildings such as barns, stables, workshops, or guesthouses must be described on the appraisal report. These must be typical for the subject area and be supported by comparable sales of properties with similar outbuildings.

12.4.5 Conversions or Additions

Conversions or additions to the living area must have been completed in a workman-like manner as confirmed by the appraiser and supported by photographs of the addition. The improvements must be of good quality and any possible health or safety violations must be noted by the appraiser.

12.5 Property Condition

All properties must have an "average" or "good" rating to be eligible for under this program. All factors that negatively impact the property's condition must be considered when assessing the overall risk of the loan file. These factors are described in Sections 13.6.1–13.6.5.

12.5.1 Deferred Maintenance

Subject-to items must be described in detail. The appraiser must determine the nature of the repairs and include the cost-to-cure. Deferred maintenance that exceeds 2.5% of the property value or that affects its basic habitability will require a Satisfactory Completion Certificate (Freddie Mac Form 442).

12.5.2 Debris, Graffiti, or Trash

Properties showing an excessive amount of debris, graffiti, or trash may require cleanup. If necessary, a Satisfactory Completion Certificate (Freddie Mac Form 442) and photos will be required.

12.5.3 Infestation

If there is indication of termites or any other infestation, the infestation issue must be investigated, treated, and remedied.

12.5.4 Roof Damage

Properties with visible evidence of roof leaks and/or interior water damage (e.g., ceiling stains) must be addressed at the time of underwriting, even if the appraisal does not list them specifically in the report. If any of these conditions exist, a roof certification must be obtained, indicating a remaining useful and physical life of at least three (3) years.

12.5.5 Other Unacceptable Property Conditions

Other unacceptable property conditions include:

- Boarded-up properties;
- Properties that pose an imminent threat to the health and safety of the occupant;
- Inadequate foundations that do not meet the current code requirements for the local municipality;
- Inadequate heating (must be permanent affixed legal heating systems);
- Properties without water or public electricity;
- Cantilevered or properties on stilts, posts, or piers;
- Shared services for well, septic, or utilities that are private agreements;
- Properties showing evidence of mold; and
- Environmental hazards or nuisances.

12.6 Disaster Areas

Originators are responsible for identifying areas impacted by disasters and taking the appropriate steps to ensure the subject property has not been adversely affected. Examples of disasters include, but are not limited to, hurricanes, earthquakes, floods, landslides, tornadoes, wildfires, volcanic eruptions, civil unrest, and terrorist attacks. Adverse events that receive a formal disaster declaration issued by local, state, or federal departments of emergency management must follow the procedures listed in this section. A list of all federally declared disaster areas may be found on the Federal Emergency Management Agency (FEMA) website at http://www.fema.gov/news/disasters.fema.

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

Guidelines for disaster areas should be followed for ninety (90) days from the incident period ending date or the date the adverse event occurred, whichever is later.

When the appraisal was completed prior to the disaster incident, an interior and exterior inspection of the subject property is required and the following requirements must be met:

- The inspection must be completed by a licensed third-party professional to certify the condition of the subject property and to identify any impact to habitability or marketability;
- The inspection report must include photographs of the front, rear, and street view of the property;
- Any damage must be repaired and re-inspected prior to purchase;
- The file must contain a copy of the inspection report and evidence of inspector licensing;
- An appraisal update or final inspection from the appraiser must also be obtained. The appraiser must comment on the adverse event and certify that there has been no decline in value. Existing damage must meet the Deferred Maintenance guidelines in Section 12.5.1, Deferred Maintenance.

When the inspection date of the appraisal is after the disaster incident, the following requirements must be met:

- Appraiser must comment on the adverse event and any effect on marketability or value; and
- Existing damage meets the Deferred Maintenance guidelines in Section 12.5.1, Deferred Maintenance.

When a disaster occurs after closing but before loan purchase, the loan is ineligible for purchase until an appraisal update or final inspection from the appraiser is obtained and the following requirements are met:

- Appraiser must comment on the adverse event and any effect on marketability or value; and
- Existing damage meets the Deferred Maintenance guidelines in Section 12.5.1, Deferred Maintenance.

12.7 Comparable Sales

The subject property appraisal must be supported by an analysis of recently closed comparable sales located near the subject property. The following key factors are considered in this review:

12.7.1 Proximity to the Subject Property

Comparable sales should be located within one (1) mile of the subject property in urban and suburban areas. If two (2) of the three (3) comparable sales used by the appraiser exceed a distance of five (5) miles from the subject property, the property will be considered as rural. The appraiser must explain the necessity of using any comparable property located outside the neighborhood.

12.7.2 Comparable Sales Inside and Outside of New Projects

The appraiser must demonstrate the marketability of homes built within new subdivisions or condominium projects by providing at least one (1) comparable sale from inside the subdivision or project and one (1) comparable sale from outside the subdivision or project.

12.7.3 Age of Comparable Sales

Comparable sales must have a recent date of sale, preferably within six (6) months of the subject property's sale date. If any of the comparable sales are over six (6) months old, the appraiser should comment on the market conditions. If it is necessary to use older comparable sales, the appraiser should supplement them with pending sales and/or current listings in the neighborhood.

12.7.4 Similarity to Subject Property

The comparable sales selected by the appraiser must represent the best market data available to support the property's estimated value. Comparable sales should be as similar as possible to the subject property in physical attributes, rights of ownership, zoning, and other amenities.

12.8 Personal Property

Any personal property transferred with a property sale must be deemed to have zero transfer value, as indicated by the sales contract and the appraisal. If any value is associated with the personal property, the sales price and appraised value must be reduced by the personal property value for purposes of calculating the LTV/CLTV/HCLTV.

12.9 Appraiser Qualifications

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

The correspondent lender must have a process in place to ensure the appraisers it selects have the appropriate knowledge, experience, access to the appropriate data sources, geographic competence, and the ability to generate a quality appraisal report. The correspondent may choose to use an appraisal-management company; however, the originator must establish appropriate procedures and qualifications and continue to meet all requirements noted in these guidelines.

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

12.10 Age of Appraisal

The appraisal report must be completed within one hundred and twenty (120) days of closing. A recertification of value is required after one hundred and twenty (120) days and is allowed up to one hundred and eighty (180) days. A new appraisal is required after one hundred and eighty (180) days.

12.11 Repair Escrows

Escrows for work completion are not allowed.

13 Property Insurance

13.1 Minimum Hazard Insurance Coverage

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

Hazard insurance policies that limit or exclude from coverage (in whole or in part) windstorm, hurricane, hail damages, or any other perils that normally are included under an extended coverage endorsement are not acceptable. Borrowers may not obtain hazard insurance policies that include such limitations or exclusions unless they are able to obtain a separate policy or endorsement from another commercial insurer that provides adequate coverage for the limited or excluded peril or from an insurance pool that the state has established to cover the limitations or exclusions.

Hazard insurance coverage should be in the amount of the lesser of:

- 100% of the insurance value of the improvements, as established by the property insurer; or
- The unpaid principal balance of the mortgage, as long as it equals the minimum amount (80% of the insurable value of the improvements) required to compensate for damage or loss on a replacement cost basis. If it does not, then coverage that does provide the minimum required amount must be obtained.

13.2 Calculating the Required Coverage Amount

Compare the insurable value of the improvements as established by the property insurer to the unpaid principal balance of the mortgage loan:

- If the insurable value of the improvements is less than the unpaid principal balance, the insurable value is the amount of coverage required.
- If the unpaid principal balance of the mortgage loan is less than the insurable value of the improvements, calculate 80% of the insurable value of the improvements.
- If 80% of the insurable value is equal to or less than the unpaid principal balance of the mortgage, the unpaid principal balance is the amount of coverage required.
- If 80% of the insurable value is greater than the unpaid principal balance of the mortgage, this calculated figure is the amount of coverage required.

Examples:

Category	Property A	Property B	Property C
Insurable Value	$90,000	$100,000	$100,000
Unpaid Balance	$95,000	$90,000	$75,000
80% Insurable Value	N/A	$80,000	$80,000
Required Coverage	$90,000	$90,000	$80,000

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

13.3 Condominium and PUD Insurance

Insurance should cover 100% of the insurable replacement cost of the project improvements and common elements, including the individual units in the project.

If the subject property is an attached planned unit development (PUD) or a condominium, the respective associations may acquire a blanket policy to cover the project. The entire project insurance policy should be reviewed to ensure the homeowners association (HOA) maintains a master or blanket type of insurance policy, with premiums being paid as a common expense. The policy must show the HOA as the named of insured.

For PUD projects, individual insurance policies are required for each unit. If the project's legal documents allow for blanket insurance policies to cover both the individual units and the common elements, blanket policies are acceptable in satisfaction of its insurance requirements for the units. The policy must require the insurer to notify in writing the HOA (or insurance trustee), and each first mortgage loan holder named in the mortgagee clause, at least 10 days before it cancels or substantially changes a condo project's coverage.

For condominium projects, if the unit interior improvements are not included under the terms of the condominium policy, the Borrower is required to have a HO-6 hazard policy ("wall-in coverage") that is sufficient to repair the condo unit to its condition prior to a loss-claim event.

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

- Carriers rated by A.M. Best Company, Inc., must have: a "B" or better Financial Strength Rating in Best's Insurance Reports, or an "A" or better Financial Strength Rating and a Financial Size Category of "VIII" or greater in Best's Insurance Reports Non-U.S. Edition.
- Carriers rated by Demotech, Inc., must have an "A" or better rating in Demotech's Hazard Insurance Financial Stability Ratings.
- Carriers rated by Standard and Poor's must have a "BBB" or better Insurer Financial Strength Rating in the Standard and Poor's Ratings Direct Insurance Service.

The following alternative policies are also acceptable:

- Policies underwritten by a state's Fair Access to Insurance Requirements (FAIR) plan or other state insurance plan, if it is the only coverage that can be obtained.

An insurance policy that includes either of the following endorsements will ensure full insurable value replacement cost coverage:

- A Guaranteed Replacement Cost Endorsement (under which the insurer agrees to replace the insurable property regardless of the cost) and, if the policy includes a coinsurance clause, an Agreed Amount Endorsement (that waives the requirement for coinsurance).
- A Replacement Cost Endorsement (under which the insurer agrees to pay up to 100% of the subject property's insurable replacement cost, but no more) and, if the policy includes a coinsurance clause, an Agreed Amount Endorsement (that waives the requirement for coinsurance).

13.4 Evidence of Hazard Insurance

Evidence of insurance may be provided in one of the following: the actual policy, Certificate of Insurance (COI), or insurance binder.

Evidence of insurance must provide the following information:

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

14 Flood Insurance

14.1 Flood Insurance Requirement

Flood insurance is required for any property located within any area designated by FEMA as a special flood hazard area (SFHA). A SFHA is typically denoted as Flood Zone A or Zone V (coastal areas). Properties in Flood Zone A or V must be located in a community that participates in the FEMA program to be eligible for financing.

Note: Loans requiring flood insurance must be escrowed for flood insurance premiums.

Determination whether a subject property is in a flood zone must be established by a Life of Loan Flood Certificate provided by FEMA.

The appraisal report should also accurately reflect the flood zone. The flood insurance requirement can be waived if:

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

14.2 Minimum Flood Coverage

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

- 100% of the replacement cost of the insurable value of the improvements;
- The maximum insurance available from the National Flood Insurance Program (NFIP), which is currently $250,000 per dwelling; or
- The unpaid principal balance of the mortgage.

14.3 Project Flood Requirements

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

14.4 Deductible Amount

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

14.5 Evidence of Flood Insurance

Flood insurance must be obtained prior to closing and maintained throughout the duration of the loan (“Life of Loan”). Acceptable evidence of flood insurance is:

- A copy of the policy declaration page; or
- A copy of the complete/signed application, plus proof of premium payment.

15 Title Insurance

15.1 Title Insurance Requirement

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

The title insurer must be qualified to do business in the state where the subject property is located. The title insurer and policy must conform to Fannie Mae requirements.

15.1.1 Title Commitment Review

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

The preliminary title report/title commitment should be dated no more than ninety (90) days prior to closing. Any requirements by title, such as Statements of Information or copies of trust agreements, must be cleared prior to closing.

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

15.1.2 Borrower Information

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

15.1.3 Coverage Amount

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

15.2 Title Policy Forms

The Title Policy must be written on one of the following forms:

- 2006 American Land Title Association (ALTA) standard form; or
- ALTA form with amendments required by state law in those states where the standard ALTA forms of coverage are not used or where the 2006 ALTA forms have not yet been adopted, provided that those amendments do not materially impair protection to the owner.

Note: Loans with Short Form title policies are not eligible for purchase.

15.2.1 Insured Name

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

15.2.2 Gap Coverage

The preliminary title report/title commitment must be updated after closing in writing to ensure the mortgage is in first lien position and documented through one of the following:

- Final title policy;
- Title bring-down search representing the period of time from the original search through the time the mortgage is recorded; or

- Gap coverage from the time of the original search until the mortgage is recorded, when the mortgage is not recorded at the time of diligence.

15.2.3 Title Policy Underwriter

A nationally recognized insurer or reinsurer that has received one of the following ratings must have underwritten the title insurance policy:

- BBB or better rating from Duff and Phelps Credit Rating Company;
- C or better rating from LACE Financial Corporation;
- Baa or better rating from Moody's Investors Service;
- BBB or better rating from Standard and Poor's, Inc.; or
- A Financial Stability Rating of S (Substantial) or better, or a Statutory Accounting Rating of C (Average) or better from Demotech, Inc.

15.3 Title Exceptions

The following items are allowable title exceptions:

- Customary public utility subsurface easements, the location of which are fixed and can be verified. The exercise of rights of easement will not interfere with the use and enjoyment of any present improvement of the subject property or proposed improvements upon which the appraisal or loan is based;
- Above-surface public utility easements that extend along one or more property lines for distribution purposes, or along the rear property line for drainage, provided they do not extend more than twelve (12) feet from the subject property lines and do not interfere with any of the buildings or improvements, or with the use of the subject property; and public utility restrictions, provided their violation will not result in the forfeiture or reversion of title or a lien of any kind for damages, or have an adverse effect on the fair market value of the subject property;
- Mutual easement agreements that establish joint driveways or party walls constructed on the subject property and on an adjoining property, provided all future owners have unlimited and unrestricted use of them;
- Encroachments on one (1) foot or less on adjoining property by eaves or other overhanging projections or by driveways provided there is at least a ten (10)-foot clearance between the buildings on the subject property and the property line affected by the encroachments;
- Encroachments on the subject property by improvements on adjoining property provided these encroachments extend one (1) foot or less over the property line of the subject property, have a total area of fifty (50) square feet or less, do not touch any buildings, and do not interfere with the use of any improvements on the subject property or the use of the subject property not occupied by improvements;
- Encroachments on adjoining properties by hedges or removable fences;
- Liens for real estate or ad valor taxes and assessments not yet due and payable; and

- Outstanding oil, water, or mineral rights as long as they do not materially alter the contour of the property or impair its value or usefulness for its intended purposes.

15.4 Survey Requirements

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

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

16 Exhibits

- Program Matrix
- Loan Delivery Checklist