SKY

TPO

JUMBO

STARRY

UNDERWRITING GUIDELINES

Jumbo | Starry
Underwriting Guidelines

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INTRODUCTION

The business we generate is primarily through relationships with lenders, brokers, real estate agents, and builders. We promote customer relationships and have elected to recruit and hire a team of mortgage professionals with existing relationships and are seeking to work for a company with a strong back-end support system and experienced operations and secondary market acumen.

Fair Lending Statement

Sky TPO believes making a loan to a borrower is more than just a business transaction. Sky TPO wants to make loans that are good for the borrower as well as compliant with the housing industry laws and regulations.

Steps taken to ensure compliance with responsible lending practices include but are not limited to:

- Spot checks during production which may occur at any time.
- Validation during the closing process regarding correct disclosures, LE, fees, etc. to comply with RESPA requirements are completed during process.
- HMDA reporting is completed as required and reviewed periodically throughout the year to ensure no negative or predatory trends are emerging.
- Training calls and emails as noted in this plan are utilized to communicate requirements.

Responsible Lending Statement

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

If a loan is subject to the ATR rules under the *Federal Truth in Lending Act* (TILA), lenders must consider 8 underwriting factors to comply:

- Current or reasonably expected income or assets (other than the value of the property that secures the loan) that the consumer will rely on to repay the loan.
- Current employment status (if you rely on employment income when assessing the consumer's ability to repay)
- Monthly mortgage payment for this loan. You calculate this using the introductory or fully indexed rate, whichever is higher, and monthly, fully amortizing payments that are substantially equal.
- Monthly payment on any simultaneous loans secured by the same property.
- Monthly payments for property taxes and insurance that you require the consumer to buy, and certain other costs related to the property such as homeowner's association fees or ground rent.
- Debts, alimony, and child support obligations
- Monthly debt-to-income ratio (DTI) or residual income, that you calculated using the total of all of the mortgage and non-mortgage obligations listed above, as a ratio of gross monthly income
- Credit history

Zero Tolerance Fraud

All employees, independent contractors, brokers and lender partners of Sky TPO are fully responsible for the content and quality of each application and all data on those applications taken and submitted to Sky TPO.

The price paid by those who participate in or are impacted by loan fraud is even more costly, impacting borrowers, family members, neighborhoods, and the nation's overall economy. If a borrower cannot legitimately qualify for a loan or afford a particular property, you are not doing them a service by encouraging or enabling them to but a property they cannot afford and may ultimately lose to foreclosure. Closing a loan for a borrower, without verifying they can afford it, is considered predatory lending.

Some of the potential consequences that may be incurred by an employee or company found or suspected to be a participant in a fraudulent loan transaction include:

- Criminal prosecution, including time in jail.
- Loss of Licensure
- Loss of lender access due to industry exchange of information between lenders, mortgage insurance companies including submission of information to investors (Fannie Mae/Freddie Mac), police agencies, and state licensing agencies.
- Loss of approval status and potential civil action by Sky TPO
- Civil action by applicant/borrower or other parties to the transaction

Sky TPO does not tolerate loan fraud. Sky TPO stands behind the quality of its loan production and expects any of our associates and employees to do the same. Sky TPO practices a zero-tolerance policy of any predatory lending, loan fraud and/or misrepresentation. We perform pre-funding as well as post-funding quality control file reviews and data integrity reverification to ensure the loan meets quality standards.

GENERAL PROGRAM INFORMATION

Refer to Super Jumbo Program *matrix* for LTVs, minimum and maximum loan amounts, appraisal requirements, etc. The sections below outline the overlays that apply to the Super Jumbo Program.

NOTE: SUPER JUMBO LOANS WITH STRONG COMPENSATING FACTORS, REQUIRING EXCEPTIONS MUST GO THROUGH THE STANDARD EXCEPTIONS PROCESS WHICH INCLUDES CREDIT COMMITTEE REVIEW. TURNAROUND TIME AVERAGES 7 BUSINESS DAYS.

Minimum Credit Score Requirements

- Min Score: 720 for all borrowers on the loan.

Credit Event Seasoning

- Credit Event Seasoning: > 48 months

Max DTI

- Max DTI: 38%

Occupancy

- Occupancy: Primary Residence Only

Housing History

- Housing History: 0x30x24
    - Borrowers who own their primary residence free and clear are considered to have an acceptable housing history.

Ineligible Borrowers

- Ineligible Borrowers:
    - Self-Employed Borrower/Business with < 2 years in operation/production.
    - Non-Occupant Co-Borrowers
    - First Time Home Buyers
    - ITIN
    - Foreign National

Bank Statement Documentation

- **Bank Statement Documentation:** Options for Self-Employed Borrower with < 2 years of employment or business operations are not permitted for Super Jumbo.

Asset Utilization and Calculation

- **Asset Utilization:** allowed as supplemental income to primary employment or other source of income when DTI prior to use of assets is <= 50%.
- **Asset Utilization Calculation:** qualified assets (sourced and seasoned for 3 months) divided by 84 months.

Cash Out Limits

- Max Cash-Out (cash in hand): $1,500,000

Property Types

- Property Types:
    - SFD/PUD/Condo (Warrantable/non-Warrantable) 1-Unit
    - Max 2 acres
    - Farms/rural properties are not permitted.

Reserves

- $3.0M to $4.0M: 12 months PITIA
- $4.0M to $5.0M: 18 months PITIA
- Cash-Out proceeds may not be used to meet reserves.

Gift Funds

Permitted on purchase transactions, after 20% minimum contribution towards down payments, closing costs, prepaids, and reserves are met from borrower's own funds.

Ineligible Transactions

Escrow Waivers: Not permitted. An escrow account for impounds of property taxes, homeowners and all applicable required insurance coverage must be set-up and collected along with the monthly mortgage payments (PITIA or ITIA).

Loan Amounts and Loan-to-Value (LTV) Ratios

See applicable Sky TPO *matrix*. Loan amounts ≥ $3,000,000 require mandatory second-level review by Underwriting Management.

Principal Curtailment

- A curtailment may be applied to refund the overpayment of fees or charges paid by the borrower, in any amount.
- If the borrower receives more cash back than is permitted for cash out refinances, a curtailment to reduce the amount of cash back to the borrower to bring the loan in compliance may be applied; however, the maximum amount of the curtailment cannot exceed the lesser of $2,500 or 2% of the original loan amount.

Maximum Interest Credit

Sky TPO. allows interest credit through the 5th of the month.

TRANSACTIONS

Occupancy

Only primary residence occupancy is allowed under the Sky TPO. Jumbo program.

Primary Residence

A primary residence (or owner-occupied property) is a dwelling occupied by the borrower as their principal residence.

To qualify as a primary residence, the transaction must meet each of the following criteria:

- Property is in the same general area as the borrower's employment.
- The borrower intends to occupy the subject property for the majority of the year.
- Property possesses physical characteristics that accommodate the borrower's family.

Purchase

A purchase transaction is one which allows a buyer to acquire a property from a seller. A copy of the fully executed purchase contract and all attachments or addenda is required.

The lesser of the purchase price or appraised value of the subject property is used to calculate the loan-to- value.

An assignment of the purchase contract is not permitted with the exception of an individual assigning the contract to an entity in which they have ownership.

Refinance

Rate & term refinance, cash out, and debt consolidation transactions are permitted.

Benefit to the Borrower

In keeping with the commitment of responsible lending, all primary residence refinance transactions must have a measurable benefit to the borrower.

When determining the benefit on a refinance transaction, one or more of the following must exist to support the benefit to the borrower:

- Balloon payoff
- Title transfer
- Property retention
- Rate reduction
- P&I reduction
- Debt reduction
- Uncontrolled cash-out

NOTE: STATE-SPECIFIC AND FEDERAL BENEFIT TO BORROWER COMPLIANCE REQUIREMENTS MUST BE ADHERED TO.

Additional restrictions apply if the new loan refinances an existing loan considered to be a special mortgage. A special mortgage is originated, subsidized, or guaranteed by or through a state, tribal, or local government, or nonprofit organization that either bears a below-market interest rate at the time the loan was originated or has nonstandard payment terms beneficial to the borrower, such as payments that vary with income, are limited to a percentage of income, or where no payments are required under specified conditions.

If the borrower will lose one or more of the benefits of the special mortgage, then both of the following apply:

- Sky TPO must check that the loan complies with all applicable federal, state and local laws as well as laws associated with the subject special loan program for compliance; ***and***
- Sky TPO must take special care to ensure a net tangible benefit to the borrower.

Rate & Term Refinance

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

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

- Existing first mortgage payoff
- Closing costs and prepaid items (interest, taxes, insurance) on the new mortgage
- The amount of any subordinate mortgage liens used in their entirety to acquire the subject property (regardless of seasoning)
- The amount of a home equity line of credit (HELOC) in first or subordinate lien position that was used in its entirety to acquire the subject property (regardless of seasoning)
- Any subordinate financing not used to purchase the subject property provided:
    - **Closed End Seconds**: the loan is at least 1 year seasoned as determined by the time between the Promissory Note date of the subordinate lien and the Promissory Note date of the new mortgage.
    - **HELOCs/Open-Ended Lines of Credit**: the loan is at least 1 year seasoned and there have been less than $5,000 in total draws over the past 12 months.

If the most recent first mortgage transaction on the property was a cash out refinance within the last 6 months, the new mortgage is not eligible as a rate & term and must proceed as a cash out refinance.

NOTE DATE TO NOTE DATE IS USED TO CALCULATE THE 6 MONTHS.

On rate & term transactions, the borrower may only receive cash back in an amount that is the lesser of 2% of the new mortgage balance or $5,000.

Determining Loan-to-Value (LTV) – Rate & Term

The appraised value is used to determine loan-to-value, regardless of the acquisition date. If the refinance is completed within 6 months of a prior refinance, there must be a minimum of 10% savings in payment to demonstrate a sufficient net tangible benefit to the borrower.

Properties Listed for Sale – Rate & Term

- Owner occupied rate & term refinance:
    - The subject property must be taken off the market on or before the application date. The borrower must also confirm in writing the reason for the prior listing and their intentions for the property.
- If the property was listed for sale in the 6 months prior to the application date, the value will be based on the lesser of the appraised value or the lowest listing price.

Cash Out Refinance

Eligibility Requirements

The following requirements apply to a cash out refinance:

- A cash out refinance is a refinance that does not meet the rate & term refinance definition.
- A mortgage taken out on a property previously owned free and clear is always considered a cash out refinance.

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

- Existing first mortgage payoff
- Closing costs and prepaid items (interest, taxes, insurance) on the new mortgage
- The amount of any subordinate mortgage liens being paid off that do not meet seasoning and draw history requirements as described in rate & term refinance
- Paying off delinquent real estate taxes (60 or more days past due)
- The amount of any non-mortgage related debt paid off through closing.
- Additional cash in hand reflected on the settlement statement.

Ownership Requirements

On a cash out transaction, at least one borrower on the new loan must have been on title to the subject property (not a borrower) for at least 6 months prior to the disbursement date of the new loan, unless one of the following exceptions apply:

- There is no waiting period if the borrower acquired the property through an inheritance or was legally awarded the property (divorce, separation, or dissolution of a domestic partnership).
- The delayed financing requirements are met.
- If the property was owned prior to closing by a limited liability corporation (LLC), partnership), or corporation that is majority-owned or controlled by the borrower(s), the time held by the entity may be counted towards meeting the borrower's 6-month ownership requirement.

NOTE: OWNERSHIP MUST BE TRANSFERRED OUT OF THE ENTITY'S NAME AT/PRIOR TO CLOSING.

- If the property was owned prior to closing by an inter vivos revocable trust, the time held by the trust may be counted towards meeting the borrower’s 6-month ownership requirement if the borrower is the primary beneficiary of the trust.

Seasoning

For all cash out refinance transactions, a minimum of 6 months must have elapsed since the most recent mortgage transaction on the subject property unless otherwise specified in a product section or matrices.

The most recent mortgage transaction includes either the most recent purchase of the property or a subsequent refinance of the property.

This requirement does not apply in the following situations:

- Delayed financing
- When buying out a co-owner pursuant to a legal agreement

NOTE DATE TO NOTE DATE IS USED TO CALCULATE SEASONING REQUIREMENTS.

Determining Loan-to-Value (LTV) – Cash Out

For cash out refinances on properties owned >= 6 months to < 12 months, the appraised value may be utilized to determine property value. If the new appraised value is more than 120% of the acquisition cost, the appraisal should show signs of recent improvements justifying the increase in value.

If the property was acquired ≤ 6 months, cash out is only permitted for delayed financing.

Properties Listed for Sale – Cash Out

- Cash out refinance:
    - The subject property must be taken off the market on or before the application date.
    - The borrower must also confirm in writing the reason for the prior listing and their intentions for the property.
- If the property was listed for sale in the 6 months prior to the application date, the value will be based on the lesser of the appraised value or the lowest listing price.
- On a debt consolidation loan, the subject property must be taken off the market on or before application date. The borrower must also confirm in writing the reason for the prior listing and intent to occupy the subject property.
- If the property was listed for sale within 6 months prior to the application date, the lesser of all the recent list prices or the current appraised value will be used to determine LTV.

Cash Out Limits

See program matrices for max cash out loan limits.

Delayed Financing – Cash Out

Cash out on properties purchased by the borrower with cash and owned for less than 6 months is allowed.

The following requirements apply:

- The original transaction was an arm's-length transaction.
- Settlement statement from purchase confirms no mortgage financing used to acquire subject except for instances in which the borrower has obtained a short term and/or hard money type loan which is being paid through proceeds. A copy of the Promissory Note is required to verify the terms.

STATE SPECIFIC NOTE: THAT IN TEXAS ON AN OWNER-OCCUPIED TRANSACTION, DELAYED FINANCING IS ONLY PERMITTED WHEN THE PROPERTY WAS PURCHASED ENTIRELY IN CASH; THE PAYOFF OF A SHORT TERM AND/OR HARD MONEY LOAN IS NOT PERMITTED.

- Source of funds used for purchase are documented, such as bank statements, personal loan documents, or a HELOC on another property. If the source of funds used to acquire the property was an unsecured loan or a loan secured by an asset other than the subject property (such as a HELOC secured to another property), the settlement statement for the refinance transaction must reflect that all cash out proceeds be used to pay off or pay down, as applicable, the loan used to purchase the property.

NOTE THAT FUNDS RECEIVED AS GIFTS AND USED TO PURCHASE THE PROPERTY MAY NOT BE REIMBURSED WITH PROCEEDS OF THE NEW LOAN.

- The new loan amount can be no more than the actual documented amount of the borrower's initial investment in purchasing the property plus the financing of closing costs, prepaid fees, and points on the new mortgage loan.

Determining Loan-to-Value (LTV) – Cash Out

For properties owned between 6 to 12 months, the appraised value may be utilized to determine property value with some restrictions:

- The loan amount may not exceed 100% of the acquisition cost plus documented improvements; ***or***
- The new appraised value may not exceed 120% of the acquisition cost.

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

Flip Transactions

When the subject property is being resold within 180 days of its acquisition by the seller with more than a 20% increase in value, the transaction is considered a "flip." To determine the 180-day period, the acquisition date (the day the seller became the legal owner of the property) and the purchase date (the day both parties executed the purchase agreement) should be used.

Flip transactions are subject to the following requirements:

- All transactions must be arm's length, with no identity of interest between the buyer and property seller or other parties participating in the sales transaction including but not limited to the spouse of the seller or borrower being the Realtor on the transaction.
- No pattern of previous flipping activity may exist in the last 12 months. Exceptions to ownership transfers may include newly constructed properties, sales by government agencies, properties inherited or acquired through divorce, and sales by the holder of a defaulted loan.
- The property was marketed openly and fairly, through a multiple listing service, auction, for sale by owner offering (documented) or developer marketing.
- No assignments of the contract to another buyer.
- If the property is being purchased for more than 5% above the appraised value, a signed letter of acknowledgement from the borrower must be obtained.
- If the value of the property being purchased after being rehabbed appraises at more than 20% of the seller's acquisition cost and the 6-month seasoning requirement is not met, 1 full interior/exterior appraisal and a Clear Capital Desk Review is required, unless the loan is an HPML purchase transaction in which case the below requirement applies.
- HPML Purchase transactions
    - On a purchase transaction, a second appraisal is required:
        - If the seller acquired the property within the past 90 days and the new purchase price is more than 10% of the seller's acquisition price; **or**
        - If the seller acquired the property within the past 91 to 180 days and the new purchase price is more than 20% of the seller's acquisition price.
        - The second appraisal must be obtained prior to the Promissory Note date.
        - The second appraisal must be provided to the borrower (standard delivery requirements apply).

NOTE: TIMELINES ARE MEASURED FROM THE DATE THE SELLER BECAME THE LEGAL OWNER OF THE PROPERTY AND THE DATE THE PURCHASE AGREEMENT WAS SIGNED BY ALL PARTIES.

- Flip transactions must comply with the HPML appraisal rules in Regulation Z. The full Reg Z revisions can be found at: *Appraisals for Higher-Priced Mortgage Loans | Consumer Financial Protection Bureau*

Non-Arm's Length Transactions

Non-arm's length transactions involve a direct relationship outside of the subject transaction between a borrower and a party to the loan.

Examples of non-arm's length transactions include, but are not limited to, the following:

- Family member sales
- Renters purchasing from current landlord.
- Buyer trading properties with the seller
- Property seller foreclosure bailouts
- Existing buyer relationship with loan officer, real estate agents, closing agent, appraiser, builder, or developer.

Non-arm's length transactions are subject to all of the following requirements for primary residence:

- Relationship must be fully disclosed.
- Borrower to provide a written explanation stating relationship to the seller and reason for purchase.
    - Letter is not required when borrower is purchasing the property they have been residing in, e.g., lease purchase or tenant-purchase situations.
- Borrower to provide a copy of the canceled earnest money check paid to the property seller.
- Sky TPO must be satisfied that the transaction makes sense.
- All liens on title to be paid in full and reflected on the settlement statement.
- Lesser of sales price or current appraised value to be used to calculate the LTV.
- Borrowers cannot provide services on transaction (closing agent, title agent, appraiser, etc.)
- Borrower may not be an owner of a business entity selling the subject property.

The following additional requirements apply only to family sales:

- Payment history for the seller's mortgage on the subject property must be obtained and show no pattern of delinquency within the past 12 months (if applicable)
- Verification that the borrower has not been vested on title to the property in the past 24 months.
- Gift of equity is permitted.

Inherited Properties and Property Buyouts

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

These transactions are subject to the following:

- Written agreement signed by all parties stating the terms of the buyout and property transfer must be obtained.

- Equity owners must be paid through settlement.
- Subject property has cleared probate, and property is vested in the borrower's name.
- Current appraised value is used to determine LTV.

Lease with Purchase Option

Lease with purchase option transactions is allowed for primary residences only. Borrowers may apply a portion of the rent paid to their down payment requirements. See the Fannie Mae Rent-Related Credits for detailed requirements *here*.

For lease with purchase option transactions, the file must contain:

- Copy of fully executed rental/purchase agreement verifying monthly rent and the specific terms of the lease; ***and***
- Copies of canceled checks for 12 months (or term of lease if less) as proof of rental payments.
- If they have been in the lease purchase agreement for more than 12 months, the borrower will not be considered a FTHB.

Permanent Financing for New Construction

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

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

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

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

Customer Identification Program (CIP)

The *USA Patriot Act* requires banks and financial institutions to verify the name, date of birth, address, and identification number of all borrowers. Brokers are to follow the published CIP procedures for each broker to ensure the true identity of all borrowers has been documented.

Fraud Report and Background Check

All loans must include a third-party fraud detection report for all borrowers and/or guarantors. Report findings must cover standard areas of quality control including, but not limited to borrower validation, SSN verification, criminal records, and property information (subject property and other real estate owned). All high-level alerts in the report must be addressed by the broker.

If the broker cannot electronically access the fraud report to clear high-level alerts within the fraud provider's system, an Underwriter's Certification is acceptable. The Certification must address each individual high alert and explain what actions were taken to satisfy the issues. It must be signed and dated by a member of the underwriting staff or operations management personnel.

U.S. Citizens

U.S. citizens are eligible for financing.

Permanent Resident Alien

A permanent resident alien is a non-U.S. citizen authorized to live and work in the U.S. on a permanent basis.

Permanent resident aliens are eligible for financing.

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

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

Non-Permanent Resident Alien

A non-permanent resident alien is a non-U.S. Citizen authorized to live and work in the U.S. on a temporary basis. If a non-U.S. citizen is borrowing with a U.S. citizen, it does not eliminate visa or other residency requirements. Individuals in possession of spouse or family member visas are to qualify as co-borrowers only. A valid EAD must be provided to use income for qualification. Any borrower not meeting the below criteria is **not** eligible.

Verification of Residency Status

- Acceptable documentation to support the borrower's legal status:
    - Borrower has SSN and a current verified status, which may be documented by a valid employment authorization card.
    - A valid Visa and SSN are required with a C33
- Visa and EAD Requirements:
    - Visa, when required, must be current. If the visa will expire within 6 months following the closing date, additional documentation is required:
        - evidence that the proper extension steps have been followed per the USCIS along with proof of payment receipt and proof the extension was done in the timeframe required by USCIS (ex. I-797 with a valid extension date along with an I-94 Form).

- When applicable, a valid EAD is required for U.S. employment if borrower is not sponsored by a current employer. If the Visa will expire within 6 months of loan application, it is acceptable to obtain a letter from the employer documenting the borrower's continued employment and continued visa renewal sponsorship. The employer on the loan application must be the same as on the unexpired Visa.

- Acceptable documentation to support the borrower's legal status for borrowers granted asylum:
  - Form I-765 Employment Authorization referencing C08.
    - After being granted asylum in the U.S., DHS issues Form I-94, an Arrival/Departure Record to asylees. Form I-94 will contain a stamp or notation, such as "asylum granted indefinitely" or the appropriate provision of the law (8CFR 274a.12(a)(5) or INA 208) to show their employment authorization. The asylee does not need to present a foreign passport with Form I-94. An Asylee can also present an electronic Form I-94 with an admission class of "AY."

- Acceptable Visa Types:
  - Visa types allowed for all programs: A-1, A-2, A-3, A-5, C-8, C-9, E-1, E-2, E-3, EB-5, G-1 through G-5, H-1, H1-B, NATO, O-1, R-1, TN NAFTA. Other Visa types permitted with valid EAD card.
  - **Visa Waivers**: Borrowers who are residents of countries which participate in the State Department's Visa Waiver Program (VWP) will not be required to provide a valid visa. Participating countries can be verified through the U.S. Department of State website at *Visa Waiver Program.*

Non-Permanent Resident Alien – Credit Requirements

A U.S. credit report is required for each borrower on the loan using a valid SSN. The credit report should provide merged credit information from the 3 major national credit repositories. A 24-month housing history is required.

Qualifying U.S. Credit

The qualifying U.S. credit designation refers to a non-permanent resident alien borrower who meets the credit requirements outlined in the product matrix *here.*

Qualifying Foreign Credit

Not eligible.

Non-Permanent Resident Alien – Employment/Income Requirements

Standard guidelines apply for verifying income and employment of non-permanent resident aliens.

Non-Permanent Resident Alien – Asset Requirements

All funds required for down payment, closing costs, and reserves on non-permanent resident alien transactions with a valid SSN must be seasoned for 30 days. See Asset Documentation.

Foreign assets deposited into a U.S. institution within 60 days of application is acceptable if there is evidence that the funds were transferred from the country from which the borrower previously or currently resides. It must also be established that the funds belonged to the borrower before the date of transfer.

Assets required for closing (down payment and closing costs) must also be seasoned in a U.S. depository institution for 10 days prior to closing or wired directly to the closing agent. (a foreign bank that is in the U.S. e.g.: RBC is considered in a U.S. depository).

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

Exclusionary List/OFAC/Diplomatic Immunity

All parties involved in each transaction must be screened through any exclusionary list used by the broker. The broker should apply its exclusionary list policy to any loans originated under these Guidelines.

Parties to the transaction must also be cleared through OFAC's SDN List (borrowers, property sellers, employers, banks, etc.). A search of the Specially Designated Nationals and Blocked Persons List may be completed via the U.S. Department of the Treasury website: *Sanctions List Search*.

Borrowers from OFAC sanctioned countries are ineligible. See *Sanctions Programs and Country Information | Office of Foreign Assets Control* for a list of sanctioned countries.

Individuals with diplomatic immunity are not eligible due to the inability to compel payment or seek judgment. Verification the borrower does not have diplomatic immunity can be determined by reviewing the visa, passport, and/or the U.S. Department of State's Diplomatic List *Resources - United States Department of State*.

Co-Borrowers

Co-borrower is often used to describe any borrower other than the first borrower whose name appears on the note. All borrowers are evaluated on their ability to meet credit requirements, underwriting, and eligibility standards. All co-borrowers must occupy and take title to the subject property. A related business entity or Inter Vivos Revocable Trust may have an ownership interest in title to the subject property.

NOTE: CO-BORROWERS MAY NOT BE AN INTERESTED PARTY TO THE TRANSACTION.

Possible examples include, but are not limited to, property seller, builder, realtor, appraiser (a buyer who also acts as their own buying agent is generally permitted).

Non-Occupant Co-Borrowers

Not permitted.

First-Time Home Buyers

Not permitted.

Limited Power of Attorney (POA)

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

- Signed and notarized recorded with the Security Instrument/Mortgage/Deed of Trust.
- Contains an expiration date.
- Used only to execute the final loan documents.
- Borrower who executed the POA signed the initial 1003.
- No interested party to the transaction (such as property seller, broker, loan officer, realtor, etc.) may act as POA.
- POA is not permitted on cash out or when title is vested in a trust or an entity.

Vesting and Ownership

Fee Simple

Acceptable forms of vesting with Fee Simple ownership are:

- Individuals
- Joint Tenants

NOTE: ONLY INDIVIDUALS CAN ACT AS BORROWERS. THE OTHER ENTITIES LISTED ABOVE RELATE ONLY TO AN OWNERSHIP INTEREST IN THE SUBJECT PROPERTY.

Ineligible Vesting

- Entity
- Trust
- Land Trusts
- Blind Trusts
- Life Estates
- Non-Profit Corporations

Multiple Financed Properties and Sky TPO MAX Exposure

Sky TPO exposure may not exceed $10M aggregate with a maximum of 10 loans for each individual borrower. Exceptions to this policy will be reviewed on a case-by-case basis to a maximum of 15 million. The maximum exposure to a single borrower balance or 10 properties.

Ineligible Borrowers

The following borrowers are not eligible:

- Self-Employed Borrower/Business with < 2 years in operation/production.
- Non-Occupant Co-Borrowers
- First Time Home Buyers
- ITIN
- Foreign National
- Borrowers with diplomatic immunity or otherwise excluded from U.S. jurisdiction.
- Trusts or Land Trusts (trusts may qualify for ownership vesting only)
- Borrowers less than 18 years old

- **NOTE: RESIDENTS OF ANY COUNTRY NOT PERMITTED TO TRANSACT BUSINESS WITH U.S. COMPANIES ARE INELIGIBLE (AS DETERMINED BY ANY U.S. GOVERNMENT AUTHORITY)**

Credit Analysis

Equal Credit Opportunity Act (ECOA), Fair Housing Act, and State Fair Lending Laws

The *Federal Equal Credit Opportunity Act* (ECOA) prohibits lenders from discriminating against credit borrowers on the basis of race, color, religion, national or ethnic origin, sex, marital or familial status, age (provided the borrower has the capacity to enter into a binding contract), disability, because all or part of the borrower's income is derived from a public assistance program or because the borrower has, in good faith, exercised any rights under the *Consumer Credit Protection Act*.

NOTE: STATE LAWS MAY ALSO PROHIBIT DISCRIMINATION ON CERTAIN ADDITIONAL BASIS SUCH AS SEXUAL ORIENTATION.

Similarly, the *Fair Housing Act* prohibits lenders from discriminating against mortgage borrowers on the basis of race, color, religion, sex, familial status, national origin, or disability.

Sky TPO expects brokers originating loans for Sky TPO to adhere to the letter and spirit of federal and state fair lending laws.

Credit Report

A credit report is required for all borrowers on a loan.

The credit report should provide merged credit information from the 3 major national credit repositories. A valid SSN is required for all borrowers on the loan.

See Non-Permanent Resident Alien – Credit Requirements for acceptability

Either a 3-bureau merged report, or a Residential Mortgage Credit Report (RMCR) is required. The credit report should include verification of all credit references provided on the loan application and must certify the results of public record searches for each city where the individual has resided in the last 2 years.

Fraud Alerts

The 3 national credit repositories have developed automated messaging to help identify possible fraudulent activity on a credit report. Examples of fraud alerts include, but are not limited to:

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

All fraud alerts must be properly addressed and resolved prior to closing. The actions must be reasonable and compliant with applicable laws. A final underwriting decision cannot be made without full resolution of the alert.

Credit Report Security Freeze

The credit report used to evaluate a loan may not reflect a security freeze and must be resolved prior to an underwriting decision. If a borrower unfreezes their credit after the date the original credit report was ordered, a new 3-bureau merged report will be obtained to reflect current and updated information from all repositories.

Inquiries

A signed letter of explanation from the borrower or creditor is required for all inquiries within the most recent 90 days to determine whether additional credit was granted as a result of the borrower's request.

Updated Payment Histories

Payment histories may be requested directly from a creditor when the credit report indicates delinquencies have been removed or when the majority of credit is from a non-institutional lender.

Gap Credit Report

A credit refresh or undisclosed debt monitoring report dated within 10 days of closing is required, unless the original credit report is dated within 10 days from the Promissory Note date.

Credit Score Requirements

The primary income-earner's score is used as the representative credit score for each loan. The primary income-earner must have a valid score from at least 2 of the following 3 agencies: Experian (FICO), TransUnion (Empirica), and Equifax (Beacon). Only scores from these agencies are acceptable. Additional borrowers on the loan must have at least one valid score of 720 or greater.

To determine the Representative Credit Score for the primary wage-earner, select the middle score when 3 agency scores are provided and the lower score when only 2 agency scores are provided.

When qualifying income amount is equal for all borrowers on the loan, the highest representative credit score of all borrowers will be used.

Tradeline Requirements

Minimum Tradelines If the primary borrower has 3 credit scores, the minimum tradeline requirement is waived.			
	Occupancy	**Tradeline History**	**Minimum Standards**
Standard Tradeline	Primary	• 3 tradelines reporting for 12+ months with activity in last 12 months; ***or*** • 2 tradelines reporting for 24+ months with activity in last 12 months; ***or*** • 24-month mortgage history reporting on credit report	0x30 for most recent 12 months
Limited Tradeline	Primary	• Does not meet minimum tradeline requirements	N/A

Only the primary wage-earner must meet the minimum tradeline requirements listed above; married couples may combine tradelines.

To qualify as a valid tradeline, the following requirements apply:

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

Credit lines on which the borrower is not obligated to make payments are not acceptable for establishing a minimum history.

Examples of unacceptable tradelines include:

- loans in a deferment period
- collection or charged- off accounts
- accounts discharged through bankruptcy
- authorized user accounts.

Student loans can be counted as tradelines as long as they are in repayment and are not deferred.

Mortgage and Rental Payment Verification

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

If the borrower is making payments to an individual or interested party, the most recent 6 months of canceled checks or bank statements must be obtained. A VOR/VOM is not required but may be requested for clarification.

All mortgages and rental payments should be current at time of closing. If the credit report or VOR/VOM reflects a past- due status, updated documentation is required to verify the account is current.

Balloon mortgages with expired maturity date can be considered provided an extension is executed. They will be considered a delinquency (1x30) not a housing event, provided the extension is executed within 180 days of the balloon's maturity.

No Housing History or Less Than 24 Months Verified

Borrowers who are living rent free must provide a rent-free letter from the property owner.

Borrowers are not considered to have "no housing history" under the following circumstances and standard program guidelines can be followed:

- Borrower(s) who own their primary residence free and clear.
- Borrowers living in the marital home.
- Borrower(s) who sold a primary residence within the past 12-months and are currently residing rent free until subject transaction closes.

Modifications

This is not permitted.

COVID Related Modification/Forbearance

A mortgage modification resulting in any of the attributes listed below is subject to housing event seasoning guidelines under Housing Events:

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

For COVID related forbearance and modifications as a direct result of COVID, follow below:

- Borrowers who entered into a forbearance plan but continued to make timely payments and remained employed without income disruption are eligible without any restrictions.

Rolling Late Payments

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

Housing Events and Prior Bankruptcy

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

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

Seasoning of a foreclosure, DIL, or short sale is measured from the date of the court order to the Promissory Note date of the new transaction. The Housing Event must be completed prior to loan closing with no outstanding deficient balance remaining.

For a 120-day mortgage late, seasoning is from the date the mortgage was brought current. Seasoning for a modification is from the date the modification was executed. See Modifications and Housing Events and Prior Bankruptcy.

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

Derogatory Credit – Written Explanations

Housing Events and bankruptcies in the most recent 4 years must be explained by the borrower with a signed letter of explanation. Housing lates > 30 days in the last 24 months are not acceptable. Explanation letters for medical collections, revolving lates, or collections are not required.

Collections and Charge-Offs

Delinquent credit, such as charge-offs of non-mortgage accounts are considered. The following accounts may remain open for all programs:

- Collections and charge-offs < 24 months old with a maximum cumulative balance of $5,000
- All medical collections
- Collections from factoring companies when the original debt can be verified on the credit report.

Collection and charge-off account balances remaining after the exclusions listed above may remain open when one of the following is met:

- Borrower has sufficient reserves to cover remaining collection and charge-off balances (in addition to the published reserve requirement); ***or***
- Payment for remaining collections and charge-offs included in DTI results in final DTI ≤ 38% (payment calculated at 5% of balance of remaining unpaid collections and charge-offs).

A combination of the two options above is allowed. A portion of the unpaid collection balance can be included in the DTI while the remainder is covered by excess reserves. Collections and charge-offs that cannot be factored into DTI or reserves must be paid off.

Delinquent Credit – Ex-Spouse

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

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

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

See also Contingent Liabilities.

Disputed Accounts

When the credit report contains tradelines disputed by the borrower and:

- If the tradeline is paid as agreed, no further action is needed.
- If the disputed account has a zero balance or is being paid at closing, no further action is needed.
- If the disputed account has delinquency within two years of the credit report date and the account balance is $2,500 or less, no further action is needed.
- If the disputed account has delinquency within 2 years of the credit report date and the account balance is over $2,500, the credit file should be documented with a credit supplement showing the dispute has been resolved.
- If the total aggregate balance of accounts in dispute exceeds $5,000, a minimum of 5% of the total balance must be included in the DTI.

Judgements, Liens, IRS Tax Repayment Plans

Judgments, liens, and IRS tax repayment plans must be paid off prior to or at closing unless the requirements listed below are met.

Adverse credit that will impact title must be paid in full as title must insure our lien position without exception.

Tax liens and IRS repayment plans on a refinance may remain open when:

- A copy of the repayment agreement is obtained.
- A minimum of 3 months has elapsed on the plan and evidence of timely payments for the most recent 3 months is provided; and
- The maximum payment required under the plan is included in the DTI.

Tax liens and IRS repayment plans on a purchase may remain open on purchase transactions only (additional LTV reductions may be required based on the size of the lien).

All of the following requirements must be met:

- A copy of the repayment agreement is obtained.
- A minimum of 2 months has elapsed on the plan and evidence of timely payments for the most recent 2 months is provided.
- The maximum payment required under the plan is included in the DTI ratio; ***and***

- When a tax lien remains open, the title company must provide written confirmation confirming (a) the title company is aware of the outstanding tax lien, and (b) there is no impact to first lien position.

IRS TAX PAYMENT PLANS ARE NOT ACCEPTABLE.

Lawsuit/Pending Litigation

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

Past Due Accounts

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

Liabilities

Installment Debt

Installment debt is a monthly obligation with fixed payments and terms. Payments on installment loans must be included in the borrower's DTI ratio.

Payments can be excluded if there are 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 overall transaction should be reviewed 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 or at closing can be excluded from the DTI. Supporting documentation, such as a credit supplement, direct verification from the creditor, or the CD can be used for verification the debt was paid off.

Installment debt may also be paid down to qualify.

If a vehicle lease is paid off to qualify, evidence the car was purchased is required. The lease payments themselves are not considered paying off the debt.

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.

A credit supplement can be obtained to verify what the minimum payment is if it is not reflected on the credit report.

Revolving accounts can be paid off prior to or at closing and do not need to be closed to exclude the monthly payment from the DTI. Supporting documentation, such as a credit supplement, direct verification from the

creditor, or the CD can be used for verification the debt was paid off. See Asset Documentation for sourcing and seasoning requirements.

Authorized User Accounts

Authorized user accounts should not be considered in the borrower's DTI ratio.

Child Support, Alimony, or Maintenance Obligations

When the borrower is required to pay alimony, child support, or separate maintenance payments under a divorce decree, separation agreement, or any other written legal agreement—and those payments must continue to be made for more than 10 months—the payments must be considered as part of the borrower's recurring monthly debt obligations; however, voluntary payments do not need to be taken into consideration and an exception is allowed for alimony. A copy of the divorce decree, separation agreement, court order, or equivalent documentation confirming the amount of the obligation must be obtained and retained in the loan file.

For alimony and separate maintenance obligations, the broker has the option to reduce the qualifying income by the amount of the obligation in lieu of including it as a monthly payment in the calculation of the DTI ratio.

Contingent Liabilities

An individual has contingent liability when an outstanding debt has been assigned to another party and the creditor does not release the borrower from liability. Contingent liabilities can be excluded from the DTI ratio under any of the following scenarios:

- Property resulting from buyout of former co-owner (e.g. divorce):
  - file must include the court order and evidence of transfer of ownership.
- Mortgage assumption by third party:
  - file must include the formal assumption agreement and evidence of transfer of ownership.
- Court ordered assignment of debts:
  - file must include a copy of the court order assigning the debt to another party.

The payment history for the assigned debt after the effective date of the assignment does not need to be evaluated.

Debts Paid by Others

When a borrower is obligated on a non-mortgage debt but is not the party actually repaying the debt, the monthly payment may be excluded from the borrower's recurring monthly obligations. This policy applies whether or not the other party is obligated on the debt but does not apply if the other party is an interested party to the subject transaction (such as the seller or realtor).

In order to exclude non-mortgage or mortgage debts from the borrower's DTI ratio, the most recent 12 months' canceled checks (or bank statements) must be obtained from the other party making the payments that document a 12-month payment history with no delinquent payments.

When a borrower is obligated on a mortgage debt but is not the party who is actually repaying the debt, the full monthly payment may be excluded from the borrower's recurring monthly obligations if:

- the party making the payments is obligated on the mortgage debt,
- there are no delinquencies in the most recent 12 months, ***and***
- the borrower is not using rental income from the applicable property to qualify.

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 DTI ratio.

Debts paid by the borrower's business can be excluded from the DTI ratio with any of the following supporting documentation:

- Most recent 6 months canceled checks drawn against the business account; along with business financials reflecting the business expense; or
- Business bank 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 3 months old, the payment must be included in the DTI ratio unless it is a vehicle and evidence the previous vehicle was paid by the business.

Current Residence Pending Sale

If the borrower's current principal residence is pending sale, but the transaction will not close with title transfer to the new owner prior to the subject transaction, and the borrower is purchasing a new principal residence, the current PITIA and the proposed PITIA must be used in qualifying the borrower for the new mortgage loan.

Sky TPO aligns with Fannie Mae in not requiring the current principal residence's PITIA to be used in qualifying the borrower as long as the following documentation is provided:

- The executed sales contract for the current resident; ***and***
- Confirmation that any financing contingencies have been cleared.

Housing Payments

The monthly mortgage payment (PITIA) used for qualification consists of the following:

- Principal and Interest
- Hazard and flood and insurance premiums
- Real Estate Taxes
- Special Assessments
- Association Dues, including Mandatory Membership Dues
- Any subordinate financing payments on mortgages secured by the subject property.

Lease Obligations

Car lease obligations must be included in the DTI calculation, regardless of time duration remaining on the lease.

Material Recurring Non-Debt Obligations

Brokers are not permitted to make inquiries or verifications prohibited by Regulation B.

A recurring non-debt obligation is defined as medical expenses for the borrower or a dependent of the borrower that are expected to continue for greater than 1 year.

If the borrower informs the broker of a recurring non-debt obligation, the loan file must be noted. If the broker believes it could be material to the borrower's ability to repay the loan, escalation is required.

Documentation of material recurring non-debt obligations should be done consistent with broker's ability to repay policies and in a form acceptable to Sky TPO.

Open 30-Day Charge Accounts

For open 30-day charge accounts that do not reflect a monthly payment on the credit report, or 30-day accounts that reflect a monthly payment that is identical to the account balance, 5% of the outstanding balance will be considered to be the required monthly payment.

Open-end accounts do not have to be included in the monthly debt payment if the borrower has sufficient funds to pay off the outstanding account balance. The funds must be verified in addition to any funds required for closing and reserves.

If the borrower paid off the account balance prior to closing or at closing, proof of payoff may be provided in lieu of verifying funds to cover the account balance.

Retirement/Savings Plan Loans

Repayment for loans against a financial asset (retirement/savings plan, insurance policy) can be excluded from the total DTI ratio provided the debt can be repaid by liquidating the asset. The value of the asset must be reduced by the amount of the debt when calculating funds to close and reserves.

Student Loans

Student loan payments must be included regardless of deferment or repayment in the DTI. If a payment amount is not identified, 1% of the current loan balance may be used.

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.

Timeshares

For credit review purposes, timeshare obligations will be considered installment loans.

Undisclosed Debt

If the asset statements provided reflect payments made on obligations not listed on the credit report or 1003, additional information must be obtained to determine if the liability should be included in the borrower's DTI ratio.

If the obligation does not belong to the borrower, supporting documentation is required. If there is a non- borrower also on the account, a signed letter of explanation from the borrower is sufficient.

If the borrower is the obligor on the debt, an account statement and pay history should be obtained to review the account for acceptability. The payment must be included in the DTI.

EMPLOYMENT/INCOME

Employment Documentation

Documentation of income is allowed using Full Documentation, and Bank Statement Documentation.

IRS 4506-C Tax Transcripts

A signed IRS Form 4506-C must be completed and signed by all borrowers on full doc transactions. The Form must request the appropriate type of transcript based on the level of loan documentation (W2s, full tax transcripts, etc.).

On full doc loans, one of the following is required:

- Wage earner's employment and income documented through a FNMA DU Validation Electronic Verification of employment vendor (e.g., Blend, Equifax, Experian, Finicity, Truework), ***or***
- Transcripts executed for 1 or 2 years, depending on the level of income documentation.

In the event the most recent year's transcripts are not available, one of the following is required:

- The prior 1- or 2-years transcripts, depending on the level of income documentation, ***or***
- All of the following:
    - The prior year's transcripts when qualifying as a 2-year full doc,
    - Copy of the e-filing certificate for the most recent year,
    - Proof the check cleared for any taxes due, or proof of receipt of the tax refund, ***and***
    - Tax Transcript confirming "No Record Found."

The transcripts must be reviewed and compared to the qualifying income to confirm consistency. The results should generally be equal to or greater than the income used to qualify the loan. Any inconsistencies between the transcripts and the qualifying income should be addressed.

Paystubs and W2s

Paystubs and W2s must be typed or computer generated. They should provide the borrower's full name, address, employer name, year-to-date earnings, and rate of pay.

If paystubs reflect garnishments (child support, IRS, etc.) or any loan deductions, additional information will be required to determine if a monthly payment should be included in the debt-to-income ratio calculation.

W2s should reflect a nine-digit Employer ID Number (EIN). Also, Social Security and Medicare withholding should be calculated at the appropriate rates on the W2s and paystubs.

Written Verification of Employment (WVOE)

Income and employment for wage-earners or salaried borrowers may be obtained via direct written verification from the borrower's employer (*FNMA Form 1005*). The verification should be signed by a member of the company's human resource department, one of the business owners, or officers. At a minimum, the verification must include the borrower's name, position, dates of employment, and base salary.

Verbal Verification of Employment (VVOE)

Verbal verifications of employment must be obtained for each borrower using employment income to qualify. VVOEs must meet all of the following criteria:

- Completed within 10 business days of closing.
- Confirm that the borrower is employed at time of verification.
- Include the name and phone number of the person processing the VVOE.
- Include the name, position and phone number of the person providing the verification(employer)
- The telephone number for the borrower's employer must be verified independently via any of the following: telephone book, the internet, directory assistance, or by contacting the applicable licensing bureau.

When VVOEs are completed through a third-party vendor, because their databases are typically updated monthly, the verification must evidence that the information in the vendor's database was no more than 35 days old as of the Promissory Note date.

For self-employed borrowers, the existence of the business must be independently verified through a disinterested third party within 30 business days of closing. The loan file should reflect the documentation secured from these sources. Sources may include:

- CPA, regulatory agency, or applicable licensing bureau
- Secretary of State listing reflecting current year registration
- Verification of a phone and address listing using the Internet.

CPA/Tax Preparer Verification

Tax Preparers must have a PTIN when available. If the state does not require a PTIN, it must be from a verifiable third-party tax preparer (verified by a business through the internet or state website) This requirement is for all sections of this guide that a tax preparer maybe utilized.

CPA license verification must be completed through an online search such as *CPA Verify*. If unable to verify online, sufficient documentation must be provided to validate the license.

Employment History

Employment must be stable with at least a 2-year history in the same job or in the same field. Income from self-employment is considered stable if the borrower has been self-employed for 2 or more years.

Frequent Job Changes

Frequent job changes to advance within the same line of work may be considered favorable. Job changes without advancement or in different fields of work should be carefully reviewed to ensure consistent or increasing income levels and the likelihood of continued stable employment.

Gaps in Employment

Borrowers should provide a signed, written explanation for any employment gaps that exceed 30 days in the most recent 12-month period, or that exceed 60 days in months 13-24.

Recent graduates and borrowers re-entering the workforce after an extended period are allowed assuming they have been back to work for 6 months.

Full Documentation

For all income sources, borrowers are qualified based on calculated stable monthly income over the most recent 2-year period. Income may be obtained from a variety of sources such as salary, bonus, commission, self-employment, etc., and should be reasonably expected to continue for the next 3 years.

Wage-Earners

Income derived from a consistent hourly, weekly or monthly wage, must be verified by all of the following:

- W2s for the most recent 2 years (1099s also acceptable: see 1099 Income); **and**
- Paystub(s) providing year-to-date earnings; **and**
- Signed and executed 4506-C (W2 transcripts only); **and**
- VVOE completed within 10 days of closing.

Annuity Income

Annuity income can be used for qualification when the following requirements are met:

- 12-month history must be verified using 1099s, tax returns, and/or bank statements
- Letter from issuer of annuity to be obtained stating that it has been set up on periodic withdrawal, amount of withdrawal, duration, and balance.
- Account asset balance must support the continuance of the monthly payments for at least 3 years after the close of escrow.

Annuities less than 12 months old must be in Trust Accounts with a minimum term of 40 months in order to use the income to qualify.

For annuity distributions from a 401(k) or pension, see Pension/Retirement.

Automobile Allowance

For an automobile allowance to be considered as acceptable stable income, the borrower must have received payments for at least 2 years. The full amount of the allowance must be added to the borrower's monthly income, and the full amount of the lease or financing expenditure to the borrower's monthly debt obligations.

Bonus and Overtime

Bonus and overtime can be used to qualify if the borrower has received the income for the past 2 years and it is likely to continue. The average bonus or overtime income should be used.

A written VOE (*FNMA Form 1005*) should be obtained to provide a breakdown of bonus or overtime earnings for the most recent 2 years. If the employment verification states the income is unlikely to continue, it may not be used in qualifying.

Capital Gains

When income from capital gains is used to qualify the borrower, tax returns for the most recent 2 years are required to determine if the income is recurring and may be considered in qualifying. If a capital gain appears to be a one-time occurrence, it should not be considered when calculating income available.

For the income to be considered stable and likely to continue, sufficient assets must be documented to show the borrower will continue receiving capital gains for a minimum of 3 years from Promissory Note date.

If the income is declining and/or there will be no asset base to generate the capital gains, it cannot be used for qualification purposes.

In addition, if assets that generated capital gains are being sold as part of the mortgage transaction, the income from capital gains must be reduced by a percentage equal to the percentage reduction in the value of the assets that generated the income.

Child Support, Alimony, or Maintenance Income

In order for child support, alimony, or separate maintenance to be considered stable income, it must continue for at least 3 years from the Promissory Note date as specified by the court order.

The following requirements apply:

- A copy of the divorce decree or legal separation agreement must be obtained.
- Documentation must be received to evidence receipt of the most recent 6 months of payments through copies of deposit slips, canceled checks, and/or bank statements.

Full and timely payments must be received for 6 months or longer. Income received for less than 6 months is considered unstable and may not be used to qualify the borrower. Also, if full or partial payments are made on an inconsistent or sporadic basis, the income is not acceptable for qualifying the borrower.

NOTE: SKY TPO EXPECTS BROKERS ORIGINATING LOANS FOR SALE TO SKY TPO TO MAKE APPROPRIATE DISCLOSURES, AS REQUIRED UNDER THE FEDERAL EQUAL CREDIT OPPORTUNITY ACT, THAT CHILD SUPPORT, ALIMONY, OR MAINTENANCE INCOME INFORMATION NEED NOT BE PROVIDED UNLESS THE BORROWER WANTS THE LENDER TO CONSIDER SUCH INCOME IN UNDERWRITING THE LOAN.

Commission Income

Commission earnings should be averaged over the most recent 2 years and require the following documentation:

- Most recent year-to-date paystub reflecting the commission earnings; **and**
- W2 forms covering the most recent 2-year period or a complete written VOE.

A borrower on their current job for less than 2 years with a minimum 2-year history of receiving commission in the same line of work may also qualify to use commission earnings.

If there are large fluctuations, the borrower must provide a signed, written explanation to support the increase or decrease in income. Additional supporting documentation is required to use commission income for qualification when documentation shows a decline in earnings from one year to the next.

With borrowers that receive a draw against the commission earnings, the draw income is not to be considered in addition to the commission income. Draws are only to be considered income paid in advance of receiving commissions, where the amount is then subtracted once the commissions are earned.

Declining Income

Declining income sources should be closely reviewed to determine if the income may be used for qualifying purposes. Income showing a consistent decline over the prior years should not be considered as stable or usable income for qualification purposes.

A signed, written explanation for the decline should be obtained from the borrower and/or employer. In instances where there is sufficient information to support the use of the income, the most recent lower income over the prior 2-year period must be used and may not be averaged.

Disability Income

Long-term and short-term disability income can be used to qualify. The following documentation should be obtained for both long-term and short-term disability:

- Documentation from either the insurance company or employer providing the payment amount, conditions for termination of payment, and the likelihood of it continuing for at least 3 years.
- A copy of the most recent check or bank statement is required if the award letter does not reflect the current payment being received.

Short-term disability also requires the following documentation:

- Signed letter from borrower stating intent to return to work once the disability no longer exists.
- Verification from employer stating that the borrower will be allowed to return to work once the disability no longer exists. The letter must identify the borrower’s position and rate of pay upon return. If the future employment income will be less than the disability income, the lower income amount must be used to qualify for the loan.

In documenting disability income, Brokers originating loans for sale to Sky TPO must not make inappropriate and/or unlawful inquiries regarding the nature or severity of the borrower's disability.

Dividend/Interest Income

Dividend and interest income derived from investments can be used as qualifying income when the following requirements are met:

Document a 2-year history of income, as verified by:

- Copies of the borrower' signed federal income tax return; ***or***
- Copies of the account statements

Sufficient assets should remain after closing to continue to generate an acceptable level of earnings. If assets that generated dividend/interest income are being sold as part of the mortgage transaction, the qualifying income must be reduced by a percentage equal to the percentage reduction in the value of the assets that generated the income.

Earnings should generally be averaged over the time period verified when current earnings are consistent with historical dividend and interest earnings.

Employed by a Relative

Income for borrowers who are employed by a relative must be verified with one of the following:

- Federal income tax returns for the most recent 2 years with transcripts; ***or***
- W2s for the most recent 2 years with transcripts; ***and***
    - Paystub(s) covering the most recent 30-day period.

Income should be averaged over the 2-year period. Clarification of potential ownership by the borrower of family-owned businesses may also be required. A borrower may be an officer of a family operated business but not an owner. Verification of their status should be provided by written confirmation obtained from a CPA or legal counsel.

Foreign Income

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

- 2 years U.S. federal income tax returns reflecting the foreign income.
- Income is translated to U.S. dollars.
- Standard income stability and continuance requirements are met.
- Standard documentation requirements apply based on the type of income.
- Income from sanctioned countries administered by *OFAC* is not allowed.

Foster Care Income

Income derived from foster care payments may be considered if there is a 2-year history of receipt and it is expected to continue for the next 3 years.

The income can be verified by letters from the organizations and copies of borrower's deposit slips or bank statements showing regular deposit of the payments, or by providing federal income tax returns for the most recent 2 years. The documentation received must clearly show the number of foster children involved, their ages, and length of care.

Income must be averaged over the 2-year period and may not be considered for children who will reach the age of 19 within 3 years.

Hourly Wages

Borrowers paid on an hourly basis, or who may not work a regular 40-hour work week throughout the year, will generally have their income averaged over the minimum employment history required. If there is an indication of declining income, the current income is used instead of the average.

Lump-Sum Distributions

Proceeds from the sale of investments held in a 401(k) or IRA account are not eligible as an income source. See Dividend/Interest Income for related allowable income sources.

Ministry/Clergy Income

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

Rental or housing allowance received can be considered income for qualifying the borrower. Written documentation, such as a WVOE provided by the church, must be obtained showing receipt of the income.

The borrower's paystub should also reflect receipt of the housing allowance. If the borrower is newly employed, obtain a copy of the church budget (in lieu of a check) showing funds have been allocated for housing allowance. Housing allowance for ministers is non-taxable income and can be grossed up for qualifying.

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

Non-Taxable Income

Non-taxable income can be grossed up by 25%. Examples of non-taxable income may include military allowances for clothing, quarters, and subsistence, child support, worker's compensation, disability retirement, social security income, clergy housing allowance, foster care income, food stamps, income from municipal bonds, and certain types of insurance benefits.

Some income types may contain both taxable and non-taxable income. Federal income tax returns may be required to accurately determine the non-taxable portion.

Income may **not** be grossed-up for calculating residual income.

Notes Receivable Income

Income from notes receivable can be used to qualify provided the income is regular and recurring. The borrower should have a documented history of receiving the income for at least 2 years and can verify that the income will continue for at least 3 years from the Promissory Note date on the new mortgage.

A copy of the Promissory Note confirming the amount, frequency and duration of payments is required along with tax returns for the most recent 2-year period (including Schedule B) or 12 months' bank statements showing consistent deposits of funds. Income from a recently executed Promissory Note/contract (less than 12 months) may not be used as qualifying income.

Part-Time/Second Job Income

Income from part-time employment or a second job can be considered stable income if it has been received for the previous 2 years and is likely to continue. Earnings must be documented with current paystubs and W2s for the most recent 2-year period. (See FNMA guides on *Secondary Employment* for clarification).

Pension/Retirement

Pension and retirement income must be verified with any of the following:

- Letters from the organization providing the income.
- Copy of retirement award letters.
- Tax returns for the most recent 2 years
- W2 forms or 1099 forms for the most recent 2 years
- Bank statements reflecting regular deposits for the most recent 2 months.

Proof of Continuance

If the borrower is of retirement age, proof of continuance does not have to be documented when the income is received from corporate, government, or military retirement/pension.

If retirement income is in the form of monthly annuity distributions, such as 401(k) or IRA, proof of continuance for 3 years is required. If the borrower intends to use the retirement account to also satisfy asset requirements, the value of the asset must be reduced by the funds being withdrawn prior to determining a 3-year continuance of income. Assets available beyond the deduction for continuance of income may be used as reserves. See also Pension/Retirement.

Forthcoming Retirement

Any borrower presently employed but anticipating retirement within 3 years from the Promissory Note date must be evaluated upon the verified anticipated retirement income. Effective income for borrowers planning to retire (or end employment for other reasons) during the period must include the amount of documented retirement or other benefits to be received, Social Security payments, or other payments expected to be received in retirement. A combination of present earnings and future retirement income does not represent a supportable level of earnings.

Rental Income

Rental income can be used for qualifying when disclosed on the loan application.

Rental Income On Tax Returns

When tax returns are used for qualifying, rental income should be calculated using the *FNMA Cash Flow Analysis Method*. When income is being qualified using 2 years, an average of income should be used unless the rental income is declining, in which case the most recent year's income should be used for qualifying.

Cash Flow Analysis of the Schedule E should be completed as follows:

- Gross Rents and Royalties received.
    - Less Total Expenses
    - Plus Depreciation
    - Plus Insurance
    - Plus Mortgage Interest
    - Plus Taxes
    - Plus HOA fees (if included on the Schedule E)
- Subtotal / 12 (24) months
- **Primary Residence**: This figure would be used as net rental income/loss and the full PITIA will be counted as a debt.
- **Rental Property**: This figure less the proposed/existing monthly payment will be used to determine net rental income/loss.

Rental Income Not On Tax Returns

In instances when tax returns are not provided in the loan file, rental income should be documented in the following manner:

- Evidence of borrower's ownership of the property
- For a refinance and/or to document rental income on other REOs:
    - Lease agreement
    - 2 months of bank statements demonstrating receipt of rental income.
    - Evidence the rental amount is at market rate, which can be documented via FNMA Form 1007 or through an online source.
    - 75% of the rental amount on the lease is used for qualifying.
- **Primary Residence**: This figure would be used as net rental income/loss and the full PITIA will be counted as a debt.
- **Rental Property**: This figure less the proposed/existing monthly payment will be used to determine net rental income/loss.
    - Rental income from a new property being acquired through a purchase transaction:
    - 75% of the appraiser's opinion of market rent on FNMA *Form 1007* or *Form 1025*, as applicable
- **Primary Residence**: This figure would be used as net rental income/loss and the full PITIA will be counted as a debt.
- **Rental Property**: This figure less the proposed/existing monthly payment will be used to determine net rental income/loss.
- **RENTAL ON VACANT UNITS NOT PERMITTED.**
- **Rental Income from a Departing Residence:**
    - 75% of the rental amount on the lease, if used for qualifying.
    - Evidence the rental amount is at market rate, which can be documented through an online source or *Form 1007*.

Seasonal Income

Income from seasonal employment can be considered if the borrower has worked the same job during the season for the past 2 years and expects to be rehired for the next season.

A WVOE and W2s for the most recent 2 years are required. The WVOE must reference the likelihood of the borrowers being rehired.

Seasonal income should be averaged over a 2-year period.

Self-Employed Income

A borrower is considered self-employed with 25% or more ownership interest in a business. The business may be a sole proprietorship, general partnership, limited partnership, corporation, or S corporation.

To utilize self-employed income for loan qualification, borrowers must be self-employed for at least 2 years and the business must be in existence for at least 2 years.

NOTE: FNMA LIQUIDITY TEST IS NOT REQUIRED.

Qualifying Income

Qualifying income is determined from the tax returns and the P&L is used to determine the stability of that income. The bank statements for the most recent months must reflect deposits that support those sales from the P&L and the qualifying income from the prior year's tax return.

When analyzing tax returns, the following may be added back to compute the qualifying income:

- Depreciation
- Depletion
- Business use of the home
- Amortization/casualty loss
- Nonrecurring losses: note that nonrecurring income must be excluded
- Net operating losses being carried forward from prior years

Sole Proprietorship

A sole proprietorship is a business structure in which an individual and their company are considered a single entity for tax and liability purposes. Income and losses are reported on the owner's schedule C of the individual federal income tax return.

Documents required for determining income from a sole proprietorship are:

- Federal income tax returns (IRS Form 1040) for the most recent 2 years, including all schedules; ***and***
- Borrower signed and dated year-to-date profit and loss statement up to the most recent month preceding the loan application; ***and***
- 2 months business checking account statements for the most recent 2 months on the P&L; ***and***
- Signed and processed IRS Form 4506-C (full 1040 transcripts capturing all schedules); ***and***
- Verification of the existence of the business within 30 business days of closing.

Partnerships

A partnership is a business organization in which 2 or more individuals manage and operate the business. The partners share profits and losses and control of the business.

Documents required for determining partnership income are:

- Federal income tax returns (IRS Form 1040) for the most recent 2 years, including all schedules; ***and***
- W2s for the most recent 2 years (if applicable); ***and***
- Partnership tax returns (IRS Form 1065) for the most recent 2 years, including all schedules and K-1s
- **(NOTE: IF BORROWER IS A LIMITED PARTNER WITH LESS THAN 50% OWNERSHIP, PARTNERSHIP TAX RETURNS ARE NOT REQUIRED); *and***
- Borrower signed and dated year-to-date profit and loss statement up to the most recent month preceding the loan application; ***and***
- 2 months business checking account statements for the most recent 2 months on the P&L; ***and***
- Signed and processed IRS Form 4506-C (full 1040 transcripts capturing all schedules); ***and***
- Verification of the existence of the business within 30 business days of closing.

Corporations

A corporation is a legal entity that is separate and distinct from its owners. If a borrower has more than 25% ownership in a corporation, they are considered to be self-employed. A borrower that is self- employed as a corporate officer will receive a paystub and W2 and will report income on their personal tax returns. Corporate income or losses are reported on the corporate tax returns (IRS *Form 1120*).

Documents required for determining income from a corporation:

- Federal income tax returns (IRS *Form 1040*) for the most recent 2 years, including all schedules; ***and***
- W2s for the most recent 2 years; ***and***
- Corporate tax returns (IRS *Form 1120*) for the most recent 2 years, including all schedules; ***and***
- Borrower signed and dated year-to-date profit and loss statement up to the most recent month preceding the loan application; ***and***
- 2 months business checking account statements for the most recent 2 months on the P&L; ***and***
- Signed and processed IRS *Form 4506-C* (full 1040 transcripts capturing all schedules); ***and***
- Verification of the existence of the business within 30 business days of closing.

S-Corporations

A Subchapter S Corporation is a type of corporation which enables the company to have the benefits of a corporation but be taxed as if it were a partnership. S corporations are generally small corporations. The profit of the corporation is given to each owner according to their share of ownership. The adjusted profit is then divided by the borrower's share of ownership and combined with W2 income used for qualifying. Income is reported with both a W2 and K-1 (reporting on the Schedule E) or only with a K-1.

Documents required for determining income from an S corporation:

- Federal income tax returns (IRS *Form 1040*) for the most recent 2 years, including all schedules; ***and***
- W2s for the most recent 2 years; ***and***

- Corporate tax returns (IRS *Form 1120-S*) for the most recent 2 years, including all schedules and K-1s; ***and***
- Borrower signed and dated year-to-date profit and loss statement up to the most recent month preceding the loan application; ***and***
- 2 months business checking account statements for the most recent 2 months on the P&L; ***and***
- Signed and processed IRS *Form 4506-C* (full 1040 transcripts capturing all schedules); ***and***
- Verification of the existence of the business within 30 business days of closing.

1099 Income

Payments to sole proprietors or contract individuals are reported on IRS *Form 1099* and included in the borrower's Schedule C. Tax returns may be waived and wage-earner documentation requirements followed in Wage-Earners when all of the following requirements are met:

- 1099s for the most recent 2 years are provided or 1 yr with evidence the borrower has been 1099 a minimum of 24 months.
- 1099s are validated with a wage and income transcript from the IRS only when borrower is employed by family members or related individuals.
- When the most recent 1099 is greater than 90 days from the note date, evidence of year-to-date earnings are verified via a YTD paystub, written VOE, or other equivalent third- party documentation or YTD Bank statements.
- Documentation is obtained from employer/employers confirming borrower has no job-related expenses or will assume 10% expenses.

If the borrower does not meet the requirements above, tax returns for the most recent 2 years (IRS *Form 1040*) are required to determine income and related expenses.

NOTE: 1099 FORMS COVERING A FULL 2-YEAR PERIOD ARE NOT REQUIRED WHEN A BORROWER CHANGES FROM BEING PAID W2S TO 1099S WHILE WORKING FOR THE SAME EMPLOYER IN THE SAME POSITION. DOCUMENTATION MUST BE OBTAINED FROM THE EMPLOYER CONFIRMING THE BORROWER HAS NO JOB-RELATED EXPENSES.

Reduced Documentation for a Secondary Business

Business tax returns, associated schedules, and profit and loss statements may be waived when all of the following requirements are met for Select Prime:

- Income/loss referenced on personal tax returns is generated from a secondary business that is not the borrower's primary income source; ***and***
- Income/loss from each separate business is ≤ 10% of qualifying income for the transaction; ***and***
- All losses are subtracted from the borrower's qualifying income.

If income from a business is used to qualify the borrower, or if business expenses are added back to income or a loss, then business tax returns, associated schedules, and profit and loss statements must be obtained.

Discretion may be used whether or not to obtain all documentation for self-employed earnings when the secondary business may have a significant impact on the loan.

Cash Flow Analysis

Sky TPO will prepare a written evaluation of the analysis of a self-employed borrower's personal income, including the business income or loss, reported on the borrower's federal income tax returns.

Social Security Income (SSI)

When a borrower is drawing SSI benefits from their own account/work record in the form of retirement or disability, one of the following items is required:

- Social Security Administrator's (SSA) Award Letter, ***or***
- Proof of current receipt.

When a borrower is drawing benefits from their own account/work record in the form of Supplemental Social Security Income (SSI), both the award letter ***and*** proof of current receipt must be obtained.

When a borrower is drawing Social Security benefits from another person's account/work record, **all** of the following items are required:

- SSA Award Letter;
- Proof of current receipt; ***and***
- Proof benefit will continue for at least 3 years (e.g., verification of beneficiary's age) See also Non-Taxable Income.

Teacher Income

Teachers are paid on a 9-month, 10-month or 12-month basis. The pay structure should be determined before calculating the monthly income. If uncertainty exists, the borrower may provide a copy of their contract or the school district's personnel office may provide verbal confirmation.

Tips and Gratuity Income

Tips and gratuity income can be considered if receipt of such income is typical for borrower's occupation (e.g. waitperson, taxi driver, etc.). Income should be received for at least 2 years and documented through the most recent year-to-date paystubs along with one of the following:

- 2 years W2s and W2 Transcripts, ***or***
- 2 years 1040s, along with IRS *Form 4137*, Social Security and Medicare Tax on Unreported Tip Income (when necessary), to verify tips not reported through the employer and tax transcripts.

See Alt Doc – Tip Income for alternative qualifying options.

Trailing Spouse or CoBorrower Income/Relocation

Trailing spouse income or co-borrower income to be received when the borrower is being relocated is not allowed to be used as qualifying income.

Trust Income

Trust income can be used for qualification as follows:

- Variable trust payments require a 24-month history of receipt and must be documented by tax returns.
- Fixed trust payments require either:
    - A minimum 12-month history of receipt; or
    - A minimum of 1 payment received prior to closing provided:
        - The payments are fixed, ***and***
        - The borrower is not the grantor of the trust.

In either case, proof of current receipt of the income is required and must be documented with a current bank statement or equivalent documentation.

Continuance of the trust income must comply with standard income requirements:

- When trust income is derived from rental income, evidence of 3-year continuance is **not** required.
- When the income is a fixed payment from a depleting asset, 3 years continuance is required.

Unacceptable Income

- Gambling winnings (except lottery continuing for 5 years)
- Educational benefits
- Stock options
- Refunds of federal, state, or local taxes
- Illegal income
- Expense account reimbursement

Unemployment Compensation

Income derived from unemployment compensation is generally not allowed due to the limited duration of its receipt. Seasonal unemployment, however, can be considered if the borrower is employed in a field where weather affects the ability to work and where unemployment compensation is often received (e.g. construction). The income can be used to qualify with a 2-year employment history in the same field of work and a 2-year history of receipt of unemployment compensation. Income should be averaged over the time period verified.

VA Survivors Benefits/Dependent Care

VA benefits must be documented with a copy of the Award Letter or distribution forms and must continue for at least 3 years.

BANK STATEMENT DOCUMENTATION

General Requirements

Self-employed borrowers are eligible for either personal bank statement documentation or business bank statement documentation.

The following restrictions apply to both documentation types:

- Borrowers must be self-employed for at least 2 years; ***and***

- the business must be existence for a minimum of 2 years, as evidenced by a letter from either the business tax professional, regulatory agency or licensing bureau.

Bank Statement Analysis Requirements

- Statements must be consecutive and reflect the most recent months available.
- Transaction histories are not acceptable in lieu of bank statements.
- Asset Statements received via a third-party asset verification vendor are acceptable as long as:
    - The information provided conforms to the information that would be provided on bank statements
- Statements must support stable and generally predictable deposits.
- ATM deposits may be included if a consistent pattern of deposits is present.
- Deposits greater than 50% of the average gross deposits over a 12-month period must be sourced.
- Any deposit deemed as non-business income will be excluded from the income analysis.
- Statements should show a trend of ending balances that are stable or increasing over time.
- Decreasing or negative ending balances must be explained.
- Transfers from other accounts on personal/comingled account statements must be documented or excluded. Net transfers between accounts must be excluded when multiple accounts are used for qualifying.
- Transfers from other accounts on business account statements must be documented or excluded only if above the large deposit threshold, or if the deposits appear not to be business income (e.g. proceeds from a loan, online transfers from other accounts owned by the borrower, refunded expenses, tax refunds, another source of documentable income, etc.).
    - Net transfers between accounts must be excluded when multiple accounts are used for qualifying.
- Wire transfer deposits on personal account/co-mingled statements must be sourced as business income or excluded.
- Wire transfer deposits on business account statements must be sourced only if above the large deposit threshold, or if the deposits appear not to be business income (e.g. proceeds from a loan, refunded expenses, tax refunds, another source of documentable income, etc.).
- If bank statements provided reflect payments being made on obligations not listed on the credit report, see Undisclosed Debt for additional guidance.
- The most recent bank statement used for the bank statement analysis must be within 90 days of the Promissory Note date.
- Any supporting documentation, such as a P&L statement used in conjunction with the bank statements must align with the dates of the bank statements used for qualifying.

Alt Doc Combined with Other Income Sources

- **W2 Wages:** Additional income deposited into the bank statements but derived from a source other than the self- employed business may not be included in the bank statement average. W2 earnings must be documented as per the requirements in Wage-Earners along with a processed 4506-C verifying the W2 earnings only.
- **Rental Income:** Borrowers using bank statement documentation, who also receive rental income as a secondary source, are permitted to qualify using both sources of income. When considered, a 25% expense ratio can be used with evidence of deposits of the rent and copies of the lease. The deposits

must be verified through 2-month bank statements from a separate account other than the one used to calculate the self-employed income.

Non-Sufficient Funds (NSF) – Underwriting

- NSF activity in the past 12 months must be satisfactorily explained by the borrower.
- **NOTE: EXCESSIVE NSF OR OVERDRAFT ACTIVITY MAY PRECLUDE THE BORROWER FROM BANK STATEMENT ELIGIBILITY AT UNDERWRITER'S DISCRETION.**
- NSF negative balances reflected on the bank statement must be considered unless tied to overdraft protection. NSF fees associated with a pre-arranged link to a savings account or line of credit are acceptable when:
    - **Overdraft protection from a depository account:**
        - Occurrences may be excluded if statements for the linked account confirm that
            - The linked account balance at the time of the transfer exceeded the amount of the overdraft transfer,
            - The linked account's balance did not report as zero or negative at any point during the statement period of the transfer, and
            - The linked account did not itself receive overdraft protection proceeds during the statement period of the transfer.
    - **Overdraft protection from a line of credit:**
        - Occurrences may be excluded if statements for the linked account confirm that
            - The line's credit limit was not exceeded during the statement period of the transfer; **and**
            - A payment amount which equals or exceeds the sum of all overdraft protection occurrences analyzed in the statement period is made within 30 days after the statement close date.
- Bounced check NSF fees are not considered when it's a customer's check that was returned.
- **Occurrences included in the analysis are subject to the following tolerances**:
    - An occurrence is defined as one or more checks returned the same day excluding customer checks that were returned. NSFS are reviewed for the past 12-month period only.
    - If there are 2 or more occurrences in the most recent 2-month time period, up to 5 occurrences are allowed in the most recent 12-month time period.
    - If there are zero occurrences in the most recent 3-month time period, up to 7 occurrences in the most recent 12-month time period is acceptable.
- The underwriter, at their discretion, may consider tolerance deviations outside of the above with a sufficient letter of explanation from the borrower outlining the reason for the occurrences and an explanation of how and when the issue leading to the occurrences was rectified. The letter will be reviewed by the underwriter to ensure the explanation supports the viability of income and overall strength of the transaction.

Personal Bank Statements – 24 Months

Borrowers may provide either 24 consecutive months of personal bank statements. See the applicable Sky TPO *matrix* for credit score and LTV restrictions.

The following documentation is required (see also Bank Statement Documentation):

- 24 months complete personal bank statements from the same account
- Most recent 2 months of business bank statements if available.
    - If a business account does not exist, see Co-Mingled Accounts below for guidance.
- To consider allowing 100% deposits, evidence of online transfer/check from the business account to the personal account must be evident.
- When using 100% of online transfer/check deposits going from the business account to the personal account, all other deposits are excluded.
- A pattern/history of deposits from the business account to the personal account must be established.
- When personal accounts are jointly owned and the other party is not an owner of the business and/or a borrower on the loan, all deposits not readily identifiable as business income must be excluded.
- Verify the borrower owns a minimum of 50% of the business by providing a CPA/tax preparer letter, operating agreement or equivalent reflecting the borrower's ownership percentage.

Calculating Qualifying Income

Qualifying income using personal bank statement documentation is the sum of total eligible deposits divided by 24 months. Only transfers or deposits from the business account(s) are considered eligible deposits.

Co-Mingled Accounts

Co-mingled accounts are defined as a single account reflecting both personal and business expenses. Co-mingled accounts are considered a business bank statement and one of the expense methods under the Business Bank Statements below must be used to calculate the income.

Business Bank Statements

Borrowers may provide 24 consecutive months of business bank statements. See the applicable *Sky TPO matrix* for credit score and LTV restrictions.

The following documentation is required (see also Bank Statement Documentation):

- 24-months complete business bank statements from the same account
- Multiple bank accounts may be used for multiple businesses.
- Multiple bank accounts may also be used if a borrower shows they closed the initial account to use another.
- Multiple bank accounts may be used for the same business, provided transfers amount accounts are excluded.
- Business bank accounts, personal bank accounts addressed to a DBA, or personal accounts with evidence of business expenses can be used for qualification.

- Required Expense Statement Documentation applicable to calculation option chosen (see Calculating Qualifying Income for requirements).
- Qualifying income must be multiplied by the ownership percentage to determine the owner's portion of income allowed for the transaction.
- Verification borrower is a minimum 25% owner.
    - Ownership percentage must be documented via tax preparer, CPA letter, operating agreement, or equivalent.
    - All non-borrowing owners of the business or the CFO, tax preparer, or CPA for the company must provide a signed and dated letter acknowledging the transaction and confirming access to the account for income-related purposes.

Qualifying Income Calculation

To calculate qualifying income using business bank statement documentation with one of the below options:.

- 50% EXPENSE RATIO
    - Qualifying Income is the monthly net income from deposits less the 50% expense ratio.
- Third Party Prepared Expense Statement
    - Qualifying Income is calculated by determining total deposits per bank statements (minus any disallowed deposits) multiplied by the expense percentage provided by CPA or licensed tax preparer and divided by 24 months.

The expense statement must be prepared and signed by a third-party (CPA or licensed tax preparer) specifying business expenses as a percentage of the gross annual sales/revenue. The tax preparer must attest they have either prepared or reviewed the borrower's most recent tax return. A minimum 10% expense ratio is required.

Alt Doc – Asset Utilization

Asset utilization may be used as the primary source of income or supplemental income to other primary sources of income, to determine qualifying income. See the applicable *Sky TPO matrix* for credit score and LTV restrictions.

Eligible Assets

Qualified assets can be comprised of publicly traded stocks, bonds, mutual funds, vested amount of retirement accounts, and bank accounts. If a portion of the qualified assets is being used for down payment, closing costs, or reserves, those amounts must be excluded from the balance before analyzing a portfolio for income determination. 3 months' seasoning for all assets is required.

When asset utilization is the **only** source of income, reserves are not required. When asset utilization is a *supplemental* source of income, traditional reserve requirements must be met.

All individuals listed on the asset account must be on the Promissory Note and Mortgage/Security Instrument/Deed of Trust. Assets held in the name of a business are not eligible to be used for the asset utilization calculation.

Asset statements utilized for asset utilization cannot be used to document any other income source. The following assets are considered qualified assets and can be utilized to calculate income:

- 100% of checking, savings, and money market accounts
- 80% of the remaining value of stocks & bonds
- 70% of retirement assets
  NOTE: FOR BORROWERS YOUNGER THAN 59 ½ YEARS OLD USE 60%

Assets held in a trust are eligible as long as the following requirements are met:

- If the funds are held in a revocable trust, the borrower is the trustee.
- If the funds are held in an irrevocable trust, the borrower is the beneficiary and the borrower has immediate access to the assets of the trust.
- Based on the asset type, use the above percentages to calculate the qualified assets.

Calculating Qualifying Income – Super Jumbo

Asset utilization is permitted as primary source of income, as follows:

- The DTI without asset utilization must be < = 50%, then follow the below calculation when determining the amount of income to use as secondary income from assets to attain a max DTI of 38%:
  - **Monthly Income = Net Qualified Assets / 84 Months**

RATIOS AND QUALIFYING

Ratios

The DTI is calculated by adding the borrower's total PITIA and the borrower's total monthly obligations and dividing by the borrower's total monthly qualifying income. Refer to the *matrix*.

Residual income

Minimum residual income thresholds apply to HPML loans on OO homes. Only using the following calculation:

Residual Income = Gross Monthly Income - Total Monthly Obligations

The initial 1003 should reflect the number of members in the household for all borrowers on the transaction.

Number of Household Members Minimum Residual Income*	Minimum Residual Income
1 Person	$1,500
2 Persons	$2,500
For Each Additional Household Member	$150

1 Person $1,500

2 Persons $2,500

For each additional household member $150

***Instructions for using the Household Members table above:** For the household member count, include all related and unrelated members of the household who depend on the borrower(s) for support.

ASSETS

Loan files must evidence sufficient funds from acceptable sources for down payment, closing costs, prepaid items, debt payoff, and applicable reserves. A borrower's ability to accumulate assets provides insight into the individual's ability to successfully manage personal finances. Assets must be dated within 90 days of the Promissory Note date.

Asset Documentation

Assets required for down payment, closing costs and reserves are to be documented as follows:

- 1-month account statement or most recent quarterly statement. Statements must include:
  - Opening and closing balances
  - Borrower as account holder
  - Account number
  - Statement date and time period covered
  - Current balances in U.S. dollars
- Assets held in foreign accounts must be seasoned 60 days and meet one of the following requirements:
  - Must be seasoned in a US depository institution for 10 days prior to closing unless funds are held in a foreign bank with U.S.-based FDIC insured branches; ***or***
  - Wired directly to the closing agent.

  NOTE THAT FOREIGN ASSETS MUST BE CONVERTED TO U.S. DOLLARS USING THE CURRENT EXCHANGE RATE.
- Business assets are permitted as follows:
  - Borrower must have minimum 25% ownership and must be an owner on the business account.
  - The balance of the business assets must be multiplied by the borrower's ownership percentage of the business.
  - When the borrower is not the sole owner of the account, the transaction must be acknowledged and borrower's access to the funds must be documented via one of the following:
    - A letter signed and dated by all non-borrowing owners of the business (not required when the spouse is the only other owner), ***or***
    - A letter signed and dated by the CFO or Board of Directors, ***or***
    - Evidence of the borrower's access to the funds via the operating agreement.

- Written Verification of Deposit (VOD), completed by the financial institution.
- Accounts verified using a FNMA approved third-party vendor. Foreign assets may be verified from a letter of reference on company letterhead from a verifiable banking institution. Contact information for the person signing the letter must be provided, and the letter must state the type of relationship, length of the relationship, how accounts are held, and the current balance. Any letters must be translated by a certified translator.
- Non-borrowing parties on the account (excluding a non-borrowing spouse) must provide a written statement that the borrower has full access and use of the funds. See also Spousal Accounts.

Large deposits on purchase transactions when personal accounts are used must be documented

NOTE THAT WHEN USING ALT DOC FOR INCOME PURPOSES, LARGE DEPOSITS MUST BE DOCUMENTED IN ACCORDANCE WITH THE BANK STATEMENT ANALYSIS REQUIREMENTS.

OTHER ASSETS

Borrowed Funds Secured by an Asset

Borrowed funds that are secured by an asset can be used as a source of funds for down payment, closing costs, and reserves. Assets that may be used to secure funds include automobiles, artwork, collectibles, real estate, publicly traded stocks and/or bonds, and 401(k) accounts.

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

The monthly payments for the loan secured by non-financial assets must be counted in the DTI ratio; however, when the loan is secured by the borrower's financial assets and there are sufficient assets to pay off the loan currently verified, the monthly payment for the loan does not have to be considered as a long- term debt when qualifying the borrower (as in the case of a 401(k) loan).

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

College Savings Account – 529 Plan

Typically, a 529 College Savings Plan is an eligible source of funds provided that the borrower is the owner of the account, and the account is revocable. A copy of the plan is required to ensure it is a savings plan, not a prepaid tuition plan. 529 accounts may be used to satisfy reserve requirements at 60% of the value.

Earnest Money/Cash Deposit on Sales Contract

If earnest money is needed to meet the borrower's minimum contribution requirement, it must be verified that the funds are from an acceptable source. Satisfactory documentation includes any of the following:

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

If funds were given over 12 months ago per the sales contract, then an escrow letter will suffice for sourcing any funds given greater than 12 months from the closing date.

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

Employer Assistance

Employer assistance in the form of a grant, direct fully repayable second mortgage, forgivable second mortgage or deferred payment second mortgage or unsecured loan, and shared appreciation down payment assistance are permitted. Funds must come directly from the employer, may be used for down payment / closing costs subject to minimum borrower contributions, may be used for reserves except for unsecured loans and are only eligible for primary residence. Any obligation for the borrower that arises from receipt of this assistance must be included in qualifying the borrower.

Documentation requirements:

- That the assistance program is an established company program, not just an accommodation developed for an individual employee.
- The dollar amount of the employer's assistance.
- An unsecured loan from an employer with an award letter or legal agreement from the Note holder and must disclose the terms and conditions of the loan.
- The terms of any other employee assistance being offered to the borrower (such as relocation benefits or gifts).
- That the borrower received the employer assistance funds directly from the employer (or through the employer-affiliated credit union).

Gift Funds

Gift funds are allowed after the borrower has made the minimum required borrower contribution toward the down payment.

- Gift funds can be used for down payment and closing costs.
- Funds from a spouse are not considered gift funds. See Spousal Accounts for additional criteria when using funds held solely in the name of a spouse.
- Gift funds may **not** be used to meet reserve requirements.

A gift can be provided by:

- A relative, defined as an individual who is related to the borrower by blood, marriage, adoption, or legal guardianship; ***or***
- A non-relative that shares a familial relationship with the borrower defined as a domestic partner (or relative of the domestic partner), individual engaged to marry the borrower, former relative, or godparent.
- The donor may not be, or have any affiliation with, the builder, the developer, the real estate agent, or any other interested party to the transaction.

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

- Donor's name, address, phone, and relationship to borrower (donor must be a relative, spouse or domestic partner); ***and***
- Dollar amount of gift; ***and***
- Donor's statement that no repayment is expected.

Sufficient funds to cover the gift must be verified as either currently in the donor's account or evidence of transfer into the borrower's account.

Acceptable documentation includes **any** of the following:

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

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

Unless otherwise specified, gift funds are acceptable if the following applies:

- Owner-occupied properties:
    - Max LTV per the *matrix* permitted with 5% down payment from the borrower's own funds.
    - Gift funds are acceptable on purchase transactions, after the borrower meets a minimum contribution of 20% toward the down payment, closing costs, prepaids and reserves from their own funds.
- In all instances, the borrower must meet reserve requirements with their own funds.

Gift of Equity

Gifts of equity can be used for down payment or to pay closing costs (including prepaid items). The applicable requirements are:

- Primary residence transactions only.
- Borrower contribution is not required.
- 6 months of reserves required of borrower's own funds.
- Signed gift of equity letter is provided containing the following:
    - Donor's relationship to borrower
        - **NOTE: GIFT OF EQUITY MUST BE FROM IMMEDIATE FAMILY MEMBER.**
    - Indicate that the gift is being provided in the form of a gift of equity.
- All liens on title to be paid in full and reflected on the settlement statement. Any mortgages being paid off cannot be reflected as seriously delinquent per the payoff; transaction must not be a bailout.
- Gift of equity must be listed on the settlement statement.
- Borrower has not been on title in the previous 12 months.

- The gift of equity is not subject to IPCs.
- The lesser of the sales price or appraised value will be used to determine the LTV.

Interested Party Contributions (IPCs)

MAXIMUM CONTRIBUTIONS		
Primary	**≤ 70%**	**9%**
Note: Percentage is based on of the lesser of the property's sales price or appraised value and may be applied towards the buyer's closing costs, prepaid expenses, discount points, and other financing concessions.		

See applicable *matrix*.

Sales concessions include:

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

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

Life Insurance

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

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

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

Net Proceeds from Sale of Real Estate

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

Non-Regulated Financial Assets

Crypto currency – such as Bitcoin and Ethereum – is an eligible source of funds for the down payment, closing costs and reserves. Crypto currency is not an eligible liquid asset for asset utilization / depletion.

- Down payment and closing costs: Crypto currency must be liquidated and deposited into an established U.S. bank account.
- Reserves: Loan file must include a statement meeting the requirements under account statements to document ownership of the crypto currency holdings. Current valuation, within 30 days of the loan's Promissory Note date, can only be determined from the Coinbase exchange. 60% of the current valuation will be considered eligible funds.

Retirement Accounts

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

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

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

Sale of Personal Assets

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

The following must be documented:

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

Spousal Accounts

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

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

Stock Options

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

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

Stocks, Bonds, and Mutual Funds

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

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

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

Trust Accounts

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

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

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

See Trust Income if trust is also being used as a source of income to qualify the borrower.

Unacceptable Funds

- Cash-on-hand
- Custodial accounts that are irrevocable trusts (e.g. Uniform Transfer to Minor Act (UTMA))
- Down payment assistance programs
- Gift or grant funds which must be repaid
- Sweat equity
- Section 8 Voucher Assistance
- Unsecured loans or cash advances

Reserves

Reserves are measured by the number of months of housing expenses a borrower can pay using their financial assets. See the applicable Sky TPO *matrix* for complete reserve requirements. The highest reserve requirement, rather than a cumulative total, should be used when a transaction has multiple required reserves.

NOTE: NET PROCEEDS FROM CASH OUT TRANSACTIONS CANNOT BE USED TO MEET THE RESERVE REQUIREMENT.

Property – Appraisal

General Property Appraisal Requirements

A completed appraisal report is required on all loan transactions to assess the adequacy of the property as collateral for the mortgage requested.

The client is responsible for all of the following:

- Ensuring the accuracy and completeness of the appraisal and its assessment of the marketability of the property
- Reviewing the completed appraisal report to determine whether the subject property presents adequate collateral for the mortgage.
- Ensuring the appraiser uses sound reasoning and provides evidence to support the methodology used for developing the value opinion.
- Ensuring the appraiser provides an accurate opinion, an adequately supported value, and an accurate description of the property.
- Ensuring the appraiser provides their license or certification on the appraisal report.
- Complying with the Appraiser Independence Requirements (AIR) published by *Fannie Mae*/*Freddie Mac* and the requirements of the *Federal Truth in Lending Act* (TILA) and *Regulation Z* with respect to valuation independence.
- Disclosing to the appraiser any information about the subject property of which it is aware of that could impact the marketability of the property.
- Providing the appraiser with the ratified sales contract and other financing or sales concessions associated with the transaction.
- Ordering and receiving the appraisal report for each mortgage transaction.
- Ensuring the appraiser does not use unsupported assumptions or use race, color, religion, sex, handicap, familial status, national origin for any party in the transaction, or impermissible demographics of the community in which the property is located, as the basis for market value.

Appraisal Independence Policy Statement

It is the policy of Sky TPO to comply with all the requirements of the Appraiser Independence Policy provisions of Dodd-Frank as adopted by Fannie Mae, Freddie Mac, and the mortgage industry in general. Sky TPO will only accept appraisals completed by appraisers who are properly licensed or certified in the state in which the property is to be appraised is located.

- Appraisal orders may not contain any estimated or requested value.
- Comparable sales may not be suggested to the appraiser.

- The appraisal must be ordered online through the appraisal company's website, with proof of same retained in the file.
- Appraisal order date may **not** be prior to initial signed dated borrowers' application and Intent to Proceed (ITP) issued with the initial application and disclosure package.
- A copy of the appraisal is required to be sent to the borrower on all loans regardless of whether the loan is closed, cancelled, or denied. Borrowers must receive a copy of their appraisal within 3 business days of the time it is delivered to Sky TPO from the appraisal management company and/or appraiser.

Approved Appraisal Management Companies (AMC)

Appraisals are to be ordered through the Sky TPO appraisal desk, with the exception of transferred appraisals which must be in compliance with the Appraisal Transfer Policy.

Brokers are responsible for ensuring transferred appraisal(s) are ordered through approved AMCs or fee panel appraisals comply with the Dodd-Frank Appraisal Independent Policy. The AMCs are responsible for ensuring that appraisers selected are fully licensed, insured and meet all Sky TPO requirements. Any noted aberrations or concerns are referred to the AMC for discussion and resolution, which can result in removing appraisers from being allowed to perform for Sky TPO.

Appraisal Transfer Policy

Transferred appraisals are only allowed when the client has received prior approval from Sky TPO To ensure compliance with the Appraiser Independence Requirements, the following items are required for consideration:

- Evidence appraisal was ordered according to Appraisal Independence Requirements,
- Appraisal Invoice along with proof of payment unless being paid through closing,
- Transfer letter, signed by an employee of the transferring lender who is not in a production capacity (e.g., Loan Officer, Loan Officer Assistants, etc. are **not** eligible to sign the transfer letter),
- SSRs, ***and***
- MISMO .XML format of the full appraisal including color photos.

Transfers are fully reviewed by underwriting, which may still reject the appraisal if not deemed acceptable.

Sky TPO will transfer appraisals out upon request on denied or withdrawn loans, and will provide appropriate documentation, AIR certs and transfer letters as needed.

Appraisal Reconsideration Request

If there is a reasonable basis to believe that the initial appraisal was flawed or tainted and such basis is clearly and appropriately noted in the loan file, Corporate Appraisal Management will review and may authorize a second appraisal order in cooperation with Underwriting Management by requesting underwriting review and determine acceptability. This is done on an exception basis only and is not allowed just because a party to the transaction does not agree with the value on the original appraisal.

AMCs have their own Reconsideration Form, and the appropriate form must be used if a dispute is being requested for any appraisal ordered through an AMC.

Second Appraisal – Ordering/Authorization

A second appraisal is required on each transaction.

Second Appraisal or Inspection Charges

Second appraisals and/or inspections must be disclosed on the Loan Estimate (LE) **but may not be charged** to the borrower.

Uniform Residential Appraisal Report (URAR)

Appraisers are required to use current appraisal report forms that are acceptable to Fannie Mae and/or Freddie Mac.

The following appraisal report forms should be used:

- Uniform Residential Appraisal Form (FNMA *Form 1004*)
- Individual Condominium Unit Appraisal Report (FNMA *Form 1073*)
- Appraisal Update and/or Completion Report (FNMA *Form 1004D*)

Appraisal Report Requirements

The following items must be contained in the appraisal report:

- Street map showing the location of the subject property and all comparable used.
- Exterior building sketch of the improvements indicating dimensions. A floor plan sketch is required along with calculations demonstrating how the estimate for gross living area is determined. For a unit in a condo project, the sketch of the unit must indicate interior perimeter unit dimensions rather than exterior building dimensions.
- Original color photographs or digital color images of the front, street, and rear views of the subject property. Original digital black and white photographs/pictures are permitted if the appraisal clearly indicates the subject property meets our standards.
- Interior photos of the subject are required to include the kitchen, all bathrooms, the main living area, any areas with physical deterioration, and any renovations/ improvements.
- Any other data as an attachment or addendum to the appraisal report form necessary to provide an adequately supported estimate of market value.
- Appraisal report must contain analysis of all agreements of sale, options or listings for the subject property current as of the effective date of the appraisal, and analysis of all sales of the subject property that occurred within the 3 years prior to the effective date of the appraisal.
- Appraisal report must include a completed Sales Comparison Approach section of FNMA *Form 1004* where there are comparable used with more than one sale or transfer in the 12 months prior to the effective date of the appraisal.
- The appraiser must identify if the property is located in a declining market. A 5% LTV reduction off matrix max LTV applies to properties in declining markets. If the borrower is financing > 5% below the matrix max LTV, a reduction is not required.
- 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.
- A copy of the appraiser's Errors and Omissions insurance policy, valid as of the date of the appraisal report, must be included with the appraisal unless confirmation is obtained from the AMC that a copy is on file with them.

Appraiser Qualifications

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

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

Appraisal Report – Electronic Submission

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

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

Age of Appraisal and Appraisal Updates

Residential Appraisal (1-4 Units):

The appraisal must be dated within 365 days of the Promissory Note date. A recertification of value is required if the report exceeds 120 days of the Promissory Note date. Refer to the Appraisal Report Requirements Section for details.

When an appraisal report will be more than 4 months old (120 days) on the date of the Promissory Note and Security Instrument/Mortgage/Deed of Trust, regardless of whether the property was appraised as proposed or existing construction, the appraiser must inspect the exterior of the property and review current market data to determine whether the property has declined in value since the date of the original appraisal. This inspection and results of the analysis must be reported on the Appraisal Update and/or Completion Report (Form 1004D), a photograph of the front of the subject property must be included.

- If the appraiser indicates on Form 1004D that the property value has declined, then the seller must obtain a new appraisal for the property.

- If the appraiser indicates on Form 1004D that the property value has not declined, then the seller may proceed with the loan in process without requiring any additional fieldwork.

The original appraiser should complete the appraisal update; however, brokers may use substitute appraisers. When updates are completed by substitute appraisers, the substitute appraiser must review the original appraisal and express an opinion about whether the original appraiser's opinion of market value was reasonable on the date of the original appraisal report. The broker must note in the file why the original appraiser was not used.

Appraisal – Minimum Property Standards

All properties must:

- Be improved real property.
- Be designed and available for year around residential use.
- Contain a kitchen and a bathroom.
- For single family must contain a minimum 400 square feet per unit.
- Be heated by a continuously fueled heat source which is permanently affixed to the real estate.
    - Alternative heat sources are acceptable when marketability has been demonstrated.
- Average or better than average condition
- Represent the "highest and best" use of the subject.
- Be free of all health and safety violations.
- **Not** be in violation of any housing codes or exhibit items that adversely affect the ownership, habitability, or marketability of the subject property.

Appraisal – Property Location

See applicable Sky TPO *matrix*. Subject property must be subject to the laws of the state in which the loan is made.

Eligible Property Types

Property Eligibility	
Property Type	Eligibility
SFR	Yes
PUD	Yes
Townhome	Yes
2-4-Unit Multi-Family*	No
Condominium (low and high rise)	Yes
Non-Warrantable Condominium*	Yes
Condotel or Condo Hotel*	No
Site Condominium	Yes
Modular Home	No
Log Home (Log exterior façade only with like comps, not true log cabins. Must also have fully functioning HVAC system, water source, gas or electric. Suitable for year-round occupancy.)	No
Mixed-Use Property	No
Assisted Living/Continuing Care Facility	No
Baltimore City Row Home	No
Boarding House	No
Co-Operative Unit	No
Farm/Hobby Farm	No
Leasehold Condominium	No
Property receiving tax abatement or farming incentives	No
Property located on an island not connected to a mainland by a bridge	Will be considered
Manufactured Home	No
SFR with more than 1 ADU; ADU on 2-4 Units	No
Properties subject to rent controls regulations (permitted when the restriction is only due to limiting the increase of rent to a certain percentage per year.	No
Unique properties (earth homes, barndominimums, berm homes, dome homes, etc.)	No
Timeshares	No
See the applicable *matrix* for LTV restrictions.	

Market Analysis

Neighborhood Review

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

- Degree of development
- Demand and supply

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

Compatibility of Subject Property and Neighborhood

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

Proximity of Comparables to Subject Property

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

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

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

Age of Comparables

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

Property Values within Market Area

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

- the trend of property values
- the supply of properties in the subject neighborhood
- marketing time for properties

The appraiser must provide their conclusions for the reasons a market is experiencing declining property values, an over-supply of properties, or marketing times over 6 months.

Redlining Prohibition

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

Over-Improvements

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

Valuation Analysis

Sales Comparison Approach

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

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

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

Comparable sales utilized in the market approach should:

- Be within one mile of the subject property.
- Have been closed within the last 6 months.
- Indicate properties that are similar to the subject property with respect to age, size, features, amenities, etc.
- Result in an overall net adjustment not exceeding 15% of the sales price of that comparable and a gross adjustment not exceeding 25% of the sales price of that comparable

- Reflect adjustments for individual line items not exceeding 10%
- Have a sales price that is within the general range of value as the subject.
- Have at least 3 of the comparable should be recently closed sales.

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

Cost Approach

When completed, the cost approach must clearly segregate value attributed to land, outbuildings, etc. If the ratio of land value to total value exceeds 50%, an explanation from the appraiser may be required to demonstrate conformance with neighboring properties. See also Land Value and Acreage.

NOTE: APPRAISALS THAT RELY SOLELY ON THE COST APPROACH AS AN INDICATOR OF MARKET VALUE ARE NOT ACCEPTABLE.

Valuation Analysis and Final Reconciliation

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

Appraisal Review Process

The Appraisal Review Process requires a secondary appraisal product to support the appraisal value for the transaction.

Acceptable review products include:

- Clear Capital Desk Review (must contain a value and comparative sales data to support the valuation result),
- Field review
- Second full appraisal (appraisals must be completed by different, independent appraisers and the lower of the 2 appraised values used to determine value)

The Appraisal Review product can be waived if the loan is submitted to Collateral Underwriter (CU) and receives a FNMA CU score of 2.5 or lower.

Sky TPO reserves the right to request additional appraisal products at their discretion based on review of the appraisal and loan file.

Appraisal Review Tolerance

- A 10% tolerance is permitted for all other secondary review products. If the review product value is more than 10% below the appraised value, the lower of the two values must be used.
- If the secondary review product tolerance is exceeded, Sky TPO may choose to order an additional review product of a higher-level review (desk review, field review, etc.). The original appraised value may then be used if the additional review product value is within 10% of the appraised value.

- If the variance of the higher-level review is greater than 10%, a second full appraisal is required. The lower of the two values must be used for qualifying.

Property Considerations

Accessory Dwelling Unit (ADU)

Properties with accessory units, also known as granny units, mother-in-law suites, etc., are acceptable if **all** of the following are met:

- Property is typical, readily acceptable, and common in the subject's market area.
- Property must conform to all zoning laws and/or regulations. The ADU is not required to be permitted provided the appraiser indicates the improvements represent a legal use of the property and completed in a workmanlike manner.
- Legal non-conforming use is acceptable provided its current use does not adversely affect value and marketability.
- Single Family Residences with more than one ADU are not permitted.
- Appraisal contains two comparable with similar additional accessory units.
- Accessory unit is substantially smaller than the primary dwelling.
- Existence of the unit must not jeopardize any future hazard insurance claim that may need to be filed for the property.
- **NOTE: IF ALL OF THE ABOVE ARE NOT MET THE APPRAISER MUST GIVE THE ACCESSORY UNIT ZERO VALUE.**
- If zoning (current or grandfathered) permits an accessory unit, the rental income may be included, subject to the following:
    - Appraisal reflects the accessory unit is legal, and the appraiser report includes at least 1 comparable with an accessory unit.
    - **Refinance:** the market rent for the accessory unit should be documented on FNMA *Form 1007* and the file must include a copy of the current lease with 2 months' proof of current receipt.
    - **Purchase:** the market rent for the accessory unit should be documented on FNMA *Form 1007*.

Dampness

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

Declining Markets

The appraiser must identify if the property is located in a declining market.

- A 5% Max LTV reduction applies to properties in declining markets.

Deed Restrictions

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

Age Restricted Communities

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

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

Limitations on Ability to Sell/Right of First Refusal

Any right of first refusal in the condo project documents will not adversely impact the rights of a mortgagee or its assignee to:

- Foreclose or take title to a condo unit pursuant to the remedies in the mortgage,
- Accept a Deed-in-Lieu (DIL) or Assignment in lieu of Foreclosure in the event of default by a mortgagor, or
- Sell or lease a unit acquired by the mortgagee or its assignee.

Deferred Maintenance

Property must be in average or better condition. Properties in C5 or C6 condition are not acceptable. Structural deferred maintenance is not permitted. Non-structural deferred maintenance can be considered provided:

- The deficiencies are not excessive; ***and***
- The deficiencies do not represent a health or safety concern; ***and***
- The appraisal report is completed as-is with an appropriate adjustment for the current condition of the property.

For additional deferred maintenance guidance for Condominiums, refer to Review Requirements for Condominiums and the Condominiums Significant Deferred Maintenance and Unsafe Conditions sections.

Electrical Systems

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

Environmental Hazards

The appraisal report should note the existence of known environmental hazards and its effect on value and marketability of the subject property.

Environmental hazards may include but are not limited to:

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

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

Escrows for Work Completion

Not permitted.

Flood Zone

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

Foundation Settlement

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

PROPERTIES WITH EVIDENCE OF SINKHOLE ACTIVITY ARE INELIGIBLE FOR FINANCING.

Heating Systems

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

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

Land Value and Acreage

Acreage and land value must be typical and common for the subject's market.

Maximum acreage permitted is 2 acres

Special consideration should be taken for properties with land values that exceed 50% of the total property value to ensure the value is justified and the property has marketability. The appraisal report must provide data which indicates like-size properties with similar land values are typical and common in the subject's market area. See also Rural Properties.

Community Land Trust Appraisal Requirements

Appraiser Qualification – Properties in a Community Land Trust

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

Appraisal Requirements – Community Land Trust

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

- The appraiser must analyze the property subject to the ground lease when a leasehold interest is held by a community land trust. Because the community land trust typically subsidizes the sales price to the borrower, that price may be significantly less than the market value of the leasehold interest in the property.
- The appraised value of the leasehold interest in the property must be well supported and correctly developed by the appraiser because the resale restrictions, as well as other restrictions that may be included in the ground lease, can also affect the value of the property.
- The lender and the borrower must execute the Community Land Trust Ground Lease Rider (FNMA *Form 2100*) to remove such restrictions from the community land trust's ground lease. The land records for the subject property must include adoption of the terms and conditions that are incorporated in that ground lease rider. The appraiser must develop the opinion of value for the leasehold interest under the hypothetical condition that the property rights being appraised are the leasehold interest without the resale and other restrictions that the ground lease rider removes when a property is disposed of through foreclosure.
- The appraiser must use a 3-step process to develop an opinion of value
  NOTE: WHEN THIS APPRAISAL TECHNIQUE IS USED, THERE IS NO NEED TO DOCUMENT THE ACTUAL LAND VALUE OF THE SECURITY PROPERTY.
- The appraiser must determine:
  - **Step 1**: the fee simple value of the property by using the sales comparison analysis approach to value,
  - **Step 2**: the applicable capitalization rate and convert the income from the ground lease into a leased fee value by using the market-derived capitalization rate, and
  - **Step 3**: the leasehold value by reducing the fee simple value by the lease fee value.

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

Multiple Dwellings on a One Lot

Properties with 2 or more detached single-family homes on a single lot are generally ineligible for financing. Single-family properties containing additional residential dwellings (guesthouse, carriage house, etc.) must comply with local zoning regulations. They must be typical and common within the subject's neighborhood.

Typically, the additional dwelling is smaller than the main dwelling and will not be rented. The subject property should be appraised as a single-family residence. Any value for additional dwellings should be supported by comparable sales. See also Accessory Dwelling Unit (ADU).

Multiple Parcels

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

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

New Construction

The following are required for all new construction properties:

- Appraisal Update and/or Completion Report (FNMA *Form 1004D*) with complete interior and exterior photos reflecting completion, if applicable. Proposed improvements are **not** allowed.
- Taxes must be based on improved value. Unless otherwise documented from the title company, use 1.5% for qualifying.

Pest Infestation

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

Plumbing

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

Private Roads

Properties on private roads are acceptable subject to the following:

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

Planned Unit Development (PUD)

A Planned Unit Development (PUD) is a project or subdivision that consists of common property and improvements that are owned and maintained by an HOA for the benefit and use of the individual PUD units. In order for a project to qualify as a PUD, all of the following requirements must be met:

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

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

Repairs

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

Solar Panels

Properties with solar panels are eligible for financing.

When solar panels are owned and financed and collateralized with a UCC lien on title, the following applies:

- Obtain and review the credit report, title report, appraisal, and/or UCC fixture filing, related promissory note and related security agreement for the solar panel loan. Include any monthly obligation in the DTI.
- The value of the solar panel may be included in the appraised value, provided the panels cannot be repossessed for default on the financing terms.

- Include the balance of the solar panel lien in the LTV/CLTV ratio. If unable to obtain the current balance of the lien, include the original loan amount in the LTV/CLTV ratio. The UCC fixture filing must be subordinated with one of the following:
    - Subordination Agreement
    - UCC Termination. Debt obligation and LTV/CLTV must still consider the solar loan unless evidence is provided to verify the debt has been paid down to zero.

When solar panels are owned and financed without a UCC lien on title, the following applies:

- Obtain and review the credit report, title report, appraisal, and/or UCC fixture filing, related Promissory Note and related security agreement for the solar panel loan. Include any monthly obligation in the DTI.
- Ensure the appraiser did not provide a contributory value for the solar panels.
- Do not include the panels in the LTV/CLTV ratio calculation.
- If a previously filed UCC was temporarily removed from title through a UCC termination, evidence must be provided that the UCC lien was paid in full, otherwise the financed balance must be included in the LTV/CLTV.

A Property Assessed Clean Energy (PACE) loan allows for repayment of the solar debt through the homeowner's real estate tax bill. PACE loans may also be referred to as HERO loans.

The following applies when a PACE loan exists:

- Properties with solar panels and other energy efficient items financed with a PACE loan are **not** eligible *if* the PACE loan is not paid in full prior to or at closing.
- Any property tax statements that reflect PACE, HERO, or equivalent will require proof of payoff.
- **IF LOAN PROCEEDS ARE USED TO PAY OFF THE LIEN, THE LOAN IS CONSIDERED A CASH OUT.**

When solar panels are leased or covered by a power purchase agreement, the following applies:

- The solar panels may not be included in the appraised value of the property.
- The property must maintain access to an alternate source of electric power that meets community standards.
- A copy of the lease or power purchase agreement must be obtained.
- The monthly lease payment must be included in the DTI ratio calculation unless the lease is structured to:
    - provide delivery of a specific amount of energy at a fixed payment during a given period, ***and***
    - have a production guarantee that compensates the borrower on a prorated basis in the event the solar panels fail to meet the energy output required for in the lease for that period.
- Payments under power purchase agreements where the payment is calculated solely based on the energy produced may be excluded from the DTI ratio.
- The lease or power purchase agreement must indicate that:
    - any damage that occurs as a result of installation, malfunction, manufacturing defect, or the removal of the solar panels is the responsibility of the owner of the equipment and the owner must be obligated to repair the damage and return the improvements to their original or prior condition (example: sound and watertight conditions that are architecturally consistent with the home).

- the owner of the solar panels agrees not to be named loss payee (or named insured) on the property owner's property insurance policy covering the residential structure on which the panels are attached. As an alternative to this requirement, the underwriter may verify that the owner of the solar panels is not a named loss payee (or named insured) on the property owner's property insurance policy; ***and***
- in the event of foreclosure, the underwriter or assignee has the discretion to:
  - terminate the agreement and require a third-party owner to remove the equipment.
  - become, without payment of any transfer or similar fee, the beneficiary of the borrower's lease/agreement with the third party; ***or***
  - enter into a new lease/agreement with the third party, under terms no less favorable than the prior owner.

Rural Properties

Not permitted.

Unconventional Floor Plans

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

Water Supply

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

- The water supply system is in proper working order and pumping an adequate supply of water for the subject property; ***and***
- The water supply is potable and complies with local and/or state health authority standards (in the absence of a local health authority, a reputable chemical testing agency must certify that the water is fit for human consumption). The water certification(s) for existing properties can be no more than 120 days old on the date of closing. If new construction, the report may be 1-year old as of the date of closing.

Zoning and Land-Use Regulations

Property improvements must constitute a legally permissible use of the land based on the zoning ordinance. If the improvements represent a legal, non-conforming use of land, the appraisal analysis must reflect any adverse effect that the non-conforming has on the value and marketability of the property; this requirement applies to all property types. See Warrantable Condo Requirements.

The appraiser must compare the existing and potential use of the subject property to the zoning regulations. In addition, the appraiser must indicate where the subject property presents:

- A legal conforming use;
- A legal non-conforming (grandfathered) use;
- An illegal use under zoning regulations; ***or***
- That here is no local zoning.

Special consideration must be given to properties that are subject to other types of land use regulations, such as coastal tideland or wetland laws, as setback lines or other provisions may prevent reconstruction or maintenance of the property improvements in the event of damage or destruction.

The intent of some land- use regulations is to remove existing land uses and to stop land development (including the maintenance, or new construction, or seawalls) within specific setback lines.

NOTE: EXCEPT AS STATED ABOVE, PROPERTIES WITH LAND-USE RESTRICTIONS WHICH PROHIBIT THE RECONSTRUCTION TO MAINTENANCE THE DWELLING ARE INELIGIBLE.

CONDOMINIUMS

General Condo Requirements

A condominium project is one in which individual owners hold title to units in the project along with an undivided interest in the real estate that is designated as the common area for the project. The units in the project must be owned in fee simple and the unit owners must have the sole ownership interest in and rights to the use of, the project's facilities, common elements, and limited common elements.

To qualify as an acceptable condominium unit, the condominium project must be common for the area and demonstrate good marketability.

- All Loan secured by condominium projects require a completed Homeowners Association (HOA) questionnaire.
- See the current LTV matrix for maximum LTV/CLTVs and loan amounts.

NOTE: IF THE MATRIX INDICATES THE PROJECT MUST BE WARRANTABLE, SEE THE Warrantable Condo Requirements **SECTION.**

- Sky TPO's project exposure maximum shall be $5,000,000 or 20% of the total units in the project, whichever is lower.
- A minimum unit square footage is not required; however, units must contain a full-size kitchen and kitchen appliances to be eligible for financing. In addition, similarly sized comparable from competing projects must be provided to demonstrate market acceptance for units with < 400 square feet.
- Projects consisting entirely of detached (site) units will not require a project review and are eligible for single-family dwelling LTV/CLTV.
- 2-4-unit condominium projects will not require a project review provided the following are met:
    - The project is not a condo hotel, houseboat, or timeshare or segmented-ownership project.
    - The priority of common expense assessments applies.
    - The standard condominium project insurance requirements apply.
- Project has been created and exists in full compliance with applicable local jurisdiction, state, and all other applicable laws and regulations.
- Any structural or mechanical Inspections completed within the past 3 years **must** be provided.
- Projects must be reviewed for significant deferred maintenance and/or unsafe conditions.
- Must meet all applicable project insurance requirements.

- Fidelity Bond is required on new projects as well as any project that must be warrantable. When required, it needs to meet the published requirements.
- Underwriter/ Condo Review must confirm that the project documents do not give a unit owner or any other party priority over the rights of the first mortgagee.
- Must not have “ineligible” characteristics, as defined below.

Non-Warrantable Condo Requirements

Sky TPO will permit non-warrantable condos with the following attributes:

- Commercial space allowed up to 50% of project.
- No more than 25% of the total units in the project may be 60 days or more past due on the condominium/HOA fees, including special assessments.
- Investor concentration allowed up to 70%. A higher percentage may be considered when the subject transaction is an investment property.
- The project developer may be in control of the condominium association provided the Master Agreement allows for the homeowners to take control upon either a predetermined percentage of unit sales or within a defined time frame.
- Single entity ownership allowed up to 30% of the project.
- Subject units on areas such as golf courses, with pool clubs, or other amenities that are subject to a mandatory membership fee are acceptable. The fees must be included in the borrower’s DTI ratio.
- Projects involved in litigation are acceptable provided the lawsuit(s) are not structural in nature which impact the subject unit and do not affect the marketability of the project units and potential damages do not exceed 25% of HOA reserves or documentation from the insurance carrier or attorney representing the insurance carrier that the insurance carrier has agreed to conduct defense and the HOA insurance policy is sufficient to cover the litigation expense.
- Deductibles above 5% and up to 10% are permitted when the HOA budget is sufficient to cover the deductible.

Warrantable Condo Requirements

Certain programs and/or LTVs require condo project be FNMA warrantable to be eligible. When a program indicates the condo must be warrantable, full *FNMA condo guidelines* must be followed to ensure warrantability.

- Investor concentration, waived for limited review. On full review, for investment occupancy transactions investor concentration must be ≤50%, and is waived for primary and secondary occupancy transactions
- Commercial space allowed up to 35% of project.
- No more than 15% of the total units in the project may be 60 days or more past due on the condominium/HOA fees, including special assessments.
- Single entity ownership allowed up to 20% for projects with 21 or more units or a max of 2 units for projects with 5 to 20 units.
- Insurance deductibles to a max of 5%
- **STATE SPECIFIC**:
    - FL Established Condos must meet the following LTV/CLTV limits:
        - Owner Occupied – 75%/90%

- FL New Projects must be FNMA approved

The following documentation must be provided to determine warrantability:

- Reserves:
  - Budget must demonstrate a minimum 10% reserve requirement. Reserve studies may be provided for consideration when the 10% is not satisfied.
- Required Documents:
  - Sky TPO Condominium Project Questionnaire
  - Current annual budget
  - Balance Sheet dated within the past 90 days.
  - Master insurance policy including property, fidelity/crime, liability and wind, along with HO-6 policy if master is not walls in.
  - Flood insurance with Replacement Cost Valuation if the subject is located in a flood zone.

Ineligible Projects

- Condos listed with a status of “unavailable” in Condo Project Manager (CPM).
- Condotels.
- A project subject to the rules and regulations of the US Securities and Exchange Commission.
- Leasehold condos.
- Timeshare or condo projects with restrictions on owner’s ability to occupy the unit.
- Houseboat project.
- Manufactured home projects.
- Assisted living facilities or any project where the unit owner’s contract includes a lifetime commitment from the facility to care for the unit owner regardless of future health or housing needs.
- Multi-family units where a single deed conveys ownership of more than one, or all of the units.
  - A common-interest apartment.
  - A project in which individuals have an undivided interest in a residential apartment building and land and have the right of exclusive occupancy of a specific apartment unit in the building.
  - The project or building is often owned by several owners as tenants-in-common or by a homeowners’ association.
- Fragmented or segmented ownership.
  - Ownership is limited to a specific period on a recurring basis (i.e., timeshare, quarter share).
- Any project where the developer (or its affiliates) owns the Common and/or Limited Elements and leases the elements back to the HOA.
- Any project that has non-conforming zoning (can’t be rebuilt to current density).
- Any project that requires Private Transfer Fees as a part of the transaction, and those fees do not benefit the association.
- Any project in need of Critical Repairs.
- Any project currently under an evacuation order due to unsafe conditions
- Any project with unfunded repairs totaling more than $10,000 per unit.

In addition, the following applies to projects of 5 or more units:

- Projects with significant deferred maintenance are not eligible, such as:
    - Projects with a full or partial evacuation of the building to complete repairs for more than 7 days or an unknown period of time;
    - Projects with deficiencies, defects or substantial damage, or deferred maintenance that
        - Is severe enough to affect the safety, soundness, structural integrity or habitability of the improvements;
        - The improvements need substantial repairs and rehabilitation, including major components; or
        - Impedes the safe and sound functioning of one or more of the building's major structural or mechanical elements, including but not limited to the foundation, roof, load bearing structures, electrical systems, HVAC or plumbing.
    - Projects that have failed to obtain an acceptable certificate of occupancy or pass local regulatory inspections or re-inspections.
- Special assessments, even if paid in full for the subject unit, must be reviewed to determine acceptability and the following must be documented:
    - The reason for the special assessment;
    - The total amount assessed and repayment terms;
    - Documentation to support no negative impact to the financial stability, viability, condition, and marketability of the project;
    - The association has sufficient funds for any repairs; ***and***
    - Borrower must qualify with the outstanding special assessment payment.
    - **NOTE THAT IF UNABLE TO DETERMINE NO NEGATIVE IMPACT AND/OR THAT THE ASSESSMENTS DEEM THE PROJECT TO BE UNSAFE OR UNSOUND, THE PROJECT IS INELIGIBLE.**
- When any of these issues are identified, for project consideration, a full review (warrantable) must be obtained and all required documents listed under the Warrantable Condo Requirements Section of the guide must be obtained and a third-party review completed.

Projects in Need of Critical Repairs

Loans secured by units in condo project with significant deferred maintenance or in projects that have received a directive from a regulatory authority or inspection agency to make repairs due to unsafe conditions are **not** eligible.

These projects are ineligible until the required repairs have been made and documented. Acceptable documentation may include a satisfactory engineering or inspection report, certificate of occupancy, or other substantially similar documentation that shows the repairs have been completed in a manner that resolves the building's safety, soundness, structural integrity, or habitability concerns.

Significant deferred maintenance includes deficiencies that meet one or more of the following criteria:

- Full or partial evacuation of the building to complete repairs is required for more than seven days or an unknown period of time.

- The project has deficiencies, defects, substantial damage, or deferred maintenance that:
    - Is severe enough to affect the safety, soundness, structural integrity, or habitability of the improvements.
    - The improvements need substantial repairs and rehabilitation, including many major components; **or**
    - Impedes the safe and sound functioning of one or more of the building's major structural or mechanical elements, including but not limited to the foundation, roof, load bearing structures, electrical system, HVAC, or plumbing.

Additionally, projects that have failed to obtain an acceptable certificate of occupancy or pass local regulatory inspections or recertifications are not eligible.

These policies do not apply to routine maintenance or repairs that a homeowners' association (HOA) undertakes to maintain or preserve the integrity and condition of its property.

Also, if damage or deferred maintenance is isolated to one or a few units and does not affect the overall safety, soundness, structural integrity, or habitability of the improvements then these project eligibility requirements do not apply.

Examples of this scenario include water damage to a unit due to a leaky pipe that is isolated or damage from a small fire impacting the interior of a specific unit; however, if the subject property unit is affected, our standard requirements for property condition apply.

Special Assessments

Any current or planned special assessment, even if paid in full for the subject unit, must be reviewed to determine acceptability.

The loan file must be documented with the following:

- the reason for the special assessment.
- the total amount assessed and repayment terms.
- documentation to support no negative impact to the financial stability, viability, condition, and marketability of the project; ***and***
- borrower qualification with any outstanding special assessment payment.

The financial documents of the HOA are required for review to confirm the association has the ability to fund any repairs.

If the special assessment is related to safety, soundness, structural integrity, or habitability, all related repairs must be fully completed, or the project is not eligible. Additionally, if the client or appraiser is unable to determine that there is no adverse impact, the project is **ineligible**.

Inspection Reports

If a structural and/or mechanical inspection was completed within 3 years of the project review, a copy of the report must be provided. The report cannot indicate any critical repairs are needed, no evacuation orders are in effect, and no regulatory actions are required.

If the inspection report indicates ongoing repairs, a letter from the engineer indicating the project is safe for occupancy while the repairs are going on should be provided when it is not evident through the inspection that the repairs are not critical in nature.

If the inspection report indicates there are unaddressed critical repairs, the project is **ineligible** until the required repairs have been completed and documented accordingly. A review of the engineer's report or substantially similar document to determine if the repairs completed have resolved the safety, soundness, structural integrity, or habitability concerns of the project is required.

Established Projects

Established projects are determined based on a review of sold and conveyed units as follows:

- 90% of the total units in the project must be sold and conveyed to the unit owners.
- If less than 90% of the units are sold and conveyed, but the deficit is the result of the developer holding back units, the project may be considered established if:
    - The developers share of the units held back for rental is no more than 20% of the project's total units;
    - HOA fees are paid current in developer held units; ***and***
    - There are no active or pending special assessments in the project.

The following are required in both instances:

- 30% of the total units in the project must be owner occupied.
- All phases are complete.
- HOA must be conveyed to the unit owners; developer or builder-controlled projects are not allowed.
- All comparable sales may be from within the subject's project if the project is established and consists of 100 or more units. Recent sales of model match units, if available, must be utilized in the appraisal report.

New Projects

- 40% of the total units in the project or subject's phase must be sold and conveyed or be under contract for sale to the unit owners *and* at least 40% of the units must be owner occupied or second homes.
- Project or subject's legal phase along with other development phases must:
    - Have a Certificate of Occupancy or other similar document issued by the applicable governmental agency for the project or subject phase; ***and***
    - All units and buildings in the legal phase in which the subject property is located are complete, subject to the installation of buyer select items, such as appliances.
- All common elements in the project or legal phase must be 100% complete or provide documentation to ensure acceptable completion assurances arrangements that guarantee the future completion of all project facilities, common elements, and limited common elements. Evidence of assurance arrangements may include:
    - An attorney opinion letter, or
    - A current balance sheet along with details on the remaining work to be done to render all amenities/facilities complete and the estimated cost to complete, or

  - Evidence escrow funds deposited for recreational amenities.

- Project may be subject to additional phasing.

Condominium Conversions

A condominium conversion is the conversion of an existing building to a condominium project. Project conversions legally created in the past year must meet new condo presale requirements.

Site Condominiums

- Projects consisting of single-family detached dwellings (also known as site condominiums) are acceptable provided the appraisal supports market acceptance of site condominiums in the subject's market area. A Condominium Project Questionnaire is not required.
- Appraisals for site condos may be documented on FNMA Form 1073 or Form 1004. When documented on the 1004, the appraiser should include an adequate description of the project, information about the homeowners' association fees, and note the quality of the project maintenance.
- Standard Condominium insurance requirements apply.

DISASTER AREA POLICY

Sky TPO is responsible for identifying areas impacted by disasters and taking the appropriate steps to ensure the subject property has not been adversely affected.

Examples of disasters include, but are not limited to, hurricanes, earthquakes, floods, landslides, tornadoes, wildfires, volcanic eruptions, civil unrest, and terrorist attacks.

Adverse events that receive a formal disaster declaration issued by local, state or federal departments of emergency management must follow the procedures listed below. A list of all federally declared disaster areas may be found on the FEMA website at *Disasters and Other Declarations | FEMA.gov*.

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

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

- Additional documentation to support ongoing business activity may be requested at the discretion of the underwriter.

Property Appraised Prior to Disaster Incident

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

- Clear Capital Post Disaster Inspection Report (PDI or equivalent); **or**
- An exterior inspection completed by licensed third-party professional:

  - Exterior Inspection must certify the condition of the subject property and identify any impact to habitability or marketability related to the named disaster.

- Inspection report must include photographs of the front, street view, and any damage to subject property.
- Inspection report and evidence of inspector licensing must be retained in loan file.

If the appraisal was complete at the time of the disaster but 'subject to completion' or 'subject to repairs', an Appraisal Update and/or Completion Report (FNMA *Form 1004D*) is required in addition to the inspections listed above. Note that both inspections may be done on the same 1004D form provided the appraiser specifies the 1004D covers both the required repair work and the post-disaster inspection.

Property Appraised After Disaster Incident

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

Disaster Incident After Closing but Prior to Funding

If the disaster incident occurred after closing, the loan is ineligible for purchase or funding until one of the following is received certifying no damage to the subject property:

- Clear Capital Post Disaster Inspection Report (PDI or equivalent) that names the disaster that required the inspection; ***or***
- Appraisal Update and/or Completion Report (FNMA *Form 1004D*) that names the disaster that required the report.

Disaster Effective Time Period

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

Employment Verification

In addition to verifying the property has not been adversely impacted, it must also be established that the employment/earnings have not been negatively impacted on all loans located in a county with individual assistance and the income documentation in file predates the date of the disaster.

- Wage Earners must have the VVOE completed after the disaster date confirming no impact to wages due to the disaster.
- Self-Employed borrowers must provide a Borrower Certification attesting to the fact that their revenue has not been impacted as a result of the disaster.

PROPERTY INSURANCE

Hazard Insurance Coverage

Hazard insurance must protect against loss or damage from fire and other hazards covered by the standard extended coverage endorsement. Extended coverage must include, at a minimum, wind, civil commotion (including riots), smoke, hail, and damage caused by aircraft, vehicle, or explosion.

Required perils include:

- Fire or lightning
- Explosion
- Windstorm (including named storms)
- Hail
- Smoke
- Aircraft
- Vehicles
- Riot or civil commotion

The coverage must provide for claims to be settled on a replacement cost basis. Property insurance policies that provide for claims to be settled on an actual cash value basis are **not** acceptable.

Hazard Insurance Coverage Amount Determination

- The unpaid principal balance of the mortgage or
- 100% Replacement Cost Coverage as stated on the policy declaration page.

If the above requirements are not met, it will be acceptable to provide coverage equal to at least 100% of the insurable value of improvements, as established by the property insurer through a Replacement Cost Estimator of equivalent.

NOTE: IF THE POLICY DOES NOT COVER THE UNPAID PRINCIPAL BALANCE, HAVE GUARANTEED REPLACEMENT COST OR A REPLACEMENT COST ESTIMATE IS NOT PROVIDED, A PROCESSOR'S CERTIFICATION FROM SKY TPO VERIFYING THE INSURER'S COVERAGE IS EQUAL TO 100% OF THE INSURABLE VALUE OF IMPROVEMENTS AS INDICATED BY THE INSURANCE AGENT OR REPRESENTATIVE. THE CERTIFICATION MUST INCLUDE THE INSURANCE COMPANY'S COMPLETE INFORMATION, SUBJECT PROPERTY ADDRESS, CONFIRM THE REPLACEMENT COST AMOUNT DETERMINED BY THE INSURER, AND BE SIGNED AND DATED BY THE PROCESSOR.

Maximum Deductible

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.

Hazard Insurance Evidence

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

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

Evidence of Insurance must provide the following information:

- Names of borrowers reflect the same as the names on the note.
- Property address agrees with the note/security instrument.

- Mailing address is the same as property address.
- Policy Number
- Loan Number
- Name of insurance company
- Insurance Agent information
- Effective and expiration dates of coverage
- Premium Amount
- Coverage amounts and deductible.
- Loss payee clause as applicable
- Signed and dated by agent.

Optional Coverage

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

Condominium and PUD Project Insurance Requirements

The master property hazard or flood insurance policy must designate the HOA as the named insured. If the condo’s legal documents permit it, the master property or flood insurance policy can specify an authorized representative of the HOA, including trustee, as the named insured.

Condo Projects

The master property hazard or flood insurance policy must designate the HOA as the named insured. If the condo’s legal documents permit it, the master property or flood insurance policy can specify an authorized representative of the HOA, including trustee, as the named insured.

PUD Projects

The master property hazard or flood insurance policy must designate the HOA as the named insured.

Coverage Requirements

The insurance policy must at a minimum protect against fire and all other hazards that are normally covered by the standard extended coverage endorsement, and all other perils customarily covered for similar types of projects, including those covered by the standard “all risk” or “special form” endorsement. If the policy does not include an “all risk” or “special form” endorsement, a policy that includes the “broad form” covered causes of loss is acceptable. If the master policy excludes or limits coverage of any of the required perils, the HOA must obtain an acceptable stand-alone policy which provides adequate coverage for the limited or excluded peril. Required perils include:

- Fire or lightning
- Explosion
- Windstorm (including named storms)
- Hail
- Smoke

- Aircraft
- Riot or civil commotion
- Vandalism
- Sprinkler leakage
- Sinkhole Collapse
- Volcanic action
- Falling objects
- Weight of snow, ice or sleet
- Water damage

The policy must be provided for claims to be settled on a replacement cost basis.

POLICIES WRITTEN ON AN ACTUAL CASH VALUE BASIS ARE NOT ACCEPTABLE.

Special Coverage Requirements

The following special coverage requirements apply to both warrantable condos and PUD Master Insurance Policies.

- **Inflation Guard Coverage**: the coverage is not required if it's not obtainable in the insurance market available to the association. In addition, inflation guard coverage is not required when the policy has guaranteed replacement cost or extended replacement cost.
- **Building Ordinance or Law Coverage**: the coverage may be included in the property coverage form or obtained as an endorsement to the property insurance policy. Coverage is not required if it is not obtainable in the insurance market to the association. When required, the coverage must include:
    - **Coverage A**: loss to the undamaged portion of a building,
    - **Coverage B**: demolition costs, and
    - **Coverage C**: increased cost of construction.
- **Boiler and Machinery/Equipment Breakdown Coverage**: this coverage is required if the project development has central heating or cooling. The coverage may be included in the property coverage form, obtained as an endorsement to the master policy, or the HOA may purchase a stand-alone policy. This coverage is not required when each unit is metered individually, or with evidence that coverage is not obtainable to the HOA in the insurance market.
    - When required, the amount must equal the lesser of $2 million or the replacement cost value of the building(s) housing the boiler or machinery.

Required Coverage Amount

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

- **Guaranteed Replacement Cost:** the insurer agrees to replace the insurable property regardless of the cost,
- Extended Replacement Cost: the insurer agrees to pay more than the property's insurable replacement cost, **or**

- **Replacement Cost**: the insurer agrees to pay up to 100% of the property's insurable replacement cost.

Policies Covering Multiple Projects

Acceptable policies must provide coverage for either an individual project or multiple affiliated projects.

Except as described below, unaffiliated projects may not share a master property insurance policy. Each project must maintain its own policy that meets the defined requirements.

If a property insurance policy that covers multiple unaffiliated projects provides a dedicated coverage amount for each individual covered project, the policy structure may provide equivalent coverage to the defined coverage amounts. The coverage amount dedicated to the subject project must be sufficient to cover the full replacement cost value of the project improvements including the common elements and

residential structures. The coverage of each insured project cannot be affected by any actions or omissions of unaffiliated projects covered by the same policy. Additionally, all other master property insurance requirements for project developments must be met.

Maximum Deductible

The maximum deductible for the following policies is 5%; however, a deductible of up to 10% is permitted on non-warrantable projects when the HOA budget is sufficient to cover the deductible.

- Policies covering the common elements in a PUD or Condo Project,
- Losses related to individual PUD units covered by a blanket policy for the project,
- Separate wind-loss policies,
- Blanket policies that cover both the individual unit and the common elements.

General Liability Coverage

Project liability insurance requirements of $1,000,000 per occurrence is required.

Fidelity Bond Coverage

Fidelity bond coverage is required for condominium projects over 20 units:

- Warrantable Project
- New Projects

When required, the coverage must be at least equal to the greater of 3 months HOA dues or the minimum required by state law. Coverage is *not* required when the calculated amount is $5,000 or less.

Flood Insurance

Flood insurance is required for any property located within any area designated by the Federal Emergency Management Agency (FEMA) as a Special Flood Hazard Area (SFHA). A SFHA is typically denoted as Flood Zone A or Zone V (coastal areas). Properties in Flood Zone A or V must be located in a community which participates in the FEMA program to be eligible for financing. Sky TPO aligns with Fannie Mae on Flood Insurance, and it is only required when a mortgage loan is secured by a property located in:

- A Special Flood Hazard Area (SFHA), ***or***
- A Coastal Barrier System (CBRS) or Otherwise Protected Area (OPA)

Flood Certificate

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

The flood insurance requirement can be waived if:

- Subject property improvements are not in the area of Special Flood Hazard, even though part of the land is in Flood Zone A or V; ***or***
- The Flood Certificate, Section B4 “Flood Zone” field is marked as “None” and Section B5 “No NFIP Map” is checked (true); **and** the “No” box in Section D “Determination” is checked validating the property is not in a FEMA flood zone containing the letters A or V; ***or***
- Borrower obtains a letter from FEMA stating that its maps have been amended so that the subject property is no longer in an area of Special Flood Hazard

Minimum Flood Insurance Coverage

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

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

Acceptable Flood Insurance Policy

The flood insurance policy must be one of the following:

- A standard policy issued under NFIP; **or**
- A policy issued by a private insurer as long as the terms and amount of coverage are at least equal to that provided under a NFIP policy based on a review of the full policy issued by the private insurer.

Project Flood Insurance Requirements

The flood policy for a PUD or condominium project must cover at minimum the subject unit’s building and any common element buildings and any other common elements and property, including machinery and equipment that are part of the building. The amount of flood insurance coverage for a PUD or condo project should be at least equal to the lesser of 80% of the replacement cost value or the maximum coverage available under the appropriate National Flood Insurance Program (NFIP) per unit.

Flood Insurance Evidence

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

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

Evidence of Insurance must provide the following information:

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

Name Insured for Property and Flood Insurance

- **Individual Units in a Project Development**
  - The individual property or flood insurance policy last name all persons holding title to the subject property as named insured to ensure the borrower(s) has full rights to the policy and the ability to receive benefits is not impaired.
- **Condo Projects**
  - The master property or flood insurance policy must designate the HOA as the named insured. If the condo's legal documents permitted the master property or flood insurance policy can specify an authorized representative of the HOA, including its insured trustee, as the name insured.
- **PUD Projects**
  - The master property or flood insurance policy must designate the HOA as the named insured.

Notice of Cancelation – Property Insurance

The policy must require the insurer to notify in writing the named insured and mortgagee before it cancels the policy.

TITLE INSURANCE

Title Insurance Policy Requirements

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

Preliminary title must indicate that the final title policy will be issued after funding. The title insurer must be qualified to do business in the state where the subject property is located. The title insurer and policy must conform to *Fannie Mae*/*Freddie Mac* requirements.

Borrower Information

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

Coverage Amount

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

Insured Name

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

Age of Report

The preliminary title report/title commitment should be dated no later than 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.

Vesting

The final title policy vesting should reflect the name of the individual borrower. See Vesting and Ownership.

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.
- 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.

Title Policy Forms

The final title policy must be written on one of the following forms:

- 2006 American Land Title Association (ALTA) standard form
- ALTA short form
- ALTA form with amendments required by state law in states in which standard ALTA forms of coverage are not used or in which the 2006 ALTA forms have not yet been adopted, provided those amendments are acceptable to Fannie Mae/Freddie Mac.

Title Policy Underwriter

A title insurer must be:

- duly authorized and licensed, as required, to issue title insurance in the state where the property is located; and
- further evaluated in accordance with the lender's procedures for title insurer approval, which may include factors such as
    - an acceptable rating from a rating agency,
    - financial strength of the title insurer,
    - adequate reserves, or
    - record related to satisfactory title claim resolution.

STATE SPECIFIC: IOWA TITLE GUARANTY IS AN ACCEPTABLE TITLE GUARANTOR FOR PROPERTIES LOCATED IN THE STATE OF IOWA

TITLE COMMITMENT REVIEW

Chain of Title

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

Title Exceptions

The following items are allowable title exceptions:

- Customary public utility subsurface easements: the location of which are fixed and can be verified. The exercise of rights of easement will not interfere with use and enjoyment of any improvement of the subject property or proposed improvements upon which the appraisal or loan is based.
- Above-surface public utility easements that extend along one or more property lines for distribution purposes, or along the rear property line for drainage, provided they do not extend more than 12 feet from the subject property lines and do not interfere with any of the buildings or improvements, or with the use of the subject property; and public utility restrictions, provided their violation will not result in the forfeiture or reversion of title or a lien of any kind for damages, or have an adverse effect on the fair market value of the subject property.

- Mutual easement agreements that establish joint driveways or party walls constructed on the subject property and on an adjoining property, provided all future owners have unlimited and unrestricted use of them.
- Encroachments on one foot or less on adjoining property by eaves or other overhanging projections or by driveways provided there is at least a 10-foot clearance between the buildings on the subject property and the property line affected by the encroachments.
- Encroachments on the subject property by improvements on adjoining property provided these encroachments extend one foot or less over the property line of the subject property, have a total area of 50 square feet or less, do not touch any buildings, and do not interfere with the use of any improvements on the subject property or the use of the subject property not occupied by improvements.
- Encroachments on adjoining properties by hedges or removable fences.
- Liens for real estate or ad valor taxes and assessments not yet due and payable.
- Outstanding oil, water, or mineral rights as long as they do not materially alter the contour of the property or impair its value or usefulness for its intended purposes.

Survey Requirements

If surveys are not commonly required in a particular jurisdiction, an Alta 9 endorsement can be obtained. If neither a survey nor the ALTA 9 endorsement are customary in a particular location, title must not have a survey exception.

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.

NOTE: 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.