MPF® Traditional Product
Eligibility and Underwriting

January 13, 2022

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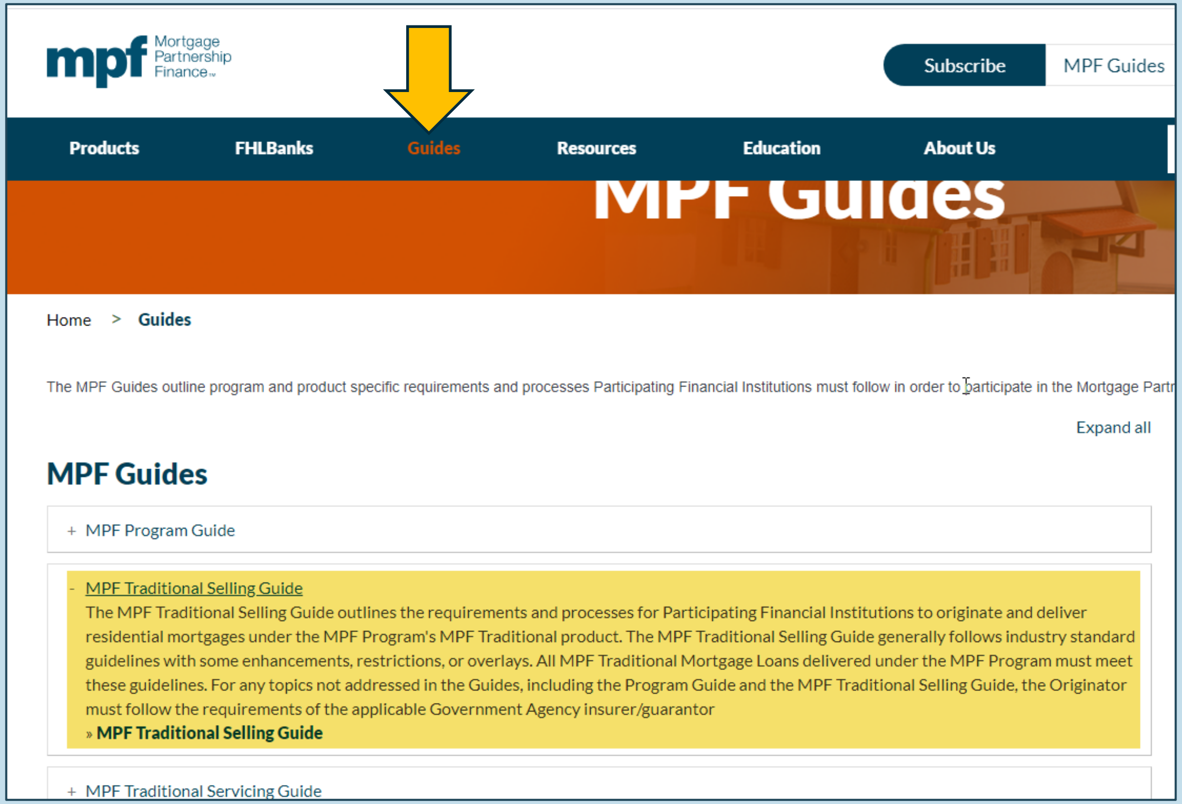
Underwriting Resources

The MPF® Traditional product Selling Guide is available on the MPF Program Website: www.fhlbmpf.com and through AllRegs®



Underwriting MPF Traditional Loans Methods, Overlays and Benefits

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Underwriting MPF Traditional Loans

Loans may be underwritten **manually** or with an Automated Underwriting System (AUS) such as Fannie Mae's Desktop Underwriter® (**DU**®) or Freddie Mac's Loan Product Advisor® (**LPA**)

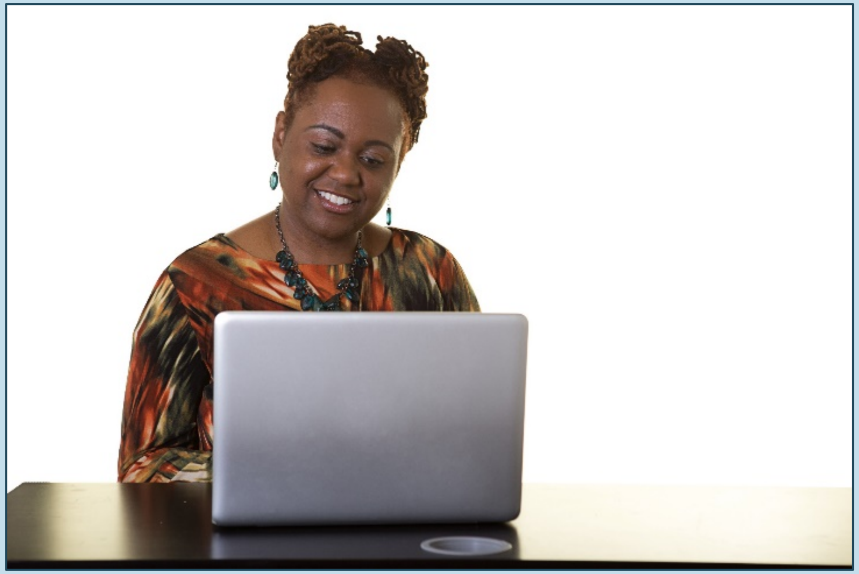
- Manually underwritten loans must follow the guidelines published in the MPF Traditional Product Selling Guide.
- If using DU or LPA, follow the guidelines of either Fannie Mae or Freddie Mac but watch out for product overlays.
- Typically when the MPF Traditional Selling Guide is silent on a topic, you may refer to Fannie Mae's guidelines for guidance. When in doubt, call the MPF Service Center.

Using DU and LPA

Jenni uses DU to underwrite her MPF Traditional loans. She knows there are some MPF Traditional overlays that supersede her DU findings.

Which item is allowed when using DU to underwrite an MPF Traditional loan?

a. LTVs over 95%
b. FICO scores less than 620
c. Debt-to-income (DTI) ratios over 43%
d. Investment properties
e. Home improvement/rehab loans
f. Fannie Mae's Refi Plus option



c. DTIs are over 43% are acceptable if an approve eligible finding is returned.

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AUS Overlays

When using DU or LPA to underwrite an MPF Traditional loan, be aware that there are a number of overlays that supersede both Fannie Mae and Freddie Mac guidelines

- Maximum LTV is 95%
- Minimum Credit Score of 620
- Full interior/exterior appraisals (or a DU eligible* appraisal waiver if permitted by your FHLB and if it meets MPF Program requirements).
- Follow the MPF Traditional Selling Guide requirements for **Eligible Property Types** (Chapter 6.1)
- Follow the MPF Traditional Selling Guide requirements for **Occupancy Requirements** (Chapter 6.2)
- Familiarize yourself with the ineligible loan or product attributes listed in Chapter 2.7

*Freddie Mac/LPA ACE waivers are not eligible.

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Eligible Property Types

- Detached or attached single-family properties
- 1-4 unit properties
- One-unit second homes
- Manufactured housing (primary residence only)
- Attached condominiums and PUDs

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Ineligible Property Types

The following are examples of ineligible property types*:

- Vacant properties
- Cooperatives (co-ops)
- Condo hotels (condotels)
- Houseboat condominium projects
- Timeshares
- Properties not suitable for year-round usage regardless of location
- Boarding houses or bed and breakfasts
- Properties not easily accessible by roads that meet local standards
- Multi-dwelling unit condominiums
- Agricultural properties such as working farms or ranches

***See the MPF Traditional Selling Guide Chapter 2.7 for a complete list.**

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Know Your Options

Alexis is frustrated because she just received an approve/ineligible finding from DU.

It’s a cash-out refinance of a second home and the loan to value (LTV) appears to be too high at 81%.

What are her options?

1. **Manually underwrite the loan. Manual underwriting guidelines permit up to an 85% LTV for cash-out/second home transactions.**
2. **Continue to use DU but lower the loan amount to meet FNMA’s LTV guideline which is 75%.**

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Benefits to Manual Underwriting

- No set reserve requirements except for second homes which require two months.
  - ✓ Reserve requirements should be determined by the overall risk profile (your decision).
  - ✓ Follow MI company reserve requirements for loans over 80% LTV.
- Minimum of 620 credit score for any applicable LTV.
- Installment loans in deferment for more than 12 months from the Note date do not have to be counted as a liability.
- Earnest money deposits that are less than 50% of the total down payment do not have to be verified.
- Cash-out refinances of second homes up to 85% LTV.
- No limit on the number of financed properties a borrower can own.

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Benefits to Using DU or LPA

- Automation and documentation guidance, sometimes less documentation.
- Income and assets of a non-occupant co-borrower can be combined with the occupying borrower for qualifying.
- DTIs over 43% may be permitted.
- 30-day accounts (i.e. American Express) with balances do not have to be paid off prior to or at closing (however, borrower must have reserves to cover the balance).
- DU appraisal waivers may be used if permitted by your MPF Bank and all program requirements are met.

Borrower Eligibility and Occupancy

Borrower Eligibility

U.S. Residency

- U.S. Citizen
- Permanent Resident Alien
- Non-Permanent Resident Alien
- Borrower must have a SSN or ITIN

Property Title Ownership Types

- Individual (a “natural person”)
- Inter Vivos (Living) Revocable Trust
- Illinois Land Trusts
- Title MAY NOT be held in the name of a partnership or corporation.

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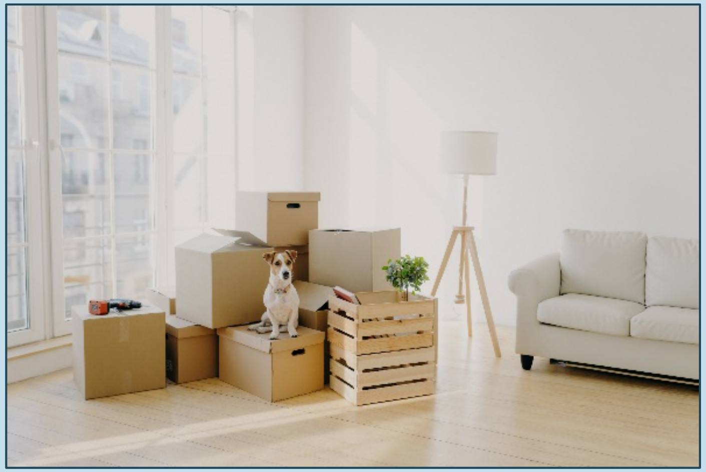
Non-Occupant Co-Borrowers

Non-occupant co-borrowers apply for joint credit with the borrower and may take title to the property but do not occupy the property

- The non-occupant co-borrower is required to sign the Note and security instrument (mortgage or deed of trust).

- If **manually underwriting**, the borrower must be able to qualify for the loan using their own income with a total DTI at or below 43.00%.

- If using **DU or LPA**, the income, assets and liabilities of **all** borrowers is combined/considered.



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Non-Occupant Co-Borrowers

Michael is purchasing his first home

- He receives a salary plus commissions but hasn't been on the job long enough to use the commissions for qualifying. Without the commissions his **DTI is 48%.**
- He has **5%** of his own funds to use as a down payment.
- His mother has offered to be a co-borrower but will not live in the property.

Can this work and if so, how would you approach this loan?

It may work if you use either DU or LPA to underwrite the loan. If manually underwritten, the co-borrower must occupy the property if the LTV is > 90%. Also his DTI is too high if manually underwritten.

Occupancy Requirements

LTV/CLTV	Co-Borrower Occupancy Status
> 95% (for loans with AHP funds only)	Co-borrower must occupy the property.
90.01% - 95%	The co-borrower must occupy the property unless the mortgage loan was underwritten using DU or LPA.
90% or below	The co-borrower is not required to occupy the property.

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Subject Property Second Homes

Second homes are properties the borrower occupies for a portion of the year

- Limited to one-unit detached homes, condos and PUDs (no manufactured homes).
- If a condo or a PUD, the borrower may own only one unit in the development (occupancy overlay).
- The property must have a full-sized kitchen, separate rooms for sleeping and no lock-out bedrooms.
- The property must not be part of a timeshare or rental pool agreement.

Second Homes

Which of the following statements about second homes is <u>not true</u>?

a. The property has to be suitable for year-round use.
b. There is no specific mileage requirement regarding distance between a second home and a primary residence.
c. If manually underwritten, a minimum of six months of reserves is required.
d. Second homes may be rented out for a portion of the year but the rental income cannot be used to qualify.

A minimum of two months is reserves is required for second homes but if the overall risk profile merits more, that it is up to the underwriter's discretion.

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Income and Employment

Income

The stability and continuance of a borrower’s income must be determined

Salaried borrowers:

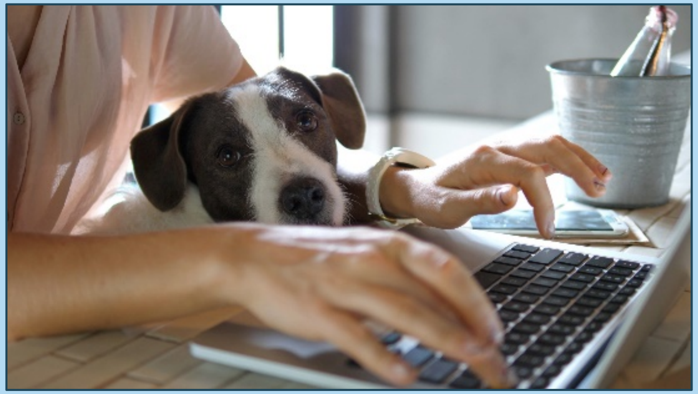
- W-2 forms for the past two years*
- Paystubs covering a 30-day period
  - ✓ If paystubs are not available, then a written verification of employment (VOE) must be obtained.
- A verbal VOE (VVOE)
  - ✓ IRS transcripts are an acceptable substitute for actual W-2 forms.
  - ✓ VVOEs must be obtained within 10 days of closing.

*DU or LPA findings may request only one year.

Self-Employed Income

In addition to tax returns, the existence of a self-employed borrower’s business must be verified

- Acceptable verification of the existence of the business includes, but is not limited to the following:
  - ✓ Third party verification, from sources such as a CPA, regulatory agency or licensing bureau.
  - ✓ A phone listing found via the internet or phone directory.
  - ✓ **What other methods can be used?**



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Employment Offers and Contracts

Leslie accepted a job offer but will not begin her job until after the loan can be delivered for purchase. This is permitted if the loan is underwritten with DU/LPA*, but which of the following statements is FALSE?

a. Purchase transactions only

b. Must be a principal residence or a second home

c. One-unit properties only

d. The borrower cannot be employed by a family member or an interested party to the transaction

e. The borrower must qualify using only fixed base income

b. Fannie Mae does not permit second homes unless the loan is delivered after the borrower receives their first paystub.

If using LPA, please review Freddie Mac guidelines, they may differ slightly.

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Retirement and Pension Income

Document regular and continued receipt of income items including:

- Letters from the organizations providing the income
- Copies of retirement award letters
- Copies of signed, federal tax returns
- W2 or 1099 forms or proof of current receipt
- Payments must continue for at least three years

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Retirement and Pension Income

Bob and Glenda are retired and are looking to relocate to a rural area. They intend to use Glenda's IRA account as additional income to help them qualify. Glenda is 66 years old and to date, hasn't taken any distributions from her IRA.

In order to consider future IRA distributions, which of the following is true?

a. There are LTV restrictions
b. Only 70% of the asset can be considered
c. Transactions are limited to a primary residence only
d. The borrower must be 65 years of age or older

The answer is a., there are LTV restrictions.

Additionally, both primary and second homes are permitted, purchases and limited cash-out refinances only.

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Retirement Distributions

There are guideline differences for establishing an asset income stream

The maximum LTV is 70% for manual underwriting, however DU will allow up to 80% if at the time of closing the borrower is at least 62 years of age. Both borrowers must meet the age requirement if the asset is jointly held.

Only use the “net documented asset” value to calculate the monthly income.

- Subtract any penalties (DU only) and any funds that are being used for down payment or/or closing costs.
- Since manual underwriting does not permit penalties, subtract any funds being used for down payment and/or closing costs.

To determine the monthly income:

- If manually underwriting, divide the net documented asset by 360.
- If using DU, divide the net documented asset by the loan term.
- If using LPA, refer to Freddie Mac guidelines.

Liabilities and Credit

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Liability Basics

- Installment debt with <10 payments remaining must be included if the debt affects the borrower’s ability to repay the mortgage during the months immediately after closing, especially if the borrower will have limited or no cash reserves.

- For a HELOC or a revolving account with no disclosed minimum payment, the greater of 5% of the outstanding balance or $10.00 must be used (or evidence of actual payment amount).

- For student loans (DU or manual underwriting*) **with no payment provided**, 1% of the outstanding balance must be used (or evidence of actual payment amount).

- A payment amount is not required for a HELOC with no balance.

Freddie Mac guideline: 0.5% of the original loan balance or outstanding balance as reported on the credit report, whichever is greater.

Liabilities: Open 30-Day Accounts

- If manually underwritten, the balance of the 30-day account must be paid off at or before closing in order to omit the payment in the borrower’s DTI ratio.

- If you use DU/LPA, the payment to be omitted if the borrower has adequate reserves to cover the balance/payment.

Installment Debt

Manual underwriting only:

- Installment debts in deferment **do not** have to be used to qualify if the borrower provides written documentation from the creditor that the debt will be deferred to a period beyond 12 months from the closing date.

Manual underwriting or using DU or LPA:

- Payments on installment debts secured by a financial asset (401k loans, margin accounts or CD loans) in which repayment may be obtained by liquidating the asset may be excluded from the total debt ratio.

- Only the balance of the assets in excess of the secured loan may be considered as reserves or assets available to the borrower.

Credit Inquiries

Any credit inquiries made within the past 90 days must be verified to establish that the inquiry did not result in a new account.

- If manually underwritten, this verification should come from the inquirer and address the purpose and outcome of the inquiry.
- If using DU/LPA, this guideline is a bit more vague but still requires confirmation that the inquiry did not result in new credit being established. Fannie/Freddie do not require reaching out to the inquirer.
- In all cases if any new credit has been established, the terms must be verified and the DTI ratios adjusted to reflect the new liability.

Collections and Charge-Offs

Past Due, Collections and Charge-Off Accounts

- If manually underwriting, single events of a past judgment, tax lien, collection, charge-off, or repossession of $250 or more, and multiple events with past due amounts totaling more than $1,000 must be paid in full at or prior to closing.
- **If DU or LPA are used, your findings will detail how the item or items need to be addressed.**

Knowledge Check

Which of the following is true about manually underwriting MPF Traditional loans?

a. DTIs cannot exceed 43%
b. If Affordable Housing Program (AHP) funds are used the maximum LTV could exceed 95%.
c. There is no reserve requirement except for second homes.
d. Cash-out refinances of second homes can go to 90% LTV.
e. Loans require full documentation.

All of the above apply except d. The maximum LTV for cash-out on second homes is 85%.

Knowledge Check

Which of the following is true about using DU or LPA to underwrite an MPF Traditional Loan?

a. DTI ratios can exceed 43% with an approve/accept eligible finding.
b. Income and assets may be combined for qualifying if using a non-occupant co-borrower.
c. Borrowers with an ITIN are not eligible.
d. Condominium projects are limited to 35% square footage for commercial spaces.
e. DU and LPA appraisal waivers are permitted.

a, b and d are true, c and e are false.
NOTE: Manually underwritten condo projects are limited to 25% commercial space square footage.

Summary

- Be aware of guideline differences between manual underwriting and underwriting with an AUS.
  - ✓Refer to Chapters 4.2.1 and 4.2.2 for details.

- Be sure to subscribe to MPF Product announcements for the most current information about MPF Traditional product updates.

- You are ultimately responsible for evaluating the overall risk profile for each loan. Even if a guideline is met, you may be more comfortable requiring a more stringent requirement or additional documentation.

Questions?

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MPF Contacts and Resources

MPF Service Center

Email - MPF-Help@FHLBC.com
Hours - 8:30 am to 4:30 pm CST
Phone: (877) 345-2673

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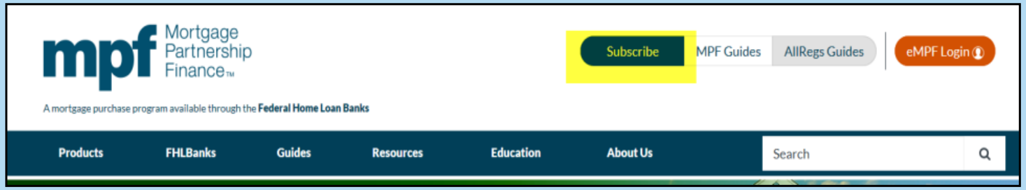

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