Mortgage Partnership Finance™

MPF® Traditional Product

Eligibility and Underwriting

September 10, 2020

FHLBANKS
A NATION OF LOCAL LENDERS

About this Material

This material is based on the current information in the MPF® Traditional Product Selling Guide as of the date of training. It should not be used in place of the MPF Traditional Product Selling Guide. The MPF Traditional Guides is the governing document and control in the event of discrepancies between this presentation and the MPF Traditional Product Guides. The official versions of all MPF Guides are available through www.fhlbmpf.com and AllRegs®.

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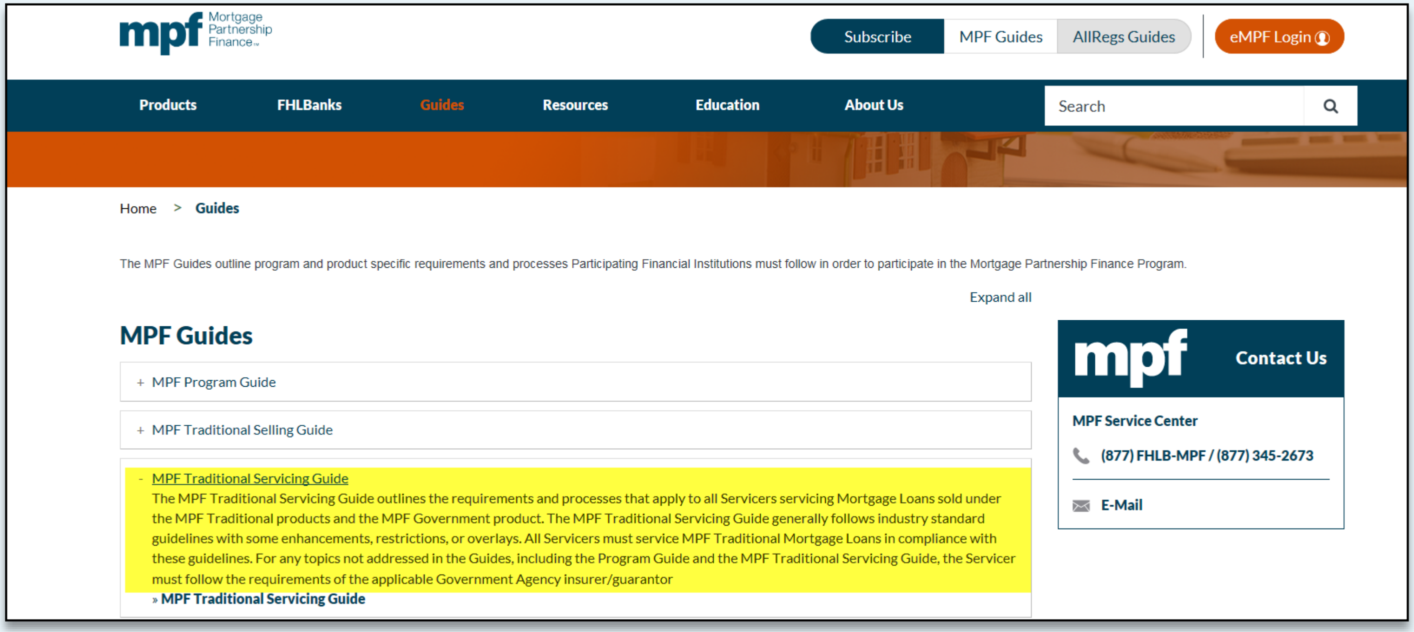
Loan Eligibility Resources

The MPF® Traditional Selling Guide contains the underwriting and eligibility requirements for the MPF Traditional products.

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



Underwriting MPF Traditional Loans

- Each MPF Traditional mortgage delivered for purchase must first receive an underwriting approval from the originating lender.
  - MPF Traditional products include:
    - ✓ MPF Original
    - ✓ MPF 125
    - ✓ MPF 35
    - ✓ MPF Government (not covered in this presentation)

- Loans may be manually underwritten or an Automated Underwriting System (AUS) may be used.
  - Fannie Mae's Desktop Underwriter® (DU®)
  - Freddie Mac's Loan Product Advisor® (LPA)
  - Desktop Originator® (DO®) **may not** be used for MPF Traditional products

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Manual Underwriting

Manually underwritten loans must meet the *Ability to Repay* and *Qualified Mortgage* (QM) rules set by the Consumer Financial Protection Bureau (CFPB)

- The ***Ability to Repay*** rule requires most lenders to make a good-faith effort to determine that a borrower(s) is likely to pay back a loan.
  - ✓ There are eight factors that must be considered to meet ATR requirements.

- A ***Qualified Mortgage*** is a category of loans that have certain, more stable features that help make it more likely that the borrower(s) will be able to afford the loan.
  - ✓ *Maximum 43.00% DTI ratio*
  - ✓ *No harmful features such as interest-only periods, negative amortization, and balloon payments.*
  - ✓ *No excessive points or fees*

Let's check your understanding of the ATR requirements…

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The Ability to Repay

Which item is not one of the eight evaluation factors that must be considered when determining the borrower's ability to repay?

a. Credit history
b. Borrower's current and expected income and assets.
c. The borrower's current employment status.
d. The value of the subject property.
e. The borrower's monthly payment on the subject property.
f. The borrower's monthly payment on any subordinate financing on the subject property.
g. Taxes, MI, HOA fees, insurance or any other mortgage-related obligations.
h. The borrower's monthly debt obligations, including alimony and child support.
i. The borrower's DTI ratio and residual income.

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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.
  - ✓ Follow MI company reserve requirements for loans over 80% LTV.

- Up to 85% LTV for cash-out refinances of second homes.
  - ✓ Fannie Mae and Freddie Mac both limit the LTV to 75%.

- Minimum of 620 credit score for any applicable LTV.

- Loans in deferment for more than 12 months from the Note date are not counted as a liability.

- Earnest money deposits that are less than 50% of the total down payment do not have to be verified.

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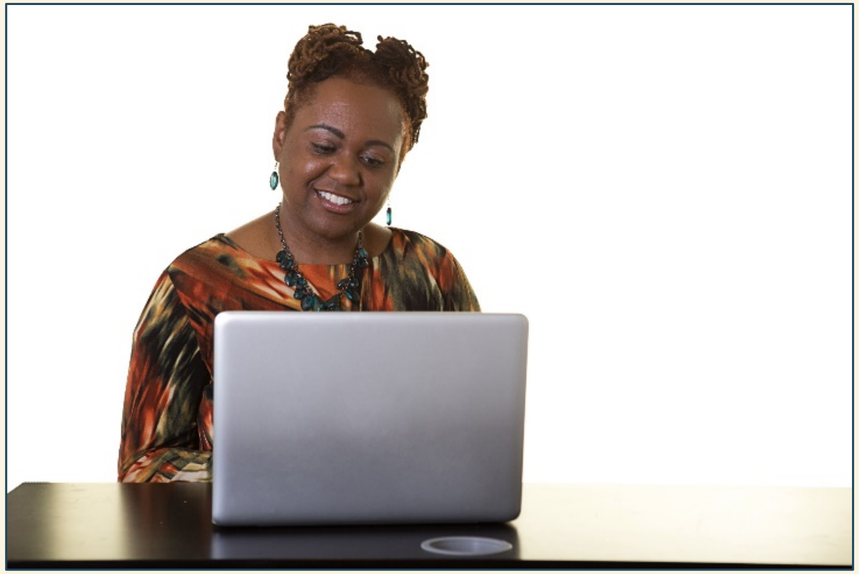
Using DU or LPA

Jenni uses DU to underwrite her MPF Traditional loans. She knows that there are some additional restrictions that supersede her DU findings. Which item <u>is not</u> something she needs to worry about?

a. Loan to Value over 95%
b. FICO score less than 620
c. Maximum DTI ratio of 43%
d. Borrower occupancy type

When using DU or LPA, DTI ratios over 43% are permitted with an approve/eligible or an accept/eligible finding.



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Underwriting Methods- DU and LPA

If using an AUS like DU or LPA, follow the applicable guidelines published by either Fannie Mae or Freddie Mac but be aware of the following differences:

- ✓The maximum LTV is 95% unless an affordable housing program (AHP) is utilized.
- ✓The minimum FICO score is 620.
- ✓Full appraisals are required, however **DU** appraisal waivers may be acceptable in certain markets (Freddie Mac ACE waivers are not permitted).
- ✓Investment properties are not permitted.
- ✓Certain property types like co-ops and condotels are not permitted.
- ✓Certain loan attributes like ARMs, negative amortization, balloons, etc. are not permitted).

See Chapter 4.2.1 in the MPF Traditional Selling Guide for more information.

Loan Eligibility Factors

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Conforming Loan Limits

Number of Units	Maximum Original Loan Amount- Conventional Mortgage Loans (Properties in Contiguous States, District of Columbia & Puerto Rico)	Maximum Original Loan Amount- Conventional Mortgage Loans (Properties in Alaska, Guam, Hawaii & Virgin Islands)
1	$510,400	$765,600
2	$653,550	$980,325
3	$789,950	$1,184,925
4	$981,700	$1,472,550

To determine the maximum loan amount for conventional high-balance mortgage loans, see **Exhibit N**: *High-cost Area Loan Limits* located in the *Exhibits* section of the MPF Guides.

The limits are determined by the Federal Housing Finance Agency (www.fhfa.gov).

Manual Underwriting LTVs and TLTVs

Purchase, Rate and Term and Limited Cash-Out Refinances		
Property Type	**MAX LTV Without Secondary Financing**	**MAX LTV/TLTV With Secondary Financing***
One-Unit Primary Residence	95%	95%
One-Unit Second Home	90%	90%
Two-Unit Primary Residence	85%	85%
Three-Four Unit Primary Residence	75%	75%
Manufactured Homes Primary Residence Only	95% ≤ 20 yrs. 90% 21-30 yrs.	**Secondary financing not permitted**

***If secondary financing is a HELOC, the TLTV is calculated using the first lien plus the full HELOC limit, even is undrawn.**

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Manual Underwriting LTVs and TLTVs

MPF Traditional Cash-Out Refinances		
Property Type	**MAX LTV w/o secondary financing**	**MAX LTV/TLTV w/secondary financing**
One-Unit Primary Residence	90%	90%
One-Unit Second Home	85%	85%
Two – Four Unit Primary Residence	75%	75%
Manufactured Home (Primary Only)	65% ≤ 20 years	Not permitted

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Use of Affordable Housing Program (AHP) Funds

The maximum LTV for manually underwritten loans that include AHP funds is <u>100%</u>

- Purchases and limited cash-out refinances only.
- Funds may be provided by a local FHLB or another third party, such as:
  - ✓ A federal agency, municipality, state, or county program.
  - ✓ State or local housing finance agency.
  - ✓ A non-profit organization.
- Refer to the MPF Traditional Selling Guide for non-FHLB AHP requirements.
- Maximum TLTV (first lien, grant and any applicable subordinate financing) is subject to a maximum of **105%.**

!

Always be sure the borrower is meeting the contribution and qualifying requirements for the applicable AHP!

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Borrower Eligibility Factors

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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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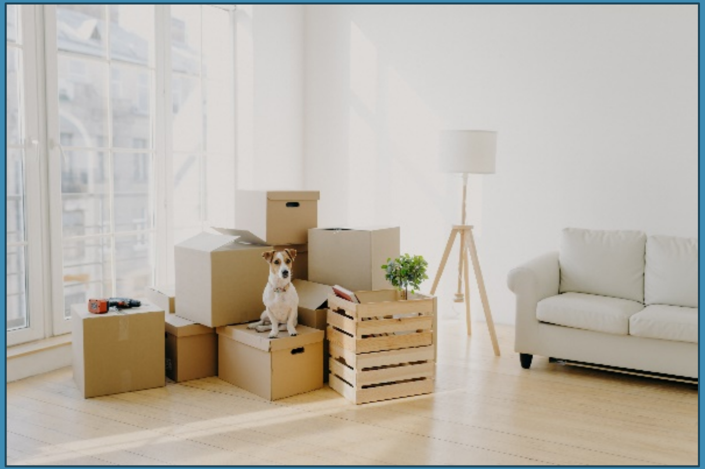
Non-occupant co-borrowers

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 considered.



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Occupancy Requirements

LTV	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.

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.

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Income

Due to COVID-19 VVOEs have been difficult to obtain

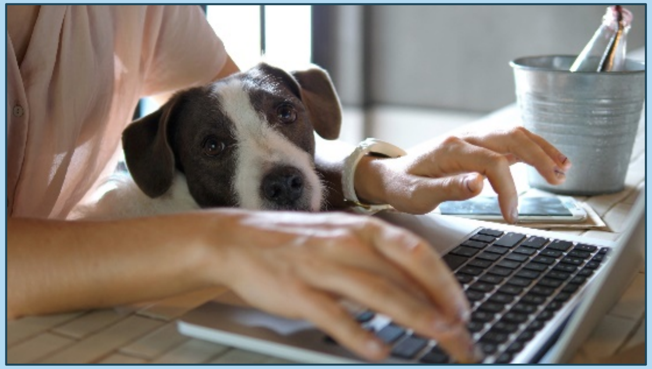
Temporary alternatives to VVOEs include:

- A written VOE dated within 10 days of closing.
- A email from the an authorized individual representing the employer.
- A borrower paystub that immediately precedes the Note date.
- A bank statement showing a payroll deposit the immediately precedes the Note date.

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.



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Self-Employed Income

Due to COVID-19, additional requirements apply to verify self-employed income

- Ensure the business is operating by obtaining evidence such as work contracts, invoices, and any receipts within 10 days of closing.

- Certify the business is open (i.e. document by phone or website).

- An audited YTD profit and loss (P&L) statement covering activity up to at least one month prior to the application date **or**;

- An unaudited YTD P&L statement covering up to the same period as above **plus**:
  - ✓ Two months worth of business account statements to supplement the information on the P&L.

Please be aware that all P&L statements should be no more than 60 days old on the day the Note is signed.

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Income

- Employment gaps greater than ____ days must be explained in writing.
- Verify that the income is likely to continue beyond ____ years from the Note date.
- Currently, income documentation cannot be more than ____ days old on the date the Note is signed.
- "At will" employment is typically considered to continue.

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Unacceptable Income

- Income based on trailing spouse income
- Draw income
- VA education benefits
- Illegal income
- Taxable income not listed on tax returns
- Any income that cannot be documented or verified
- Income that is not stable
- Grants

Commission Income

Manual underwriting guidelines no longer require tax returns to analyze commission income or unreimbursed business expenses.

- The following documentation may be utilized:
  - ✓ A completed written Verification of Employment (VOE), or;
  - ✓ The borrower's recent paystubs and IRS W-2 forms covering the most recent two-year period.

- Due to tax law changes, unreimbursed business expenses no longer need to be considered in income calculations.

Automobile Allowances

How are automobile allowances treated?

a. Add it to the borrower’s income and include any applicable loans/leases in their DTI ratio.
b. If the allowance covers the borrower’s loan or lease payment, remove the payment from the borrower’s monthly obligations.
c. If the allowance doesn’t cover the loan/lease payment, only count what is not covered in the borrower’s monthly obligations.
d. Both answers b and c.

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Self-Employed Income Scenario

Carla is a high school band director. As a side job, she plays the clarinet in a local orchestra. She files a Schedule C (Sole Proprietor) for her performance income/loss.

If Schedule C shows a loss, can you ignore it?

- **Yes,** but the borrower must qualify using their primary source of income and/or other income that is not derived from self-employment.

- Additionally, income or losses from self-employed co-borrowers does not have to be considered if their income is not used for qualifying.

Retirement and Pension Income

- Document regular and continued receipt of income.
  - 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
- If there is no history of draws on an employment-related asset, the income may be used if:
  - The LTV is less than or equal to 70%*
  - Purchase or rate/term refinance transactions only
  - Asset must be liquid and available without penalty
  - Use 70% of the asset balance and divide by 360** months

$435,000 account balance
70% of $435,000 = $304,500
$304,500 ÷ 360 = $846.00 per month

**DU permits 80% if the owner is at least 62 years old at the time of closing (10/2/2018)*
***Always divide by 360, despite the loan term or borrower age.*

Liabilities and Credit

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 minimum payment, the greater of 5% of the outstanding balance or $___ must be used (or evidence of actual payment provided).

- For student loans **with no payment provided**, ___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.

Liability Basics

- Balloon-payment notes that come due within 12 months of the closing must be considered in the underwriting analysis.

- The monthly payment on every revolving and open-ended (i.e. 30-day account) account with a balance, regardless of the apparent number of payments remaining, must be included in the borrower's long-term debt-to-income ratio calculation (manual underwriting).
  - ✓ Fannie Mae (DU) permits the payment to be omitted if the borrower has adequate reserves to cover the balance/payment.

- If an account is to be paid off by the borrower at or prior to closing, the obligation is not required to be included in the debt-to-income ratio.

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.

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Credit Inquiries

- PFIs should include a step in the underwriting process to verify that any credit inquiries within the past 90 days did not result in a new credit account opened by the borrower.
- This verification should come from the inquirer and address the purpose and outcome of the inquiry.
    - ✓ If a new account is established, the terms, balance and monthly payment must be obtained and verified.

Collections and Charge-Offs

Past Due, Collections and Charge-Off Accounts

- Single events of a past judgment, tax lien, collection, charge-off, or repossession of $____or more, and multiple events with past due amounts totaling more than $______ must be paid in full at or prior to closing.
- **If DU or LPA are used, and requires that the amount be paid, the AUS rule supersedes these requirements.**

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Funds to Close
Assets and Reserves

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Minimum Borrower Contributions

Property Type	LTV/TLTV Ratio	Minimum Borrower Contribution Requirements
1 Unit Primary Residence	More than 80%	**No minimum contribution** from the borrower's own funds is required
1-4 Unit Primary Residence **One Unit Second Home**	80% or Less	**No minimum contribution** from the borrower's own funds is required
2-4 Unit Primary Residence **1 Unit Second Home**	More than 80%	A minimum contribution of **5%** must come from the borrowers own funds

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Sources for Down Payment Funds, Closing Costs, and Reserves

Funds held in a checking, savings, money market, certificate of deposit or other depository accounts may be used for down payment closing costs and reserves.

- Other sources may include:
  - ✓ Proceeds from a sale of another property.
  - ✓ Gift funds, including gifts of equity.
  - ✓ Loan against a 401k or another financial asset
  - ✓ *Documented* sale of a personal item (i.e. automobile, boat).

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Digital Currency

Bitcoins and other types of digital currency are <u>not</u> eligible assets.

- Bitcoin or other digital currency exchange may be considered if converted to US currency and deposited into an eligible account .
- If the converted funds are deposited into an eligible account and considered a large deposit, documentation showing the funds coming from the borrowers digital currency source must be provided.

Gifts

A gift can be provided by:

- A relative, such as the borrower's spouse, child or other dependent.
- Any other individual who is related to the borrower by blood, marriage, adoption or legal guardianship.
- A fiancé, fiancée, or domestic partner

The donor may not be, or have any affiliation with the builder, developer, real estate agent, or any other interested party to the transaction.

- Gifts from a family member or domestic partner who has resided with the borrower for the past 12 months and intends to continue doing so, may be considered the same as the borrower's funds (must be properly documented).

- **Gift letters should contain:** The amount of the gift, donor's name, date of transfer, the donor's address and telephone number, the relationship to the borrower, and **a statement that no repayment is necessary.**

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Verifying Gift Funds

If gift funds are received:

Before Verifying Assets	After Verifying Assets	At Closing
Verify that funds have been transferred into the account. • Cancelled donor's check • Evidence of deposit into the borrower's account.	**Document the transfer of funds into the borrower's account using:** • Copy of the donor's check and borrower's deposit slip or; • Copy of the donor's withdrawal slip and borrower's deposit slip	**Funds must be in the form of a certified check, cashier's check, other official check or wire transfer (must show donor as the remitter).** • Copy of the donor's check to the closing agent. • A Closing Disclosure (CD) showing receipt of the donor's check/funds.

If there are enough assets verified to close without including the gift funds, subtract the amount of the gift from the verified liquid assets.

Reserves

- **Reserves should be adequate to cover risk factors present in the mortgage application.**
  - When using retirement accounts as reserves, 100% of the vested value may be used.
    - ✓ Retirement accounts are not eligible for reserves if as of the closing date, withdrawals are prohibited.
    - ✓ Due to recent market volatility, all market-based assets used as reserves must be reduced by 30%.
  - Reserves in the form of cash, stocks, bonds or other liquid financial assets should be adequate to cover the risk factors present in the loan application.
  - Two months cash reserves are required for second homes (manual underwriting).

Remember, DU and LPA will always determine if the amount of reserves are acceptable.

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Property Eligibility

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

Ineligible Property Types

The following are examples of ineligible property types:

- Investment properties
- Cooperatives (co-ops)
- Condo hotels (condotels)
- Houseboat condominium projects
- Timeshares
- Multi-dwelling unit condominiums

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Second Homes

Which of the following statements about second homes is not true?

a. Second homes are limited to one unit properties only.

b. Manufactured homes are not permitted if manually underwritten or underwritten with LPA.

c. There is no specific mileage requirements regarding distance between a second home and primary residence.

d. If manually underwritten, six months of reserves are required.

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Second Homes

Second Home Considerations

- The property must be suitable for year-round occupancy.
- There must be a full kitchen with standard-sized appliances.
- Separate rooms for living and sleeping.
- The borrower(s) may only own one unit in a project (if condo or PUD).
- Second homes require 10% down with at least 5% coming from the borrower’s funds.
- If gift funds are >10% of the purchase price, the 5% borrower contribution does not apply.

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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) 463-6673

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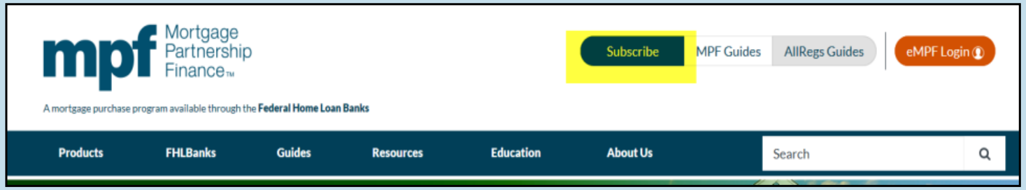

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