COMPREHENSIVE RESIDENTIAL MORTGAGE UNDERWRITING POLICIES

Standards & Guidelines for Loan Approval

This document establishes the comprehensive underwriting standards and policies for evaluating residential mortgage loan applications. These policies ensure consistent, fair, and prudent lending practices while maintaining compliance with federal regulations including the Truth in Lending Act (TILA), Real Estate Settlement Procedures Act (RESPA), Equal Credit Opportunity Act (ECOA), and the Dodd-Frank Wall Street Reform and Consumer Protection Act.

1. CREDIT POLICY

The credit evaluation process is fundamental to determining a borrower's creditworthiness and likelihood of repayment. This section establishes minimum credit standards for loan approval while allowing for compensating factors that may offset certain credit deficiencies.

1.1 Credit Score Requirements

Credit scores are derived from consumer credit reports and provide a standardized measure of credit risk. The following minimum credit scores apply:

- **Conventional Loans:** Minimum credit score of 620 (FICO or equivalent)
- **FHA Loans:** Minimum credit score of 580 for maximum financing (3.5% down payment)
- **VA Loans:** No minimum score mandated by VA, but lender overlay requires 580
- **USDA Loans:** Minimum credit score of 640 recommended
- **Jumbo Loans:** Minimum credit score of 700, with some programs requiring 720+

Compensating Factors for Lower Credit Scores: Borrowers with scores between 620-659 may be approved with significant compensating factors including: substantial cash reserves (6+ months PITI), minimal debt obligations (DTI below 36%), significant down payment (20%+), stable employment history (5+ years same employer), or demonstrated history of timely housing payments.

1.2 Bankruptcy Discharge Requirements

Borrowers with prior bankruptcies must demonstrate re-established credit and financial stability. The following waiting periods apply from the discharge or dismissal date:

- **Chapter 7 Bankruptcy:**

- Conventional Loans: 4 years from discharge date

- FHA/VA/USDA Loans: 2 years from discharge date

- Extenuating Circumstances: May reduce to 2 years for conventional with documentation

- **Chapter 13 Bankruptcy:**

- Conventional Loans: 2 years from discharge, 4 years from dismissal

- FHA/VA/USDA: 1 year of payment history with trustee approval

- **Chapter 11/12 Bankruptcy:** Evaluated on case-by-case basis, generally 3-5 years

Required Documentation: Discharge papers (all pages), complete bankruptcy schedules, letter of explanation detailing circumstances, evidence of re-established credit (minimum 2 new credit tradelines maintained for 12+ months), and demonstration of financial recovery.

1.3 Foreclosure and Short Sale History

Previous foreclosures, deeds-in-lieu, or short sales indicate significant mortgage credit risk. The following waiting periods apply from the completion date:

- **Foreclosure:** 7 years for conventional loans, 3 years for government loans
- **Deed-in-Lieu of Foreclosure:** 4 years for conventional, 3 years for government
- **Short Sale:** 4 years for conventional, 3 years for government (2 years with extenuating)
- **Pre-Foreclosure Sale:** 2-4 years depending on loan type and circumstances

Extenuating Circumstances: Waiting periods may be reduced for documented hardships including: serious illness/disability, death of wage earner, divorce, loss of employment outside borrower's control, or natural disaster. Documentation must demonstrate the event was beyond the borrower's control and that credit was satisfactory prior to the event.

1.4 Late Payment History

Payment history is the strongest predictor of future payment behavior. The following standards apply to evaluating payment patterns:

- **Recent Payment History (Last 12 months):** Maximum 2 late payments (30+ days) acceptable
- **60-Day Lates:** No 60-day late payments in past 24 months
- **90-Day Lates:** No 90-day late payments in past 36 months
- **Housing Payment History:** No mortgage/rent lates in past 12 months
- **Installment/Revolving Lates:** Pattern evaluation required; isolated instances acceptable with explanation

Payment Pattern Analysis: Underwriters evaluate the context of late payments including: timing (recent vs. older), type of account, reason for delinquency, and overall payment pattern. Multiple recent lates indicate higher risk regardless of credit score. A letter of explanation is required for any late payments in the past 12 months.

1.5 Collections, Charge-offs, and Judgments

Outstanding collections, charge-offs, and judgments may impact loan approval and must be evaluated based on type, amount, and payment status:

- **Medical Collections:** Collections under $5,000 can be disregarded for qualifying purposes
- **Non-Medical Collections:** Collections over $1,000 must be paid off or included in DTI
- **Disputed Collections:** If disputed with credit bureau, may be excluded with documentation
- **Charge-offs:** Must be paid in full or payment plan established for amounts over $2,000
- **Judgments and Liens:** All judgments must be paid in full or payment plan with minimum 3 months history
- **Tax Liens:** Federal tax liens must be subordinated or released; state tax liens must be paid

Aggregate Collection Analysis: Total outstanding collection accounts are evaluated in context of overall credit profile. Aggregate non-medical collections exceeding $5,000 may require payment or payment plans, even if individual accounts are below threshold. Borrower must demonstrate ability to resolve collection accounts without depleting required reserves.

2. INCOME VERIFICATION & STABILITY POLICY

Income verification ensures borrowers have sufficient stable and predictable income to support monthly mortgage obligations. All income sources must be documented, verified, and evaluated for continuity over the next three years minimum.

2.1 Employment History Requirements

Stable employment history demonstrates earning capacity and probability of continued income. The following standards apply:

- **Minimum Work History:** 2 years continuous employment in same line of work or field
- **Current Employment:** Must be currently employed with 30+ days on the job before closing
- **Job Changes:** Changes within same field acceptable; career changes require 6 months new employment
- **Recent Graduates:** Degree holders may use education to satisfy work history if job relates to degree
- **Military Personnel:** Active duty time counts toward employment history; reserve/guard requires civilian employment
- **Multiple Jobs:** Secondary employment requires 2-year history to be included in qualifying income

Verification Requirements: Written Verification of Employment (VOE) or recent paystubs covering 30 days plus W-2s for past 2 years. Verbal verification of employment (VVOE) required within 10 days of closing to confirm continued employment. Self-employment and non-traditional income sources have additional documentation requirements detailed in subsequent sections.

2.2 Employment Gaps and Interruptions

Gaps in employment may indicate income instability and must be documented and explained:

- **Minor Gaps (30 days or less):** Generally acceptable without explanation
- **Moderate Gaps (31-90 days):** Letter of explanation required detailing reason and circumstances
- **Significant Gaps (Over 90 days):** Detailed explanation plus 6 months current employment required
- **Acceptable Reasons:** Education/training, family medical leave, seasonal work patterns, relocation
- **Concerning Patterns:** Multiple unexplained gaps or prolonged unemployment periods require offsetting factors

Seasonal Employment: Borrowers with seasonal work patterns must demonstrate consistent seasonal employment over 2 years and adequate reserves to cover off-season periods. Income may be averaged over 24 months. Documentation of re-hire agreements or contracts for upcoming season required.

2.3 Self-Employment Income

Self-employed borrowers (25%+ ownership in business) require extensive documentation to verify income stability and business viability:

- **Tax Returns Required:** Complete personal returns (1040) for 2 most recent years with all schedules
- **Business Returns:** Business returns (1065, 1120, 1120S) for 2 years if applicable
- **Year-to-Date P&L;:** Current profit and loss statement and balance sheet prepared by CPA/bookkeeper
- **Business License:** Copy of business license showing 2+ years of self-employment
- **Income Calculation:** IRS Form 1084 or similar; includes salary, distributions, non-recurring expenses
- **Income Trend:** Income must be stable or increasing; declining income requires explanation
- **CPA Letter:** May be required for complex business structures or income calculations

New Self-Employment (Under 2 years): Businesses operating less than 2 years may be acceptable if borrower has prior experience in same line of work. Minimum 1 year self-employment required with full tax return. Must demonstrate positive income and business viability. Additional reserves (6+ months) typically required.

2.4 Bonus, Overtime, and Commission Income

Variable income sources require demonstrated consistency and likelihood of continuance:

- **History Required:** Minimum 2-year history of receiving bonus/overtime/commission income
- **Income Calculation:** Average of 2 years; declining trend requires explanation or exclusion
- **Documentation:** W-2s showing breakdown, recent paystubs, employer verification letter
- **Employer Confirmation:** Written statement that income type will likely continue
- **Commission-Only:** Sales professionals require additional scrutiny of income stability
- **Year-End Bonuses:** Must have 2-year history; one-time bonuses excluded from qualifying income

Declining Variable Income: If bonus/overtime/commission income shows declining trend over 2-year period, underwriter may use lower amount, most recent year only, or exclude entirely depending on decline severity. Borrower must provide written explanation for decline. If decline is temporary/situational with recovery demonstrated, may use current level.

2.5 Other Income Sources

Alternative income sources may be used for qualifying with proper documentation:

- **Rental Income:** Current lease agreement plus tax returns showing rental income (75% of gross rent)
- **Social Security/Disability:** Award letter showing amount and continuance; must continue 3+ years
- **Pension/Retirement:** Award letter or proof of regular distributions; 3+ year continuance required
- **Child Support/Alimony:** Court order plus 6 months receipt history; must continue 3+ years
- **Trust Income:** Trust agreement and proof of regular distributions for 2+ years
- **Investment Income:** 2 years tax returns showing consistent investment income
- **Unemployment Income:** Generally not acceptable as qualifying income
- **Public Assistance:** May be used if verified to continue for 3+ years

2.6 Debt-to-Income Ratio Requirements

Debt-to-Income (DTI) ratios measure borrower's ability to manage monthly debt obligations:

- **Front-End Ratio:** Maximum 28% (housing payment ÷ gross monthly income)
- **Back-End Ratio - Conventional:** Maximum 43% (total monthly debts ÷ gross monthly income)
- **Back-End Ratio - FHA:** Maximum 50% with compensating factors, 43% without
- **Back-End Ratio - VA:** Maximum 41% residual income method, up to 50% with strong credit
- **Compensating Factors:** Higher ratios (up to 50%) acceptable with: excellent credit (720+), significant reserves (12+ months), substantial down payment (25%+), low housing payment increase

DTI Calculation Methodology: Front-end includes principal, interest, taxes, insurance, HOA dues, and mortgage insurance. Back-end includes all monthly debt obligations: housing payment, auto loans, student loans, credit cards (minimum payment or 5% balance), installment loans, alimony, child support, and other continuing obligations. One-time debts payable within 10 months may be excluded.

3. ASSET VERIFICATION & RESERVES POLICY

Adequate assets demonstrate borrower's financial stability, ability to close the transaction, and capacity to withstand financial setbacks. All assets must be sourced, seasoned, and verified.

3.1 Reserve Requirements

Reserves represent liquid assets remaining after closing, providing financial cushion:

- **Primary Residence - Conventional:** 2 months PITI reserves required (0-2 units)
- **Primary Residence - 3-4 Units:** 6 months PITI reserves required
- **Second Home:** 2-6 months reserves depending on overall profile
- **Investment Property:** 6 months PITI reserves required (may vary by investor)
- **Multiple Properties:** Reserves required for all financed properties, may be aggregated
- **High-Risk Profiles:** Additional reserves may be required for: borderline credit, high DTI, limited employment history, self-employment under 2 years

Reserve Calculation: Reserves equal months of PITI (Principal, Interest, Taxes, Insurance, HOA dues, and MI). For multiple properties, 2 months per property for primary/second home, 6 months per investment property. Only liquid or semi-liquid assets count toward reserves.

3.2 Down Payment Source Requirements

Down payment funds must be verified to source and seasoned appropriately:

- **Minimum Down Payment - Conventional:** 3% (5% for investment, 10% for second home)
- **Minimum Down Payment - FHA:** 3.5% (580+ credit score), 10% (500-579 score)
- **Minimum Down Payment - VA/USDA:** 0% down payment available for eligible borrowers
- **Seasoning Requirements:** Funds must be sourced to origin; 60 days bank statements required
- **Acceptable Sources:** Checking/savings accounts, sale of assets, gift funds, grants, employer assistance
- **Unacceptable Sources:** Unsecured borrowed funds, cash on hand without paper trail

3.3 Large Deposit Requirements

Any deposit exceeding $1,000 (or 25% of monthly income, whichever is less) requires documentation and explanation:

- **Threshold:** Single deposits over $1,000 or multiple deposits totaling $1,000+ in statement period
- **Acceptable Explanations:** Payroll deposit, tax refund, sale of assets, transfer between own accounts

- **Documentation Required:** Letter of explanation plus supporting evidence (bill of sale, transfer receipt, etc.)
- **Undocumented Deposits:** May be deducted from available assets for qualifying purposes
- **Payroll Deposits:** Must match paystubs and employment verification
- **Gift Deposits:** Must be documented with gift letter per Section 3.4

Pattern Analysis: Multiple large deposits or unusual deposit patterns may indicate undisclosed debt or fraud. Underwriters will scrutinize patterns including: cash deposits, multiple wire transfers, round-number deposits, deposits followed by immediate withdrawals, or deposits inconsistent with income sources.

3.4 Gift Funds

Gift funds from family members or approved sources are acceptable with proper documentation:

- **Acceptable Donors:** Family member (related by blood, marriage, adoption), domestic partner, fiancé
- **Employer Gifts:** Acceptable if employment is not conditioned on purchase
- **Charitable Organization:** Gifts from 501(c)(3) organizations acceptable with proper documentation
- **Government Assistance:** Down payment assistance programs from governmental entities
- **Unacceptable Donors:** Interested party to transaction (seller, builder, real estate agent, loan officer)

Gift Letter Requirements: Must include: donor's name, address, phone; donor's relationship to borrower; dollar amount of gift; date funds transferred; statement that no repayment expected; donor and borrower signatures; property address. Evidence of transfer required (donor's withdrawal plus borrower's deposit). Large gifts may require evidence of donor's ability to gift (bank statement showing sufficient funds).

3.5 Retirement and Investment Accounts

Retirement accounts may be used for down payment and reserves with restrictions:

- **401(k)/403(b) Accounts:** May be used with 60-70% valuation (accounting for taxes/penalties)
- **IRA Accounts:** May be used with similar valuation adjustments
- **Roth IRA:** Contributions may be withdrawn penalty-free; 100% value for contributions
- **Brokerage Accounts:** 70% of stock/mutual fund value (volatility adjustment)
- **Bonds/Fixed Income:** 80-90% of current value depending on maturity
- **Required Documentation:** Most recent quarterly or annual statement showing vested balance
- **401(k) Loans:** If borrowed against, payment must be included in DTI calculation

Vesting Requirements: Only vested amounts may be counted. Unvested employer contributions must be excluded. For accounts with loans outstanding, net available balance is reduced by loan amount.

Statement must be dated within 90 days of application.

3.6 Acceptable Asset Types and Verification

The following asset types are acceptable with appropriate documentation:

- **Checking/Savings Accounts:** 2 most recent monthly statements (100% value)
- **Money Market Accounts:** Recent statement (100% value)
- **Certificates of Deposit:** Recent statement; penalty for early withdrawal deducted
- **Stocks/Bonds/Mutual Funds:** Recent statement with current valuation (70% value)
- **Sale of Assets:** Bill of sale for vehicles, jewelry, equipment; funds must be deposited and verified
- **Bridge Loan:** Secured by existing residence pending sale; full documentation required
- **Cash Value Life Insurance:** Policy documents showing cash value available for withdrawal
- **Trust Accounts:** Trust documents showing borrower access to funds

Unacceptable Asset Sources: Cash on hand without documented source, unsecured personal loans, borrowed funds (except secured by owned asset), cryptocurrency (limited acceptance case-by-case after liquidation and seasoning), earnest money deposits (unless refundable), funds not accessible without penalty.

4. COLLATERAL & PROPERTY REQUIREMENTS

The subject property serves as collateral for the mortgage loan and must meet minimum standards for condition, marketability, and value retention. Property evaluation ensures adequate security for the loan amount.

4.1 Appraisal Requirements

Professional appraisal determines fair market value and property condition:

- **Appraiser Qualifications:** Must be state-licensed or certified; FHA roster for FHA loans
- **Independence Requirements:** No prior relationship with transaction parties
- **Appraisal Format:** Uniform Residential Appraisal Report (URAR/Form 1004) for 1-4 units
- **Comparable Sales:** Minimum 3 comparable sales within 1 mile and sold within 12 months
- **Rural Properties:** May extend search area to 10 miles and 24 months for sales
- **Appraisal Age:** Valid for 120 days; may require update or recertification if older
- **Second Appraisal:** Required for loans over $1,000,000 or as determined by risk assessment

Appraisal Review Process: All appraisals undergo quality control review for: accurate comparable selection, appropriate adjustments, correct calculations, proper condition assessment, compliance with USPAP standards. Desk reviews conducted by qualified reviewers; field reviews ordered if concerns identified.

4.2 Property Condition Standards

Subject property must meet minimum habitability and safety standards:

- **Structural Integrity:** Foundation, roof, walls must be sound with no significant defects
- **Safety Hazards:** No fire hazards, electrical hazards, or other immediate safety concerns
- **Mechanical Systems:** Heating, cooling, plumbing, electrical must be functional
- **Weatherproofing:** Property must protect against elements (leaks, drafts, moisture)
- **Deferred Maintenance:** Excessive deferred maintenance may require repairs prior to closing
- **Health Hazards:** No known lead paint hazards (pre-1978), mold, asbestos, or contamination
- **Code Violations:** No outstanding code violations that affect safety or habitability

Required Repairs: If appraisal identifies conditions affecting safety, soundness, or structural integrity, repairs must be completed prior to closing. Alternative holdback escrow may be established for minor repairs (maximum $5,000 or 3% of value, whichever is less). FHA loans have stricter repair requirements including peeling paint on pre-1978 properties.

4.3 Loan-to-Value (LTV) Ratio Limits

Maximum LTV ratios vary by property type, occupancy, and loan program:

- **Primary Residence (1 unit):** Maximum 97% LTV for conventional first-time buyers
- **Primary Residence (Standard):** Maximum 95% LTV conventional, 96.5% FHA, 100% VA/USDA
- **Primary Residence (2-4 units):** Maximum 85% LTV (75% for 3-4 units with limited experience)
- **Second Home:** Maximum 90% LTV (10% down payment required)
- **Investment Property:** Maximum 85% LTV first-time investors, 80% experienced investors
- **Cash-Out Refinance:** Maximum 80% LTV primary, 75% investment property
- **High-Balance Loans:** May have lower LTV limits (typically 90% maximum)

Combined Loan-to-Value (CLTV): When subordinate financing exists (second mortgage, HELOC), combined LTV includes all liens. Maximum CLTV typically 5-10% lower than maximum LTV. Piggyback loans (80-10-10 structure) must meet CLTV requirements and both liens must close simultaneously.

4.4 Acceptable Property Types

The following property types are acceptable as collateral with varying requirements:

- **Single Family Detached:** Standard property type; most flexible guidelines
- **Townhouse/Rowhouse:** Acceptable if individually owned with clear title
- **Condominium:** Must be in FNMA/FHA approved project or undergo project review
- **Planned Unit Development (PUD):** Acceptable with HOA documentation
- **Manufactured Housing:** Must be permanently affixed to foundation and titled as real property
- **Multi-Family (2-4 units):** Acceptable if one unit is owner-occupied (primary residence)
- **Rural Properties:** Acceptable with well/septic; agricultural use may limit financing
- **Properties with Acreage:** Acceptable up to 10 acres for primary residence

Ineligible Property Types: Properties not acceptable as collateral include: cooperative housing (co-ops), properties with environmental hazards, properties in declining markets without compensating factors, properties with commercial use exceeding 25%, properties with major access issues, properties with significant easements, non-warrantable condos, properties on leasehold land (unless 30+ years remaining).

4.5 Rural and Unique Property Requirements

Properties in rural areas or with unique characteristics require additional review:

- **Well Water:** Well water test required showing potability; testing within 90 days of closing
- **Septic Systems:** Inspection required showing system functional; capacity adequate for property size
- **Access:** Year-round access required via public road or recorded easement
- **Utilities:** Property must have electricity and water; other utilities should be available

- **Acreage Limits:** Properties over 10 acres may require additional review
- **Agricultural Use:** Property primarily for residential use; agricultural activity must be secondary
- **Outbuildings:** Contributory value of barns, sheds may be limited in appraisal

Flood Zone Considerations: Properties in FEMA-designated flood zones require flood insurance. Flood zone determination required for all properties. Special Flood Hazard Areas (SFHA) require compliance with community participation in National Flood Insurance Program. Properties in coastal barrier zones ineligible for federally-backed financing.

4.6 Condominium Project Requirements

Condominium projects must meet specific financial and operational standards:

- **Project Approval:** Must be on FNMA/FHA approved list or undergo full project review
- **Owner-Occupancy:** Minimum 50% of units must be owner-occupied or second homes
- **Single-Entity Ownership:** No single entity may own more than 10% of units
- **Commercial Space:** Commercial space limited to 25% of total building area
- **HOA Reserves:** Association must maintain adequate reserves (10%+ of budget)
- **Delinquencies:** No more than 15% of units with HOA fees over 60 days delinquent
- **Litigation:** No material pending litigation against HOA; disclosure required
- **Insurance Coverage:** Master policy must provide adequate property and liability coverage

Required Documentation: Condominium questionnaire, current budget, financial statements, declaration and bylaws, HOA insurance certificate, list of unit owners, reserve study (if available). For new construction, additional developer documentation required including warranties, construction plans, and unit purchase agreements showing 70%+ presold.

5. ADDITIONAL UNDERWRITING POLICIES

5.1 Occupancy Classification

Occupancy type affects qualification requirements and pricing:

- **Primary Residence:** Borrower intends to occupy within 60 days and maintain as primary residence for 12+ months
- **Second Home:** Borrower occupies occasionally; minimum 50 miles from primary residence recommended
- **Investment Property:** Not owner-occupied; purchased for rental income or appreciation

5.2 Loan Documentation Requirements

- **Full Documentation:** Complete verification of income, assets, and employment
- **Alternative Documentation:** May be available for self-employed or complex situations
- **Asset Depletion:** Qualify using asset liquidation over loan term

5.3 Special Underwriting Considerations

- **First-Time Homebuyers:** May receive more favorable terms and lower down payment requirements
- **Non-Permanent Residents:** Require valid work authorization continuing 3+ years
- **Non-Occupant Co-Borrowers:** Acceptable with additional reserves and down payment requirements
- **Mortgage Buydowns:** Temporary or permanent buydowns acceptable with proper documentation

These underwriting policies are subject to change based on regulatory requirements, investor guidelines, and market conditions. All exceptions to these policies require senior management approval with documented justification. Underwriters maintain discretion to require additional documentation or impose stricter requirements based on individual loan risk assessment.
