825.00: Underwriting Philosophy - Credit Score and Loan Score Selection (05/18/2015)

All conventional Loans require a credit score for each borrower. Each Credit Bureau offers a product which scores the applicant's credit report using the Fair, Isaac and Company ("FICO") model. Trademark names include The Experian Fair Isaac Credit Score, Trans Union Emperica Score, and Equifax Beacon Score. All are acceptable to Wells Fargo Funding and are referred to as the "credit score."

Wells Fargo Funding has adopted the term **Loan Score** to refer to the overall credit score applicable to a specific Loan as determined using the Agencies' "middle/lower, then lowest" credit score selection methodology. Wells Fargo's **Loan Score** is equivalent to Freddie Mac's *Indicator S*core and Fannie Mae's *Representative* credit score.

Credit Score Selection

The following criteria may be used to determine each individual borrower's credit score using the "middle/lower" method.

- If there are three valid credit scores for a borrower, the middle score (numerical middle of the three scores) is used.
- If there are three valid scores for a borrower but two of the scores are the same, the duplicate score is used.
- If there are two valid scores for a borrower, the lower of the two scores is used.
- If there is one valid score for a borrower, that score is used.

Loan Score Selection

After selecting the appropriate credit score for each borrower, the Loan Score must be determined

- The credit score of the borrower with the highest income and a valid credit score is used as the Loan Score.
- When there is a non-occupant co-borrower, the credit score of the occupying borrower with the highest income is used as the Loan Score.
- If a borrower does not have a valid credit score, that score is not considered in the selection of the Loan Score, regardless of the borrower's income.
- In the event that both borrowers have equal income, the score of the borrower with the lower credit score will be the Loan Score.

Additionally, the Seller must include an original credit report in the file showing the score.

Rescoring and Credit Repair

Wells Fargo Funding prohibits the use of credit repair vendors designed to help a borrower falsely repair their credit profile by intentionally manipulating data to improve their credit score for purposes of loan eligibility, pricing improvement, and/or creditworthiness.

Loans where the borrower utilizes:

- credit monitoring services,
- fraud alerts,
- non-profit credit counseling services, or
- credit reporting agencies as defined by the Fair Credit Reporting Act are eligible for purchase by Wells Fargo Funding.

Wells Fargo Funding reserves the right to determine if the credit history and Credit Scores are legitimate, acceptable and meet guideline requirements. If usage of credit repair services is revealed at any time during the loan process, the Loan will be deemed ineligible and the Seller subject to remedies for Events of Default.

Wells Fargo Funding/Wells Fargo Funding Seller Guide/SECTION 800: CONVENTIONAL UNDERWRITING/825: Non-Conforming Underwriting Guidelines/825.01: General Information (06/13/2017)

825.01: General Information (06/13/2017)

The information contained in this section represents Wells Fargo's Non-Conforming Underwriting Guidelines. Non-Conforming conventional Loans sold to Wells Fargo should be underwritten to the standards and guidelines stated in this section to ensure salability to our investors. Where policy is not stated, Sellers should refer first to **Section 820: *Conforming Underwriting Guidelines*** and then to the more restrictive of standard Fannie Mae/Freddie Mac guidelines. Refer to **Section 805.09: *Wells Fargo Funding Direct Express*SM**, Wells Fargo's proprietary feedback tool.

Note: A separate approval is required by Wells Fargo for Sellers who wish to sell Non-Conforming Loans to Wells Fargo Funding.

Age of Documents

Information used to make the credit decision must be current. The maximum age of documents at Closing is:

Item	Non-Conforming Existing Property	Non-Conforming New Construction
Credit Documents[2]	120 days old	120 days old
Appraisal[2]	120 days old [1]	120 days old [1]
Homeowners Certification Review[3]	180 days old	180 days old

1. At closing, if the appraisal is older than 120 days but is less than one year old at closing:
   - Obtain an update from the appraiser indicating that the property value has not declined since the original Appraisal date. If the effective date of the appraisal exceeds one year or the value has declined, a new appraisal is required.
   - If the property is located in a Market Classification of 3 or 4, or is a condominium (attached/detached) located in Miami-Dade County, FL., a field review (Fannie Mae Form 2000/2000A or Freddie Mac Form 1032/1072) obtained from an AMC authorized to provide valuation products for Non-Conforming Program Loans is required in addition to the appraisal update. Refer to **Section 800.10: *Appraisal/Valuation Policy*** for authorized AMCs and ordering requirements.
2. Refer to **Section 820.19: *Disaster Policy*** for requirements related to specific Disaster Areas.
3. Wells Fargo Prior Approval Homeowners Association Certification Review (Form 24 or Form 25).

825.02: Borrower - General Information (06/13/2017)

Refer to **Section 820.02: *Title Holder General Requirements*** for specific requirements regarding title holder general requirements including Illinois Land Trusts.

LIVING "INTER VIVOS" TRUSTS

Living ("inter vivos") trusts must comply with local state regulations and the requirements to be eligible below for financing.

Eligible borrowers

To be eligible the borrower must be:

- The settlor, or the person who created the trust, and
- The beneficiary, or the person who is designated to benefit from the trust, and
- The trustee or the person who will administer the trust for the benefit of the beneficiary, the borrower.
- One or more borrowers with one living trust, or
- Two or more borrowers with separate living trusts, or
- Multiple borrowers with one or more holding title as an individual and one or more holding title as a living trust.

Documentation requirements

A Trust Certification, where allowable under state law in the state where the property is located.

Where state law does not allow for a Trust Certification, the following requirements must be met:

1. Attorney's Opinion letter from the borrower's attorney verifying all of the following:

a. The trust was validly created and is duly existing under applicable law,

b. The trust is revocable,

c. The borrower is the settlor of the trust and the beneficiary of the trust,

d. The trust assets may be used as collateral for a loan,

e. The trustee is:

- Duly qualified under applicable law to serve as trustee,
- Is the borrower,
- Is the settlor,
- Is fully authorized under the trust documents and applicable law to pledge or otherwise encumber the trust assets

2. Complete copy of the trust documents certified by the borrower to be accurate, **OR** a copy of the abstract or summary for jurisdictions that require a lender to review and rely on an abstract or summary of trust documents instead of the trust agreements.

Other title and closing requirements

- The title to the property must be vested in the trustee on behalf of the trust (or such other customary practices).

- Title binder may not contain any exceptions to coverage based on the mortgaged property being held by the living trust.
- The Note must be executed individually by the settlor and by the trustee on behalf of the trust.
- The Mortgage or Deed of Trust must be executed by the trustee on behalf of the trust. The Revocable Trust Rider must be used with the mortgage or Deed of Trust.
- The date of the Trust must be reflected on the Note as part of the description below the Trustee's signature (e.g., Jane Doe, Trustee of the Jane Doe Trust dated April 1, 2000).

SEPARATED BORROWERS

When the borrower indicates that he/she is separated, it must be determined whether it is a legal separation.

If the borrower is legally separated, a copy of the legal separation agreement must be provided to determine the division of assets, liabilities and potential obligations. If there is no legal separation, a letter from the attorneys of both parties involved specifying the proposed settlement terms must be provided. If no documentation can be obtained to verify the division of assets and liabilities, the Loan will generally be considered an unacceptable risk.

If the borrower states there are no plans for a legal separation, no further documentation is necessary; he/she is legally married and qualified accordingly.

Wells Fargo Funding/Wells Fargo Funding Seller Guide/SECTION 800: CONVENTIONAL UNDERWRITING/825: Non-Conforming Underwriting Guidelines/825.04: Borrower - Multiple Loans to One Borrower (07/21/2014)

825.04: Borrower - Multiple Loans to One Borrower (07/21/2014)

MULTIPLE FINANCED PROPERTIES

The following guidelines apply to the number of 1-4 unit financed properties owned by all borrowers on the Loan transaction, not just the primary borrower.

Property Type	Then the maximum number of 1-4 unit properties that may be financed with Wells Fargo is:	and the total maximum number of financed 1-4 unit properties with all lenders including Wells Fargo is:
Primary	4	4
Second Home	4	4
Investment	4	4

When aggregate financing for all properties owned by borrower exceeds $3 million one of the following is required:

- Minimum reserve (post-closing liquidity) is 36 months PITI or
- Maximum 50% LTV/CLTV

PROPERTY OWNERSHIP LIMITATIONS

There are no restrictions on the number of properties that a borrower owns free and clear.

825.05: Borrower - Citizenship (05/30/2017)

SOCIAL SECURITY NUMBER – U.S. CITIZENS AND NON-U.S. CITIZENS

Each borrower on the Loan transaction must have a valid Social Security number.

In addition, any borrower who is not a U.S. citizen must meet the requirements in this following section.

PERMANENT RESIDENT ALIENS

Green Cards

A copy of the green card is required for all permanent resident aliens whose income and/or assets are being used to qualify for a Loan. A copy of the front and back of the card is required and must be included in the Loan file.

While the green card itself states “Do Not Duplicate” for the purpose of replacing the original card, U.S. Citizenship and Immigration Services (USCIS) allows photocopying of the green card. Making an enlarged copy or copying on colored paper may alleviate any concerns the borrower may have with photocopying.

NON-PERMANENT RESIDENT ALIENS

All non-permanent resident aliens must provide evidence of a valid, acceptable visa.

A copy of the unexpired visa (see expired visa requirements below) must be included in the loan file evidencing one of the following visa classes:

- A Series (A-1, A-2, A-3): these visas are given to officials of foreign governments, immediate family members and support staff. Only those without diplomatic immunity, as verified on the visa, are allowed.
- E-1 Treaty Trader and E-2 Treaty Investor: this visa is essentially the same as an H-1 or L-1; the title refers to the foreign country's status with the United States.
- E-3: these visas are given to Australian nationals employed in a specialty occupation.
- G Series (G-1, G-2, G-3, G-4, G-5): these visas are given to employees of international organizations that are located in the United States. Some examples include the United Nations, Red Cross, World Bank, UNICEF and the International Monetary Fund. Verification that the applicant does not have diplomatic immunity must be obtained from the applicant’s employer and/or by the viewing the applicant’s passport.
- H-1 Temporary Worker (includes H-1B and H-1C): this is the most common visa given to foreign citizens who are temporarily working in the United States.
- H-4: these visas are given to dependents (spouse and unmarried children under 21 years of age) of a qualified H-1 visa holder. When income is being used to qualify, a

current (unexpired) Employment Authorization Document (EAD) issued by United States Citizenship and Immigration Services (USCIS) is also required.

- L-1 Intra-Company Transferee: an L-1 visa is given to professional employees whose company's main office is in a foreign country.
- L-2: these visas are given to dependents (spouse and unmarried children under 21 years of age) of a qualified L-1 visa holder. When income is being used to qualify, a current (unexpired) EAD issued by USCIS is also required.
- O-1A: individuals with an extraordinary ability in the sciences, education, business, or athletics (not including the arts, motion pictures or television industry).
- O-1B: individuals with an extraordinary ability in the arts or extraordinary achievement in motion picture or television industry.
- O-2: individuals who will accompany an O-1, artist or athlete, to assist in a specific event or performance.
- TN, NAFTA visa: used by Canadian or Mexican citizens for professional or business purposes.
- TC, NAFTA visa: used by Canadian citizens for professional or business purposes.

A Borrower with an expired visa may be considered, subject to each of the following:

- Visa classification is one of the eligible visas listed above.
- Confirmation that the Borrower has submitted an application for extension of the visa or an application for a green card. Documentation includes, but is not limited to:
    - USCIS Form I-797 (Issued when an application or petition is approved)
    - USCIS Form I-797C or I-797E (must not state that the application has been declined)
    - application for extension of current visa (USCIS Form I-539 or equivalent) or copy of application for green card (USCIS Form I-485 or equivalent) and electronic verification of receipt from the USCIS web site

If the borrower is sponsored by the employer, the employer may verify that they are sponsoring the visa renewal.

All standards for determining stable monthly income, adequate credit history and sufficient liquid assets must be applied in the same manner to each borrower including borrowers who are non-permanent resident aliens.

Restrictions

All non-permanent resident aliens must have a minimum two-year history of credit and employment in the U.S. or another country. In addition, non-permanent resident aliens who meet at least one of the following requirements are generally eligible for the same financing terms as U.S. citizen:

- Minimum two-year history of residence, employment and credit in the U.S., or
- Borrowing with a U.S. citizen or permanent resident alien.

FOREIGN NATIONALS

Not allowed

DIPLOMATIC IMMUNITY

Not allowed. Refer to Section 820.04 of this Seller Guide.

825.06: Borrower – Employment and Income Analysis (05/30/2017)

EVALUATING EMPLOYMENT HISTORY

Stability

All income used in qualifying must be verified, stable, and have a reasonable expectation of continuance.

Generally, the greater the job tenure and stability, the greater the ability to repay obligations in a timely fashion. Employment should be stable with at least a two-year history in the same job or in a similar job or jobs.

Underwriters may assume that salary or wage income from employment verified in accordance with above can be reasonably expected to continue if a borrower’s employer verifies current employment and income and does not indicate that employment has been, or is set to be, terminated. Underwriters should not assume that income can be reasonably expected to continue if a verification of current employment includes an affirmative statement that the employment is likely to cease, such as a statement that indicates the employee has given (or been given) notice of employment suspension or termination.

Refer to *Continuance of Income* in this section for additional requirements.

Job Changes

A borrower who changes jobs frequently to advance within the same line of work should receive favorable treatment if this can be verified. Frequent job changes without advancement or in different fields of work should be carefully reviewed to ensure consistent or increasing income levels and likelihood of continued stable employment.

Employment Gaps

The borrower must provide a detailed two-year employment history. Obtain a written explanation from the borrower for any gaps in employment that span one or more months. The underwriter must determine that any gaps do not affect employment stability. Gaps in employment due to the borrower attending training or schooling for a specific profession should be favorably considered. Verification of the schooling (for example, diploma, or transcripts) must be provided.

Employment Beginning After Subject Loan Closing

Loans may close prior to the start date with a New Employer provided the following requirements are met:

- Primary residence and 1-unit only.
- Maximum 80% LTV.
- Purchase transactions only.
- Salaried borrowers only.
- Fully executed non-contingent employment contract or offer letter indicating salary and start date is required. The contract must be fully guaranteed and non-revocable.
- The time period between closing date & commencement of employment must not exceed 60 days.

- Borrower must have adequate cash reserves to cover PITI during employment gap plus two additional months over and above any other reserve requirements that may apply.
- Post Close verbal Verification of Employment (verbal VOE) and Paystub not required.
- Documentation evidencing all contingencies have been satisfied must be provided prior to closing.

Employment Less Than Two Years

The following apply:

- For borrowers who are reentering the workforce after an absence of six months or more, the borrower's income may be qualifying income if the borrower has been at the current employer for a minimum of six months and can document a two-year work history prior to an absence from employment using:
  - traditional employment verifications and/or
  - copies of Form W-2s or pay stubs, refer to **Form W-2 Alternative Documentation** requirements below.
- A move from dependence on public assistance to reliance on employment and earned income should be viewed as a positive factor.

Note: One, but not the only example of an acceptable employment situation, includes individuals who took several years off from employment to raise children and then returned to the workforce.

Considerations

Many components make up income potential: borrower's occupation, employment tenure, opportunities for future advancement, educational background, and occupational training.

Verification

Income used to qualify the borrower must be verified by an independent third party source. This includes documents prepared by an individual or institution with no interest in the transaction.

Continuance of Income

Income sources that may have a finite period of receipt such as the income types listed below must have a continuation period of at least five years. The continuance requirement may be reduced to three years if this income source contributes 25% or less of the qualifying income.

- Alimony or separate maintenance payments
- Child support
- Note income
- Trust Income
- IRA/401K/Keogh income
- Certain types of retirement income, such as annuities (excluding social security income)
- Social Security survivor benefits for children
- Foreign income
- Certain types of benefit income, such as worker's compensation
- Public assistance income
- Mortgage differential

- Relocation compensation
- Royalty income

Because these income sources have a defined expiration date, care must be taken when this is the sole source or majority of qualifying income. Underwriters must consider the borrower's continued ability to repay the Loan when the income source expires or the distributions will deplete the asset prior to maturity of the mortgage.

Effective income for borrowers planning to retire during the first three-year period must include the amount of:

- Documented retirement benefits
- Social Security payments or
- Other payments expected to be received in retirement.

Form W-2 Alternative Documentation

IRS *Wage and Income Transcript* (W-2 Transcript) may be provided in lieu of IRS *Form W-2 Wage and Tax Statement* (Form W-2) when Form W-2 is required to document income. The W-2 Transcript must:

- Be obtained directly from a tax transcript vendor or the IRS by the Seller.
- Reflect all information that would be included on the actual Form W-2.

Tax Return Signature Requirements

When tax returns are used to verify qualifying income, regardless of income type, tax return signature requirements must be met.

Any one of the following are acceptable documents:

- Tax returns signed by borrower(s), regardless of date, or
- Tax returns with Form 8879, indicating that e-signatures are filed, or
- Tax returns signed or stamped by the CPA, or
- Tax returns with a cover letter prepared by the CPA, or
- A Preparer Tax Identification Number (PTIN).

DECLINING INCOME POLICY (SELF-EMPLOYMENT, BONUS, OVERTIME, COMMISSION, RESTRICTED STOCK)

If any of the borrower's income indicates a 20% or greater decline in self-employed, bonus, overtime, commission and restricted stock income in the past two years or year to date, risk/offset factors must be considered by the underwriter when determining if the Loan should be approved, restructured, or denied. When income has declined less than 20%, underwriters should use judgment to determine whether similar assessment is warranted (for example, Loans with debt ratios at or near maximum allowed could be impacted with even small income declines). The list of risk/offset factors include but are not limited to the following:

- Is the decline an isolated or a onetime occurrence?
- Has the decline been addressed and expectations for non-recurrence documented / supported?
- Are the bonus or commission income programs being used to qualify still in place?
- Has it been verified that the amount of income used to qualify will continue?
- Is the proportion of declining income relative to total income?

- Self-employment income is frequently more volatile and less stable than other professional income sources.
- Additional years of income trending may be required to support stability and expected continuance.

If the self-employed, bonus, and commission income has declined more than 20%, then:

- The lower income must be used in qualifying.
- Income cannot be averaged with previous higher years' income or current income unless both of the following apply:
  - Decline is an isolated, onetime occurrence.
  - The reason for onetime decline has been satisfactorily addressed and documented to support a strong expectation of non-recurrence or further decline in income.

If there have been declines over multiple years or further declines are possible, an additional risk offset of one of the following is required:

- DTI ratio at least 5% less than required.
- Housing ratio less than 36%.
- Reserve (post-closing liquidity) over minimum required.
- Another equivalent offset as documented and supported by the underwriter.

Additional supporting documentation required:

- For self-employed borrowers, the CPA must be contacted to provide documentation and support for income trends and continuance.
- For borrowers with bonus or commission income, the employer must be contacted for income trends and continuance as well as verification the employee is still eligible and that programs are ongoing:
- If a publicly held company, earnings reports can be used to evidence favorable business trends.

Reserve (post-closing liquidity) exceptions with declining income are generally not available.

Loans that do not meet all the declining income guidelines may not be eligible for approval as submitted.

INCOME ANALYSIS – RESTRICTED STOCK

Restricted stock refers to stock of a company that is not fully transferable until certain conditions have been met. Upon satisfaction of those conditions, the stock becomes transferable to the person holding the grant. Restricted stock should not be confused with stock options. Restricted stock must be vested as well as received on a regular, recurring basis.

The following documentation is required:

- Issuance agreement or equivalent (part of the benefits package), and
- Schedule of distribution of units (shares), and
- Vesting schedule, and
- Evidence that stock is publicly traded, and
- Evidence of payout of the restricted stock (e.g., YTD pay stub and 2 years W2s)

Calculation of income:

- To determine the restricted stock price use the lower of:

  - current stock price, or
  - the two year stock price average.

- Qualifying income will be calculated using an average of the restricted stock income for the past two years, and year to date stock earnings. The average stock price should be applied to the number of stock units vested each year. If stock income is declining, refer to **DECLINING INCOME POLICY (SELF-EMPLOYMENT, BONUS, OVERTIME, COMMISSION, RESTRICTED STOCK**.
- Future vesting must support qualifying income.

INCOME ANALYSIS – SELF-EMPLOYED BORROWERS

Borrowers are considered self-employed when their income is derived from a business in which they maintain a majority owner interest or can otherwise exercise control over the business' activities. Generally, a 25% or greater ownership interest in the business is considered a majority. There are circumstances where borrowers may be considered self-employed if they own less than 25% of a business.

Example:

In partnerships with each of five general partners owning 20%, the borrower is considered self-employed if this 20% ownership is the borrower's major source of income.

Increased Risk Consideration

Self-employed borrowers present a greater credit risk than salaried borrowers because their income is directly linked to the success of their business. The following additional risks are associated with self-employed borrowers:

- Difficulty in verifying actual income/cash flow.
- Cash flow may not be regular because it is affected by marketplace fluctuations.
- Business may decline if borrower becomes ill.
- Borrower may be liable for business debts.
- Business may suffer from inadequate control or dissension among partners.
- Maximum financing for a borrower self-employed less than two years.

Two-year history

Income from self-employment may be considered stable if the borrower has been self-employed two or more years. Stable income is the average income for the previous two years. Any income from self-employment earned by the borrower must be documented with tax returns or financial statements prepared by the borrower's accountant.

Income of a borrower with at least one year, but less than a two-year history of self-employment may be considered stable if both of the following requirements are met:

- Borrower must have had at least two years of previous successful employment in the same occupation.
- Borrower must be able to document a reasonable probability of business success based on market feasibility, research, or studies and pro forma financial statements.

The following factors must be carefully considered when a borrower has been self-employed for at least one year, but less than two years:

- The borrower's training and experience.
- The location and nature of the business.

- The demand for that type of business in the area.

Less than one-year history

Income from a self-employment of less than one year may not be considered effective income.

Business Classifications

Sole proprietorship

A sole proprietorship is a business owned by one person. It is the least expensive and simplest form of business to establish. As long as the establishing individual uses his own name, no fees, registrations, agreements, or taxes are involved.

- **Sole proprietorship liability** In a sole proprietorship, the individual owner is personally liable for all debts of the business, and, therefore, has unlimited liability. No distinction is made between the owner's personal assets and the assets used in the business. Either may be taken by creditors to satisfy business obligations.
- **Sole proprietorship death of owner**With a sole proprietorship, the death of the owner would terminate the business and place the assets into probate, delaying the disposition of assets to creditors and heirs. There is no legal provision for continuity of sole proprietorships.
- **Sole proprietorship risks** Management control of the business is concentrated in the owner. While this is useful for rapid decision making, continuity of the business may be endangered by:
    - A lack of checks and balances.
    - Illness or long absence of the owner.
    - Inability to raise adequate capital.
- **Sole proprietorship taxes** The business income or loss is reported on Schedule C, Internal Revenue Service (IRS) Form 1040, and included with the individual owner's tax return.
- **Sole proprietorship qualifying income** Income based on the individual tax returns, IRS Form 1040, for the previous two years is averaged. If the earnings trend for the previous two years is downward and the most recent tax return or P&L is less than the prior year's tax return, the borrower's most recent year's tax return or P&L must be used to calculate his/her income.

Partnership

A partnership is basically a sole proprietorship multiplied by the number of people involved. A partnership is based upon a contractual relationship formed to carry on a trade or business.

- In a general partnership, each partner is personally liable for the total debts of the business.
- In a limited partnership, a limited partner is liable only to the extent of his own investment in the business.

General Partnership

- **General partnership liability**A general partnership is formed so that each partner is personally liable for the debts of the whole business. Therefore each partner is responsible for the actions of every other partner. This can create significant control problems and the necessity for a written partnership agreement. The personal liability to partnership creditors exists even after the partnership is dissolved.

- **General partnership dissolution**Unless specified in the partnership agreement, a partnership is dissolved immediately upon the death, withdrawal, incompetence, or insolvency of any one partner.
- **General partnership risks**There may be a lack of prompt and centralized control particularly where loose assignment of responsibilities exists. The concept that equal partners have equal voice may produce more reasonable judgment but may also cause more frequent arguments.Generally, large amounts of capital are difficult to obtain because of the relative instability of this form of organization.
- **General partnership taxes**Partnerships are treated like sole proprietorships. Although the partnership is not subject to taxation, it is required to calculate and report partnership income on IRS Form 1065, United States Partnership Return of Income. The net income distributable to each partner is reported on Schedule K-1 of IRS Form 1065 and on the individual's Schedule E, Part II. Partners then pay taxes on their proportionate share of net partnership income at their individual tax rate, whether or not the income was actually withdrawn from the partnership.
- **General partnership qualifying income**Refer to EVALUATING PARTNERSHIP TAX RETURNS (IRS FORM 1065) AND SCHEDULE K-1 below.

Limited Partnership

- **Limited partnership liability**Limited partnerships are usually formed for the purpose of investing money. Limited partners usually take a loss on this invested money. In turn, this reduces their taxable income. Limited partners have limited decision-making opportunities and their liability is limited to the amount they invest. Unlike general partners, a limited partner's death or withdrawal does not terminate the partnership.
- **Limited partnership capital**Limited partnerships raise capital by attracting investors in the form of limited partners. As a result, limited partners are an excellent source of capital for the general partners without any loss of management control.
- **Limited partnership taxes**Limited partnerships carry the same tax implications as general partnerships and sole proprietorships. Both the limited and general partners in a limited partnership pay taxes on their proportionate share of net income as reported on their individual tax returns. Limited partners report their income or loss to the IRS on Schedule K-1 of Form 1065 and the individual Schedule E, Part II.
- **Limited partnership qualifying income**Refer to **EVALUATING PARTNERSHIP TAX RETURNS (IRS FORM 1065) AND SCHEDULE K-1** below.

Corporation

Corporations are state-chartered businesses owned by stockholders. The stockholder is not personally responsible for the debts of the corporation. The corporation's profits (retained earnings) are put back into the business or are distributed to stockholders as dividends. A corporation may choose to do both. The ultimate legal control of a corporation rests with its owners, the shareholders. These shareholders delegate their control to an elected board of directors. The board of directors, in turn, elects the officers of the corporation who are responsible for the day-to-day operations of the business.

- **Corporation taxes**Corporations report their income and losses on the United States Corporation Income Tax Return, Form 1120. Schedule L of IRS Form 1120 presents the current year corporation balance sheet. Income to the officers is reported by a Form W-2 and is reflected on IRS Form 1040.
- **Corporation qualifying income**Qualifying income is determined by using a two-year average of income reported on Form W-2s.Refer to **Evaluating Corporate Tax Returns (IRS Form 1120)** below.
- **Corporation additional income**

- For an analysis of corporate tax returns, refer to **Corporation qualifying income** below.
- For an analysis of financial statements in this document, refer to **Financial Statements Analysis** below.

Subchapter S Corporation

This entity is formed as a result of an elective provision of the federal law, which permits certain small business corporations and their shareholders to elect special income tax treatment. It has the characteristics of a corporation, except for the special tax treatment.

- **Subchapter S corporation substantial risk**Because S corporations are generally small, start-up businesses, which are taxed like partnerships, they are in the developmental stage and present a substantial underwriting risk. This is particularly true because the limit on the number of shareholders allowed affects sources of borrowing and limits management options.
- **Subchapter S corporation taxes**S corporations pass gains and losses onto their shareholders, who are then, taxed at the tax rates for individuals. Income is detailed on IRS Form 1120S (U.S. income tax return for an S corporation), and is transferred to the individual shareholder's personal returns by the Schedule K-1. The owners' salaries are reported on Form W-2s.
- **Subchapter S corporation qualifying income**Refer to **Evaluating S Corporation Tax Returns (IRS Form 1120s) And Schedules K-1** below.

Required Documentation

The following documents are required for all self-employed borrowers on loans that require documentation of income:

- **Verbal Verification of Employment – self-employed required documentation**If any borrower on a loan is self-employed, a verbal VOE (Exhibit 3) must be completed not more than 30 calendar days prior to the date printed on the note. Employment needs to be verified by analyzing tax returns and financial statements.The Seller must perform additional diligence to verify income stability and continuance including but not limited to:
- Confirm with a disinterested third party, for example, a CPA, regulatory agency, contractor or professional organization and
- Provide supporting documentation verifying the existence of the business including, but not limited to:
  - Yellow page ads.
  - Copies of business licenses.
  - Internet websites. Acceptable Internet websites include the borrower's business website and government, union, and professional association websites or accessing LexisNexis.

The verification must be documented in writing, including:

- Independently-verified source of the employment information.
- Name and title of the person who verified the borrower's employment

- **Tax returns**Copies of signed individual income tax returns for the past 2 years including all applicable schedules are used to document income. Refer to Tax Return Signature Requirements above.If the borrower is self-employed and the self-employment income is not used to qualify, the self-employed borrower must provide a copy of the first page of the most recent individual federal tax return to determine whether there was a business loss that negatively impacts the borrower's ability to repay. When that is the case, additional documentation about the self-employed borrower's business income is needed to fully evaluate the impact of the business loss.

Corporations, S-corporations, partnerships

The following additional documentation is required if the business is a corporation, Subchapter S corporation, or partnership:

Business income tax returns

Copies of signed federal business income tax returns for the previous two-years with all applicable schedules attached:

-
    - Corporation - IRS 1120.
    - S corporation - IRS Form 1120S and Schedule K-1.
    - General partnership - IRS Form 1065, and Schedule K-1.
    - Limited partnership - IRS Schedule K-1.
- **Financial statements**The individual preparing financial statements cannot be an immediate relative of the applicant.A year-to-date profit and loss (P&L) statement and balance sheet are required if more than four months have lapsed since the last fiscal year end. Since balance sheet information is not included on the Schedule C, balance sheets are also required for sole proprietorships when less than four months have lapsed since the last fiscal year end.The individual preparing or reviewing the financial statements must be an appropriate third party:
    - An unrelated and qualified individual (e.g. accountant / bookkeeper), including employee of the applicant's business, particularly if that employee has filed tax documents with the IRS.
    - An appropriate third party who has reviewed the document or other record prepared by the consumer is also acceptable.

  Additional reviewed or audited financial statements prepared by a certified public accountant may be required at the discretion of the underwriter. Cases which may warrant reviewed or audited financial statements are:
    - An applicant who has been self-employed for less than two years.
    - Excessive variation in income or expenses from year to year.
    - Reported delinquencies on the business credit report.

Sole proprietorship

The following additional documentation may be required if the business is a sole proprietorship:

- **Balance sheet**A balance sheet for the previous two years may be required at the underwriter's discretion if the business has significant assets, employees other than family members, and regularly prepares separate business financial statements.
- **Request for tax returns from IRS (Form 4506-T)**Seller to obtain fully executed IRS Form 4506-T from the borrower for each business tax return that was used in the Loan decision.

Income Calculation Methods

The Wells Fargo Cash Flow Method must be used to qualify the borrower, taking into account any supported adjustments made during the analysis of income.

Two calculations must be performed to validate cash flow:

- The Wells Fargo Cash Flow Method (Cash Flow Method) considers distributions that the borrower is taking from the business.

- The Wells Fargo Baseline Method (Cash Flow Method) considers the net income from the business.

The Baseline Method allows the underwriter to determine if distributions are less than or greater than the net income from the business. If positive adjustments to cash flow are made, further analysis and documentation are required to determine if the adjustments are supported, considered stable, and likely to continue.

If the income from the Cash Flow Method, including any adjustments, exceeds the income from the Baseline Method, careful consideration and analysis must be given to documenting the income is available, considered stable, and likely to continue.

Calculations for each method are shown in the sections below for the various business classifications/tax return types (sole proprietorship, corporate, or partnership).

Written analysis of income

Lenders must provide documentation to evidence the income calculations above were performed.

Evaluating Tax Returns

Introduction

To determine the income of the self-employed borrower, personal and business tax returns must be obtained and evaluated.

Averaging

Because self-employment income may change each year, an average better approximates the borrower's long-term earning ability.

Earnings trend

Establish the borrower's earnings trend. Annual earnings that are level or increasing are acceptable. However, a large decline in gross income over two or three years may result in an unacceptable income source, even if the borrower's current income and debt ratios meet the guidelines.

Earnings trends from the previous two years are established using the tax returns. If borrower:

- Provides quarterly tax returns, the income analysis may include income through the period covered by the tax filings, or
- Is not subject to quarterly tax returns, or does not file them, then the income shown on the P&L statement may be included in the analysis, provided the income stream based on the P&L is consistent with the previous years' earnings.

If the P&L statements submitted for the current year show an income stream considerably greater than what is supported by the previous year's tax returns, base the income analysis solely on the income verified through the tax returns.

If the consumer's earnings trend for the previous two years is downward and the most recent tax return or P&L is less than the prior year's tax return, the borrower's most recent year's tax return or P&L must be used to calculate his/her income.

Income source

Give particular attention to the actual income source, not just the total income. For example, the adjusted gross income (AGI) may be increasing annually due to income not related to the business, such as real estate capital gains, while the business income may be declining.

Only sources of income that are likely to continue may be used for qualifying.

Schedule C

Business income or loss

This is the business income or loss for a sole proprietorship.

Income is calculated as follows:

	Baseline Method	**Wells Fargo Cash Flow Method**
Schedule C - Profit or Loss From Business (Sole Proprietorship)	Net profit + depletion + depreciation	Net profit + expenses for business use of home + depletion + depreciation - meal and entertainment exclusion + amortization/casualty loss

Note: The Wells Fargo's cash flow method is used to qualify the borrower, taking into account any supported adjustments made during the analysis of income.

Schedule D

Capital gain or loss

Capital gains or losses generally occur only one time, and should not be considered when determining effective income. However, if the individual has a constant turnover of assets resulting in gains or losses, the capital gain or loss must be considered when determining the income. Three years' tax returns are required to evaluate an effective earning trend. If the trend:

- Results in a gain, it may be added as effective income, or
- Consistently shows a loss, it must be deducted from the total income.
- Anticipated continuation of income must be documented through verified assets.

Example:

Capital gain for an individual who purchases old houses, remodels them, and sells them for a profit.

When using income from capital gains, the underwriter must determine that the borrower's current asset portfolio is sufficient to support future capital gains. The underwriter must also consider whether an income-generating asset was sold during the year, as future business income may be reduced as a result of the sale.

Schedule E

Part I (For self-employed borrowers who also have rental income)

Refer to **INCOME ANALYSIS – RENTAL INCOME** within this Section.

Part II

Income or loss from partnerships and S corporation income or loss is determined by reviewing the business tax returns.

Schedule F

Farm income or loss

This is the profit or loss from farming.

Income is calculated as follows:

	Baseline Method	**Wells Fargo Cash Flow Method**
Schedule F - Farm Income or Loss	Net profit (loss) + depreciation	Net profit (loss) - nonrecurring other income/loss + depreciation + amortization/casualty loss + expenses for business use of home + Non-Tax Portion Ongoing Coop and CCC Payments

Note: The Wells Fargo's cash flow method is used to qualify the borrower, taking into account any supported adjustments made during the analysis of income.

Evaluating Corporate Tax Returns (IRS Form 1120)

Purpose of review

The primary purpose for reviewing business tax returns is to analyze the financial strength of the business and to confirm that it will continue to generate the income the borrower needs to qualify for the requested Loan. When the individual tax return confirms sufficient borrower income and the business tax return indicates a viable company, the corporation need not be investigated any further.

Additional income

Qualifying income is determined by using a two-year average of income reported on Form W-2s. However, if the borrower needs (and has the legal right) to draw additional income from the corporation to qualify for this Loan, further evaluation is necessary to verify that the business is capable of contributing additional income. The following are required:

- Borrower has the legal right to withdraw income from the corporation, per corporate resolution or comparable document.
- Withdrawal of additional income will not impact the business operations, based on careful analysis of the corporate financial statements.
- The business has positive sales and earnings trends.

Verify right to business funds

Before proceeding with the analysis of additional income, it should be verified that the owner / borrower has a right to these funds. Verification includes corporate resolution or other comparable document.

Calculation

Income is calculated as follows:

	Baseline Method	Wells Fargo Cash Flow Method
C-Corporation	Officer's compensation (W-2) + Borrower's share of: taxable income - tax liability + depreciation + depletion	Officer's compensation (W-2) + dividends/distributions + loans to shareholders - loans from shareholders - unreimbursed employee expenses

Note: The Wells Fargo's cash flow method is used to qualify the borrower, taking into account any supported adjustments made during the analysis of income.

Fiscal year

Many corporations operate on a fiscal year that is different from a calendar year. In these cases, a time adjustment is necessary to relate the corporate income to the individual tax return because the individual return is on a calendar year.

Individual percentage of ownership

- The borrower's percentage of ownership can be determined from the Compensation of Officers section of the corporate tax return.
- If this information is not provided, other evidence of the borrower's ownership must be obtained for this business income to be considered. A statement by the corporation's accountant is satisfactory evidence.
- This percentage should be applied to the total of the above figures to determine the borrower's share of corporate after-tax income and non-cash expenses.

Evaluating S Corporation Tax Returns (IRS Form 1120s) And Schedules K-1

Calculation

The gains or losses of an S corporation are passed on to the shareholders who are then taxed at the tax rates for individuals. This income or loss is reflected on Schedule K-1 (IRS Form 1120S) and transferred to Schedule E of the individual tax return.

The primary source of income for an owner of an S corporation comes from W-2 wages, which are traced to the Compensation of Officers line of the IRS Form 1120S and reported on IRS Form 1040. However, if the borrower needs (and has the legal right) to draw additional income from the corporation to qualify for this Loan, further evaluation is necessary to verify that the business is capable of contributing additional income. The following are required:

- Documentation of ownership and access to income.
- The business must have adequate liquidity to support the withdrawal of earnings.
- The business must have positive sales and earnings trends.

If the borrower meets the above requirements, calculate income as follows:

	Baseline Method	Wells Fargo Cash Flow Method
S-Corporation	Officer's compensation (W-2) + Borrower's share of: Ordinary income/loss + net rental real estate income (loss) + depreciation + depletion - total obligations payable in < 1 year	Officer's compensation (W-2) + cash distributions + loans to shareholders - loans from shareholders - unreimbursed employee expenses

Note: The Wells Fargo’s cash flow method is used to qualify the borrower, taking into account any supported adjustments made during the analysis of income.

The Schedule K-1 (IRS Form 1120S) must be reviewed to determine the borrower’s percentage of ownership.

Evaluating Partnership Tax Returns (IRS Form 1065) And Schedule K-1

All Partnerships

Both general and limited partnerships use the IRS Form 1065 federal income tax return. The gains or losses of a partnership are passed on to the partners who are then taxed at the tax rates for individuals. This income or loss is reflected on Schedule K-1 (IRS Form 1065) and transferred to Schedule E of the individual tax return.

If the borrower is a general partner and needs (and has the legal right) to draw additional income from the partnership to qualify for this Loan, further evaluation is necessary to verify that the business is capable of contributing additional income. The following are required:

- Documentation of ownership and access to income.
- The business must have adequate liquidity to support the withdrawal of earnings.
- The business must have positive sales and earnings trends.

If the borrower meets the above requirements, calculate income as follows:

	Baseline Method	Wells Fargo Cash Flow Method
Partnership	Partner's share of: Ordinary income/loss + net rental real estate income (loss) + guaranteed payments + depreciation + depletion - total obligations payable in < 1 year	Guaranteed Payments to Partner - capital contributed during year + withdrawals and distributions + loans to partners - loans from partners - unreimbursed partnership

		expenses

Note: The Wells Fargo's cash flow method is used to qualify the borrower, taking into account any supported adjustments made during the analysis of income.

The Schedule K-1 (IRS Form 1065) is used to determine the borrower's percentage of ownership.

Re-Evaluation of Business Income

Introduction

Once the additional business income has been credited to the borrower, the overall business financial position must be re-evaluated.

Recent withdrawals

Additional borrower withdrawals of cash may have a severe negative impact on the business and may lead to negative cash flow. When this occurs, it may not be possible to confirm the stable, on-going income needed to approve the mortgage.

The taxable income line must be reduced by the amount of the borrower's withdrawal.

To determine the impact on the business, income and expenses for the previous two-years must be compared with year-to-date income and expenses. In addition, a current balance sheet should be reviewed to determine that the business has adequate funds to cover short-term liabilities.

Financial Statements Analysis

Purpose of analysis

Self-employed borrowers' ability to repay the mortgage Loan depends on the stability and success of their business because the net income from that business will be used to repay the mortgage.

Financial statements of the business should be reviewed if there are any doubts about the continued stability of the business. Income statements and balance sheets can be evaluated for solvency (the ability to repay debts) and profitability (the ability to achieve monetary gain).

By reviewing financial statements for two or more years, the underwriter can develop a historical view of operations.

The two principal business statements that reveal the financial status of a company are:

- Balance sheet: An overview of a business, which shows a company's financial position at one point in time.
- Income statement: The short-term (one year or less) look at a business, which shows the income realized and expenses incurred over that period.

The balance sheet

The balance sheet presents what a company or individual owns and owes at a specific point in time, usually the last day of the year. The balance sheet is an indicator of the individual's or company's financial strength.

Balance sheet organization

The balance sheet has two sides and lists the general ledger account balances in three main categories:

- Assets are things of value owned by the company or individual and are shown on the left side of the balance sheet.
- Liabilities are debts owed by the company or individual to its creditors in exchange for goods and services required to operate the business. They are shown on the right side of the balance sheet.
- Stockholder's equity, sometimes called capital, is the value of the financial interest put into the business by its stockholders, owners, or both and is shown on the right side of the balance sheet.

Must balance

Both sides of the balance sheet must be equal as shown in the following formula:

Assets = liabilities + stockholder's equity.

Typical balance sheet categories

<table>
<tr><th rowspan="3">Assets</th><th>Liabilities</th></tr>
</table>

Assets	Liabilities
Current assets: • Cash • Accounts receivable • Inventory • Prepaid expenses • Marketable securities Fixed assets: • Property, plant, and equipment (less accumulated depreciation) Intangibles and other assets: • Goodwill • Patents • Trademarks • Copyrights	Current liabilities: • Accounts payable • Notes payable (current portion) • Federal income tax payable Long-term liabilities: • Mortgages • Notes payable • Bonds **Stockholder's equity** • Capital stock • Capital surplus • Retained earnings

Assets

The assets column lists all the goods and property owned. It also shows amounts to be collected. There are three major sections: current assets, fixed assets, and other (intangible) assets.

Current assets

Current assets can be converted to cash quickly within a current year. Current assets are in a constant cycle of being changed into cash to pay debts and operating expenses. The test usually applied to distinguish current assets from fixed assets or other assets is whether the business will consume these assets within the operating cycle of the business.

Current assets include:

- Cash - all money on deposit or in petty cash.
- Accounts receivable - money owed to the business for goods and services.
- Inventor - finished goods, goods-in-process or raw materials.

Fixed assets

Fixed assets are of a relatively permanent nature. They are the assets the business needs to operate its ongoing activities. Fixed assets last longer than the current operating cycle and are depreciated over their useful lives to allow for normal wear and tear. Fixed assets are items such as buildings, furniture, fixtures, and automobiles.

Other assets

Other assets are long-term rights and privileges which are intangible but add value to a business because of their worth. These include:

- Copyright: Exclusive rights to publish and sell a musical, literary, or artistic piece of work for a number of years.
- Patent: A document granting a privilege to someone who has invented a product or a concept.
- Goodwill: Accrues when a business's rate of expected future earnings is greater than the rate of earnings normally realized in the industry.
- Trademark: The right to use an identifying name or mark given exclusively to a company (for example, *Coca-Cola®*).

Liabilities

Liabilities are the debts owed by an individual or corporation in exchange for goods and services. The two categories of liabilities are:

- Current liabilities: All amounts owed and due within the coming year. The portion of a long-term liability, such as a mortgage, that is due within the coming year is classified as a current liability.
- Long-term liabilities: Debts due more than one year from the balance sheet date.

Stockholder’s equity

The stockholder's equity is the third section of the balance sheet and is also known as the capital section. It reflects the business's net worth and is equal to the assets minus the liabilities.

There are three categories:

- Capital stock: A share of interest or ownership in a company. There are two types:
  - Common stock.
  - Preferred stock.
- Capital surplus (sometimes called additional paid-in capital): This is the excess of market value over the stated (par) value of stock paid by shareholders.Example: If the par value of a company’s stock is $6 and one share is purchased for $10, the capital surplus has a balance of $4 and the capital stock account has a balance of $6.
- Accumulated retained earnings is the amount of after-tax earnings that is put back into the business to conduct ongoing operations. Retained earnings cannot be used as income to qualify or as cash to close.

Income statement

The income statement presents the income and expenses over a 12-month period. The net profit or loss for the year is shown on the income statement. By reviewing the income statements for two or more years, the underwriter can develop a historical review of operations, especially in terms of net profit and net loss, and be better able to predict how the business might perform in the future.

Organization

The income statement is made up of two major sections:

- Inflow of revenue.
- Outflow of expenses.

Matching concept

The accounting principle, matching concept, refers to matching expenses with the revenue they help generate. Expenses are subtracted from revenues. Net profit or net loss for the year is what remains.

Sample income statement	
Sales (revenue, including returns and allowances)	$0,000
Less: cost of goods sold	(000)
Gross profit on sales	$0,000
Less: o selling expenses o general administrative expenses o other expenses	(000) (000) (000)
Other sources of income	000
Less: federal income taxes	(000)
Net income	$0,000

Income Definition

Sales

Sales are generally the major source of revenue for the business. Gross sales are reduced by sales returns and allowances. The result is referred to as net sales.

Cost of goods sold

Cost of goods sold is the cost of materials used to produce the goods sold or cost of items to be resold during the accounting cycle. This account may be inappropriate if the business sells a service or other intangible item such as insurance.

Gross profit on sales

Gross profit on sales is also called gross margin, the results from subtracting the returns and cost of goods sold from the gross sales.

Expenses

Selling expenses

Selling expenses are incurred to produce the sales revenue. Included in the selling expenses are commissions and salaries to salespeople, advertising, and travel and entertainment.

General and administrative expenses

General and administrative expenses include office expenses, staff salaries, and other overhead expenses, which are unrelated to directly producing sales revenues.

Other expenses

Other expenses are the expenses incurred outside of the main operations of the business. These include dividend and interest expense.

Federal income tax

Federal income tax is generally the last expense deducted from income.

INCOME ANALYSIS – SALARIED INCOME

A salaried worker is paid on a regular, recurring basis by an employer. Income is reported to the Internal Revenue Service (IRS) on a Form W-2. The borrower has minimal (less than 25%) or no interest in the business. Income is verified with one of the following:

- Verification of Employment (VOE) form, completed by the employer.
- Current pay stubs, a verbal VOE (Exhibit 3), not more than 20 business days prior to the date printed on the Note, and most recent two years of Form W-2s. Refer to **Form W-2 Alternative Documentation** requirements above.

Employment verification for the most recent two full years must be documented.

A borrower with a 25% or greater ownership interest in a business is considered self-employed and is evaluated as a self-employed borrower for underwriting purposes.

See **INCOME ANALYSIS – SELF-EMPLOYED BORROWERS** – Definition/risk/stability for circumstances when borrowers may be considered self-employed if they own less than 25% of a business.

Overtime Income

Overtime may be used as stable monthly income if the employer verifies:

1. Two year history of receipt
2. Probability of continued receipt
3. Dollar amount of overtime paid in the last two years

If the employment verification states that the overtime income is unlikely to continue, it may not be used in qualifying.

The underwriter must develop an average of overtime income for the past two years. Periods of overtime income less than two years may be acceptable, provided the underwriter can justify, document and confirm in writing the reason for using the income for qualifying purposes.

To document, obtain all of the following:

1. Most recent YTD paystub or salary voucher documenting at least one month of income.
2. Form W-2s covering the most recent two years. Refer to **Form W-2 Alternative Documentation** requirements above.
3. Verbal VOE (Exhibit 3) not more than 20 calendar days prior to the date printed on the Note.

Bonus Income

Bonuses may be used as stable monthly income if the employer verifies all of the following:

- Two-year history of receipt.
- Probability of continued receipt.
- Dollar amount of bonuses paid in the last two years.

If the employment verification states that the bonus income is unlikely to continue, it may not be used in qualifying.

The underwriter must develop an average of bonus income for the past two years. Periods of bonus income less than two years may be acceptable, provided the underwriter can justify and document in writing the reason for using the income for qualifying purposes.

To document, obtain all of the following:

1. Most recent YTD paystub or salary voucher documenting at least one month of income.
2. Form W-2s covering the most recent two years. Refer to **Form W-2 Alternative Documentation** requirements above.
3. Verbal VOE (Exhibit 3) not more than 20 calendar days prior to the date printed on the Note.

In some financial professions when the borrower secures new employment the borrower is offered a bonus which will be awarded on a recurring monthly, quarterly, or annual basis. Treat this as eligible income pursuant to stability and continuance requirements.

Refer to **Section 825.07(b): *Assets – Down Payment*** for additional requirements when using bonus income as qualifying income and as cash to close.

Commissioned Borrower

Borrowers who received commissions must provide all of the following:

1. The most recent two years' federal tax returns to verify commissions earned and expenses incurred.
2. Current paystub.
3. Most recent two years' Form W-2s. Refer to **Form W-2 Alternative Documentation** requirements above.
4. Verbal VOE (Exhibit 3) not more than 20 business days prior to the date printed on the Note.

Commission income must be averaged over the previous two years. Commission income earned for less than one year is not considered effective income unless the underwriter can verify and document in writing that the borrower's compensation changed from salary to commission within a similar position with the same employer.

Borrowers whose commission income was received for more than one year, but less than two years, may be considered favorably if the underwriter can do both of the following:

- Document the likelihood that the income will continue.
- Soundly rationalize accepting the commission income.

Commission income received for a minimum of two years from similar positions with different employers within the same industry may be considered if the underwriter can soundly rationalize accepting the commission income.

If the borrower is self-employed, for documentation requirements see **INCOME ANALYSIS – SELF-EMPLOYED BORROWERS**.

INCOME ANALYSIS – RENTAL INCOME

Stability of Rental Income

The stability of the rental income must be documented with two years of rental management experience or rental income history. This can include any rental property, not exclusive to the subject.

Rental Management Experience or Rental Income History

Rental management experience and rental income history is verified by obtaining the most recent two years of filed and signed federal IRS 1040 tax returns.

The two-year rental management experience and rental income history requirement may be waived for rental income from the subject property only, if all of the following apply:

- Purchase transaction
- Two-unit property
- Primary residence
- LTV less than or equal to 75%
- Loan Score greater than or equal to 740
- No gift funds

When waiving the property management experience, use the Operating Income Statement (216) to support rental income (a current lease is not required). A 25% vacancy/maintenance expense factor must be deducted from the gross rental income.

Eligible Rental Income

The following are acceptable sources of rental income:

- Rent received from investment properties or other units of an owner-occupied multifamily property may be considered stable income.
- Rents received from a live-in aide, generated from a disabled borrower's 1 unit, primary residence may be used for qualifying purposes, in an amount up to 30% of the total gross income that is used to qualify the borrower for the mortgage.

Typically, a live-in aide will receive room and board payments through Medicaid waiver funds from which the live-in-aide then makes rental payments to the borrower. This source of income is non-taxable and is not reported on the borrower's personal filed and signed federal IRS 1040 tax returns.

This income source may be considered stable monthly income, if both of the following are met:

- The borrower has received rental payments from a live-in aide for the past 12 months on a regular basis.
- The live-in aide plans to continue to reside with the borrower for the foreseeable future.

Ineligible Rental Income

The following are ineligible rental income types:

- Rent from boarders in a single-family property that is also the borrower's primary residence.
    - Income from a live-in aide may be allowed. Refer to **Eligible Rental Income** requirements above.
- Rent from a property that is the borrower's second home.

Non-Subject Investment Property Pending Sale

If a non-subject investment property is pending sale, review the following documents to consider offsetting the principal, interest, taxes, insurance (PITI) payment:

- Lease duration, and
- Three months of canceled checks or bank statements verifying receipt of rental income.

Note: Any additional income, above the PITI offset, from the non-subject investment property cannot be used as qualifying income.

Principle Residence Converting to Investment Property

For existing principle residence converting to investment property, refer to **Section 825.23: *Departure Residence Policy*** requirements

Documentation Requirements – Rental Income Used To Qualify

Rental management experience and rental income history is verified by obtaining the most recent 2 years filed and signed federal IRS 1040 tax returns, including Schedule E., regardless of how long the property has been owned. Refer to **Rental Management Experience or Rental Income History** requirements above for when this can be waived.

Rental income from commercial rental properties requires two years' complete filed and signed federal IRS 1040 tax returns, including schedule E.

Any indication of a gap in rental history/income greater than three months requires a written explanation from the borrower.

For subject property, rental income used to qualify must be supported by operating income statement (216) or comparable rent schedule (1007).

Tax Returns Aged Nine Months or More From the Date of the Last Tax Year Filed

Verification of current lease agreement and three months cancelled checks to verify current cash flow/rental management experience OR 10% Post Close Liquidity (PCL) based on the total aggregate liens on the subject property, in addition to standard PCL, is required unless:

- The rental income makes up less than 25% of the total qualifying income; or
- Appraisal indicates that units generating rental income used to qualify are tenant-occupied.

Property Owned Less Than 12 months

When property has been owned less than 12 months and is not reflected on the borrower's most recent, filed and signed federal IRS 1040 tax returns, the following is required:

- Copies of the present, signed leases may be used only if the borrower has a two-year history of property management experience as evidenced by the most current two years' filed and signed federal IRS 1040 tax returns.
- A vacancy/maintenance expense factor of 25% should be deducted from the rental income verified by the current lease agreement for determining qualifying income.

In addition:

- For refinance transactions, three months of canceled checks or bank statements verifying receipt of rental income, or
- For purchase transactions, existing tenant lease agreement may be used when transferred as part of the sale of the property. Three months canceled checks are not required.

Insurance Requirements – Subject Property

Rent loss insurance is required:

- For 1-unit investment property and 2- to 4-unit primary residence where borrowers are relying on rents from the units they will not be occupying.
- If the income from those units is used to qualify the borrowers.

The insurance must provide coverage for an amount equal to a minimum of six months of the rental income.

Documentation Requirements - Rental Income Not Used to Qualify

Documentation is not required when rental income is not used to qualify.

Determining Qualifying Rental Income

Determine qualifying rental income utilizing the following Cash Flow calculation only with IRS Form 1040 tax return or other business returns, including Schedule E.

Make the following adjustments to the net income shown on Schedule E to determine the monthly operating income:

	Net Income
+	Depreciation, mortgage interest, real estate taxes, insurance and homeowners association fees, if any
-	Unallowed losses, if any
+	Loss carry-overs from previous years, if any
-	Annualized mortgage payment for rental property
=	Annual operating income

÷	Annual operating income 12 months
=	Monthly operating income

When the monthly housing expense is included in the rental cash flow, it should not also be added to the long-term debt.

Monthly Operating Income

- Positive net rental income may be considered stable monthly income.
- Negative net rental income must be considered a liability for qualification purposes.

When using rental income to qualify from a 2-4-unit primary residence that is the subject property:

- The current monthly principal, interest, taxes, insurance (PITI) payment on the borrower's primary residence must be included in the liabilities as the housing payment.
- The monthly operating income should be included in qualifying income.

When using rental income to qualify from a 2-4 unit primary residence that is not the subject property:

- The current monthly principal, interest, taxes, insurance (PITI) payment on the borrower's primary residence must be included in the liabilities.
- The monthly operating income should be included in qualifying income.

For an investment property, subtract the monthly housing expense from the monthly operating income to determine the net cash flow.

Lease Agreements

A vacancy/maintenance expense factor of 25% should be deducted from the rental income verified by the current lease agreement for determining qualifying income. However, when a lease agreement is used to support higher income, review the prior year's filed and signed federal IRS 1040 tax returns to determine the appropriate vacancy/maintenance factor to use, which may be higher than 25%.

Positive net rental income from Schedule E of the borrower's tax returns or positive net cash flow from Freddie Mac 998/Fannie Mae 216 or Freddie Mac 1000/Fannie Mae 1007 may be considered stable monthly income.

Negative net rental income from Schedule E of the borrower's tax returns or negative net cash flow from Form Freddie Mac 998/Fannie Mae 216 or Freddie Mac 1000/Fannie Mae 1007 must be considered a liability for qualification purposes.

When using rental income to qualify from a 2-4 unit primary residence that is not the subject property:

- The current monthly principal, interest, taxes, insurance (PITI) payment on the borrower's primary residence must be included in the qualifying ratios.
- The monthly operating income should be included in qualifying income.

For an investment property, subtract the monthly housing expense from the monthly operating income to determine the net cash flow.

- If net cash flow is positive, include it in qualifying the income.

- If net cash flow is negative, include it with the long-term debts.

Aggregate net rental income may be counted as stable monthly income, provided the reliability of receipt is clearly supported by the documentation in the file.

Aggregate net rental loss from investment properties and 2-4 unit primary residences must be considered a liability for qualification purposes.

The monthly housing expense is already accounted for in the net cash flow so it should not be added to the long-term debts.

Baseline method

Only Depreciation shown on Schedule E may be added back to the net income or loss.

Positive rental income is considered gross income for qualifying purposes, while negative income must be treated as a recurring liability.

Lease Agreements

Deduct a 25% maintenance expense/vacancy factor from the monthly rent stated on the lease agreements to determine the monthly operating income.

When using rental income to qualify from a 2-4 unit primary residence that is **not** the subject property:

- The current monthly PITI payment on the borrower's primary residence must be included in the qualifying ratios.
- The monthly operating income should be included in qualifying income.

For 1-4 unit investment property, subtract the monthly housing expense. From the monthly operating income to determine the net cash flow.

- If the net cash flow is positive, include it in the qualifying income.
- If net cash flow is negative, include it with the long-term debts.

The monthly housing expense is already accounted for in the net cash flow, so it should not be added to the debts.

INCOME ANALYSIS – OTHER INCOME

Other Income – Second jobs/Part-Time Income

For qualifying purposes, "part-time" income refers to employment taken to supplement the borrower's income from regular employment; part-time employment is not a primary job and it is worked less than 40 hours.

Note: When a borrower's primary employment is less than a typical 40-hour work week that income should be evaluated as regular, on-going primary employment.

A part-time/second job is considered stable income if:

- The borrower's primary profession lends itself to a second job.
- Income can be verified as having been received and uninterrupted for at least two years.
- Income is expected to continue for at least three years.

Part-time income received for less than two years may be included as effective income, provided that the underwriter justifies and documents that the income is likely to continue.

Part-time income not meeting the qualifying requirements may not be used in qualifying.

To document provide all of the following:

- Most recent YTD pay stub covering one month,
- Form W-2s covering the two most recent tax years. Refer to **Form W-2 Alternative Documentation** requirements above, and
- a verbal VOE (Exhibit 3) within 20 business days prior to the date printed on the Note.

Other Income - Seasonal Income

Seasonal part-time or seasonal second job income can be considered as stable income when the borrower has a two-year history of receipt in the same line of work, there is a reasonable expectation that the borrower will be rehired the next season, and that the income is likely to continue for the next three years.

To document, obtain all of the following:

1. Seasonal employment income must be reported on the borrower's two most recent years' federal tax returns.
2. Year-to-date (YTD) paystub or salary voucher documenting at least one month of income.
3. Form W-2s covering the two most recent years. Refer to **Form W-2 Alternative Documentation** requirements above.
4. Verbal VOE (Exhibit 3) within 20 business days prior to the date printed on the Note.

Every attempt should be made to obtain a VVOE. However, if the VVOE is unattainable due to business closure during specified times of the year the underwriter should use judgment to determine if the income source will continue. The borrower does not have to be currently employed in order to use seasonal income, if received for the last two years and reasonably expected to continue.

Other Income - Seasonal Employment With Associated Unemployment Compensation

Seasonal employment with associated unemployment compensation can be considered as stable income when the borrower has a two-year history of receipt in the same line of work, there is a reasonable expectation that the borrower will be rehired the next season, and that the income is likely to continue for the next three years.

To document, obtain all of the following:

1. Seasonal employment and unemployment income must be reported on the borrower's two most recent years' federal tax returns.
2. YTD paystub or salary voucher documenting at least one month of income.
3. Form W-2s covering the two most recent years. Refer to **Form W-2 Alternative Documentation** requirements above.
4. Verbal VOE (Exhibit 3) within 20 business days prior to the date printed on the Note.
5. Proof of receipt of unemployment compensation for two years.

Every attempt should be made to obtain a VVOE. However, if the VVOE is unattainable due to business closure during specified times of the year the underwriter should use judgment to determine if the income source will continue. The borrower does not have to be currently employed in order to use seasonal income, if received for the last two years and reasonably expected to continue.

Other Income - Unemployment Compensation

Income derived from unemployment compensation is generally not to be considered stable due to the limited duration of its receipt. Seasonal unemployment compensation income may be used when an applicant is employed.

To document Seasonal Income with Unemployment Compensation include the following:

- Two most recent years' federal tax returns.YTD paystub or salary voucher documenting at least one month of income.
- Borrower expects to be rehired next season.
- Form W-2s covering the two most recent years. Refer to **Form W-2 Alternative Documentation** requirements above.
- Verbal VOE within 20 business days prior to the date printed on the Note.
- Proof of receipt of unemployment compensation for two years.

Other Income - Borrower's Income Per Job/Contract Basis

Borrowers whose income per job/contract basis is equal to or greater than 25% of their total income are considered to be self-employed. See **INCOME ANALYSIS – SELF-EMPLOYED BORROWERS**.

Other Income - Automobile Allowance

An automobile allowance may not be used for qualifying and may not be used to offset a car payment.

Other Income - Capital Gain Income

Income received from capital gains is generally a one-time transaction; therefore, it should not be considered as part of the borrower's stable monthly income. However, if the borrower needs to rely on income from capital gains to qualify, the income must be verified in accordance with the following requirements:

- Must have a two-year consecutive history of receipt and likely to continue for the next three years.

Other Income – Restricted Stock

Restricted stock refers to stock of a company that is not fully transferable until certain conditions have been met. Upon satisfaction of those conditions, the stock becomes transferable to the person holding the grant. Restricted stock should not be confused with stock options.

To document restricted stock income include the following:

- Issuance agreement or equivalent (part of the benefits package)
- Schedule of distribution of units (shares)
- Vesting schedule
- Stock must be publicly traded
- Evidence of payout of the restricted stock (e.g., YTD pay stub and 2 years W2s)

Calculation of income:

- Stock price should be averaged.
    - In most cases the lower of current price or the price of the stock averaged (generally a minimum of 2-years) should be used to support qualifying income. The average stock price should be applied to the number of stock units vested each year.

- Qualifying income will be calculated using an average of the restricted stock income for the past two years, and year to date stock earnings. If stock income is declining, refer to **DECLINING INCOME POLICY (SELF-EMPLOYMENT, BONUS, OVERTIME, COMMISSION, RESTRICTED STOCK**.

Future vesting must support qualifying income. Value of future vesting should be based on the lower of current value **or** the average of stock price.

Other Income - Employment By Relatives Or Transaction Participants

If the borrower is employed by a relative, a closely held family business, the property seller, real estate agent, or any party to the real estate transaction, the following documentation must be obtained:

- Borrower's signed and completed personal federal income tax returns for the most recent two years.
- If business is a corporation, obtain either of the following:
  - A signed copy of the corporate tax return showing ownership percentage.
  - A signed letter from the corporation accountant stating the borrower has no ownership interest in the corporation.
- Most recent two years' Form W-2s.
- Year-to-date pay stubs covering 30 days.
- Verbal VOE (Exhibit 3) within 20 business days prior to the date printed on the Note.

Current income reported on the pay stub may be used if it is consistent with W-2 earnings reported on the tax returns. If the tax returns do not include W-2 earnings or income is substantially lower than the current pay stubs, further investigation is needed to determine whether income is stable.

Other Income – Military Income

Military Income – Active Duty Personnel – Within 12 Months Of Release From Active Duty

The date that the in-service borrower is scheduled to be released from active duty must be verified. The date of separation is on the enlisted personnel's Leave and Earnings Statement (LES). An officer's LES does not show a date of separation. In most cases, a copy of the Statement of Service is satisfactory verification of continued service.

When the separation date is verified by a VOE, LES, and Officer's Orders, or other documentation, and indicates the veteran will be released from active duty within 12 months of the projected date upon which the Loan will be closed, the file must include one of the following:

- Documentation that the service member has reenlisted or extended the period of active duty to a date beyond the 12-month period following the projected Loan closing date.
- Verification of civilian employment following the release from active duty (with all pertinent underwriting documentation, such as job position, rate of pay, start date, number of hours scheduled per week, and probability of continued employment).
- A statement from the borrower indicating the intention to reenlist or extend active duty to a date beyond the 12-month period and a statement from the veteran's commanding officer confirming that the service member is eligible to continue on active duty and the commanding officer has no reason to believe the reenlistment or extension of active duty will not be granted.

- Other strong positive underwriting factors that minimize the effect of the possible discharge such as a non-military spouse's income being so high that only minimal income from the active duty member is needed to qualify, along with evidence that the veteran and spouse will be remaining in the community in which the property is located. A down payment of at least 10% and exceptional cash reserves would also minimize the effect of a possible release from active duty.

Military Income – Probability Of Continued Employment

If an employer declined to indicate the probability of continued employment on a verification of employment, the lender is not required to make any further attempt to get such a statement.

Military Income – Non-Taxable Income

Some military income is non-taxable. Other military income is partially taxed. Examples include:

- Base pay is the only income taxed for social security on in-service personnel.
- Base pay, Propay, sea pay, and flight pay are federally and state taxed.

Quarters allowance, variable housing allowance, clothing allowance, and rations are not taxed.

See **Other Income – Non-Taxable Income**.

Military Income – Reservist or National Guard (Called To Duty) Obligation

Lenders must ask every applicant, whose income is being used to qualify for a Loan, if their income is subject to change due to participation in a reserves/national guard unit due to activation. When the answer is yes, lenders must determine what the applicant's income may be if activated. If the income is:

- Reduced – carefully evaluate the impact the reduction may have on the borrower's ability to repay the loan.
- Increased – consider the likelihood the income will continue beyond a 12-month period.

Underwriters must evaluate all aspects of each individual case, including credit history, accumulation of assets, and overall employment history and make the best decision for each Loan regarding the use of income in qualifying for the Loan.

It is very important that Loan files be carefully and thoroughly documented, including any reasons for using or not using reservist income in these situations.

Weigh the desire to provide veterans their benefit with the responsibility to ensure the veterans will not be placed in a position of financial hardship.

To accomplish this, a statement must be obtained that affirms that a veteran-applicant's status relative to membership in the Reserves or National Guard has been ascertained and considered. The statement should be made as part of the origination package.

Military Income – Military Reserve Income

For income to be used for qualifying purposes, substantiate income by documenting all of the following:

1. The continuity of employment and income history for the two years that precede the date of the mortgage application.
2. YTD LES documenting at least one month of income.

3. Form W-2s covering the most recent two years. Refer to **Form W-2 Alternative Documentation** requirements above.

4. Verbal VOE (Exhibit 3) within 20 business days prior to the date printed on the Note. (In lieu of a verbal VOE, a military LES within 30 days prior to the date printed on the Note date is acceptable).

5. Provide proof that entitlements are expected to continue over a three-year period.

Other Income - Mortgage Differential Income

An employer may subsidize an employee's mortgage payments by paying all or part of the interest differential between the employee's present and proposed mortgage payments.

When calculating the qualifying ratio, the differential payments are added to the borrower's gross income.

The payments may not be used to directly offset the mortgage payment, even if the employer pays them to the mortgage lender rather than to the borrower. Two-year history is not required. The payments must be likely to continue for the next five years; however, the continuance requirement may be reduced to three years if this income source contributes 25% or less of the qualifying income.

Other Income - Public Assistance/Government Assistance Income

In order to be included in the borrowers' qualifying income, income from public assistance programs must be verified as received for the past two months and must reasonably be expected to continue for at least five years; however, the continuance requirement may be reduced to three years if this income source contributes 25% or less of the qualifying income. Public assistance income should be documented by letters or exhibits from the paying agency that state the amount, frequency, and duration of the benefit payments.

Other Income – Income Received From an Illegal Activity

All sources of income must be legal in accordance with all applicable federal, state, and local laws, rules and regulations, without conflict. Indication of income obtained from illegal sources makes the transaction ineligible for purchase.

Disability Income – Long-Term

General Requirements

Permanent/Long-term disability benefits may be paid to the applicant by a Federal agency, such as the Social Security Administration or Veterans Administration, a State agency, a private insurance company, workers compensation insurance, an employer, or other disinterested third party.

Continuance

Continuance is not required for Social Security Disability Income (SSDI). For all other types of long-term disability income, the income must be likely to continue for the next 5 years. The continuance requirement may be reduced to 3 years if this income source contributes 25% or less of the qualifying income.

- If documentation does not contain any indication that the income will terminate within the next 5 years, assume income will continue for the next 5 years.
- If documentation indicates a termination date or conditions for termination of the payment, the termination must not occur within the next 5 years.Note: If the documentation indicates the borrower's benefits are subject to periodic reviews or

evaluations, this is not an indication that the income is unlikely to continue and does not require additional documentation for determining likelihood of continuance.
- If documentation indicates an expiration or modification date (such as reaching a certain age, etc.), verify that the remaining term is for at least 5 years.

Documentation

An Award Letter or equivalent written documentation confirming the source, amount, frequency, and borrower as the recipient of the payments must be provided.

Calculation Requirements

Use the actual monthly amount received unless disability income is non-taxable. Refer to **Other Income - Non-Taxable Income** requirements in this Section regarding grossing up income.

If the documentation indicates a reduction of the payment, use the lowest income indicated during the next 5-year period.

Temporary Leave/Short-Term Disability/Family Leave Income

TEMPORARY LEAVE

Temporary leave from employment is typically short in duration and may be for many reasons, including parental (maternity or paternity) leave, short-term disability, and family leave. It may be taken with or without pay.

A borrower that is on, or scheduled to be on, temporary leave may still qualify for approval.

A Loan with a borrower on temporary leave, including parental leave, is not ineligible for purchase merely because of such leave status. Wells Fargo may purchase a Loan with a borrower on temporary leave provided:

- The application meets applicable underwriting and regulatory requirementsAND
- The income used to qualify the borrower is sufficient to meet applicable debt-to-income ratios

Wells Fargo allows underwriters to require documentation to verify income before and during temporary leave as necessary and appropriate to qualify the borrower for a mortgage loan.

The borrower must state they intend to return to work. The borrower is **not** required to return to work prior to closing.

If a borrower will not return to active work status on or before the first mortgage payment due date, temporary income received (if any) during the leave period and verified liquid assets after closing and reserves may be evaluated for use as qualifying income.

Calculation Requirements

For borrowers returning to work with their current employer prior to or on the first Mortgage payment due date:

- Qualify using pre-leave regular gross monthly employment income unless the borrower or employer has provided information about a reduction in that income upon the borrower’s return to active work status.

For borrowers that will not return to work prior to or on the first Mortgage payment due date:

- Qualify using the lesser of:

- The borrower’s temporary leave income (if any) combined with any available supplemental asset income.**OR**
- Pre-leave regular gross monthly employment income unless the borrower or employer has provided information about a reduction in that income upon the borrower’s return to active work status.

- If the temporary leave income is less than the borrower’spre-leave regular gross monthly employment income, available verified liquid assets may be used as a partial or complete income supplement to the temporary leave income if all of the following requirements are met:
  - Only verified liquid assets can be used to supplement temporary leave income.
  - Assets that are required for the subject transaction (e.g., down payment, closing costs, and reserves) may not be used to supplement the borrower’s temporary leave income.
  - Supplemental asset income amount must be calculated as follows:
    - Available, verified liquid assets divided by the number of months of supplemental asset income.
    - The number of months of supplemental asset income is determined by the number of months from the first Mortgage payment due date to the date the borrower will begin receiving regular employment income after returning to work (i.e. pre-leave income unless the borrower or employer has provided information about a reduction in that income upon the borrower’s return to active work status), rounded to the next whole number. (See example provided in table below)
  - Note: If using assets to supplement income, manually reduce the assets before data entry of assets to avoid counting the same portion of these assets for both income and assets.
  - Written rationale explaining the analysis used to determine the qualifying income.

Supplemental asset income calculation example:	
Pre-leave income amount	$6,000 per month
Temporary leave income	$2,000 per month
Total verified liquid assets	$30,000
Funds needed to complete the transaction	$18,000
Available liquid reserves	$12,000 ($30,000 - $18,000 = $12,000)
First payment date	July 1
Date borrower will begin receiving regular employment income	November 1
Supplemental income	$12,000/4 = $3,000

Total qualifying income	$3,000 + $2,000 = **$5,000**

Documentation Requirements

All of the following:

- Verbal VOE. If the employer confirms that the borrower is currently on temporary leave, Wells Fargo considers the borrower employed.
- Documentation of the borrower's pre-leave income and employment, regardless of leave status. And,
- Written statement from the borrower confirming he or she intends to return to active work status at the current employer and the intended date of return (must be consistent with employer-generated document). And,
- Documentation generated by current employer confirming the borrower's eligibility to return to the current employer after temporary leave and the duration or end date of the leave period.
    - Acceptable forms of employer documentation include, but are not limited to:
        - An employer-approved leave request, or
        - A Family Medical Leave Act (FMLA) document, or
        - Other documentation generated by the employer or a third-party verifier on behalf of the employer

AND

The following documentation is required **if** the borrower will not return to work prior to or on the first Mortgage payment due date AND where the borrower relies upon temporary leave income (not limited to short term disability benefits) for qualification purposes:

- Award Letter or equivalent written documentation confirming the following:
    - The amount and duration of the temporary leave income, and
    - The borrower as the recipient of the payments, and
    - The name of the payer (insurance company, employer, agency, or other qualified and disinterested party)
- If liquid assets are used to supplement income, assets must be verified and meet documentation requirements. See **Section 825.07(b): *Assets – Down Payment*** and **Section 820.08: *Cash Assets***.

Other Income – Royalty Payments

Royalty payments must have a 12-month history of receiving payments on a regular basis and must have a continuation period of at least five years; however, the continuance requirement may be reduced to three years if this income source contributes 25% or less of the qualifying income.

Obtain completed, signed, individual federal tax returns for the most recent two years, including Supplemental Income and Loss and Schedule E, and a signed 4506-T.

Other Income – Section 8 Homeownership Assistance/Homeownership Subsidies

A monthly subsidy may be treated as income, if the borrower is receiving subsidies under Section 8 housing choice voucher home ownership option from a public housing agency (PHA). There is no requirement for the payments to have been received for any period of time prior to the date of the mortgage application. Section 8 voucher payments must be reasonably expected to continue for at least five years from the date of the mortgage application; however, the continuance requirement may be reduced to three years if this income source contributes 25% or less of the qualifying income.

The monthly subsidy must be treated as income in determining the homebuyer's qualifying ratios when the monthly subsidy is remitted to the borrower.

See **Other Income – Non-Taxable Income**.

Other Income – Retirement Income

Retirement income may be used if properly verified. Acceptable documentation is:

- Most recent two months of bank statements, and one of the following:
    - Written verification from former employer
    - Federal tax returns
    - IRS 1099-R form

See **Continuance Of Income**.

See **Other Income – Non-Taxable Income**.

Other Income – Social Security Income

Social security income may be used if properly verified. Examples of acceptable documentation are:

- Most recent two months of bank statements.
- Social Security Administration benefit verification letter (sometimes called a proof of income letter, budget letter, benefits letter, or proof of award letter).

See **Continuance Of Income**.

See **Other Income – Non-Taxable Income**.

Other Income – Tip Income

Tip income must be verified with two-year history of receipt.

To document, obtain all of the following:

- Most recent YTD paystub or salary voucher documenting at least one month of income.
- Form W-2s covering the most recent two years. Refer to **Form W-2 Alternative Documentation** requirements above.
- Verbal VOE (Exhibit 3) within 20 business days prior to the date printed on the Note. The employer must verify that the tip income is expected to continue in the written VOE or in a separate statement.

Tip income that is not reported to the employer may be used as qualifying income when a two-year history of receipt is documented by the most recent two years' tax returns, including IRS Form 4137.

Other Income - Foster Care Income

Income derived from foster care payments may be considered if written verification can be obtained that the income is regular, recurring, and continued receipt is likely. A two-year history of providing foster care services under a recognized program from a state- or county-sponsored organization is required. Income used to qualify must be averaged over this two-year period. Projected income may not be used. The income must be likely to continue for the next three years.

Other Income - Child Support, Alimony, Or Maintenance Income

Child support, alimony, or maintenance payments may be used as income only if this information is volunteered by the applicant, and if there is evidence that the court-ordered amount has been received on a continual basis for the most recent 12 months. In order to be used as income, these payments must reasonably be expected to continue for a five-year period; however, the continuance requirement may be reduced to three years if this income source contributes 25% or less of the qualifying income.

If the payor has been obligated to make payments for less than 12 months, if the payments are not for the full amount, or are not received on a consistent basis, the income may not be considered for qualifying.

Required documentation:

- Final divorce decree
- Legal separation agreement
- Court order
- Voluntary payment agreement that has been approved by a court or is government-enforceable (for example, administered by a state agency) and acceptable evidence that payments have been received during the last 12 months, such as:
    - Canceled checks
    - Deposit slips or deposit receipts
    - Bank or other account statements
    - Tax returns
    - Court records

See **Other Income – Non-Taxable Income**.

Other Income - Alimony and Separate Maintenance Payments to be Paid

Required alimony and separate maintenance payments must be deducted from income and should not be included in monthly liabilities. Alimony and separate maintenance payments must be documented with a copy of the court order (such as a divorce decree).

Required Alimony or separate maintenance with less than 10 monthly payments remaining does not need to be deducted from income. A copy of the court order is required.

Other Income - Non-Taxable Income

Special consideration can be given to regular sources of income that are non-taxable such as:

- Child Support
- Disability benefits
- Retirement income
- Worker's Compensation benefits
- Military allowances
- Other income that is documented as being exempt from Federal income taxes

To be considered as qualifying income, the underwriter must obtain documentation verifying that:

- The particular source of the income is non-taxable
- Both the income and its non-taxable status are likely to continue

Acceptable documentation includes tax returns and/or awards letters. If the income meets these requirements, the amount of tax savings attributable to the non-taxable income may be added to the borrower's income to develop an adjusted gross income. The adjusted gross income is used in calculations for the income and debt rations. Standard qualifying ratios should not be exceeded when using grossed up income.

The following method must be used to determine the amount of tax savings that can be added back to the borrower's income:

- Add 25% of the non-taxable income to the borrower's qualifying income. This adjustment must be made whenever the non-taxable income source(s) is needed to qualify the borrower.

Other Income - Interest or dividend income

Interest and dividend income may be used in calculating the qualifying income if the assets generating the income are verified and the interest income has been received for at least two years consecutively.

Complete, signed, individual tax returns for the most recent two years and a 4506-T must be used to verify this income.

The income must be averaged over 24 months. Subtract any funds used for down payment, closing costs, or as collateral for a Loan before calculating the interest at the rate of return received over the past 24 months.

Interest and dividend income must be expected to continue for three years if included in qualifying income.

Other Income – Notes Receivable, Installment Sales And Land Contracts

Secured or Unsecured

A copy of the Note is required to establish the payment amount and length of payment.

- Notes receivable payments must continue for at least five years; however, the continuance requirement may be reduced to three years if this income source contributes 25% or less of the qualifying income.
- Installment sales and land contracts must continue for at least three years beyond the date of the mortgage application.

Evidence that these payments have been consistently received for the last 12 months must be verified through one of the following:

- Bank deposit slips or deposit receipts
- Canceled checks
- Bank or other account statements
- Tax returns

If the borrower is not the original payee on the Note, validate that the borrower is able to enforce the Note.

Other Income - Trust Income

Trust income may be used if the trust income will continue for at least five years; however the continuance requirement may be reduced to three years if this income source contributes 25% or less of the qualifying income. A photocopy of the trust agreement or the trustee's statement confirming the amount, frequency, and duration of the payments should be obtained to verify the income and continuance of the income.

Trust account funds may be used for the required down payment, closing costs, and reserve (post-closing liquidity)if the borrower provides adequate documentation that the withdrawal of funds will not negatively affect income. The borrower may use funds from the trust account for the required cash investment, but the trust income used to determine repayment ability cannot be affected negatively by its use.

If trust agreement or trustees statement does not provide historical level of distributions, most recent two years of tax returns must be obtained.

Other Income – Foreign Income

Foreign income, for borrowers who do not qualify under the borrower requirements, is acceptable only if the income can be verified on United States personal tax returns.

Foreign income should be paid in United States currency. However, income paid in foreign currency may be considered on a case-by-case basis if it is converted into United States currency.

The following documentation requirements must be met:

Funds in foreign accounts: Must be transferred to U.S. account. Completed Verification of Deposit (VOD) or the two most recent months' bank statements for U.S. account.

Foreign Source – Employment Income:

- Most recent two years complete personal tax returns (IRS Form 1040).
- For Foreign National borrower only: Form W-8 (If borrower does not have tax ID number) or Form W-9 (If borrower has tax ID number) and letter from employer (translated into English) with:
  - annual income for most recent two years,
  - current monthly income,
  - current employment status,
  - name and title of person providing information,
  - borrower's job title, and
  - term of employment.
- A verbal VOE (Exhibit 3) within 20 business days prior to the date printed on the Note is required.
- IRS 1040 Tax Return Transcripts from processed 4506-T may be used in lieu of tax returns provided by the applicant.

Foreign Source – Interest/Dividend Income:

Most recent two years individual federal income tax returns (IRS Form 1040).

Other Income - Unacceptable income

The following types of income or compensation cannot be included when calculating the borrower's qualifying income:

- Expense account payments.

- Automobile allowances.
- VA education benefits – education benefits used to offset education expenses are not acceptable.
- Retained earnings in a company.
- Rent from boarders living in the borrower's primary residence or second home.
- Proceeds from a reverse mortgage or other financing.
- Gambling income.

825.07(a): Borrower Liquidity (02/21/2017)

LIQUIDITY REQUIREMENTS

Evidence the borrower meets Wells Fargo's reserve (post-closing liquidity) requirements for certain Non-Conforming programs or parameters must be provided. Refer to **Section 950** for detailed reserve (post-closing liquidity) requirements.

Liquid assets verified to meet the reserve (post-closing liquidity) requirements may be in the form of:

- Cash equivalents (checking, savings, or money market accounts)
- 100% of the vested value of publicly traded stocks, mutual funds, and government securities may be used.
- Cash surrender value of life insurance (less outstanding loans, if repayment not included in debt ratio calculation)
- Retirement funds may be used to meet up to 50% of the minimum reserve requirements.
  - Gross retirement funds must be discounted by 30% to account for tax consequences (less any outstanding loan balances) to determine the actual funds available for reserve requirements.
  - There must be an additional 10% reduction if an early withdrawal penalty exists.
  - 100% of Roth IRA (less outstanding loans)
- Equity proceeds from the sale of a residence.
- Funds held in business accounts may be eligible for use if the requirements detailed in **Section 825.07(b): *Assets - Down Payment*** are met.

Stock Options

Stock options may be used in certain situations as reserves, but not as qualifying income.

Stock option grants:

- Must be fully vested and not restricted (either by the company or IRS, such as being subject to Rule 144)
- Must be from a publicly traded company listed on the NYSE, AMEX, or NASDAQ
- May be part of a qualified or non-qualified plan

To calculate the value:

- Subtract the strike price/optioned price (the price at which the employee was issued the stock) from the current stock price and multiply by the number of shares.
- Discount the value by 40% (to account for taxes).

Ineligible Assets

The following assets are **ineligible** for purposes of meeting the minimum reserve (post-closing liquidity) requirement:

- Gift funds
- Borrowed funds
- Stock in a closely held corporation
- Proceeds from the sale of assets other than the sale of a residence.
- Proceeds from a cash-out refinance transaction.

825.07(b): Assets - Down Payment (02/07/2017)

ILLEGAL ACTIVITY

All asset sources must be legal in accordance with all applicable federal, state, and local laws, rules and regulations, without conflict.

MINIMUM DOWN PAYMENT

For Loans with a LTV less than or equal to 80%, the full down payment may be gifted.

CASH ASSETS FOR DOWN PAYMENT AND CLOSING COSTS

Bonus Income Used for Cash to Close

A borrower’s recent bonus may be used for cash to close when the impact to borrower’s qualifying income is analyzed.

It may be required to deduct the bonus from qualifying income when it is used as cash to close if the Underwriter determines that the borrower is unable to meet all financial obligations and living expenses until the next bonus payout. Considerations may include, but are not limited to:

- How often is the bonus paid (i.e. quarterly, semi-annual, annual) and what is the date of the last bonus payout?
- What is the amount of the bonus used for cash to close?
- Are base income and liquid reserves sufficient to allow borrower to meet all obligations and living expenses until the next bonus is received?
- Are liquid reserves sufficient to ensure the borrower has the ability to repay obligations in a timely fashion and to support the borrower’s overall income profile for acceptable risk?

In addition to standard liquid assets, the following are considered to be cash assets at 100% of the verified amounts:

- A gift or grant from a municipality, nonprofit religious organization, nonprofit community organization, or the borrower’s employer

GIFT OR GRANT FROM A MUNICPALITY, NON-PROFIT ORGANIZATION OR EMPLOYER

A gift or grant from a municipality, non-profit religious organization, nonprofit community organization or the borrower's employer must be evidenced by a copy of:

- The award letter sent to the borrower, or
- The legal agreement that specifies the terms and conditions of the gift or grant.
- If the gift or grant is from the borrower's employer, the employer's formal gift program must be verified. Examples of acceptable documentation include, but are not limited to:
  - Copy of gift program guidelines from employee handbook
  - Letter from employer's human resources department
- File must contain evidence of the transfer of the funds.
- The award letter or the legal agreement must verify all of the following:
  - No repayment of the gift or grant is required
  - How the funds will be transferred (e.g., to borrower, closing agent, Lender, etc.)
  - There will be no lien against the property.

The borrower is not required to contribute 5% of the down payment from his own funds. The gift or grant can be used as the down payment

USE OF CREDIT CARD FOR PAYMENT OF FEES

A credit card may be used to pay fees associated with the Mortgage. Acceptable fees are:

- Appraisal
- Credit Report
- Origination fee
- Commitment fee
- Lock-in fee
- Extended Lock fee

Acceptable credit cards are:

- Visa
- MasterCard
- Discover

The Loan must meet all of the following requirements:

- Borrower must have sufficient liquid assets to pay the amount charged (in addition to all other Closing costs).
- The maximum amount charged or advanced may not exceed 2% of the Mortgage amount.
- Under no circumstances may credit card financing be used for the down payment.
- The amount charged or advanced must be included in the borrower's total outstanding debt and the repayment of that amount must be included when determining qualifying ratios (greater of $10 or 5% of the outstanding balance).
- A copy of the charge receipt must be included in the Loan file.
- The HUD-1 or Closing Disclosure must reflect a paid outside/before Closing (POC) credit to the borrower for the amount charged.

USE OF PREMIUM PRICING

Refer to **Section 825.15:** ***Eligible Transactions***

GIFT FUNDS

For primary homes, the full down payment may be from a gift when the LTV/CLTV is 80% or less.

USE OF BUSINESS FUNDS

When a borrower has insufficient personal liquid assets to qualify or close, but has sufficient verified funds in a 100% owned business, the business funds may represent an adequate source of down payment and reserves (post-liquidity) if both of the following conditions are met:

- Business average annual cash flow is greater than the amount to be withdrawn/reserves.
- Cash on company year-end balance sheet for each of the previous three years is greater than the amount to be withdrawn/reserves. This information is found on line 1 of the schedule L for the Partnership, S-Corporation and the Corporation. A three-year history of a balance greater than or equal to the amount being considered for reserves (post-closing liquidity) or down payment is required. Two years of the schedule L will show three years of cash on hand for the company.

Full analysis of the business must consider the effect of the withdrawal of the assets and how it will impact the strength and viability of the business in the future.

The following questions need to be considered:

- What is the pattern of company cash flows? Do we have declining gross or net income?
- Do we have concerns about the type of business? Is the business experiencing a downturn?

Extreme care needs to be taken when considering business use of funds and in some cases even though a business is profitable, it may not be prudent to use the business assets in our transaction.

PROCEEDS FROM SECURED LOANS

Subordinate Financing

Subordinate financing, Closed End or HELOC, is allowed subject to the guidelines in **Section 825.09:** ***Credit – Long-Term Debt***.

The maximum LTV/CLTV* may not exceed the guideline limits for the product and occupancy type shown in **Section 950:** ***Non-Conforming Conventional LTV Matrix***.

INDIVIDUAL DEVELOPMENT ACCOUNT

Refer to **Section 820.08:** ***Cash Assets***.

IRA, 401(k), SEP, KEOGH, 403(b), and IRS-qualified employer plans

IRA, 401(k), SEP, KEOGH, and other IRS-qualified employer plans may be used for down payment and closing costs, up to the post-tax and post-penalty amount available to the borrower for distribution.

A copy of the plan statements for the most recent two months is required. The statement should be reviewed to determine the borrower's vested amount in the plan.

If there is a penalty for withdrawal, discount the asset by the applicable amount.

Verification of liquidation is required.

TRADES

Equity from trading a borrower's existing property is acceptable after the borrower has made a 5% cash down payment. The amount of equity is determined by subtracting the outstanding Loan balance of the property that is being traded, plus any transfer costs, from the lesser of that property's appraised value or its trade-in value, as agreed to by both parties.

A separate written appraisal for the property that is being taken in trade is required. A search of the land records to verify ownership of the property and to document if there are any existing liens on the property is also required.

1031 TAX DEFERRED EXCHANGES

Refer to **Section 820.10: *Other Assets For Down Payment***.

STOCK, BONDS, MUTUAL FUNDS, U.S. GOVERNMENT SECURITIES AND PUBLICLY TRADED SECURITIES

Allowed. Refer to **Section 820.08: *Cash Assets***.

Publicly Traded Stocks, Bonds, Mutual Funds, U.S. Government Securities

A copy of the account statement for the most recent two months/quarter is required; proof of liquidation is required provided that the existence of these accounts is fully documented. When the asset is needed to complete the transaction, verify:

- the borrower's ownership of the asset,
- the value of the asset at the time of sale or liquidation, and
- the borrower's actual receipt of funds realized from the sale or liquidation.

RESTRICTED STOCK SUBJECT TO U.S. SECURITIES AND EXCHANGE COMMISSION (SEC) RULE 144

Many executives receive a portion of their compensation in the form of company stock. When using vested company stock that is subject to SEC Rule 144 the following documentation is required:

- When stock is used for down payment provide proof of liquidation.
- When stock used for reserves provide:
  - Evidence that stock is eligible for resale as defined by the SEC Rule 144,
  - A letter from the company which includes:
    - Vesting statement
    - Eligibility to liquidate stock
    - Current stock price
    - Addresses any additional restrictions on liquidating stock other than those imposed under SEC Rule 144

Refer to SEC website for the current Trading Volume Formula for calculating eligible value.

DEPOSITORY ACCOUNTS

For all transactions, generally, single deposits that are greater than 50% of the borrower's monthly qualifying income should be explained and documented. Consideration will also be given to total monthly income, type of employment, total amount of all assets and reasonableness based on borrower's overall credit and transaction profile.

SALE OF PERSONAL PROPERTY

The following are required to document the sale of personal assets for funds to close:

- Bill of sale reflecting:
    - Date of sale
    - Asset to be sold
    - Sales price
    - Signatures of buyer and seller
- Copy of the check from the purchaser of the asset or the borrower's bank statement verifying the deposit of proceeds from the sale.

INELIGIBLE ASSETS

The following assets are not allowed:

- Sweat equity
- Group Savings
- Pooled Funds
- Saving cash to close
- Stock options in a qualified plan but not fully vested
- Stock options in a non-qualified plan
- Assets held in a UGMA (Uniform Gift to Minors Act) or UTMA (Uniform Transfers to Minors Act)

Suspicious Activity Related to Deposits or Payments

In accordance with Representations and Warranties, including but not limited to, 300.02, 23.: *Origination, Underwriting and Servicing Compliance*, 300.02, 57.: *Error or Fraud*, Sellers are required to review for patterns of unusual payments, deposits, and/or gift funds, regardless of when they were provided to the borrower, that can be indicative of structuring to avoid compliance with laws and regulatory reporting requirements of the United States or foreign countries. Unusual patterns can include, but are not limited to, large cash deposits, large and numerous gifts, and any other unexplained activity not typical for the borrower.

Any indication of possible structuring and/or unsourced assets will result in an increased level of review from Wells Fargo Funding.

Red Flags

Transactions which include any of the following characteristics should be given additional scrutiny as part of the Seller's underwriting, closing and quality control functions:

- A borrower receives multiple gifts of similar amounts wired from outside the U.S.
- A borrower receives gift funds in the form of a wire transfer from an individual with no ties to the borrower or the transaction.
- A borrower receives a wire from a business not associated with the transaction and it is explained as payment for services rendered or products provided.
- A borrower receives large deposits listed as tuition expenses comingled with funds for down payment from the same account.

- A borrower receives gift funds from a donor that transferred the funds through multiple financial institutions, prior to deposit in the borrower's account.

825.08(a): Credit Reports (01/06/2014)

INDIVIDUAL CREDIT REPORTS

The Seller should refer to the **Credit Documents** portion of Section 820.13(b) of this Seller Guide.

All Non-Conforming Credit Packages must include either a *CoreLogic® Credco®* or *Equifax®* credit report. If one is not provided at the time the Credit Package is submitted to Wells Fargo for underwriting, Wells Fargo will obtain a credit report from *CoreLogic Credco* or *Equifax* prior to underwriting the file. The Loan Score from this credit report will be used to determine pricing and used during the Wells Fargo Prior Approval underwriting process.

BUSINESS CREDIT REPORTS

Business credit reports are not required; however, there are certain circumstances when it will be imperative to obtain a business credit report to determine the acceptability of a Loan.

When the Borrower's business entity is a corporation, subchapter "S" corporation or a partnership, it is at the sole discretion of the underwriter to determine the appropriate times to require a business credit report.

825.08(b): Credit - Evaluating Credit Information (09/27/2016)

MINIMUM LOAN SCORE REQUIREMENTS

To be eligible for Non-Conforming conventional financing, Wells Fargo Funding requires sufficient credit with a minimum Loan Score (refer to **Section 825.00: *Underwriting Philosophy – Credit Score and Loan Score Selection***) of *at least*:

- 700 for purchase and rate/term transactions with fixed rate product
- 740 for investment property transactions
- 720 for all other transactions
- Non-traditional credit is not allowed

Additionally, a housing payment history (mortgage, rental or combination of the two) covering the most recent 12 months (minimum) with no late payments must be verified either by the credit bureau or by direct verification.

A professional management company or an individual landlord may verify rental housing payments. If an individual landlord provides a reference, either directly or on a credit report, the borrower must provide evidence of timely payment for the most recent 12 months with:

- Canceled checks, or
- Bank statements showing the payment, or
- Money order receipts, or

- Cash receipts
    - Cash receipts are not allowed, and canceled checks, bank statements, or money order receipts are required, if the landlord:
        - is a relative, or
        - has an established relationship, prior to the Loan transaction, with the borrower beyond their connection as renter and landlord (examples include, but are not limited to, co-workers, close personal friends, partner, business associate, relator, etc.).
    - If using cash receipts, the name, address, and telephone number of the individual receiving the payments must be provided.

In the event the borrower is living with family, or when no mortgage or rental payment history can be obtained the following documentation must be provided:

- A letter of explanation, and
- Credit report verifying an acceptable traditional credit history and evidencing compliance with minimum Loan Score requirements.

INSUFFICIENT CREDIT

Insufficient credit is defined as **any** of the following:

- Fewer than three tradelines.
- No tradeline with activity in the most recent 12-months.
- No tradeline with at least a 24-month history.

There may be instances where the borrower's credit score is valid but insufficient credit exists.

In addition, the credit risk of the entire borrower profile must be evaluated to determine if the credit history supports the borrower's ability and willingness to repay the Loan.

BANKRUPTCY, FORECLOSURE, DEED-IN-LIEU, SHORT SALE, REPOSSESSION REQUIREMENTS AND LOAN MODIFICATIONS

Borrowers with a bankruptcy, foreclosure, deed-in-lieu, short sale, repossession, or Loan modifications are subject to the following requirements:

- LTV/CLTV greater than 70%: Not allowed
- LTV/CLTV less than or equal to 70% is allowed when:
    - The adverse Credit was due to **extenuating circumstances** and a minimum of 60 months re-establishment of credit since the discharged/dismissal/completion date, *or*
    - The Adverse Credit was due to **financial mismanagement** and 84 months re-establishment of credit since the discharged/dismissal/completion date.

COLLECTIONS, JUDGMENTS, AND JUDGMENT LIENS

Unpaid collections, judgments, and judgment liens may impact the borrower's ability to repay the mortgage or may impact title to the property.

A collection account is a loan that has been turned over to a third-party debt collection agency due to negligent payment practices of the borrower. The collection agency assumes the responsibility of collecting the debt for the original creditor. While the borrower makes payments on the collection account, the account will remain open and will be listed as a "collection account" on the borrower's credit report.

A judgment, or judgment lien, is a court order to pay a certain amount of money to someone who has filed a lawsuit against the borrower. If a creditor, lender, debt collector, attorney, or another party files a lawsuit against the borrower and wins, a judgment is made against the borrower. With a judgment the creditor often has the ability to levy wages, bank accounts or other property to collect the judgment, depending on state law.

Collections, judgments, and judgment liens must be:

- Considered in the overall evaluation of the credit, and
- reviewed for possible impacts to the borrower's ability to repay the mortgage or impacts to title, and
- explained in a letter of explanation provided by the borrower.

Collections, judgments, and judgment liens that have not already been satisfied are subject to payoff and requirements as indicated in the table below:

Collections, Judgments, and Judgment Liens			
Account Types (Not Attached to Title)	**Dollar Amount per Tradeline**	**Required Payoff**	**Included in DTI**
Judgment or Judgment Lien	Any	Yes	Does Not Apply
Collection	≤$500	No[1]	No
Collection	>$500	Yes[2]	Does Not Apply

1. Accounts may not be paid down to $500 to avoid payoff.
2. Collection accounts >$500 must be paid off unless the borrower can document a formal dispute. The rationale for not paying the collection must be documented and reasonable. The borrower must have the funds to be able to pay off the collection in the future, if necessary.

CHARGE-OFF

Accounts reporting as a "charge off" indicate that the credit grantor wrote the account off of their receivables as a loss and it is closed to future charges. When an account displays the status of "charge off," the account is closed for future use, although the debt is still owed. If the customer pays the account, the status will reflect as a "paid charge-off."

The following requirements apply to accounts reporting as charge-off:

- Individual, paid or unpaid account that was charged-off within two years of the application date for an amount greater than $500 is not allowed.
- Individual, unpaid account that was charged-off more than two years from the application date for an amount greater than $500 is not allowed.

NON-REAL ESTATE SETTLED FOR LESS ACCOUNTS

Settled for less than full payment accounts may impact the borrowers' ability to repay the mortgage or may impact title to the property.

Loans with non-Real estate settled for less accounts that settled less than two years prior to application date are not eligible for purchase by Wells Fargo Funding.

825.09: Credit – Long-Term Debt (11/01/2016)

PAYOFF VS. PAYDOWN

Accounts may not be "paid down" to less than 10 months to allow the borrower to qualify. Installment or mortgage accounts must be paid in full. Payoff of revolving accounts in order to qualify the borrower is not allowed.

BUYDOWNS

Not Allowed

ARM LOANS

Please refer to individual product descriptions in **Section 973: *Non-Conforming 5/1 LIBOR ARM***, **Section 974: *Non-Conforming 7/1 LIBOR ARM***, or **Section 975: *10/1 LIBOR ARM***, the *Qualifying Ratio Tables* in **Section 850**, and LTV limits in **Section 950: *Non-Conforming Conventional LTV Matrix***.

QUALIFYING RATIOS

Please refer to the *Qualifying Ratio Tables* in **Section 850**.

RATIOS ANALYSIS

Debt ratios are based on the borrowers' stable monthly income and are the primary indicator used to determine their capacity to repay a mortgage.

The following is required:

- Underwriters must review the application to confirm that all housing expenses and long-term debts are listed on the application and were included in the ratio calculations.
- The underwriter must evaluate the ratios to determine if the Loan is an acceptable risk to Wells Fargo. See program guidelines and the Qualifying Ratio Tables for specific requirements.
- The underwriter must evaluate changes in present versus proposed housing expenses and consider future increases associated with adjustable rate products in the overall capacity risk assessment.
- If the borrower has several debts with large payments, the underwriter must consider the borrower's ability to make the payments when there are less than 10 monthly payments remaining.

HOUSING EXPENSE RATIO

The housing expense ratio equals the total monthly primary housing expense divided by the qualifying monthly income.

The monthly housing expense is the sum of the following:

- Monthly principal and interest payment on the borrower's primary residence.
- Monthly principal and interest payments are required for interest only HELOC payment calculations.

Note: See table under Liabilities Analysis – Revolving Accounts below for methods of calculating home equity line of credit (HELOC) payment.

- 1/12th of the annual real estate taxes (do not use a lot only tax figure for new construction).
- 1/12th of the annual hazard insurance premium (including flood, earthquake, or subsidence insurance if any)
- Monthly leasehold payments if applicable.
- Monthly homeowners association dues, condominium maintenance fees, or cooperative monthly assessments if applicable.

TOTAL DEBT RATIO

The total debt to income ratio is the sum of the monthly housing expense and all long-term debt divided by the qualifying monthly income.

The long-term debt (recurring obligations) is defined as the sum of all continuing monthly obligations including but not limited to:

- The total proposed monthly housing expense.
- Payments on all revolving accounts with a balance.
- Payments on all installment obligations with 10 or more monthly payments remaining until payoff.
- When calculating the DTI, full principal and interest payments are used for all other mortgages, including home equity lines of credits (HELOCs) on other real estate held by the borrower. See table under Liabilities Analysis – Revolving Accounts below for methods of calculating HELOC payment.
    - For Closed End subordinate loans (not HELOCs) with an interest-only feature: Qualify using monthly principal and interest payment, based on full amortization over the term of the loan remaining as of the date the loan is or will be recast, at the fully indexed rate or any introductory rate, whichever is greater, not including any rate/payment discounts that will not apply over the term of the loan.
- Real estate loans (if not accounted for in rental income analysis).
- Child support.
- Unsecured loans from an employer.
- Other continuing obligations.

It is not acceptable to pay down installment debts to less than 10 months in order to qualify. Installment debts must be verified as paid-in-full at closing in order to exclude the debt from the borrower's qualifying ratios.

Debts lasting less than 10 months must be included if the amount of the debt affects the borrower's ability to pay the mortgage during the months immediately after Loan closing, especially if the borrower will have limited or no cash assets after Loan closing.

Some debts may be excluded from total obligations with additional documentation. See Liabilities analysis for additional information. All debts, including debts that are excluded from ratio calculations, should be listed on the application.

Obligations not considered long term debt, and therefore excluded from DTI, include:

- Federal, state, and local taxes
- Federal Insurance Contributions Act (FICA) or other retirement contributions, such as 401(k) accounts

- Commuting costs
- Union dues
- Automatic deductions to savings accounts
- Child care
- Voluntary deductions

Employment/Income Stability

The following analysis is required:

- Underwriter must determine the stability of income.
- Only income that is reasonably expected to continue for at least three years should be considered. For additional information, see BORROWER EMPLOYMENT AND INCOME ANAYLSIS.
- Stability of employment must also be considered when determining if the income should be used in qualifying.
- For self-employed borrowers, stable income is generally considered to be a 24-month average of net income.
- When reviewing information from a tax return, a 24-month income average is used when two years' tax returns are required and a 12-month average when one year's tax return is required.

SUBORDINATE FINANCING

There are two types of subordinate financing:

- Home Equity Line of Credit (HELOC): a mortgage loan that allows the borrower to obtain multiple advances from a line of credit at his/her discretion and that is typically in a subordinate position.
- Closed End Loan: a mortgage providing a single advance of funds at the time of loan closing and that is not eligible for additional draws.

Terms

New and existing closed-end and home equity line of credit (HELOC) subordinate financing is permitted when the loan terms meet the following guidelines:

- The subordinate financing must be recorded and clearly subordinate to Wells Fargo Funding's first mortgage.
- The maximum LTV/CLTV* may not exceed the guideline limits for the product and occupancy type shown in **Section 950: *Non-Conforming Conventional LTV Matrix***.
- Negative amortization is not allowed: scheduled payments must be sufficient to cover at least the interest due.
- If there is/will be an outstanding balance at the time of closing, the payment on the subordinate financing must be included in the calculation of the borrower's debt-to-income ratio(s)
    - For all HELOCs, regardless of the line amount, see **Liabilities Analysis – Revolving Accounts** for methods of calculating a payment.
- For Closed End Loans: Balloon payments are not allowed.
    - The terms of a HELOC may provide for a balloon or call option within the first five years after the Note date of the first Mortgage.

- For new Closed End subordinate financing: Maturity date or amortization basis of the junior lien must not be less than five years after the Note date of the first lien Mortgage, unless the junior lien is fully amortizing
- For Closed End Loans with Interest-Only feature: see **Total Debt Ratio** above.
- Equity share or shared appreciation mortgages are not allowed.
- Subordinate financing from the borrower's employer may not include a provision requiring repayment upon termination.
- Subordinate financing from the property seller (seller carry-back, including any property seller or other private party carried financing.)
  - Is allowed only after the borrower has made a 5% minimum down payment/cash investment
  - Is allowed only when the maximum CLTV meets the published CLTV limits for the product/program
  - Affects interest party contribution limits, refer to **Section 825.17: *Contribution Limits***
  - Should be at market rate. If the interest rate is more than 2% below Fannie Mae's posted net yield in effect for second mortgages at time of Closing, it must be treated as a sales concession and a dollar for dollar reduction made to the sales price.

*For Non-Conforming Loans, the CLTV is calculated by adding the first mortgage amount to all subordinate financing and dividing that sum by the value of the mortgaged premises. When subordinate financing is a HELOC, the credit line limit, rather than the amount of the HELOC in use, must be used.

- If an existing HELOC is not in the repayment period and is reduced without modifying the original Note, the original line limit must be used to calculate the CLTV ratio.
- IF an existing HELOC is in the repayment period, the current balance is used to calculate the CLTV ratio. A copy of the line agreement is required to verify the customer can no longer draw on the account.

Acceptable Documentation

The terms of any subordinate financing must be verified. The following sources of verification are acceptable:

- An existing subordinate lien that will be re-subordinated may be verified with any of the following:
  - A copy of the credit report
  - A copy of the mortgage note that will be re-subordinated
  - A direct verification from the lender
  - A copy of the loan/line statement
- A new subordinate line that will be obtained at, or prior to, closing may be verified with any of the following:
  - A copy of the mortgage note
  - A direct verification from the lender
  - A copy of the commitment letter from the lender
  - A copy of the HUD-1 or final Closing Disclosure evidencing proceeds

Notes:

- Whether the subordinate financing is existing or new, a full underwrite of the documentation provided is required to ensure the subordinate financing meets the requirements identified in this section.
- If the subordinate lien's terms cannot be verified in their entirety with a single source of verification, the use of a combination of the above documentation options is acceptable.
- If the subordinate financing is a community second or affordable second, it must comply with Fannie Mae and Freddie Mac requirements.

LIABILITIES ANALYSIS

The following provides guidance in determining which liabilities should be included in the borrower's long term debts for calculating ratios. All debts should be listed on the application and included as part of the ratio analysis. If the borrower does not qualify with all debts, the debts should be analyzed to determine whether any debts could be excluded. The following requirements include guidelines for exclusion of debts.

Liabilities Analysis – Revolving Accounts

Revolving accounts, including credit cards, department store accounts, equity lines and other open-ended accounts are accounts that do not fully amortize and have balances and payments that vary from month-to-month.

The minimum payment amount for all revolving accounts with a balance must be included in the total monthly obligations.

If the credit bureau does not reflect a payment on a current reporting liability, a payment should be calculated as follows:

- Revolving: The greater of $10 or 5% of outstanding balance.
- Home equity line of credit (HELOC): When calculating the DTI, full principal and interest payments are used for all other mortgages, including home equity lines of credits (HELOCs) on other real estate held by the borrower. See the table below for methods of calculating HELOC payments. This is to account for loans that require less than a full principal and interest payment, including but not limited to Interest Only.

Transaction	Wells Fargo HELOC	Non-Wells Fargo HELOC
• New HELOC on subject property **or** • Cash-out refinance first lien – all subordinated HELOCs on subject property	• Full credit line limit • 20-year amortization term • Fully indexed rate (prime + margin) from the Note + 2.0 Wells Fargo qualifying economic adjuster	When there is a payment reported on the credit bureau, use: • Full credit line limit • 20-year amortization term • Current prime rate + 1.5 margin + 2.0 Wells Fargo qualifying economic adjuster Or, Obtain the Note and use: • Full credit line limit

		• 20-year amortization term • Fully indexed rate (prime + margin) from the Note + 2.0 Wells Fargo qualifying economic adjuster When no payment is reported on the credit bureau and the Note cannot be obtained, use the higher of: • Full credit line limit • 20-year amortization term • Current prime rate + 1.5 margin + 2.0 Wells Fargo qualifying economic adjuster Or, 5% of the outstanding balance
Rate/term refinance–Existing HELOC on subject property	• Outstanding balance • 20-year amortization term • Fully indexed rate (prime + margin from the Note + 2.0 Wells Fargo qualifying economic adjuster	When there is a payment reported on the credit bureau, use: • Outstanding balance • 20-year amortization term • Current prime rate + 1.5 margin + 2.0 Wells Fargo qualifying economic adjuster Or, Obtain the Note and use: • Outstanding balance • 20-year amortization term • Current prime rate + 1.5 margin + 2.0 Wells Fargo qualifying economic adjuster When no payment is reported on the credit bureau and the Note cannot be obtained, use the higher of:

		• Outstanding balance • 20-year amortization term • Current prime rate + 1.5 margin + 2.0 Wells Fargo qualifying economic adjuster Or, 5% of the outstanding balance
Non-subject property HELOC	**When the Wells Fargo, or non-Wells Fargo, HELOC is aged less than or equal to 12 months** (calculated from open date to note date) Obtain the Note and calculate the qualifying payment based on: • Full credit line limit • 20-year amortization term • Actual rate/margin may be verified with a copy of the note • Do not include any rate/payment discounts that will not apply over the term of the line When there is a payment on the credit bureau and a copy of the note is not available: • Full credit line limit • 20-year amortization term • Current prime rate+ 1.50 margin+ 2.0 Wells Fargo qualifying economic adjuster • Do not include any rate/payment discounts the will not apply over the term of the line When no payment is reported on the credit bureau and the Note cannot be obtained, use the higher of: • Outstanding balance or full credit line limit, as outlined above ◦ 20-year amortization term ◦ Current prime rate+ 1.5 margin+ 2.0 Wells Fargo qualifying economic adjuster Or, 5% of the outstanding balance or full credit line limit, as determined by above criteria If the borrower has sufficient liquid assets to pay off the full	

	credit line limit amount in addition to standard policy requirements for post-closing reserves, the qualifying payment calculation may be based on outstanding balance rather than the full credit line limit. **When the Wells Fargo, or non-Wells Fargo, HELOC is aged more than 12 months** (calculated from open date to note date) Obtain the Note and calculate the qualifying payment based on: • Outstanding balance • 20-year amortization term • Actual rate/margin may be verified with a copy of the note When there is a payment on the credit bureau and a copy of the note is not available: • Outstanding balance • 20-year amortization term • Current prime rate+ 1.50 margin+ 2.0 Wells Fargo qualifying economic adjuster When no payment is reported on the credit bureau and the Note cannot be obtained, use the higher of: • Outstanding balance or full credit line limit, as outlined above ○ 20-year amortization term ○ Current prime rate+ 1.5 margin+ 2.0 Wells Fargo qualifying economic adjuster Or, 5% of the outstanding balance or full credit line limit, as determined by above criteria
Non-subject property – first mortgage/lien	When calculating the DTI, full principal and interest payments are used for all first mortgage/lien on all real estate owned/held by the borrower. **Note:** This is accounts for Loans that require less than a full principal and interest payment, including but not limited to Interest Only.

Note: Prime rate can be found in the *Wall Street Journal*.

Liabilities Analysis – HELOCs On Real Estate Owned Other Than The Subject Property

For qualifying purposes, Mortgage payments included HELOCs, must use a fully indexed, fully amortized principal and interest payment calculation.

First mortgages on a non- subject property will use the following data to calculate a qualifying principal and interest payment:

- Outstanding principal balance
- Fully indexed note rate
- Existing amortization term

Borrowers should be qualified with a full PITI payment including Homeowner Association fees, if applicable.

Liability Analysis – Authorized User Accounts

When the borrower is the credit account owner on an authorized user account, the debt must be considered in the credit analysis and the monthly payment obligation must be included in the debt to income (DTI) ratio.

When the borrower is the authorized user and the account is being used as a tradeline, the debt must be considered in the credit analysis and the monthly payment obligation must be included in the debt to income (DTI) ratio.

Liabilities Analysis – Open-Ended Accounts

Certain open-ended accounts (such as American Express) require payment in full monthly. For such accounts, one of the following options may be used for qualifying:

- Document sufficient assets to pay off the full balance (beyond cash required to close and reserves). In addition, use the greater of 5% of the balance or $10 for a qualifying payment.
- If sufficient assets are not available, use the full balance for a qualifying payment; if a lower payment amount can be documented from the creditor, that amount may be used for qualifying purposes.

Liabilities Analysis – Installment Accounts

Installment accounts are accounts that fully amortize or have a balloon payment at a predetermined date. The account balance cannot be increased during the term of the loan. Payments are made on a regular basis and may be fixed or adjustable.

Whenever the installment debt's payment amount is not provided on the credit report then documentation of the payment amount must be obtained. Examples of documentation of the payment include but are not limited to:

- Direct verification from the creditor.
- Copy of the installment loan agreement.

Installment debts with less than 10 monthly payments remaining may be excluded from the qualifying ratios, but must be listed on the application. It is not acceptable to pay down installment debts to less than 10 months in order to qualify. Installment debts must be verified as paid-in-full at closing in order to exclude the debt from the borrower's qualifying ratios.

Liabilities Analysis – Deferred Payments, Balloon Payments, and Single Payments Notes (including interest only payment Notes)

Some debts may have deferred payments or are in a period of forbearance. These debts must be included in the qualifying ratios if scheduled to begin or come due within 12 months of the mortgage Loan closing. Examples of installment debts with deferred payments include:

- Debts on automobiles, furniture, and appliances for which the initial payment is delayed for a period of time as part of a promotional campaign by the retailer.Some deferred payments must be included in the qualifying ratios even if deferred 12 months or more. Examples include:
  - Deferred payments must be included if the amount of the debt or payment affects the borrower's ability to pay the mortgage after Loan closing, especially if the borrower will have limited or no cash assets after Loan closing, (such a borrower with high ratios / no or low cash assets after closing with a sizable debt event that is just outside of the 12-month window for inclusion in ratios).
  - Balloon and single payment Notes must be considered in the underwriting analysis:
    - If sufficient liquid assets (excluding assets used to meet reserve (post-closing liquidity)/down payment/closing costs requirements) can be verified to pay off Note, the Note does not need to be included in the ratios.
    - If sufficient liquid assets cannot be verified, verify the term of the Note, and include a payment in the ratios based on amortization over remaining term of the Note.

When the credit report does not include a payment on the debt, documentation of the payment amount must be obtained. Examples of documentation of the payment include but are not limited to:

- Direct verification from the creditor.
- Copy of the installment loan agreement.

Liabilities Analysis – Student Loan Payments

For student loans that are deferred, in forbearance, or not reporting a payment on the credit report:

- Calculate a payment using 1.15% of the higher of the original high credit limit or current balance.
  - Documentation of the actual payment may be requested in lieu of 1.15% calculation. Documentation options include, but are not limited to, the following:
    - Direct Verification from the Creditor
    - A copy of the Installment Loan Agreement

For student loans that are reporting a payment on the credit report:

- Compare the reported payment to 1.15% of the current balance and use the higher of the two payments.
  - If using the 1.15% calculated payment for qualifying and the DTI exceeds the maximum, documentation of the actual payment is required.
- Documentation options include but are not limited to the following:
  - Direct verification from the creditor
  - A copy of the Installment Loan Agreement
    - The documentation must be reviewed to validate that the reported payment is reasonable.
    - If the student loan is an income based repayment plan, the documentation must be reviewed to validate that it is reasonable that the qualifying income on the Loan application matches the qualifying income used to assess the student loan payment.
      - If the student loan payment will be reassessed less than 12 months after the borrower started their most recent job, the underwriter will need to perform additional investigations to validate the borrower will not experience payment

shock upon reassessment. The 1.15% calculation should be used for qualifying unless the underwriter can document rationale for using the lower payment.

- If the student loan payment will be reassessed more than 12 months after the borrower started the most recent job, the documented payment may be used for qualification purposes.

Liabilities Analysis – Lease Payments

The monthly payment associated with a lease must be included in the total monthly obligations regardless of the number of payments remaining until the end of the lease term, with the following exception:

- Payments for a solar panel system lease or Power Purchase Agreement (PPA), regardless of the number of payments remaining, can be excluded from the total monthly obligations.

Liabilities Analysis – Business Debt

Business debts for which the borrower is personally liable are usually included in long term debt according to the requirements for revolving or installment accounts. Installment debts with 10 or more monthly payments remaining and revolving debts may be excluded if the account has a satisfactory payment history and all of the following is provided as evidence that the business is paying the debt:

- The account does not have a history of delinquency.
- Minimum of 12 months of consecutive canceled checks from the business.
- The cash flow analysis of the business takes the payment obligation into consideration.

Liabilities Analysis – Child Support

Child support payments must be documented with a copy of the court order (such as a divorce decree).

Child support payments with less than 10 monthly payments remaining may be excluded from the qualifying ratios. A copy of the court order is required.

Alimony and separate maintenance payments to be paid policy must be followed. See **Section 825.06: *Borrower – Employment and Income Analysis***.

Liabilities Analysis – Unsecured Loans from an Employer

In some financial professions the employee is offered an upfront loan to be repaid from earnings. The borrower's monthly payment on this debt must be included in the total monthly obligations. A copy of the promissory note must be used to verify the terms of repayment.

Liabilities Analysis – Net Rental Loss

If the analysis of rental income on an investment property as described in BORROWER – EMPLOYMENT AND INCOME ANALYSIS indicates a loss, the monthly net rental loss is included in the long term debts.

Liabilities Analysis – Sale of Prior Home

The borrower's previous mortgage payment does not have to be included in long term debt as long as one of the following can be provided:

- A copy of the HUD-1 or Closing Disclosure from the sale of the real estate.
- Departure Residence Policy is met. See **Section 825.23: *Departure Residence Policy***.

Liabilities Analysis – Bridge Loans

The payment on a bridge loan may be excluded from the total debt ratio when the following documentation is provided:

- A copy of the fully executed sales contract for the previous residence.
- A lender's commitment to the buyer of the previous residence (if the executed sales contract includes a financing contingency).
- Documented reserves of six months' payments covering all liens on the previous residence.

Liabilities Analysis – Rental Of Previous Residence Listed For Sale

See **Section 825.23: *Departure Residence Policy***.

Liabilities Analysis – Ready Reserve Accounts

Any ready reserve (overdraft protections or extended credit option) on a checking account with a balance must be treated as a revolving account.

Liabilities Analysis – Loans Secured by a Financial Asset

Payments on loans secured by a borrower's financial asset (such as, SIP, IRAs, or stocks) are not included in long term debt because they are voluntary payments. However, the underwriter must consider these payments in terms of their possible impact on cash flow and debt ratios. The borrower must indicate plans for debt repayment if the inclusion of a loan payment in the monthly debts results in a high total obligation to income ratio or negative cash flow.

Liabilities Analysis ��� Loans from 401(k), 403(b), and KEOGH Plans

Payments on loans from 401(k), 403(b), and KEOGH plans must be included in qualifying ratios unless there are sufficient liquid assets to pay off the debt. If sufficient liquid assets exist then the payment can be excluded.

Liabilities Analysis – Margin Accounts

If the borrower discloses the existence of a margin account on the application or it is indicated on brokerage account statements, repayment must be considered and included in total monthly obligations unless the value of the stock exceeds the amount of the Loan.

Liabilities Analysis – Group Savings

If the borrower is part of a group savings plan with a remaining obligation period of 10 months or more, the monthly contribution to the account must be included in the total obligations to income ratio.

Liabilities Analysis – Contingent Liabilities

Contingent liabilities are debts in which the borrower has become a cosigner / guarantor with another person. A contingent liability exists when an individual is held responsible for payment of a debt if another party defaults on the payment. These could be a present co-signed loan, a loan that was assumed, or a loan assigned to another party by court order. Contingent liabilities must be included in liabilities if there are 10 or more monthly payments remaining.

Liabilities Analysis – Cosigned Loans

The monthly payment on a cosigned loan with 10 or more monthly payments remaining may be excluded from long term debt if there is documentation that the primary obligor has been making regular payments during the previous 12 months and does not have a history of delinquent payments on the loan during that time. If the payments have not been paid on time or if there is no evidence that someone other than the borrower is making payments, the cosigned loan is treated as borrower's own obligation. Copies of canceled checks for the most recent 12 months or a statement from the creditor are acceptable documentation.

The above applies to:

- A car loan
- A student loan
- A mortgage
- Any other obligation

Liabilities Analysis – Assumptions

Contingent liability must be considered when the borrower remains obligated on an outstanding mortgage (including conventional, FHA insured, VA guaranteed, or any other mortgage or line of credit) secured by property that:

- Has been sold or traded within the last 12 months without a release of liability; or
- Is to be sold on assumption without a release of liability being obtained.

If a property has been sold on assumption, the following documents are required:

- Copy of the documents transferring ownership of the property.
- The assumption agreement executed by the transferee.

When a mortgage is assumed, the contingent liability may be excluded from the total monthly obligations, if:

- A payment history from the servicer of the assumed loan is obtained showing that the mortgage has been current during the previous 12 months; or
- Value of the property, as established by an appraisal or the sales price on the HUD-1 Settlement Statement or Closing Disclosure from the sale of the property, results in a LTV/CLTV ratio of 75% or less.

Liabilities Analysis – Previously Paid In Full

The monthly payment on a debt may be excluded from the total monthly obligations if the borrowers can document that they no longer owe the debt. The following documents are required:

- Copy of the documents detailing debt paid in full.
- Copy of the documents releasing liability.

Liabilities Analysis – Court Order

If the obligation to make payments on a debt has been assigned to another person by a court order such as a divorce decree, the payment may be excluded from the total monthly obligations regardless of the number of payments remaining. The following documents are required:

- A copy of the court order or divorce decree.
- For mortgage debt, a copy of the documents transferring ownership of the property.

Any late payment in the last 12 months associated with the debt must be evaluated. Potential impacts to the capacity to repay (should the financial institution holding the note pursue repayment from the borrower) must be taken into account, as well as potential impacts to the borrower's credit profile if the account is significantly delinquent.

Liabilities Analysis – Bankruptcy

If a debt has been included in a court order such as a bankruptcy, the payment may be excluded from the total monthly obligations regardless of the number of payments remaining. The following documents are required:

- A copy of the bankruptcy papers detailing the debt to be excluded.
- For mortgage debt, a copy of the documents transferring ownership of the property.

Any late payments associated with loans on the property should be taken into account when reviewing the borrower's credit profile.

Liabilities Analysis – Pending Lawsuits

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 must be requested and reviewed. 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 required.

If the risk is considered minimal, the title company closing the Loan must be informed of the lawsuit or litigation and provide affirmative coverage of its lien position.

Wells Fargo Funding/Wells Fargo Funding Seller Guide/SECTION 800: CONVENTIONAL UNDERWRITING/825: Non-Conforming Underwriting Guidelines/825.10 Property and Appraisal – Sales Contract Changes (01/10/2017)

825.10 Property and Appraisal –Sales Contract Changes (01/10/2017)

If the contract is amended prior to the appraisal completion, the Seller must provide the updated contract to the appraiser. This ensures the appraiser has the opportunity to consider any changes and their effect on value.

If the contract is amended after the effective date of the appraisal but prior to closing (whether or not it results in an addendum to the purchase contract), the amendment does not need to be provided to the appraiser when:

- Lower renegotiated sales contract reducing sale price resulted from low appraised value
- A change to interested party contributions provided:
    - Wells Fargo property underwriter determines that the change / revision would not impact value or methodology; **and**
    - Interested party contribution change is for:
        - Financing contributions / concessions where total contributions fall within published loan limits applicable for the transaction; **or**
        - Total sales concessions do not exceed 3%.

Wells Fargo Funding/Wells Fargo Funding Seller Guide/SECTION 800: CONVENTIONAL UNDERWRITING/825: Non-Conforming Underwriting Guidelines/825.11: Property Appraisal - Number of Appraisals Required/Exhibit Requirements (06/19/2017)

825.11: Property Appraisal - Number of Appraisals Required/Exhibit Requirements (06/19/2017)

Appraisal requirements are determined by the total Loan amount provided by Wells Fargo.

- Valuation products obtained by the Seller must be ordered through the correct vendor and completed by an AMC authorized to provide valuation products for Non-Conforming

Loans. Refer to **Section 800.10: *Appraisal/Valuation Policy*** for authorized AMCs and ordering requirements.

- Uniform Appraisal Dataset (UAD) compliant appraisals are required for appraisal report forms 1004/70 and 1073/465.
- Refer to Wells Fargo Funding's **Exhibit 4: *Value Based Median Home Price Classification List*** to determine the median home price range for the subject property.

Total Loan Amount Provided by Wells Fargo	**CLTV**	**Appraisal Documentation Required**		
		Median Home Price Multiple		
		≤4 times Median Home Price	**>4 ≤10 times Median Home Price**	**>10 times Median Home Price**
≤$1,000,000	**All**	One full appraisal[1]	One full appraisal[1]	One full appraisal[1]
>$1,000,000 - ≤$1,500,000	**≤70%**	One full appraisal[1]	One full appraisal[1] completed by a certified appraiser[2] and a Residential Valuation Services (RVS) Desk Review[3]	One full appraisal[1] completed by a certified appraiser[2] and a Residential Valuation Services (RVS) Desk Review[3]
	>70% ≤80%	One full appraisal[1] completed by a certified appraiser[2] and a Residential Valuation Services (RVS) Desk Review[3]		
>$1,500,000 – ≤$2,000,000	**All**	One full appraisal[1] completed by a certified appraiser[2] and a Residential Valuation Services (RVS)	One full appraisal[1] completed by a certified appraiser[2] and a Residential Valuation Services (RVS) Desk Review[3]	One full appraisal[1] completed by certified appraiser[2] and a Residential Valuation Services (RVS) Interior Field Review[3]

		Desk Review[3]		
>$2,000,000	**All**	One full appraisal[1] completed by certified appraiser[2] and a Residential Valuation Services (RVS) Interior Field Review[3]	One full appraisal[1] completed by certified appraiser[2] and a Residential Valuation Services (RVS) Interior Field Review[3]	One full appraisal[1] completed by certified appraiser[2] and a Residential Valuation Services (RVS) Interior Field Review[3]

1. A full appraisal is one prepared on form 1004/70, 2090, or 1073. An ACE/PIW, 2055, 1075 or 2095 Summary Report is not acceptable.
2. When ordering the appraisal, Seller must specify that the appraisal be completed by a certified appraiser and, upon receipt of the appraisal, Seller must confirm the appraisal was completed by a certified appraiser.
3. RVS review products will be ordered by Wells Fargo Funding. LTV/CLTV will be based on the lower of the reviewed value or the sales price.

Wells Fargo Funding/Wells Fargo Funding Seller Guide/SECTION 800: CONVENTIONAL UNDERWRITING/825: Non-Conforming Underwriting Guidelines/825.12: Property and Appraisal - Specific Property Types (08/01/2017)

825.12: Property and Appraisal - Specific Property Types (08/01/2017)

ACCEPTABLE PROPERTY TYPES

Acceptable property types are:

- **All products:**
  - Single family detached or attached dwellings
  - Condominiums/PUDs.
  - Factory built except manufactured (mobile) homes
  - Cooperatives. Refer to **Section 950** for LTV/CLTV limits.
  - Properties with accessory units refer to **Section 820.14(b): *Specific Property Types***.

UNACCEPTABLE PROPERTY TYPES

Unacceptable property types include, but are not limited to:

- Time-share projects
- Unimproved land
- Mobile home type manufactured housing
- Condotels/Resort Condominiums
- Hotel Condominium
- Log, earth or dome homes
- Hobby farms

If there is indication of an activity occurring on the subject property that does not comply with federal, state, and local laws, rules and regulations then the Loan is ineligible for purchase by Wells Fargo Funding.

PROPERTY FLIP TRANSACTIONS

Not allowed

RESTRICTIONS FOR CLTV GREATER THAN 80%

Properties with any of the following characteristics are not eligible for CLTV greater than 80%:

- Properties that are experiencing interrupted or unstable utility service hazards (such as severely curtailed water service, water contamination or extended power shortages) as identified by the appraiser.
- Properties that are located in an energy market, as identified by Wells Fargo Funding. Refer to Wells Fargo Funding's *Energy Markets* Exhibit 24 list for a complete list of energy markets.

Refer to **Section 825.14: *Property and Appraisals – Disasters*** for properties impacted by major disasters.

SPECIFIC PROPERTY LOCATIONS AND TYPES

- For properties located in Lava Zones, refer to **Section 820.14(a): *Specific Property Types***.
- For Mixed Use Properties and Ohanas, refer to **Section 820.14(b): *Specific Property Types***.

PROPERTIES LOCATED ON ISLANDS

The following are considerations when making lending decisions on island properties:

- Regardless of where a property is located, it must be suitable for residential use and occupancy year-round. This is the area of greatest concern and the one most critical in determining acceptability. On some islands, public and private utilities such as water and electricity are not available year round, and the properties have no central heat source. These properties are ineligible for Wells Fargo financing.
- The island should be accessible via public transportation. If a boat or ferry is the only means of access, it should be public, not private transportation. Public transportation is defined as that which is owned or controlled by local or state governing agencies or has been established for generations and is now considered public with assurance of public ownership should the business close.
- Due to location, access, and availability of utilities, the property may suffer limited marketability. Marketability must be demonstrated by sales of comparable properties.

CONDOMINIUMS

A site condominium property that consists of single family detached homes requires no project review/analysis, but must be coded as a condominium property type.

1. **Acceptable Condominium Project Reviews** The following project reviews are acceptable for Loans submitted to Wells Fargo Funding:

a. Wells Fargo Streamlined Review.

b. Wells Fargo HOA Certification (Form 25)

c. *Condo Project Manager*™ (*CPM*™) submitted by Wells Fargo Funding. Sellers electing to submit for a *CPM* approval will be billed for submission and processing.

d. Wells Fargo Full Project Review.

e. Final Condominium Project Acceptance through Fannie Mae Project Eligibility Review Service (PERS). Fees apply for new approvals. See the Wells Fargo Correspondent Review Fee Schedule, Exhibit 23, in this Seller Guide for applicable fees.

2. General Condominium Project Eligibility Requirements The following guidelines apply to all condominium Loans submitted to Wells Fargo. Project information may be reported by the appraiser, disclosed by the homeowners association or developer, shown on the purchase contract, or obtained through review of the Homeowners Association Certification as well as from other types of condominium documents such as CondoCerts.com when available.

a. Ineligible Projects The following projects are considered ineligible projects as defined by Fannie Mae published guidelines and are not eligible for sale to Wells Fargo.

i. Condotels, defined as a condominium project in a resort or destination area, which, while units are individually owned, are used frequently for short-term transient, vacation rentals

ii. Mandatory rental pool agreements

iii. Occupancy restrictions mandated by zoning

iv. Timeshare or segmented ownership projects

v. Houseboat projects

vi. Projects that restrict the owner's ability to occupy the unit

vii. Investment securities (i.e., projects that have documents on file with the Securities and Exchange Commission, or projects where unit ownership is characterized or promoted as an investment opportunity)

viii. Any project identified with a blanket insurance policy that covers multiple unaffiliated associations or projects. Refer to section 2.m below for additional guidance.

ix. Common interest apartments or community apartment projects are projects or buildings that are owned by several owners as tenants-in-common or by a homeowners association 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 in the building.

x. New projects where the seller is offering sale/financing structures in excess of either Wells Fargo or Fannie Mae's eligibility policies for individual mortgage Loans. These excessive structures include, but are not limited to, builder/developer contributions, sales concessions, HOA or principal and interest payment abatements, and/or contributions not disclosed on the HUD-1 Settlement Statement (for Loans with applications dated prior to October 3, 2015) or the Closing Disclosure (for Loans with applications dated on and after October 3, 2015).

xi. Multi-dwelling unit condominium projects that permit an owner to hold title (or stock ownership and the accompanying occupancy rights) to more than one dwelling unit, with ownership of all of his or her owned units (or shares) evidenced by a single deed and financed by a single mortgage (or share Loan).

xii. Condominium projects that represent a legal, but non-conforming, use of the land, if zoning regulations prohibit rebuilding the improvements to current density in the event of their partial or full destruction.

xiii. Projects that have been converted from a hotel or motel with short term rentals.

b. Additional Project Review Required In addition to ineligible projects defined by Fannie Mae published guidelines, the following combination of characteristics require additional review by a Wells Fargo Funding underwriter for eligibility:

i. The project is located in a resort destination.

ii. Live/work or segmented ownership projects.

iii. Projects with non-incidental business operations owned or operated by the homeowners association such as, but not limited to, a restaurant, a spa, a health club, etc.

iv. Conventional Non-Conforming condominium projects with units less than 400 square feet.

v. Transactions under which the borrower will own more than one unit in the project.

vi. More than one unit within the project is less than 600 sq ft.

vii. The project name includes “condotel”, “condo hotel”, “hotel”, “motel”, “inn”, “resort” or “lodge”.

viii. The project shares facilities with a hotel or motel.

ix. The project is in an area zoned primarily for transient accommodations.

x. The unit is in a building that functions like a traditional condominium, yet the project contains additional resort type amenities or other buildings with resort type amenities.

xi. Projects with leased back recreational facilities.

xii. The unit is fully furnished.

xiii. The unit does not have a full kitchen.

xiv. The project provides any of the following services:

1. Management desk
2. Bellman
3. Daily maid service
4. Maid service
5. phone service
6. Centralized utilities, for example: central telephone or cable
7. Centralized key system not in negotiated terms

c. Special Assessments Newly constructed projects generally have pending special assessments. Details of the special assessments are evaluated to determine impact on all units and marketability.

d. Multiple Ownership

Number of units in project	**Multiple ownership requirements**
> 20	A maximum of 10% of the units may be sold to one party.
5–to-20	A single entity is allowed to own no more than two units.

2-to-4	A single entity may not own more than one unit, unless: • The condominium project is a 2-unit project; and • The LTV is less than or equal to 80%; and • If the current transaction is an investment transaction, the other unit must be a primary or second home. Both units cannot be investment, primary, or second homes.

e. Commercial Use Commercial use within the project may not exceed 25% of the total square footage for the project and must be compatible with residential use. Unacceptable commercial space includes, but is not limited to:

i. Restaurant

ii. Medical

iii. Chiropractic / alternative medicine

iv. Manufacturing

v. Industrial

vi. Any commercial space requiring multiple employees, machinery, or nuisance

vii. Any business that generates significant customer traffic

f. Completion All common areas and amenities within the project (or subject phase) must be complete. If completion is in question, the Seller must obtain the following:

i. Final Certification of Substantial Completion (FNMA 1081) or

ii. Equivalent document (appraisal addendum, builder's certification, etc.) which lists the common amenities and facilities that are incomplete

g. Right Of First Refusal Any right of first refusal in the condominium project documents will not adversely impact the rights of a mortgagee or its assignee to:

i. Foreclose or take title to a condominium unit pursuant to the remedies in the mortgage.

ii. Accept a deed in lieu of foreclosure in the event of default by a mortgagor.

iii. Sell or lease a unit acquired by the mortgagee.

h. Adverse Environmental Factors Any adverse environmental factors affecting the condominium project must be addressed by the appraiser. Any factors affecting safety, habitability or marketability of the unit or project will render the project ineligible.

i. Litigation Loans secured by condominiums where the project is involved in litigation due to construction defects, are not eligible for Prior Approval. Condominium projects involved in other types of litigation may be approved depending on the risk and marketability. If the HOA is involved in any litigation, arbitration, mediation or other dispute resolution process, obtain the details from the HOA. This information should be verified with an attorney's letter, insurance information, structural report, and/or other documentation.

i. The following types of litigation generally pose little or no risk to the project and are acceptable:

1. HOA is suing individual owners for unpaid dues.

2. HOA is being sued for a “slip and fall” liability issue and project has adequate liability insurance to cover the damages being sought by the plaintiff.

3. Other suits filed by the HOA that do not impact the value or livability of the project.

4. Project is involved in a minor matter described below and has been reviewed by Wells Fargo project review:
(a) Non-monetary litigation involving neighbor disputes or rights of quiet enjoyment;

(b) Litigation for which the claimed amount is known, the insurance carrier has agreed to provide the defense, and the amount is covered by the association’s insurance; or

(c) The homeowners association is named as the plaintiff in a foreclosure action, or as a plaintiff in an action for past due homeowners association dues

ii. The following types of litigation may impact the project's marketability and are not acceptable:
1. HOA is suing the developer for construction defects or other property deficiencies that impact health and safety.

2. Suits filed against the HOA in which the damages exceed or are not covered by the HOA's insurance.

iii. Projects involved in pending litigation (lawsuit has not yet been filed) may be approved when the risk to the project is assessed and it is determined that:
1. HOA insurance will cover potential damages, or

2. HOA is in a position to benefit from the lawsuit.

j. Delinquent HOA Dues If more than 15% of the units are delinquent on their HOA dues, the project is ineligible for financing. In the event that the mortgagee acquires a unit through foreclosure or deed-in-lieu, the mortgagee may not be responsible for more than the greater of six months or, the maximum amount permitted under applicable state law, of delinquent HOA dues.

k. Insurance Requirements Minimum requirements for hazard (including applicable unit interior coverage, commonly known as H06), general liability, and flood insurance are as established by Fannie Mae and Wells Fargo Funding. Sellers should refer to Fannie Mae published guidelines and **Section 545.06: *Flood Insurance*** for complete details. **Fidelity Insurance** Fidelity insurance is required if the condominium project has more than 20 units and fidelity crime insurance coverage is greater than $5,000. The policy must name the condominium project as the insured and premiums must be paid as a common expense by the condominium project, apportioned to each shareholder, or by the HOA.

- The condominium project must carry fidelity bond or employee dishonesty insurance to cover losses resulting from dishonest or fraudulent acts committed by the directors, managers, trustees, employees, or volunteers who manage the funds collected by the project. A management company must be covered as well, typically via an endorsement to the HOA’s policy that recognizes the management company as a designated agent.
- Directors and officers insurance is not the same as fidelity insurance
- Crime insurance alone is not the same as fidelity insurance
- Employee dishonesty insurance is the same as fidelity insurance

Coverage Requirements

The amount of coverage must be equal to the greater of either:
- three months of assessments/maintenance fees for all units in the project **or**

- the sum of all cash and reserve fund monies that are in the custody of the condominium project or its management agent.

Reduced Coverage Requirements

If the sum of all cash reserves is the greater amount, but the fidelity insurance coverage is at least equal to three months of maintenance fees, the three months' coverage may be acceptable if the project's legal documents require the condominium project and any management company to adhere to certain financial controls listed below.

Reduced fidelity insurance coverage may be acceptable (three months' coverage) only when the financial controls take one or more of the following forms:

- The condominium project or the management company maintains separate bank accounts for the working account and the reserve account, each with appropriate access controls, and the bank in which funds are deposited sends copies of the monthly bank statements directly to the condominium project;
- The management company maintains separate records and bank accounts for each condominium project that uses its services and the management company does not have the authority to draw checks on, or to transfer funds from, the condominium project's reserve account; or
- Two members of the board of directors must sign any checks written on the reserve account.

Under the Wells Fargo Streamlined Review, the following do not require verification:
i. Hazard endorsements for:
1. Inflation Guard

2. Ordinance or Law, or

3. Mechanical Breakdown and Equipment Failure (aka Steam Boiler and Machinery Coverage).

ii. Fidelity bond insurance

iii. General liability insurance
1. If Wells Fargo Funding or the Seller becomes aware of an active General Liability policy with insufficient coverage, the HOA must obtain proper insurance to be eligible for the Wells Fargo Streamlined review process.

l. Nightly Rentals Nightly rentals are allowed in a project, providing the project is not classified as a condotel, under the following conditions:
i. No mandatory rental pool

ii. No timeshare units

iii. No other condotel features; for example, registration desk or maid service

Eligible transactions are:
i. Purchase or rate / term refinance.

ii. Primary or second / vacation home

m. Blanket Insurance (Pooled Insurance) Condominium projects with a blanket insurance policy that covers multiple projects are only allowed if all of the insured locations are legally affiliated. Blanket insurance policies that insure multiple unaffiliated projects are not allowed.

i. Affiliated projects are defined as those projects that are under the same master association or that share the use of common facilities; either owned individually or as part of a master development.

ii. Projects that do not meet the above definition, including projects managed by the same management company, are considered unaffiliated.

3. Wells Fargo Project Review Requirements

a. Wells Fargo Streamlined Review This option requires only the appraisal to verify property and project marketability. In addition to the General Condominium Project Eligibility Requirements (Section 2 above), the following eligibility requirements apply when reviewing a project using Wells Fargo Streamlined review:

i. Primary residence and second home transactions only

ii. Maximum of 75% LTV/CLTV

iii. Property must be located in an established project

iv. Established project requirements:

1. Project must be 100% complete, including all units and common elements

2. Control of the HOA has been turned over to the unit owners

3. 90% of units have been conveyed to the unit owners

4. Project is not subject to additional phasing or annexation

v. Projects with greater than four units: At least 70% of the units in the project must be sold to individuals occupying as a primary residence or second home

vi. Projects with two to four units: All but one unit must be sold to individuals occupying as a primary residence or second home

vii. Project must have demonstrated market acceptance

viii. Maximum financing for an established project in the state of Florida is the lesser of the product/program maximum or:

1. 75% LTV/CLTV for a primary residence or second/vacation home.

b. Wells Fargo Homeowners Association Certification Review In addition to the General Condominium Project Eligibility Requirements (Section 2 above), the following eligibility requirements apply when reviewing a project using the Wells Fargo Prior Approval Homeowners Certification Review. Refer to Form 25 for projects with greater than 4 units and Form 24 for 2-4 unit projects.

i. Minimum eligibility requirements

1. Project may be subject to additional phasing or add-ons

2. At least 50% of the units sold must be sold to owner-occupants for use as primary residence or second home

3. At least 70% of the units in the project or subject phase must be sold. This includes closed sales and units under contract with bona fide purchasers.

a) In a project subject to additional phasing a section or phase may be included with existing sections or phases to meet the pre-sale requirement. If, however, there is evidence that units in the subject phase are not selling at an acceptable rate, prior phases should not be included in determining the pre-sale requirements.

b) For conversion projects when all units are not for sale, pre-sale may be calculated using the total number of units available for sale in the project.

4. Project has demonstrated market acceptance.

5. Maximum financing for an established project in the state of Florida is the lesser of the product/program maximum or:
a) 75% LTV/90% CLTV for a primary residence.

b) 70% LTV/75% CLTV for a second/vacation

6. Documentation requirements:
a) Individual Condominium Appraisal Report.

b) Homeowners Association Certification (Form 25/24) completed by a representative of the HOA or CondoCerts.com (**Note:** if condominium association information obtained through CondoCerts.com the information must be no older than 45 days).

ii. Ineligible The following characteristics render a condominium project ineligible for Wells Fargo HOA Certification Review. If the project has any of these characteristics, or the Wells Fargo HOA Certification Review determines a project is ineligible, the Seller may be able to use another acceptable review option to obtain project approval. Refer to Acceptable Condominium Review Options above.
1. All new construction and new conversion projects located in the state of Florida

2. All investment transactions located in the state of Florida

3. Condominium projects that have incomplete items

4. New conversion projects which did not have a full gut-rehabilitation

c. Wells Fargo Full Project Review This option is available for new construction or recent conversion condominium projects, full gut rehabilitation conversions of condominium projects, or when the project does not meet eligible condominium project reviews listed above. The Seller should be aware of the following:
i. Wells Fargo Full Project Review includes an in-depth analysis of the legal, financial and other documents.

ii. Wells Fargo provides Full Project Reviews upon request only; contact a member of your sales team for details.

iii. The fee for these services varies by the type of approval requested. Please see the Wells Fargo Project Review Fee Schedule, Exhibit 23, in this Seller Guide.

iv. Maximum financing for an established project in the state of Florida is the lesser of the product/program maximum or:
1. 75% LTV/CLTV for a primary residence

2. 70% LTV/CLTV for a second/vacation home

PLANNED UNIT DEVELOPMENTS (PUDS)

Refer to **Section 820.14(b): *Specific Property Types***.

FACTORY BUILT HOUSING/MANUFACTURED HOUSING

- Factory built housing may not be part of a PUD or condominium project.
- Manufactured/Mobile homes are not allowed.

COOPERATIVE PROPERTIES

All cooperative projects must be submitted to and approved by Wells Fargo's Cooperative Project Approval Team (CPAT). See Wells Fargo Funding Cooperative Project Approval Process below for details.

Eligible Occupancy Types

Primary residence or second home

INELIGIBLE LOAN CHARACTERISTICS

Work escrows for completion are not allowed.

Eligible Products, Transactions, and LTV/TLTV/CLTV

Refer to **Sections 950-975** for eligible products, transactions, and LTV/TLTV/CLTV limitations.

Eligible Geographic Locations for Loans Without Subordinate Financing

- Non-Conforming Loan amounts up to $650,000 allowed in the states of New York and New Jersey (Bergen and Hudson counties only).
- Loan amounts greater than $650,000 to $2,000,000 allowed in New York City.
  - New York City is defined as:
    - Boroughs of Bronx, Brooklyn, Staten Island, Manhattan, and Queens
    - Counties of Nassau, Rockland, Suffolk, and Westchester

Eligible Geographic Locations for Loans With Subordinate Financing

- Non-Conforming Loan amounts up to $650,000 allowed in the state New York
- Loan amounts greater than $650,000 to $2,000,000 allowed in New York City.
  - New York City is defined as:
    - Boroughs of Bronx, Brooklyn, Staten Island, Manhattan, and Queens
    - Counties of Nassau, Rockland, Suffolk, and Westchester

Project Eligibility

- New construction and new conversion projects allowed in New York City only. Refer to Additional Requirements for New Construction and New Conversion Projects within this section.
- Existing construction allowed in the states of New York and New Jersey.
- Project must have a minimum of two units.
  - Two- to four-unit cooperative projects:
  - Must be 100% owner-occupied.
  - May have only one unit in the project financed by Wells Fargo.
  - Must meet ***Appraisal Requirements*** within this Section.
- Cooperative maintenance fee must be included in the borrower's housing expense for qualifying. Maintenance fees must be paid and current on the Closing date.
- Project must be complete and not subject to additional phasing or annexation.
- Secondary financing allowed if the cooperative does not prohibit and the second is not a Wells Fargo loan/ line.
- Financing to combine two co-op units into one unit is not allowed.

Ineligible Projects

The following types of projects are ineligible for purchase by Wells Fargo Funding:

- Projects composed of single family detached units.
- Cooperative hotels or time share, fractured, fragmented or segmented ownership projects.

- Houseboat projects.
- Land owned by community land trusts.
- Any project where the builder, developer, or property seller is offering contributions that may affect the value of property such as rent backs or lease backs, payment of PITI and undisclosed contributions. Refer to **Section 825.17: *Contributions*** for seller contribution requirements.
- Cooperative Share Mortgages in cooperative projects with units that are subject to resale restrictions.
- A tax-sheltered syndicate leasing to a cooperative or "leasing" cooperatives, i.e., projects that involve the leasing of the land and improvements to the cooperative corporation, even if the cooperative corporation owns part of the building.
- Cooperative projects that are subject to leasehold estates or ground rent outside of New York City. (This is not a reference to the proprietary lease, which gives the borrower the right to occupy the unit.)
- Multi-dwelling unit cooperatives, i.e., projects that permit an individual or entity to hold individual stock ownership and the accompanying occupancy rights for more than one dwelling unit, with ownership of all of his/her shares financed by a single share loan.
- Limited equity cooperatives, AKA Mitchell Lama-projects, in which the cooperative corporation places a limit on the amount of return that can be received when stock or shares are sold.
- Cooperative projects in which the developer or sponsor has an ownership interest or other rights in the project real estate or facilities, other than the interest or rights it has in relation to any unsold units.
- Cooperative projects that represent a legal, but non-conforming use of the land, when zoning regulations prohibit the rebuilding of the improvements to their current density in the event of their partial or full destruction.
- Cooperative projects in New Jersey created (new construction or conversions) after May 9, 1988.
- Any project identified with a blanket insurance policy that covers multiple unaffiliated associations or projects. Refer to section 2.m. for a definition of unaffiliated.

Pre-sale and Owner Occupancy Guidelines

No more than 10% of the units may be owned by any single entity other than the sponsor or holder of unsold shares.

For new construction properties, at least 50% of the total stock or shares in the co-op corporation and related occupancy rights of units in the project must be under bona fide contract for sale to primary residence purchasers.

For existing construction properties, at least 50% of the total stock or shares in the co-op corporation and related occupancy rights of units in the project must have been sold and conveyed to primary residence purchasers.

Leaseholds – Allowed in New York City Only

- The lessee must be the cooperative board not the sponsor/developer and must not be a commercial entity.
- The ground and proprietary lease expiration must be at least five years longer than the term of the mortgage being requested.

- The original ground lease terms can be no less than 60 years with at least one option to renew for a term not less than the original term.
- The ground lease provides that the cooperative blanket mortgagee shall receive notice of any monetary or non-monetary default by the cooperative and grants the mortgagee the right to cure any such monetary or non-monetary default on behalf of the cooperative.
- The cooperative may assign or transfer its interest in the ground lease.
- If an increase in the cooperatives obligation to pay annual ground rent, over and above any other payments to be made by the cooperative, is scheduled to occur on or before the second anniversary of the date of Loan delivery, the amount of increase cannot exceed 10% of the cooperative's annual operating budget, as disclosed in the cooperative's fiscal year-end financial statements. The increase must be included in the monthly expense-to-income ratio.
- If the cooperative's blanket mortgage is a balloon mortgage with a remaining term of fewer than three years, but not fewer than two years, or if the mortgage provides for interest rate adjustments, those increases in debt obligations and any ground rent increases must not cause the borrower's monthly assessment to be increased by more than 10% at the time the Loan is underwritten.
- CPAT will investigate the enforceability of the terms and conditions of the ground lease has been duly and diligently investigated.
- CPAT will investigate the existence of monetary and non-monetary defaults under the terms and conditions of the ground lease has been duly and diligently investigated.

Commercial Use

Commercial units should not exceed 25% of the project's total square footage. Additionally the following should be considered:

- The presence of commercial units should not negatively impact the marketability of the project.
- The project should not be unique in its market.
- The commercial units' intended use and the effect on the viability of the cooperative project. For example, retail use may cause more traffic and impede parking availability more than a doctor's or dentist's office.

Common Elements

The unit owners can be the sole owners of and have right to the use of the project's facilities, common elements, and limited common elements.

Amenities can be shared with one or more community association(s) when the sharing agreement provides clear terms for use, expenses, and dispute resolution.

The developer or sponsor may not retain an ownership interest in any of the facilities related to the project such as parking, recreational facilities, etc.

Cond-ops

A cond-op is a condominium project consisting of multiple condominium units, one of which would be the residential condominium (cooperative) and the others being non-residential.

Because the commercial portion of the project impacts the financial viability of the residential cooperative units, the financial statements of the condominium must be obtained and reviewed in conjunction with the review of the financial statements for the cooperative.

The underwriter should look for any indication that one of the entities has a loan with the other entity or is in arrears on any obligations. Both the cooperative corporation and condominium association must be financially viable.

If the legal relationship between the cooperative corporation and condominium association cannot be determined from the financial statements, a review of the cooperative offering statement may be required. In addition, the underwriter must determine that the commercial use does not adversely impact the marketability of the residential units.

Insurance

The cooperative corporation must maintain hazard, liability, fidelity, and flood (if building is in a flood zone) insurance with the following coverage from an insurance company with minimum rating of at least:

- AM Best - General policy holder rating = A and financial size category V, or
- Standard & Poor's insurer financial strength rating = BBB, or
- Demotech hazard insurance financial stability rating = A

Hazard Insurance Coverage

100% of the insurable replacement cost of the project improvements, including cooperative units

- Additional coverage for mechanical breakdown or equipment failure must be equal to, at minimum, the lesser of 100% of the insurable replacement cost of the building housing the property, or $2,000,000.
- Policy must show the cooperative as the named insured.

Deductible

Unless a higher maximum is required by state law, the maximum deductible is 5% of the policy face amount.

Liability Insurance Coverage

$1,000,000 for any single occurrence of bodily injury and property damage

Fidelity Insurance Coverage

Required if the cooperative project has more than 20 units and the amount of fidelity insurance coverage required is greater than $5,000.

The policy must name the cooperative as the insured and premiums must be paid as a common expense by the cooperative apportioned to each shareholder or by the HOA.

- The cooperative must carry fidelity bond or employee dishonesty insurance to cover losses resulting from dishonest or fraudulent acts committed by the directors, managers, trustees, employees, or volunteers who manage the funds collected by the project. A management company must be covered as well, typically via an endorsement to the HOA's policy that recognizes the management company as a designated agent.
- Directors and officers insurance is not the same as fidelity insurance
- Crime insurance alone is not the same as fidelity insurance
- Employee dishonesty insurance is the same as fidelity insurance

Coverage Requirements

The amount of coverage must be equal to the greater of either:

- Three months of assessments/maintenance fees for all units in the project **or**
- The sum of all cash and reserve fund monies that are in the custody of the cooperative corporation or its management agent.

Reduced Coverage Requirements

If the sum of all cash reserves is the greater amount, but the fidelity insurance coverage is at least equal to three months of maintenance fees, the three months' coverage may be acceptable if the project's legal documents require the cooperative corporation and any management company to adhere to certain financial controls listed below.

Reduced fidelity insurance coverage may be acceptable (three months' coverage) only when the financial controls take one or more of the following forms:

- The cooperative corporation or the management company maintains separate bank accounts for the working account and the reserve account, each with appropriate access controls, and the bank in which funds are deposited sends copies of the monthly bank statements directly to the cooperative corporation;
- The management company maintains separate records and bank accounts for each cooperative corporation that uses its services and the management company does not have the authority to draw checks on, or to transfer funds from, the cooperative corporation's reserve account; or
- Two members of the board of directors must sign any checks written on the reserve account.

Flood Insurance Coverage

If any part of the cooperative project's improvements are in a Special Flood Hazard Area, the cooperative corporation must maintain flood insurance equal to the replacement value of the building, up to the maximum available under the National Flood Insurance Program (NFIP):

- $250,000 on any one building with than five units
- $500,000 on any one building with five or more units

Deductible

Maximum deductible allowed is the maximum available through the NFIP, which is currently $10,000 on any one building regardless of the number of units. For private (non-NFIP) policies, a higher deductible is acceptable only when all of the following conditions are met:

- Deductible does not exceed 5% of the coverage amount
- The per-unit deductible does not exceed $2,500 per unit
- Homeowners Association reserves are equal to at least 75% of the deductible

Recognition Agreement/Right to Cure Borrower's Default

In the event of a default by the borrower, the cooperative corporation must permit the servicer to cure the borrower's default to the cooperative corporation.

Litigation

If the cooperative is involved in any litigation, arbitration, mediation, or other dispute resolution process, obtain the details from the cooperative board and evaluate the risk. This information should be verified with a letter from the attorney for the cooperative board or, if new construction or conversion, a sponsor's or an attorney's letter, insurance information, structural engineer's report, or other documentation as appropriate.

The following are some examples of types of litigation that generally pose little risk to the project and are typically acceptable:

- Board is suing individual owners for unpaid dues.
- Cooperative is being sued for a "slip and fall" liability issue and the project has adequate liability insurance to cover the damages being sought by the plaintiff.
- Other suits filed by the cooperative that do not impact the value or livability of the project.
- Project is involved in a minor matter described below:
  - Non-monetary litigation involving neighbor disputes or rights of quiet enjoyment;
  - Litigation for which the claimed amount is known, the insurance carrier has agreed to provide the defense, and the amount is covered by the association's insurance; or
  - The cooperative board is named as the plaintiff in a foreclosure action, or as a plaintiff in an action for past due homeowners association dues.

The following are some examples of types of litigation or threatened litigation that may impact the project's marketability and are not acceptable:

- Lawsuit against the sponsor/developer for construction defects or other property deficiencies that impact health and safety. The project may be acceptable if the defects have been corrected and the project is financially sound and marketable or adequate insurance coverage exists.
- Suits filed against the cooperative in which the damages exceed or are not covered by insurance.

Projects involved in threatened litigation (lawsuit has not yet been filed), excluding structural defects or property deficiencies that impact health and safety, may be approved when the risk to the project is assessed and it is determined that the:

- Cooperative's insurance will cover potential damages or
- Project is in a position to benefit from the lawsuit

Subsidies/Tax Abatements

Any subsidies, tax abatements, or similar benefits that will terminate in whole, or in part, within three years must be added to the borrower's monthly housing expense for qualifying. Use the portion of such subsidies or benefits that will be in effect on the third underwriting anniversary.

Wells Fargo Home Mortgage Exposure

Wells Fargo's maximum mortgage exposure in any project should not exceed 30%. Exposure is calculated as the number of Wells Fargo loans in the cooperative divided by the total number of units in the cooperative.

Exposure is contingent upon daily loan production and verified during the project review.

If the 30% exposure is exceeded during the project review process, the Loan will not be eligible for purchase by Wells Fargo Funding. The project review process includes the time frame after the ***Cooperative (Co-op) Project Approval and Validation Request Form*** is submitted by the Seller until the time the project approval is provided to the Seller.

The 30% exposure limit can only be exceeded if:

- The current exposure is less than 30% and the subject Loan will put the exposure over 30%.

- A Loan is a refinance or a purchase of a current cooperative Loan that will replace a loan already being considered in the current exposure calculation

Financial Stability

The project documentation must provide for the cooperative to make financial statements for the most recent fiscal year available to the holder, insurer, or guarantor of any cooperative loan for a unit in the project on submission of a written request. Federal tax returns may be requested at the CPAT underwriter's discretion.

On existing cooperative projects, the most recent financial statements (income and expense statement and balance sheet, including footnotes, if available) must be obtained and reviewed for financial stability. The most recent New York Attorney General's Disclosure Statement, which includes the financial statements and operating budget for the cooperative, is acceptable in addition to the financial statements from the cooperative corporation.

The underwriter must determine that:

- Maintenance fees are adequate to cover the expenses of the cooperative corporation.
- No more than 15% of owners (shareholders) are more than 60 days delinquent on any obligation to the cooperative corporation.
- If rent from unsold units does not support the portion of maintenance fees related to those units, the negative cash flow from the unsold units will not cause the borrower's maintenance fees to increase by more than 20%.
- Reserves are adequate when considered in relation to the age and condition of the building(s).
- The sponsor (or holder of unsold shares) is current and has been current on maintenance fees and any other obligations to the cooperative corporation for the previous 18 months. This can be verified with a written certification from the cooperative board or in the New York Attorney General's Financial Disclosure Amendment.
- The sponsor (or holder of unsold shares) is current on all financial obligations relating to other projects in which the sponsor (or holder of unsold shares) has at least a 10% interest. This can be verified with a written certification from the accountant for the sponsor (or holder of unsold shares) or in the New York Attorney General's Financial Disclosure Amendment.

Current Operating Budget

On cooperative projects with low pro-rata shares, positive cash flows, good reserves, and consistent information between the financial statements and the appraisal (with nothing adverse noted), the operating budget may be waived.

Information found in the current operating budget can help the underwriter determine whether there are enough funds budgeted for expenses and reserves. The operating budget may also provide information regarding special assessments, major repairs, and pending lawsuits.

The operating budget is generally attached to current financials and not needed unless:

- The financial statements are more than 16 months old,
- The information provided by the appraiser is significantly different than that found in the financial statements, or
- The financial statements show a significant negative cash flow.

Note: It is always within the underwriter's discretion to require the current operating budget to review for a full financial picture of a project.

Underlying Blanket Mortgage

- The amount and terms of the underlying blanket Mortgage must be verified by the appraiser and be reflected in the financial statements for the project.
- Any blanket Mortgage for the project may be a balloon Mortgage with a remaining term of less than three years, but not less than six months.
- If the balloon Mortgage incorporates an adjustable rate feature, the current interest rate may not be subject to an interest rate adjustment prior to the maturity date.

Transfer Fees (Flip Taxes/Waiver fee)

A flip tax is a fee paid by a seller or buyer on a housing cooperative transaction typically in New York City. It is not a tax, and not deductible as a property tax. It is a transfer fee payable upon the sale of a unit to the cooperative.

Eligibility

- The cooperative project's legal documents must indicate that that a flip tax is allowed and provide for one of the following:
  - Exemption for lenders from paying the flip tax if the property is taken back in foreclosure, deed in lieu, etc.,
  - Flip tax is only payable when the unit is being sold for a profit, or
  - Flip tax is calculated based on *one* of the following and does not exceed 5%:
    - Flat fee or
    - Fee per share or
    - Percentage of the appraised value or sales price or
    - Dollar amount per room
- Transfer fees are generally found in the sales contract and may be noted by the appraiser.
- A project is ineligible for financing if it has a transfer fee (flip tax) that does not have a stated value or if the value will be established by the cooperative board at a later date.

Note: If the transfer fee is to be paid by the borrower at the time of purchase, that amount must be included in the cash to close.

Pro Rata Share – New York City

For cooperative projects in New York City, calculate the pro rata share of the underlying mortgage as follows:
[(Underlying blanket mortgage balance ÷ total number of outstanding shares in cooperative corporation x subject shares] ÷ (appraised value + subject share of underlying blanket mortgage)

The pro rata share should not exceed 35%. A higher ratio (not to exceed 40%) may be used when there are fully documented compensating factors that justify using the higher ratio.

Refer to the ***Appraisal Requirements*** in this section for pro rata share requirements when the property is outside of New York City.

Proprietary Lease/Occupancy Agreement

The borrower must have a right to occupy the unit for a period that extends at least to the maturity date of the Loan. The proprietary lease/occupancy agreement must also prohibit the co-op from imposing unreasonable limitations on the borrower's ability to sell, transfer, or convey membership, or to sublease unit.

Appraisal Requirements

The appraisal must demonstrate market acceptance for the cooperative form of ownership by the availability of similar comparables sales for cooperative units in the market area.

- For areas outside of New York City, the appraisal must report the value of the cooperative interest excluding its pro rata share of the blanket mortgage.
  - Appraisers must certify in the appraisal report that the pro rata share of the blanket mortgage on the real estate has not been included in the opinion of the market value of the cooperative interest.
- For two- to four-unit co-op projects, the appraisal:
  - must reflect that the project is located in an area with a demonstrated market acceptance for such co-op projects.
  - Appraisal should provide similar comparable sales from other two- to four-unit co-ops located in the subject co-op market area.
  - If there is a lack of comparables from other two- to four-unit co-ops in the subject market area, the appraiser may provide a list of two- to four-unit co-ops in the subject market area to support that two- to four-unit co-ops are common and customary in the market.

Additional Requirements for New Construction and New Conversion Projects

New construction cooperatives are defined as projects and units that have not been turned over to the cooperative board or the units have never been occupied. New conversion cooperatives are defined as projects and units that are being converted to a cooperatives form of ownership and the cooperative board has not been in existence for more than three years.

Offering Plan or Prospectus

The entire offering plan and all amendments must be obtained for all new construction and new conversion cooperative projects. Areas of focus include, but are not limited to the items below.

1. *Special Risk Section* – The *Special Risk* section should be reviewed in its entirety. Any information that is not acceptable, requires additional clarification, or is of concern should be addressed or followed up on. Some examples of items that may be of concern are:

- Litigation
- Sponsor's length of control of project (if less than 75% sold, recommend up to five years, no date may be of concern or over five years, recommend modification of offering plan).
- Responsibility for payment of transfer taxes (typically borrowers cost).
- Sponsor's unconditional right to rent rather than sell. The sponsor is to at least provide assurance of the intent to sell. 30% is the typical max limit on units held for rent.
- Lot line windows. Need to identify if any concerns with future window restrictions as may impact future value of unit as this may restrict the number of legal bedrooms, for example.
- Summary of any ground leases, if applicable.

- Summary of proprietary lease
    - Resale restrictions
    - Expiration date.
- Existence of tax exemption or tax abatement program.
- Rights and obligations of the sponsor, board, and owners.

2. *Introduction Section - Budget*

- Schedule of purchase prices and share allocations.
- Identity of parties – who's involved in the transactions.
- Procedures to purchase including Closing costs, penalties, and fees.
- Terms of underlying mortgage, if one exists.

Architect or Engineering Report

Project conversions that do not involve gut rehabilitation must be reviewed to:

- Verify that all necessary repairs are complete.
- Ensure replacement reserves are identified for all capital improvements and noted as adequate by the party evaluating the project.
- Confirm the report comments favorably on the following, if the conversion was legally created during the past three years:
    - Structural integrity of the project
    - Condition and remaining useful life of the major project components, such as the heating and cooling systems, plumbing, electrical systems, elevators, boilers, roof, etc.
- Ensure all rehabilitation work involved in the cooperative conversion was completed in a professional manner.

Note: A gut rehab refers to the renovation of a property down to the shell of the structure, including replacement of all HVAC and electrical components.

Marketing Plan

For new construction and conversion projects, information on the number of units sold should be obtained. Typical documentation or information can be obtained from a "late stage sellout verification" and statement from sponsor on the outside marketing company being used.

Developer Resume

Obtain a developer resume for new construction and conversion projects. Complete a due diligence review into the developer and their previous experience via a web search.

Collateral Loan File Documentation

Refer to Seller Guide **Section 505.13: *Additional Documentation Required for Cooperative Loans*** for specific collateral Loan file documentation required for co-ops.

Wells Fargo Funding Cooperative Project Approval Process

All cooperative projects must be submitted to and approved by Wells Fargo's Cooperative Project Approval Team (CPAT). Outlined below are instructions Sellers may use to:

1. Validate an existing project review status and/or
2. Initiate a cooperative project review with Wells Fargo

Note: The Loan must close (Note signed by the borrower and funds disbursed) on or before the Wells Fargo CPAT project approval expiration date.

Validate a Project's Status

- Select the "Validate Status of Co-op Project" option on the *Cooperative (Co-op) Project Approval and Validation Request Form* (Form 22) and complete sections 1 and 3.
- Submit the completed form to CPAT. See submission details under ***Seller Submission to the Cooperative Project Approval Team (CPAT)*** below.
- Within two business days from receipt of your inquiry, CPAT will contact you via email to let you know whether the project is currently approved or not approved with Wells Fargo Funding.
- If the project has not yet been reviewed by Wells Fargo, CPAT will (via email):
    - Indicate what documentation is needed to begin the review. To expedite the review process, the Seller will be asked to provide any applicable documentation that they may have already obtained.
    - Contact the management company to obtain additional information.

Initiating a Co-op Project Review

Before delivering a Prior Approval underwriting package:

1. Select the "Initiate Co-op Project Review" option on the *Cooperative (Co-op) Project Approval and Validation Request Form* (Form 22) and complete all sections.
2. Submit the completed form and the required documentation for project approval to CPAT. See submission details under ***Seller Submission to the Cooperative Project Approval Team (CPAT)*** below. CPAT will work directly with the co-op board contact, or managing agent, to request all the required documentation and complete the review.
3. Sellers no longer need to contact the co-op board for documents and information.

Note: Full cooperative project approval is subject to an acceptable review of appraisals on individual loans in the project. Additional information about the cooperative project obtained from an appraisal or during the Loan approval process could result in a change to the project's approval status.

Seller Submission to the Cooperative Project Approval Team (CPAT)

Fax or email the completed form as follows:

- Fax to 1-866-967-2312
- Email to CPATPremier@wellsfargo.com

Contact the CPAT team with questions as follows:

- Email at CPATPremier@wellsfargo.com
- Phone at 1-866-708-2131

Required Documentation for Project Approval

CPAT will work with Sellers to obtain the following documents required to evaluate the cooperative project:

1. *Documentation Required for all Projects*

a. Individual Cooperative Interest Appraisal Report (Fannie Mae form 2090, dated March 2005).

b. Most recent financial statements available, including footnotes if available, for the project. If the project is new construction or a conversion, the budget will be used instead of financials. (The budget will be included in the offering plan.)

c. New York Attorney General Financial Disclosure Amendment is required when the sponsor/holder of unsold shares owns more than 10% of the project shares.

d. Evidence of adequate hazard, liability, fidelity, and flood (if applicable) insurance coverage.

e. Form 23 Combined Cooperative Certification/Questionnaire.

f. Leasehold documentation for leasehold projects in New York City.

g. If the ownership document is not the standard Stock Certificate, a copy or example of the ownership documentation.

h. If the occupancy document is not the standard Proprietary Lease or occupancy agreement, a copy or example of the occupancy documentation.

2. *Additional Documentation Required for New Construction/Conversion Documentation*
a. The complete offering plan with all amendments is required (see Offering Plan and Prospectus above).

b. Conversion projects fewer than three years old require that the cooperative board has been operating for at least one year and an Engineer Survey/Property Condition Assessment be provided.

c. Sales status report with contract dates and closed dates.

d. Builder resume with history of past projects.

e. Certification Memorandum from a qualified attorney, based on a review of the project's legal documents, stating they are in compliance with Wells Fargo's requirements. Memorandum can be prepared by the same attorney who prepared the cooperative's legal documents, but he or she cannot be an employee, principal, or officer of the developer or sponsor of the project.

PROPERTIES WITH SOLAR PANEL SYSTEM

When the property has a solar panel system that is leased or subject to a Power Purchase Agreement (PPA), documentation must be submitted using the *Solar Panel Approval Request* (Exhibit 9). Wells Fargo will provide an email notification that will include the Decision Form with review status (approved/denied/suspended) and any approval conditions. This Decision Form must be included in the Credit Package.

PROPERTIES SUBJECT TO LOCALIZED PERILS

When localized perils (flood, sinkhole, mine subsidence, volcanic eruption, avalanche, etc.) are evident as identified through a review of documentation within the file, and are not covered by standard property insurance, additional coverage specific to the localized peril must be obtained if such insurance coverage is required by local laws or is common and customary.

Documentation Requirements

Evidence of insurance covering the specific localized peril must be provided (e.g., an endorsement to the hazard insurance policy or a separate policy).

RESALE DEED RESTRICTIONS

Resale deed restrictions are a right in perpetuity or for a certain number of years, stated in the form of a restriction, easement, covenant, or condition in any deed, mortgage, ground lease, agreement or other instrument executed by or on the behalf of the owner of the land.

Resale-deed restrictions may limit the use of all or part of the land to occupancy by persons or families of low-income or moderate-income or on the basis of age, or may restrict the resale price of the property to ensure its availability to future low-income and moderate-income borrowers. A restricted resale price provides a subsidy to the homeowner, in an amount equal to the difference between the sales price and the market value of the property without resale deed restrictions. Resale deed restrictions are binding on current and subsequent property owners, and remain in effect until they are formally removed or modified, or terminate in accordance with their terms (such as at a foreclosure sale or upon acceptance of a deed-in-lieu of foreclosure).

Eligible Resale Deed Restrictions

Wells Fargo Funding will purchase conventional Non-Conforming Loans subject to resale deed restrictions for **age-restricted properties only**.

ELIGIBLE OCCUPANCY/PROPERTY TYPES

- Owner-occupied, primary residence
- Second home (provided recorded by-laws do not limit to primary/principal occupancy-see documentation requirements)
- 1- or 2-unit property
- Condominium
- PUD

General Requirements

The following requirements apply for all units that are subject to the resale deed restrictions for the project or subdivision:

- Standard applicable condominium and PUD guidelines must be met. The acceptability of the resale-deed restrictions does not constitute project acceptability.
- The presale requirements for condominium projects apply separately to the non-restricted and restricted units in the project. Presale requirement must be met for both non-restricted and restricted units.
- The appraisal must include three comparable sales of units with similar resale deed restrictions. For new projects or subdivisions, at least two of the sales must be from outside the project or subdivision.
- The appraisal must note the existence of the resale-deed restrictions and comment on any impact the resale deed restrictions have on the property’s value and marketability.
- For units in a condominium or PUD project, the homeowners’ association assessment must be based on the size of the unit or on the ratio of one to the total number of units in the entire project, but may not be based on the sale price of the unit. Exterior maintenance must be the responsibility of the homeowners association, and the charges for maintenance must be included in the monthly assessment.
- Wells Fargo Home Mortgage must have first claim to any property insurance payment or condemnation award.
- Property insurance coverage in the amount of replacement cost is required.

- Only the subsidy provider (municipality, government entity) that imposed the resale-deed restrictions may be entitled to a right of first refusal when the borrower is in default or the property is in foreclosure. The maximum time period is 90 days.
- Lender's title insurance policy issued at time of closing must ensure Wells Fargo's security instrument is in a first lien position.
- The source (such as ordinance, statute, published policy or imposed restrictions) of the terms of the resale-deed restrictions must be included in the public land records so that it is readily identifiable in a routine title search.

Properties Subject to Age Restrictions

If a housing development has an age restriction, it must comply with one of the following Fair Housing Act exemptions:

- **Government Housing Programs –** Dwellings provided under any state or local federal program specifically designed and operated to assist the elderly or to house elderly persons. The Secretary of HUD must determine that the development meets this exemption.
- **Age Restrictions – 62 years of age or older –** Dwellings intended and operated for occupancy solely by persons 62 years of age or older.
- **Age Restrictions – 55 years of age or older –** Dwellings intended and operated for occupancy by persons 55 years of age or older provided that **all** of the following apply:
  - At least 80% of the occupied units are occupied by persons 55 years of age or older, and
  - The housing facility or community publishes and adheres to policies and procedures that demonstrate the intent to provide housing to persons 55 years of age or older, and
  - The housing facility or community can provide documentation for verification of occupancy, by means of:
    - Reliable surveys and affidavits
    - Examples of published written policies and procedures for determination of compliance with the Act.

Required Documents for Age-Restricted Properties

When it is determined that a housing development is subject to age restrictions, the Homeowners Association must complete and sign the *Housing Developments Subject to Age Restrictions* form (Form 38) or other compliant alternative form.

The alternative form must:

1. Be signed by the HOA.

2. State that, upon request, the development/association will provide the necessary documentation to support compliance with the Fair Housing Act.

3. Certify that the development complies with one of the following Fair Housing Act exemptions:

a. Age Restrictions – 62 years of age or older The development is intended for, and solely occupied by, persons 62 years of age or older. **or**

b. Age Restrictions – 55 years of age or older

i. At least 80% of the occupied units are occupied by persons 55 years of age or older **and**

ii. The housing facility or community can provide documentation for verification of occupancy by means of:

- Reliable surveys and affidavits and
- Examples of published written policies and procedures for determination of compliance with the Act.

Supporting documentation to verify the accuracy of the information completed by the HOA is not required unless requested by Wells Fargo.

By providing a signed Form 38, or other compliant alternative form, the HOA certifies that the housing development is in compliance with the Fair Housing Act.

The fully executed Form 38, or compliant alternative form, must be included in the Credit Package.

When occupancy type is second home, documentation must be submitted using the *Resale Deed Restriction Approval Request Form* (see Exhibit 21) to confirm occupancy eligibility. Wells Fargo will provide an email notification called the "Resale Deed Restrictions Project Approval" or "Resale Deed Restrictions Project Decline" that will include the status (approved/denied), any approval conditions, type of resale deed restriction and notification information. This approval notice must be included in the Credit Package.

Wells Fargo Funding/Wells Fargo Funding Seller Guide/SECTION 800: CONVENTIONAL UNDERWRITING/825: Non-Conforming Underwriting Guidelines/825.13: Property and Appraisal - New Construction (02/15/2016)

825.13: Property and Appraisal - New Construction (02/15/2016)

CONSTRUCTION-TO-PERMANENT FINANCING

RATE/TERM REFINANCE

If the construction-to-permanent financing is **treated as a rate/term refinance**:

- The LTV/CLTV must be within the rate/term guidelines for the product.
- The LTV/CLTV is based on the lesser of:
  - The current appraised value for the property (both the lot and the improvements) or
  - The sum of the documented costs of the construction and the current appraised value of the lot.
- Cash out is not allowed.

Rate/term refinance proceeds may be used to:

- Pay off the interim construction financing secured by the property, which may include paying off a lot lien.
- Pay Closing costs and prepaids.
- Pay off the remainder owed to the builder when the interim construction loan is insufficient to pay the amount contractually owed to the builder.
- The borrower may be reimbursed for actual cash investment into the property. Cash investment must be verified. Verification options include, but are not limited to:
  - Obtaining canceled checks showing deposit to the builder.
  - The settlement statement or Closing Disclosure from the interim loan verifying that cash was brought to close.
  - If the lot was acquired separately, a copy of the settlement statement or Closing Disclosure, canceled check, etc.

Documentation Requirements

The borrower must provide:

- A copy of the purchase contract or construction statement (cost breakdown), signed by the borrower and the builder.
- If the lot was acquired separately, verification of the purchase price of the lot.

SINGLE-CLOSE CONSTRUCTION

Single-close construction to permanent financing offers borrowers a one-time closing by allowing a modification of the interim construction Loan. Wells Fargo does not purchase single-close construction to permanent Loans.

BORROWER IN CONSTRUCTION INDUSTRY

If the borrower is acting as his/her own builder (general contractor or sub-contractor) and his/her primary occupation is in the construction industry, the following must be met:

- Acquisition Cost Documented
  - Acquisition cost must be fully documented, regardless of LTV/TLTV/CLTV.
  - To document acquisition cost, the borrower must provide copies of receipts, bills, lien waivers, lot purchase agreement, etc, in addition to an itemized cost breakdown.
  - The LTV/TLTV/CLTV will be based on the lesser of the documented acquisition cost or appraised value.
  - The subject property must be an owner occupied primary residence.
  - The borrower cannot receive cash back at closing that is not a direct verifiable reimbursement of expenses.

Wells Fargo Funding/Wells Fargo Funding Seller Guide/SECTION 800: CONVENTIONAL UNDERWRITING/825: Non-Conforming Underwriting Guidelines/825.14: Property and Appraisals - Disasters (01/06/2014)

825.14: Property and Appraisals - Disasters (01/06/2014)

The Seller should refer to Sections 820.19 and 820.20 of this Seller Guide.

Wells Fargo Funding/Wells Fargo Funding Seller Guide/SECTION 800: CONVENTIONAL UNDERWRITING/825: Non-Conforming Underwriting Guidelines/825.15: Eligible Transactions (03/28/2017)

825.15: Eligible Transactions (03/28/2017)

REFINANCE OF LOANS WITH LESS THAN ONE YEAR SEASONING

The underwriter should analyze transactions involving the payoff of a first lien that has been seasoned for less than one year.

If the first lien being paid off was a purchase transaction, and the original purchase price, as stated on the application, is less than the new appraised value the file should contain documentation supporting the increase in value (e.g. appraisal indicates increasing values for the market, appraisal comparables support increasing values, documented home improvements, or a copy of the original appraisal showing the original appraised value higher than the original sales price).

If the increase in value is unsupported, the underwriter should use the lower of the original purchase price or the new appraised value to determine LTV/TLTV/CLTV.

RATE/TERM REFINANCES

A rate/term refinance is a new first lien that replaces the borrower's existing financing on a property. The purpose of any simultaneous secondary financing does not impact the rate/term classification of the new first lien.

The new first lien amount for a rate/term refinance may not exceed the sum of:

- Payoff of the current mortgage (principal balance plus accrued interest, and any required prepayment penalty, only; other costs such as late fees and past-due amounts may not be paid with the new Loan)
  - If the first mortgage is a Home Equity Line of Credit (HELOC) a copy of the HUD-1 Settlement Statement or Closing Disclosure from the borrower's purchase of the subject property, or documentation of home improvements made to the property, must be provided evidencing the proceeds were used in their entirety to acquire or improve the subject property.
- Payoff (as defined above) of any subordinate mortgage lien used in its entirety to acquire or improve1* the subject property
- Payoff (as defined above) any other mortgage lien against the subject, provided:
  - The lien has been open at least 12 months, and
  - Total draws in the past 12 months do not exceed 2% of the new first mortgage amount.
- Standard Loan fees (e.g., closing costs on the new mortgage; prepaids, such as interest, taxes and insurance, etc. and points).
- Incidental cash to the borrower not to exceed 1% of the principal balance of the new Loan amount.

1. Home improvement costs may include the following:

- Materials
- Architectural fees
- Supplies
- Labor
- Liability insurance on laborers
- Installation costs (water, sewer, well, etc.).
- Permits
- Non-recurring costs of obtaining financing, including origination fees, discount points, title searches, recording fees.

TEXAS OWNER-OCCUPIED, HOMESTEAD PROPERTY

General Requirements

In addition to standard guidelines, the following guidelines apply to all first mortgage transactions secured by owner occupied, homestead properties in the state of Texas:

Transactions in the state of Texas are defined four ways depending on investor and state law requirements:

- **Purchase:** Acquiring or buying a property (therefore exempt from Section 50(a)(6) provisions*).

- **Rate/Term Refinance:** The transaction is considered a rate/term refinance by both the investor and the state of Texas (therefore exempt from Section 50(a)(6) provisions*).
- **Cash-out Refinance:** The transaction is considered a cash-out refinance by the investor, but a rate/term refinance by the state of Texas (therefore exempt from Section 50(a)(6) provisions*).
- **Home Equity/Cash-out Refinance:** The transaction is considered a cash-out refinance by both the investor and the state of Texas, therefore ineligible for purchase by Wells Fargo.

Note: Transactions with subordinate financing subject to Section 50(a)(6) provisions are limited to a maximum LTV/TLTV/CLTV of the lesser of 80% or the maximum allowed by product or loan amount.

Purchase Requirements

Purchase transactions that include subordinate financing subject to Section 50(a)(6) provisions are limited to a maximum LTV/TLTV/CLTV of the lesser of 80% or the maximum allowed by product or loan amount.

Refinance Requirements

To determine the type of refinance the transaction is considered, review the following:

- **Home Equity/Cash-out Refinance Transactions under Section 50(a)(6) are not eligible for purchase by Wells Fargo Funding.** Once the borrower has executed a home equity/cash-out refinance on an owner occupied, homestead property under Section 50(a)(6), Article XVI of the Texas Constitution, all subsequent transactions are considered home equity-cash-out refinances until title is transferred. In other words, once a cash-out, always a cash-out. Therefore, a rate/term refinance originated to pay off an existing home equity/cash-out mortgage is ineligible for purchase by Wells Fargo Funding.
- Wells Fargo requires the lender to provide documentation (commitment for title insurance, mortgage/deed of trust and/or HUD-1/Closing Disclosure) in each Loan package to verify that a home equity/cash-out loan under Section 50(a)(6) has not previously been originated against the subject property. If the purpose of the loan is not clearly identified on the commitment for title insurance, it will be necessary to provide previous mortgage/deed or trust or HUD-1/Closing Disclosure for each transaction originated on or after January 1, 1998, to verify the purpose of the existing loan.

TEXAS REFINANCE TRANSACTIONS		
Lien Being Paid off or Down with New Mortgage	**Non-Conforming Policy**	**To ensure Valid First lien, Must Be Closed As**
Home Improvement Lien, regardless of seasoning	Rate/Term	Rate/Term
Purchase Money Lien, regardless of seasoning	Rate/Term	Rate/Term
Section 50(a)(6) Lien,	Ineligible for financing	N/A

seasoned less than 12 months		
Section 50(a)(6) Lien, seasoned at least 12 months	Ineligible for financing	N/A
Federal Tax or Owelty Lien	Cash-out	Rate/Term

Rate/Term Refinances

In addition to standard rate/term refinance guidelines and those set forth above, the following guidelines apply to all rate/term refinances secured by owner occupied, homestead properties in the state of Texas:

- Total financed closing costs are limited to 10% of the new loan amount. 10% is deemed reasonable.
- Special title insurance coverage must be obtained when impounds for prepaid expenses* are included in the new loan amount. The following must be included as a **Schedule B Exception**:
- Possible defect in lien of the insured mortgage because of the Insured's inclusion of reserves or impounds for taxes and insurance in the original principal of the indebtedness secured by the insured mortgage.
- Prepaids are defined as funds collected for the payment of:
  - real estate taxes (includes non-delinquent taxes which are due and payable, as well as reserves)
  - hazard insurance premiums
  - monthly MI premiums covering any period after the settlement date

Incidental Cash Back

Incidental cash back to the borrower at closing is not allowed.

Options When POCs are Credited to Closing Costs

- The amount of paid outside closing (POC) costs up to $1,000 may be applied as a principal reduction at closing. However, the principal and interest payment on the loan may not be adjusted and the loan may not be reamortized. If the amount to be credited exceeds $1,000 the loan amount must be reduced and the closing documents redrawn.
- The amount of the POC may be applied as a credit towards closing costs reducing the amount of cash needed to close.
- The borrower's POC items may be applied as a credit to closing costs resulting in reimbursement to the borrower of not more than the amount paid prior to closing. Please note this is the only circumstance when the HUD-1 or Closing Disclosure may reflect any cash back to the borrower on rate/term refinance transactions of Homestead property in Texas.

Subordinate Liens

Certain restrictions apply to Rate/Term refinance transactions that include subordinate liens. These restrictions include:

- Only one loan subject to Section 50(a)(6) provisions may be secured by the subject property at any given time, regardless of lien position.

- When the subordinate lien is subject to Section 50(a)(6) provisions, the maximum LTV/TLTV/CLTV is the lesser of 80% or the maximum allowed by product or loan amount.

If the subordinate lien was **used entirely for home improvements**, the lien is eligible for pay off as a rate/term refinance.

- The subordinate lien must have been originally closed using the entire amount for home improvements as evidenced by a Mechanic's lien contract on the commitment for title insurance. Documenting the home improvements by obtaining canceled checks, invoices, receipts, lien waivers, etc., is not acceptable.

Refer to subordinate lien requirements for Cash-out Refinance transactions if the subordinate lien does not meet the above parameters.

Maximum LTV/TLTV/CLTV

Cash-out refinances must be treated as cash-out refinances for LTV/TLTV/CLTV, minimum Loan Score and pricing purposes. However, the state of Texas defines this as a rate/term refinance and therefore eligible with Wells Fargo, subject to the requirements listed in this section.

Subordinate Lien

Pay Off of Subordinate Lien(s)

- If the subordinate lien was used for home improvements, it must have been originally closed using the entire amount for home improvements as evidenced by a Mechanic's lien contract on the commitment for title insurance. Documenting home improvements by obtaining canceled checks, invoices, receipts, lien waivers, etc., is not acceptable.
- If loan proceeds are being used to pay off a federal tax lien or a co-owners' interest in the subject property (known as an Owelty lien), the lien must be recorded and appear on the commitment for title insurance.
- The commitment for title insurance may not reflect that the subordinate lien was originated as a home equity/cash-out Section 50(a)(6) loan.
- The borrower may not have received any cash back from the subordinate lien. If the borrower received any cash back from the subordinate lien, and the loan is being paid off or paid down, the lien is subject to Section 50(a)(6) provisions and, therefore, ineligible.

Property Listed for Sale

Wells Fargo will not provide financing on any refinance transaction secured by a property:

- Currently listed for sale, or
- Listed for sale within the six months prior to the Loan application.

Investment Properties

Investment properties are allowed with the following restrictions:

- Allowed on one unit properties only
  - Cooperatives not allowed
- Two years property management experience required if rental income from subject is used to qualify
- Maximum DTI of 38%

CASH-OUT REFINANCES

Allowed. Any refinance transaction not meeting the requirements for a rate/term refinance is a cash-out refinance.

Delayed Financing/Allowable Cash-out for Properties Recently Purchased with Cash

If borrowers have purchased a primary, second home, or investment property for cash within the preceding 90 days, an application may be considered to provide cash-out as a reimbursement of the borrower's cash investment providing all of the following are met:

1. HUD-1 or Closing Disclosure indicating cash purchase within 90 days prior to the application.
2. Maximum LTV/CLTV based on the purchase LTV/CLTV matrix.
3. Maximum DTI based on the purchase DTI requirements.
4. Minimum Loan Score based on the purchase Loan Score requirements.
5. The LTV/CLTV will be based off the lesser of the original purchase price or current appraised value.
6. Borrower has exhibited a historic level of assets to support the cash purchase (supported by Schedule B of the last two years' tax returns) or other supportive documentation to verify receipt of such funds. A paper trail evidencing the funds used to acquire the subject property is acceptable as long as the funds had been on deposit at least 90 days prior to the date of the original transaction.
7. Funds used for the original purchase cannot be borrowed, except by means of a fully secured Loan (for example, margin account, or other real estate). These will be treated on a case-by-case basis.
8. Not allowed in Texas.
9. The Loan must be registered and Closed as a Cash-out refinance since the borrower is already in title to the property. The Loan can be underwritten based on purchase transaction guidelines.

NEW CONSTRUCTION

Age of Documents

The Seller should refer to **Section 820.13(a):** ***Age of Documents*** of this Seller Guide.

IDENTITY OF INTEREST TRANSACTIONS

Identity of Interest Transactions includes both non-arm's length and at-interest transactions. Refer to **Section 800.01(c):** ***Identity of Interest Transactions Guiding Principles***.

Loans for second home or investment properties are not eligible for purchase by Wells Fargo Funding if the transaction includes non-arm's length and/or at-interest characteristics. On a case-by-case basis, non-arm's length or at-interest transactions may be considered when the borrower is purchasing the property as a primary residence.

For newly constructed properties, the Loan is not an eligible transaction when the borrower has a relationship or business affiliation (any ownership interest, or employment) with the builder, developer, or seller of the property.

Scenarios

Flip Transactions

A flip transaction is generally defined as a purchase transaction for a property that has recently been acquired by the seller and is being sold for a quick profit. A flip transaction is evident if the title reveals several changes in ownership in the course of a few months. Flip transactions are not eligible for purchase by Wells Fargo.

Title Changes

Title changes from LLC or partnership to an individual are not allowed.

Assignment of Sales Contract

Transactions where the purchase contract has been assigned to the borrower are generally not acceptable but may be eligible for consideration provided there was no increase in sales price and the explanation for the assignment seems reasonable. If the earnest money is being transferred it is treated as a sales concession and deducted from the sales price.

Employer/Employee Sales

This is a transaction in which a builder or developer is selling a property to one of its employees who does not hold a principal ownership interest.

Family Sales

This is a transaction where one family member is selling to another. Often there is no real estate agent involved or the agent may also be a family member. These transactions carry the potential for increased risk as they may be bailout situations (e.g. the selling party has financial problems and is unable to refinance).

Gift of Equity

Gift equity in the subject property is an acceptable source of down payment, as long as the amount of equity has been verified. The donor must provide a gift letter. Equity gifts are only allowed after the required minimum down payment has been made from the borrower's own funds.

Documentation Requirements:

- Copy of the canceled earnest money check to verify payment to the seller.
- Verification that the borrower is not now, nor has been in the previous 24 months, in title to the property.
- Payment history for the existing mortgage (verification of seller's mortgage) on the subject property must be provided and show no pattern of delinquency within the past 12 months.
- Letter of explanation from the borrower stating the relationship to the seller and the reason for purchase.

PROPERTIES PURCHASED FOR OCCUPANCY BY A DIRECT FAMILY MEMBER

When the subject property is being purchased for occupancy by a direct family member (parents, siblings, children):

If…	And the borrower's relationship is…	Then occupancy is considered…
Only the occupant borrower's income is needed to qualify	N/A (borrowers do not have to be related)	Primary residence

Only the non-occupant borrower’s income is needed to qualify	Direct family members (parent/child or siblings)	Second home
	Not direct family members	Investment property
Both the occupant and non-occupant borrowers’ incomes are needed to qualify	N/A (borrowers do not have to be related; relationship does not impact occupancy type)	Investment property

When qualifying using only the non-occupant borrower’s income (i.e., the direct relative occupant is not required to be on the Loan), the following applies:

If…	**Then…**
The primary income earner’s Loan Score is ≥740	The maximum LTV/CLTV is 5% below the second home policy.
The primary income earner’s Loan Score is ≥700 and <740	The maximum LTV/CLTV is 10% below the second home policy.

REO CONTRACTS

Real Estate Owned (REO) properties are acceptable for financing when the following requirements are met:

- The purchase contract for the property has no financing restrictions.
- LTV is based on the lesser of the appraised value, sales price, auction/foreclosure bid value or auction/foreclosure sales price.

MARKET CLASSIFICATION

The Seller must also check WFF Market Classification list (Exhibit 20) for all transactions. Restrictions are published in the LTV matrix for properties located on the Wells Fargo Funding Market Classification List.

MEDIAN HOME PRICE

The Seller must check Wells Fargo Funding’s Value Based Median Home Price Classification List (Exhibit 4) to determine the subject property’s county-level median home price. Refer to following Seller Guide Section **Section 825.11: *Property Appraisal - Number of Appraisals Required/Exhibit Requirements*** for additional median home price restrictions/requirements.

Wells Fargo *Direct Express*SM

Direct Express is Wells Fargo’s online feedback tool for Non-Conforming Loans. To assist Sellers in complying with these requirements, *Direct Express* will include messaging on the Feedback to identify when a subject property is located in a Market Classification as follows:

- "The county of the subject property is located on the Market Classification List as a market classification 4 (or, as appropriate, market classification 3 or 2) Market. An LTV/CLTV reduction may be required. Refer to Market Classification Policy for details."

Note: *Direct Express* does not automatically reduce the LTV/CLTV according to the guidelines. Therefore, the Seller is required to review the LTV/CLTV of the subject Loan for compliance prior to delivery to Wells Fargo Funding.

USE OF PREMIUM PRICING

For all transactions, the funds derived from premium pricing (Credit for Interest Rate Chosen, CFIRC), are only allowed to be used to pay the borrower's typical Closing costs and/or prepaid expenses.

Typical prepaid items paid by the borrower:

- Interest charges covering any period after the settlement date.
- Real estate taxes covering any period after the settlement date.
- Hazard insurance premiums.
- HOA dues

Typical Closing costs paid by the borrower:

- origination fee
- discount points
- appraisal fees
- title searches and surveys
- title insurance
- taxes
- deed-recording fees
- credit report charges

CFIRC may not be used to pay any portion of the borrower’s down payment, personal debts (ex: revolving debt), collection accounts, judgments, escrow shortages or any other item that is not considered a typical prepaid item or typical Closing cost paid by the borrower as listed above. Other property improvement expenses not related to the transaction or not required by the purchase contract are not allowed.

For transactions where CFIRC exists, cash back to the borrower as a result of the premium pricing is restricted to the lesser of 1% of the Loan amount or $2500.

TITLE CHANGES LESS THAN 12 MONTHS

These are transactions where the borrowers have been transferred into title, perhaps by a quit claim deed, and may include a transfer from one individual to another or from an LLC or another business entity to an individual. The borrowers are attempting to refinance the existing mortgage from the previous owner’s name to their name. This situation presents red flags for credit and transaction risk similar to the risks of a flip transaction.

The following title changes are eligible with appropriate documentation to evidence the relationship and to show that there is not an unrelated party entering the chain of title:

Eligible Title Changes	Required Documentation
Marriage/domestic partnership/civil union	Marriage, domestic partnership, or civil union certificate

Court-ordered, including but not limited to, divorce, death, or inheritance	Divorce decree, court order, or estate documents
Transfer out of an LLC where the borrowers match the members of the LLC	LLC certification or Articles of Organization showing no members other than the borrowers on the subject transaction
Transfer in or out of a trust where the borrowers match the settlor/trustor/grantor of the trust	Trust agreement or Trust Certification

In addition to the documentation requirements above, the following must be met:

- Borrower(s) qualify under standard underwriting requirements.
- Transaction is considered a rate/term or cash-out refinance (refer to eligible transaction requirements specified previously in this section).
- The reason for the title transfer is explained.
- Status of the new title holders is identified and listed in Schedule B-1 of the preliminary title policy.

Transactions that do not meet the requirements above are eligible when the following are met:

- The borrower has been on title for more than six months, and
- The reason for the title transfer is explained, and
- Requirements listed in **Section 820.26: *Identity of Interest Transactions***, with the exception that the transaction must be considered a rate/term or cash-out refinance (refer to eligible transaction requirements specified previously in this section).

825.16: Prepaids (03/16/2015)

PREPAIDS

Prepaids may be financed in a refinance transaction except on Texas Rate/Term Refis.

825.17: Contributions (03/28/2017)

CONTRIBUTION LIMITS

The maximum allowable contributions from interested parties are based on the lesser of the purchase price or appraised value.

Property Type	CLTV	Contribution[1]
Primary Residence	>80% ≤80%	3% 6%

Second Home	≤80%	6%
Investment Property	Any	2%
1. HOA fees/dues prepaid by any party other than the borrower are not allowed.		

Refer to **Section 950: *Non-Conforming Conventional LTV Matrix*** for LTV/CLTV limits.

Wells Fargo Funding/Wells Fargo Funding Seller Guide/SECTION 800: CONVENTIONAL UNDERWRITING/825: Non-Conforming Underwriting Guidelines/825.18: Tax and Insurance Escrows (01/01/2016)

825.18: Tax and Insurance Escrows (01/01/2016)

Sellers are responsible for adhering to applicable state laws for LTV requirements.

For all Loans where the property is located in a Special Flood Hazard Area (SFHA), an escrow/impound account must be established for the payment of flood insurance premiums, regardless of LTV.

Refer to **Section 515.04: Escrow/Impound Accounts** for escrow/impound accounts requirements for a property located in Special Flood Hazard Area.

Wells Fargo Funding/Wells Fargo Funding Seller Guide/SECTION 800: CONVENTIONAL UNDERWRITING/825: Non-Conforming Underwriting Guidelines/825.20: Relocation (07/11/2017)

825.20: Relocation (07/11/2017)

TRANSACTION TYPE AND OCCUPANCY

- Purchase transactions
- Primary residence

DOCUMENTATION REQUIREMENTS

Written documentation of the borrower's employee relocation program must be obtained.

EMPLOYER FINANCING

Financing provided by the employer, whether secured by the property or unsecured, must be treated as secondary financing and meet subordinate financing requirements in **Section 825.09: *Credit - Long Term Debt*** and **Section 950: *Non-Conforming Conventional LTV Matrix***.

Wells Fargo Funding/Wells Fargo Funding Seller Guide/SECTION 800: CONVENTIONAL UNDERWRITING/825: Non-Conforming Underwriting Guidelines/825.23: Departure Residence Policy (11/16/2015)

825.23: Departure Residence Policy (11/16/2015)

Current principal residence is pending sale but will not be sold (closed) prior to the new transaction:

Both the current and the proposed mortgage principal, interest, taxes and insurance (PITI) payments must be used to qualify the borrower for the new transaction, unless the following requirements can be met:

- A copy of the fully executed non-contingent sales contract for the departure residence (cash sale of the departure residence is not allowed), and

- A lender’s commitment from a regulated institution to the buyer of the departure residence with all financing contingencies cleared, and
- Standard reserve requirements plus an additional six months PITI for departure residence.
- Borrower is required to have a 20% equity position in the departure residence based on contracted sales price. Further documentation may be required if there is a significant difference between the sales price and estimated property value.

When the departure residence will not be sold at the time of closing and is in a negative equity position, the following **may** be required to reduce the overall risk:

- Additional reserves to cover the negative equity of the departure residence, **OR**
- Pay down the lien on the departing residence to eliminate the negative equity.

Existing Principal Residence Converting to Second Home

- Both the current and the proposed mortgage PITI payments must be used to qualify the borrower for the new transaction, **and,**
- Reserve requirements are the greater of six months PITI for both properties or the standard post-closing/reserve requirements.

Existing Principal Residence Converting to Investment Property

If there is documented equity of at least 30% in the departure property, 75% of rental income may be used to offset the mortgage PITI payment in qualifying when:

- Reserve requirements are the greater of six months PITI for both properties or the standard post-close liquidity, **and**
- Rental income is documented with a fully executed lease agreement when the borrower’s tax returns reflect a two-year history of managing investment properties, as evidenced by the most current two years filed and signed Federal IRS 1040 tax returns, **and**
- Proof is provided that a security deposit was received from the tenant and deposited into the borrower’s account.

If rental income will not be used to offset the mortgage payment to qualify, the following reserve requirements must be met:

- The greater of six months PITI for both properties or the standard post-closing/reserve requirements.

If 30% equity in the departure property cannot be documented, or the borrower does not have a two-year history of managing investment properties as evidenced by the most current two years filed and signed Federal IRS 1040 tax returns, rental income may not be used to offset the mortgage PITI payment in qualifying **and**:

- Both the current and the proposed mortgage PITI payments must be used to qualify the borrower for the new transaction; **and**
- Reserve requirements are the greater of six months PITI for both properties or the standard post-closing/reserve requirements.

Departure Residence Converting to Investment Property Equity Position

To document equity position in the departure property converting to an investment property, a full appraisal must be obtained from an AMC approved to provide valuation products for Non-Conforming Program Loans. Refer to **Section 800.10: *Appraisal/Valuation Policy*** for authorized AMCs and ordering requirements.

The appraisal must be dated within 120 days of the date printed on the Note of the current transaction.

825.24: Private Transfer Fee Covenants (10/18/2016)

PRIVATE TRANSFER FEE COVENANTS

Properties encumbered by a private transfer fee covenant are not eligible for financing unless the fee directly benefits the property owners and is paid to:

- A mandatory homeowners association, including master and sub-associations, or
- A non-profit organization as defined in the Internal Revenue Code

Direct benefit may include acquisition, improvement, administration, and maintenance of property owned by the HOA; or cultural, educational, charitable, recreational, environmental, conservation or other similar activities that directly benefit the home owners.

A private transfer fee covenant is a covenant attached to real property that requires a fee to be paid to a third party (frequently the property developer) upon each re-sale of the property. The fee may be expressed as a fixed amount or as a percentage, and may also be called a reconveyance fee or a capital recovery fee.

This policy does not apply to mortgages on properties encumbered by private transfer fee covenants, if those covenants were created before February 8, 2011. This policy applies to mortgages on properties encumbered by private transfer fee covenants that were created on or after February 8, 2011.