Avoiding Common Underwriting Errors

Suggested Best Practices
February 2019
Agenda

Introduction

General Underwriting Tips
  – Resources
  – Examining and Documenting Files

Specific Errors and Recommendations
  – Capacity, Credit History, Capital, Compliance

Questions and Answers
Resources
Job Aides, Tools, Websites
For Information:

https://www.fanniemae.com/singlefamily
# Fannie Mae Job Aids/FAQs

## Originating & Underwriting Training

The Originating & Underwriting Training page provides Fannie Mae training on originating & underwriting loans, our underwriting applications, and best practices. Training solutions include live webinars, virtual classrooms, on-demand eLearning courses, job aids, and FAQs.

## Find the Training Resources You Need

### General Underwriting

Training focusing on underwriting the borrower and the property.

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[https://www.fanniemae.com/singlefamily/originating-underwriting-training](https://www.fanniemae.com/singlefamily/originating-underwriting-training)
Fannie Mae Borrower Income Verification FAQs

Answers Common Lender Income Questions

– https://www.fanniemae.com/content/faq/borrower-income-verification-faqs.pdf

Avoiding Common Underwriting Errors
# Fannie Mae Top Trending Questions

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>If a home is purchased at an auction and the purchase price includes the buyer’s premium and/or technology fee, will that be acceptable?</td>
<td>Yes. We will permit the combining of the buyer’s premium and the winning bid to calculate the final sales price. However, the amount of the buyer’s premium should be common and customary (that is, an amount that is consistent with a typical auction and tech fee transaction). As with all purchase transactions, the lesser of the sales price or appraised value must be used when establishing the LTV, CLTV, and HCLTV ratios. (Ref: Selling Guide B2-1.2-01, Purchase Transactions)</td>
</tr>
<tr>
<td>For employment offers and contracts, if the lender is unable to obtain a paystub to meet the Selling Guide requirements, do we have options?</td>
<td>In lieu of a paystub, the lender can obtain a fully completed Verification of Employment (VOE) with year-to-date earnings to verify the income used to qualify. (Ref: Selling Guide B3-3.1-09, Other Sources of Income)</td>
</tr>
<tr>
<td>Can the borrower’s parent, who is also the selling realtor, give a gift of cash or commission to the borrower for down payment?</td>
<td>No, the donor may not be, or have any affiliation with, the builder, the developer, the real estate agent, or any other interested party to the transaction. (Ref: Selling Guide B3-4.3-04, Personal Gifts)</td>
</tr>
<tr>
<td>Can we use the credit report to support a mortgage that was included in a bankruptcy if the credit report states “included in a BK?”</td>
<td>“Included in a BK” does not necessarily mean the debt was discharged in the bankruptcy. In order to disregard a mortgage debt that was included in a BK, the lender must obtain documentation that the debt was discharged. (Ref: Selling Guide B3-5.3-07, Significant Derogatory Credit Events - Waiting Periods and Re-establishing Credit)</td>
</tr>
<tr>
<td>When a borrower converts their primary into an investment, do we still have to follow the old guidelines, in reference to 30% equity and 6 months reserves?</td>
<td>The equity and reserve requirements that applied specifically when a borrower converted their current principal residence into an investment property have been eliminated. The lender should follow standard reserve requirements and rental income policy. (Ref: Selling Guide B3-6-06, Qualifying Impact of Other Real Estate Owned)</td>
</tr>
</tbody>
</table>

https://www.fanniemae.com/singlefamily/trending-questions?taskId=task-47
### Fannie Mae Underwriting FAQs

**Answers Common Lender Income Questions**

- [https://www.fanniemae.com/content/faq/underwriting-faqs.pdf](https://www.fanniemae.com/content/faq/underwriting-faqs.pdf)

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#### Underwriting FAQs

This document highlights frequently asked questions about policies that are covered in the Selling Guide, and provides direct links to the relevant Selling Guide topic and other resources. The document is updated periodically to align with policy changes.

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Can the amount of distributions reported on IRS Schedule K-1 be used as income to qualify the borrower?</td>
<td>No, distributions are not an additional or secondary source of income for qualifying purposes. A documented history of distributions demonstrates that business income has been received by the borrower. When the borrower cannot document a history of distributions consistent with the amount of business income used to qualify, the lender can alternatively confirm the business has adequate liquidity to support the withdrawal of earnings.</td>
</tr>
<tr>
<td>2. How is the minimum replacement reserve allocation for HOA budgets calculated?</td>
<td>To determine whether the association has a minimum annual budgeted replacement reserve allocation of 10%, divide the annual budgeted replacement reserve allocation by the association’s annual budgeted assessment income. Certain types of income may be excluded from the reserve calculation. Additional information can be found in RA 3.2.02: Full Review Process.</td>
</tr>
</tbody>
</table>
| 3. Are lenders permitted to use a reserve study in lieu of calculating the replacement reserve? | Yes. The lender may use a reserve study in lieu of calculating a replacement reserve of 10% provided the following conditions are met:  
  - The lender obtains a copy of an acceptable reserve study and retains the study and the lender’s analysis of the study in the project approval file;  
  - The study demonstrates that the project has adequate funded reserves that provide financial protection for the project equivalent to Fannie Mae’s standard reserve requirements; and  
  - The study demonstrates that the project’s funded reserves meet or exceed the recommendation made in the study. Additional requirements for reserve studies can be found in RA 3.2.02: Full Review Process. |
| 4. Do employee business expenses reported on IRS Form 1065 always need to be deducted from the borrower’s income? | No. If the borrower is qualified using base, bonus, and overtime pay, and commission income is less than 25% of the borrower’s annual employment income, unreimbursed employee business expenses are not required to be analyzed or deducted from qualifying income or added to the monthly liabilities. See AD 3.1.04: Commission Income and AD 3.1.03: Deductions Reported on IRS Form 1065. |
| 5. When a borrower has a bankruptcy and a foreclosure, what event is used to determine the waiting period? | If a mortgage was discharged through a bankruptcy (and documented by the lender), the bankruptcy waiting periods may be applied. Otherwise, the greater of the bankruptcy or foreclosure waiting periods must be applied. See AD 3.5.07: Significant Derogatory Credit Events – Waiting Periods and Reestablishing Credit. |
| 6. Can gift funds come from trust or estate accounts? | No. Gifts must come from individuals related to the borrower. Trusts and estates do not meet the gift donor requirements. See AD 3.5.04: Derogation Gifts. |
| 7. Does Fannie Mae require borrower signatures in conjunction with the Closings Disclosure? | No. As stated in the Selling Guide A2 6.1.02: Individual Mortgage Loan Files, Fannie Mae is not currently requiring that the borrower and seller (if applicable) sign the Closings Disclosure. Although these signatures are not required, the lender should consider documenting their review of the Closings Disclosure. |

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For Information:
https://www.freddiemac.com
Documentation Matrix

– Updated February 2019
– Assists with processing and documenting loan files
– Be mindful of Investor Overlays

Avoiding Common Underwriting Errors
Genworth Underwriting Guidelines

new.mi.genworth.com
Avoiding Common Underwriting Errors
Delegated Underwriting
MI Decision Tips

4th Quarter 2018

Genworth’s Risk Quality Assurance team creates this report to help underwriters to submit quality origination applications. Each quarter, you can use this report to discover the most frequently made MI decision errors and learn how to avoid them. You’ll find excerpts from the associated underwriting guidelines along with corrective actions for each — including relevant examples when appropriate. Loans requiring an exception to Genworth published guidelines must be sent in for a Genworth underwrite.

<table>
<thead>
<tr>
<th>Assets -- Analyzing the Borrower’s Assets</th>
<th>Decision Error</th>
<th>Underwriting Guideline</th>
<th>Corrective Action</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Assets Not Documented as Required by Program or AUS Guidelines</td>
<td>Genworth Section 4.1 Simply Underwrite Eligibility</td>
<td>Underwriter must ensure Genworth, AUS and investor documentation requirements have been met for verification and documentation of assets. AUS assumes any assets required will be verified and documented in file.</td>
</tr>
<tr>
<td></td>
<td>Source of Funds not Adequately or Properly Documented for Large Deposits</td>
<td>Genworth Standard Guidelines Section 7.10 Assets and Liabilities</td>
<td>Example 1: Insufficient verified liquid funds for closing. Cash to close per Closing Disclosure was $30,856 and verified liquid funds in file are $25,404; funds are short by $5,452.</td>
</tr>
<tr>
<td></td>
<td>Insufficient Assets to Close and/or Pay Off Required Obligations</td>
<td>Follow Freddie Mac’s guidelines when Freddie Mac is the investor or the Freddie Mac Seller Guide is your standard guideline set.</td>
<td>Example 2: Missing documentation to evidence source of a large deposit in the amount of $6,500,000.</td>
</tr>
<tr>
<td></td>
<td>Gift not Disclosed in AUS or Missing Gift Documentation</td>
<td>Follow the least restrictive of the agencies guidelines for all other situations, unless a specific GSE’s guideline is noted to follow for all others.</td>
<td>Example 3: Gift not disclosed in AUS.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Example 4: Missing all pages to bank statements or missing second month statement if required.</td>
</tr>
</tbody>
</table>

continues on next page
**Assets – Analyzing the Borrower’s Assets**

**Decision Error**
- Excessive Seller Contributions

**Underwriting Guideline**
- Section 5.30 Builder/Seller Contributions
  Follow GSE standard guidelines for treatment of builder/seller contributions, subject to these maximum contributions amounts:

<table>
<thead>
<tr>
<th>Occupancy</th>
<th>LTV</th>
<th>Max Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Residence</td>
<td>90%</td>
<td>6%</td>
</tr>
<tr>
<td>Second Homes</td>
<td>90%</td>
<td>6%</td>
</tr>
<tr>
<td>Investment Property</td>
<td>85%</td>
<td>2%</td>
</tr>
</tbody>
</table>

Loans with payment abatements are ineligible. Payment abatements are funds provided by an interested party used to offset or fully fund a borrower’s monthly payments.

**Note:** The payment of HOA fees is not considered an abatement unless the payment of the fee extends for more than 12 months. The payment of HOA fees for 12 months or less is considered an interested party contribution.

For HomePath® properties, we allow up to 6% Interested Party Contribution (IPC) for primary residence transactions with LTV/CLTV > 90%. All other requirements related to interested party contributions continue to apply. As DU will not be able to identify the subject property as a HomePath property, it is the lender’s responsibility to verify and ensure that the property is a HomePath property and document the Loan File accordingly.

**Corrective Action**
- Underwriter must ensure that AUS, Genworth and Investor guidelines have been met.

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**Income – Analyzing the Borrower’s Income**

**Decision Error**
- Verbal VOE Missing, Incomplete or Incorrect

**Underwriting Guideline**
- Genworth Section 4.1 Simply Underwrite Eligibility
  Follow Verbal VOE requirements by DU and LP.
- Genworth Standard Guidelines Documentation Section 7.2
  Verbal VOE is required to be dated within 30 calendar days prior to the note date for both salaried and self-employed borrowers.

**Corrective Action**
- Underwriter must ensure that AUS, Genworth and Investor documentation requirements have been met.
Genworth Rate Express®
LOS Connections
Training Tools and Information
Training Tools and Information

Genworth offers a comprehensive suite of training opportunities to boost your know-how, benefit your bottom line and ultimately best serve your borrowers. With more than 90 courses in our catalog, our team is here to help you stay up-to-date on the mortgage industry and regulatory environment. Classes are all offered at no cost to you.

Due to various internet browser versions, please download and save PDF before entering data. Please note, calculators are updated periodically.

Avoiding Common Underwriting Errors
Common Underwriting Errors
Capacity, Credit History, Capital, Compliance
Underwriting Reminders

Every loan is unique

Always follow prudent underwriting standards

Information must be consistent

All applicable guidelines should be followed

Guidelines show minimum requirements
Five Cs
Capacity
Credit History
Collateral
Capital
Compliance

Six Cs
Capacity
Credit History
Collateral
Capital
Compliance
Common Sense
Capacity Errors

Income Calculation and Documentation, Self-Employed Borrowers
Capacity

Steady, Stable, Likely to Continue
– Two Year History
– Guideline exceptions for some income types
– Examples: Alimony, Survivor Benefits, Retirement
  • Three Year Continuance from application date

Documentation
– Check guidelines for minimum documentation requirement
– Seek additional documentation if:
  • Inconsistent
  • Discrepancies
  • Possible misrepresentation
## Capacity: Fannie Mae

### Fannie Mae Single Family Selling Guide §B3-3.1-01, Employment and Other Sources of Income

<table>
<thead>
<tr>
<th>Expiration Date Not Defined</th>
<th>Defined Expiration Date*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lender does not need to document 3–year continuance</td>
<td>Lender must document 3–year continuance</td>
</tr>
<tr>
<td>• automobile allowance</td>
<td>• alimony or child support</td>
</tr>
<tr>
<td>• base salary</td>
<td>• distributions from a retirement account – for example, 401(k), IRA, SEP, Keogh</td>
</tr>
<tr>
<td>• bonus, overtime, commission, or tip income</td>
<td>• mortgage differential payments</td>
</tr>
<tr>
<td>• capital gains income</td>
<td>• notes receivable</td>
</tr>
<tr>
<td>• corporate retirement or pension</td>
<td>• public assistance</td>
</tr>
</tbody>
</table>

- mortgage credit certificates
- part-time job, second job, or seasonal income
- rental income
- self-employment income
- Social Security, VA, or other government retirement or annuity

- VA benefits (not including retirement or long-term disability)
Capacity: Fannie Mae

https://www.fanniemae.com/content/guide/selling/b/index.html
## Capacity: Freddie Mac

**Topic 5300: Stable Monthly Income and Asset Qualification Sources**
- Chapter 5301: General Requirements for All Stable Monthly Income and Asset Qualification Sources
- Chapter 5302: General Documentation Requirements
- Chapter 5303: Employed Income
- Chapter 5304: Self-Employed Income
- Chapter 5305: Other Income
- Chapter 5306: Rental Income
- Chapter 5307: Asset Qualification Sources

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**Avoiding Common Underwriting Errors**

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**Genworth**
Capacity: Freddie Mac

Income continuance charts were added to Topic 5301.1
– Income and earnings types typically without documentable continuance
– Income types with documentable continuance
– Other income types that may or may not have documentable continuance

Freddie Mac’s Single-Family Seller/Servicer Guide Series 5000: Origination and Underwriting
Topic 5300: Stable Monthly Income and Asset Qualification Sources
Chapter 5301: General Requirements for All Stable Monthly Income and Asset Qualification Sources
Capacity: Freddie Mac

Employed Income Types

Primary
- Borrower’s primary source of employed income

Secondary
- Second job, part-time job or multiple jobs

Additional
- Commissions
- Bonus
- Overtime
- Tips
- Auto allowance
- Mortgage differential
- Military entitlements
- Military Reserves & National Guard
- Unemployment with seasonal employment

Freddie Mac’s Single-Family Seller/Servicer Guide Topic 5300
Capacity

Examine Paystubs Carefully

– Clear explanations for withholding items
  • Possible undisclosed debt
– Consistent information
  • Address
  • Social Security number
    – Last four digits
– Year to date income
  • Showing on paystub
  • Consistent with income
– Stale dated?
– Year End paystub for borrowers with OT, bonus, commission incomes or
– Verification of Employment
  • Additional support
  • Clarify information
    – OT
    – Bonus
    – Commission
**Capacity: Fannie Mae**

### Commission Income

#### Verification of Commission Income

The following table provides verification requirements for commission income.

<table>
<thead>
<tr>
<th>Verification of Commission Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>A minimum history of 2 years of commission income is recommended; however, commission income that has been received for 12 to 24 months may be considered as acceptable income, as long as there are positive factors to reasonably offset the shorter income history.</td>
</tr>
</tbody>
</table>

One of the following must be obtained to document commission income:
- a completed Request for Verification of Employment (Form 1005 or Form 1005(S)), or
- the borrower’s recent paystub and IRS W-2 forms covering the most recent two-year period.

A verbal VOE is required from each employer. See B3-3.1-07, Verbal Verification of Employment, for specific requirements.

See B3-3.1-01, General Income Information, for additional information about calculating variable income.

See B3-3.1-02, Standards for Employment Documentation, for additional information about verifying employment income.
Freddie Mac 2106 Policy

Effective February 2019

- All commission income will be treated the same
- Individual returns or tax transcripts will not be required for any commission income
- Loan Product Advisor will be updated at a future date so Sellers can disregard the message for tax returns until then when using commission income
Capacity

Show Your Income Calculation Work

– Agencies/Investors require calculations
– Self-Employed Borrowers

• Written analysis
• Available worksheets
  – Fannie Mae Cash Flow Analysis (Form 1084)
  – Freddie Mac Income Analysis (Form 91)
  – Schedule Analysis Method
  – Specific Lender/Investor Forms

• Genworth calculators can be found at https://new.mi.genworth.com/training
Capacity

Income Trend/Declining Income
– Can the income be used to qualify?
– If so, use only the lower of the two years

Fannie Mae Comparative Income Form (Form 1088)
– For Self-Employed Borrowers
– Reference Guide on the Genworth website

Genworth calculators can be found at https://new.mi.genworth.com/training
Capacity: Self-Employed Income

Fannie Mae Income Calculations

– Bulletin 2016-05
  • Clarification in determining adequate business liquidity when required
  • Eliminated the requirement to document the borrower’s access to income
  • Extended the VVOE on Self-Employed from 30 days prior to the note to 120 days

– Form 1084 Income Calculations Form
  • Genworth posted Form 1084 at https://new.mi.Genworth.com
Capacity: Self-Employed Income

Freddie Mac Income Calculations

– Bulletin 2016-19
  • Revised and clarified self-employed income requirements for Freddie Mac
  • Distributions are not required for partnerships and S corporations but business must be capable of paying out profit and generating future earnings

– Form 91 Income Calculations Form
  • Genworth posted Form 91 at https://new.mi.Genworth.com

– Documentation requirements
  • Two years tax returns for businesses in existence less than five years
  • One year tax return for businesses in existence more than five years
  • Verification of existence of the business required and must be completed prior to delivery date but not more than 120 days prior to the Note date.

– Bulletin 2018-15
  • Updated policy for self-employment when disclosed and not used for qualifying. Income or loss not required to be evaluated or documented for each borrower when:
    – Has a primary source of income, other than self-employment, used for qualifying the Mortgage and
    – Is self-employed, and the self-employment income is a secondary source of income
Capacity: Self-Employed Income

Freddie Mac Income Documentation

<table>
<thead>
<tr>
<th>Topic</th>
<th>Documentation Requirements (Streamlined and Standard Documentation Levels)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Self-employed Income (continued)</strong></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Business in existence ≥ 5 years</strong></td>
</tr>
<tr>
<td>Sole proprietorship</td>
<td>Obtain complete signed federal individual (Form 1040) income tax return for the most recent year.</td>
</tr>
<tr>
<td>Partnership</td>
<td>Verify the number of years that the business has been in existence and obtain complete signed federal individual and Partnership (Form 1065) income tax returns, including the Schedule K-1(s) for the most recent year.</td>
</tr>
<tr>
<td>S Corporation</td>
<td>Verify the number of years that the business has been in existence and obtain complete signed federal individual and S corporation (Form 1120S) income tax returns, including Schedule K-1(s) for the most recent two years.</td>
</tr>
<tr>
<td>Corporation</td>
<td></td>
</tr>
</tbody>
</table>

**SELF-EMPLOYMENT INCOME**

We are updating our requirements to state that when self-employment is disclosed in the Mortgage file but is not used to qualify for the Mortgage, the Seller is not required to obtain any additional documentation or evaluate the income or loss from the self-employment for each Borrower who:

- Has a primary source of income, other than self-employment, used for qualifying the Mortgage (e.g., salaried income from primary employment), and
- Is self-employed, and the self-employment income is a secondary source of income

Guide impact: Section 5304.1

Refer to Chapter 5304 for complete requirements and guidance.

Freddie Mac Bulletin 2018-15

Avoiding Common Underwriting Errors
Capacity

Rental Income Guidelines And Rental Income Forms

• Fannie Mae Forms 1037, 1038 and 1039
  – Genworth has calculators on website
• Genworth Rental Income Calculator is an option
• Freddie Mac Update - Rental Form 92
  – Genworth has posted Form 92 calculator on our website

– Overview
  • Leases may be used if property recently acquired or acquired subsequent to the filing of tax returns but additional guidelines may apply
  • Fannie Mae: Clarification on calculating when a Partnership or S-Corp owns the property
    – Form 1039 can be used to determine if PITIA can be excluded from the borrower’s debt ratio
    – The 1039 does not allow use of net positive cash flow as qualifying income

Include Taxes, Insurance, HOA Dues In The Monthly Payment, Even If The Investment Property Is Owned Free And Clear.
Capacity: Freddie Mac Long Term Rental Income

One-year management history or ownership of a primary home income (Section 5306.19c)(ii) March 1, 2019

– The borrower must own a Primary Residence to use rental income to qualify when purchasing a new rental property; and
– Whether purchasing a new rental property or converting a Primary Residence to a rental property, if the Borrower does not have minimum of one-year investment property management experience
  • The rental income can only offset the PITI of the rental property; and
  • Rental income exceeding the PITI cannot be added to the Borrower’s gross monthly income to qualify

– Genworth offers a Rental Income webinar which includes recent Freddie Mac Bulletin 2017-12 changes which are effective March 1, 2019
Credit History Errors
Credit Scores, Credit Reports, Liabilities
Credit History

Credit Concerns Not Always Recognized by AUS or Common Errors

– Examples of Errors
  • No evidence in file why you are *omitting a debt
  • Taxes and insurance for properties owned free and clear omitted
  • Debts evidenced on paystub or disclosed during initial application
  • Paid mortgage tradeline with paid P&L noted in the comments section with no explanation or documentation

– Significant derogatory events
  • Financial mismanagement
  • Extenuating circumstances?
    – Does my investor allow?
  • Re-established credit requirements met?
  • Waiting period met?

*See Fannie Mae DU Version 10.2 June Updates-Bankruptcy and Mortgage Delinquency Assessment updates. Effective date June 23, 2018

*See Fannie Mae Selling Guide or Freddie Mac Seller/Servicer Guide for guidance on excluding debts from a borrower’s DTI Ratio.
Credit History

Credit Scores

– Minimum score requirement?
  
  • Non-traditional credit borrowers (without a credit score) eligible for AUS submission with Fannie Mae’s Desktop Underwriter® 10.0
    – Two non-traditional credit references must be reviewed and one must be housing related
    – See Selling Guide §B3-5.4-03: Verification and Documentation of Alternative Credit
  
  • Non-traditional credit borrowers (without a credit score) eligible for AUS submission with Freddie Mac’s Loan Product Advisor May 14, 2017
    – Two Non-traditional tradelines must be verified and one must be housing related
    – See Freddie Mac Bulletin 2017-02 for more details

– Within definition
  
  • Genworth Simply UnderwriteSM
    – 620 minimum credit score
    – No additional requirements with valid AUS Approve/Accept Eligible recommendation
  
  • Genworth Standard Guidelines (Non-AUS)
    – Minimum of three (3) tradelines / credit references
      • Open or closed
      • That have been evaluated at least 12 months

– Lender, Investor, GSE requirement met?
Credit History

Credit History
– Trended Credit Data
  • Additional information can be found in Fannie Mae’s DU Version 10.0 Frequently Asked Questions
  • Credit reports used with Version 10.0 must include trended credit data
  • For now, lenders do not need to analyze trended data
  • Borrowers making minimum monthly revolving account payments may still be able to receive an Approve recommendation from DU

<table>
<thead>
<tr>
<th>Research has shown that borrowers who</th>
<th>are</th>
<th>than borrowers who</th>
</tr>
</thead>
<tbody>
<tr>
<td>Never exceed their limit</td>
<td>75% less likely to become delinquent</td>
<td>Exceeded their credit card limit in the last 12 months</td>
</tr>
<tr>
<td>Pay off their credit card every month</td>
<td>60% less likely to become delinquent</td>
<td>Only make their minimum payment each month</td>
</tr>
</tbody>
</table>
Credit History

Disputed Information
– AUS Loans
  • DU provides messaging if impactful and further action necessary
  • Loan Product Advisor will provide “Invalid” recommendation if impactful
  • Manually underwritten typically significant items must be resolved prior to approval

Inaccurate Information
• Determine impact (Was AUS credit score impacted?)
• Obtain
  – Written explanation from Borrower
  – Credit report supplement
  – New credit report
  – Creditor documentation
– Manually underwritten loans
  • Reporting company confirms inaccuracy
    – Credit report unreliable
    – Traditional credit evaluation without regard to inaccurate information
  • Investors often require the “inaccuracy” be cleared and resolved before loan approval
Credit History

Minimum Payments
– Usually on credit report. If not on credit report
  • Creditor supplied documentation
  • Revolving,
    – DU uses the greater of:
      • 5% of outstanding balance or
      • $10
    – Loan Product Advisor allows
      • 5% of outstanding balance

Open Ended Accounts (O-J or O-I under MOP on Credit Report)
– Sufficient funds for repayment plus funds to close and reserves
  • Yes
    – Inclusion not required
  • No
    – Inclusion of 5% outstanding balance required for Freddie Mac if no payment listed
    – Cannot close loan for Fannie Mae
– Third party responsibility
  • Example: employer reimbursement
  • Document with letter from employer/responsible party
Credit History

Student Loans
– Fannie Mae

Student Loans
If a monthly student loan payment is provided on the credit report, the lender may use that amount for qualifying purposes. If the credit report does not reflect the correct monthly payment, the lender may use the monthly payment that is on the student loan documentation (the most recent student loan statement) to qualify the borrower.

If the credit report does not provide a monthly payment for the student loan, or if the credit report shows $0 as the monthly payment, the lender must determine the qualifying monthly payment using one of the options below.

• If the borrower is on an income-driven payment plan, the lender may obtain student loan documentation to verify the actual monthly payment is $0. The lender may then qualify the borrower with a $0 payment.

• For deferred loans or loans in forbearance, the lender may calculate
  - a payment equal to 1% of the outstanding student loan balance (even if this amount is lower than the actual fully amortizing payment), or
  - a fully amortizing payment using the documented loan repayment terms.

Guidelines Stated Are Generic Fannie Mae Policy
Credit History

Student Loans
– Freddie Mac

<table>
<thead>
<tr>
<th>Student Loans (Guide Section 5401.2)</th>
<th>Debt Type</th>
<th>Eligibility and Documentation Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>In repayment, forbearance or deferment</td>
<td>If the monthly payment amount is greater than zero, use the monthly payment amount reported on the credit report or other file documentation, or</td>
<td></td>
</tr>
<tr>
<td></td>
<td>If the monthly payment amount reported on the credit report is zero, use 0.5% of the outstanding balance, as reported on the credit report.</td>
<td></td>
</tr>
</tbody>
</table>

Prudent Underwriting Practices Will Apply
Credit History

Excluding Debts – Contingent Liabilities or Not

– Fannie Mae
  • Allows for any type debt (revolving, leases, student loans & mortgage debt)
    – Must document 12 month payment history with no delinquencies
    – Evidence payments made by someone other than borrower(s)
    – Mortgaged properties must be counted in the maximum financed properties. See additional guidelines regarding use of rental income.
    – For mortgages payments to be excluded, the person making the payments must be obligated on the mortgage debt

– Freddie Mac same as above. See Freddie Mac Bulletin 2017-23

– Situations requiring inclusion in debt ratio
  • Obligator’s payment not documented
  • Sufficient history (12 months) not established
  • History of Delinquency
  • Business debt not paid from separate business account
    – Cannot be borrower’s personal account
    – Cannot be business account from which personal debts are paid
Credit History

Recent Credit Inquiries

– Definition
  • Freddie Mac: within past 90 days
    – Review updated messages on Loan Product Advisor Feedback
  • Fannie Mae: The report must list all inquiries that were made in the previous 90 days.

– Confirm if new credit obtained
  • Do you see the new account on credit report?
  • Was it disclosed on application?
  • Obtain verification
    – Freddie Mac documentation examples
      • Creditor letter
      • Signed borrower letter
  • Include in ratios
  • Evaluate risk
Capital Errors

Assets to Close, Borrower’s Own Funds, Gift Funds, Reserves and Large Deposits
Capital

Excessive Seller Contributions
– Follow GSE, Investor and MI Guidelines
– Loans with payment abatements are ineligible
  • Exception condo/HOA dues up to 12 months but amounts must included as IPC
– Check for guideline overlays
– See guidelines on next slides
IPC’s - Fannie Mae

IPC Limits

The table below provides IPC limits for conventional mortgages.

IPCs that exceed these limits are considered sales concessions. The property’s sales price must be adjusted downward to reflect the amount of contribution that exceeds the maximum, and the maximum LTV/CLTV ratios must be recalculated using the reduced sales price or appraised value.

<table>
<thead>
<tr>
<th>Occupancy Type</th>
<th>LTV/CLTV Ratio</th>
<th>Maximum IPC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal residence or second home</td>
<td>Greater than 90%</td>
<td>3%¹</td>
</tr>
<tr>
<td></td>
<td>75.01% – 90%</td>
<td>6%</td>
</tr>
<tr>
<td></td>
<td>75% or less</td>
<td>9%</td>
</tr>
<tr>
<td>Investment property</td>
<td>All CLTV ratios</td>
<td>2%</td>
</tr>
</tbody>
</table>

¹Not applicable for properties that are not residential.
Based on *"value," as defined in Section 4203.1, the maximum permitted financing concessions are as follows:

<table>
<thead>
<tr>
<th>Occupancy</th>
<th>LTV/TLTV ratios &gt;90%</th>
<th>LTV/TLTV ratios &gt; 75% and ≤ 90%</th>
<th>LTV/TLTV ratios ≤ 75%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Residences and second homes</td>
<td>3%</td>
<td>6%</td>
<td>9%</td>
</tr>
<tr>
<td>Investment Properties</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
</tr>
</tbody>
</table>

The amount of any financing concessions in excess of the limitations set forth above will be considered a sales concession. Funds paid by the property seller that are fees or costs customarily paid by the property seller according to local convention are not subject to the maximum financing concession limitations above.

*Freddie determines value by using the lessor of the sales price or appraised value
Purchase Price (or refinance of all debt to be paid off)
- Earnest Money Deposit (only if verified)
- Other Financing (if applicable)
- Loan Amount Applied for
+ Balance Owed on 30 day accounts “O”
+ Closing Costs
+ Prepaids and escrows
+ Judgments, collections and debt to be brought current, paid down or paid off prior to/or at closing.
+ Required Reserves

__________________________ 
= Total Required Funds
Capital

Assets to Close
– Cash to close
– Reserves
  • Loan Product Advisor/DU
    – Verify funds required
    – Best practice: only enter needed funds
– Manual calculation
  • Additional reserves need to be calculated when:
    – Borrower is selling a home and needs cash to complete that transaction
    – For Loan product Advisor loans when discount points are being paid by anyone other than borrower
– Other funds necessary for transaction (manual calculation??)
  • Debts paid at close (check guidelines)
  • 30-day accounts, if applicable
  • Credit card financing, if applicable (funds to payoff or include in DTI)
  • Collections and charge-off
    – Multi family owner occupied, second homes and investment transactions - see guidelines
  • Judgements or garnishments

Avoiding Common Underwriting Errors
Capital

Large Deposits Fannie Mae
- A large deposit is any deposit that is 50% or more of the total qualifying income being used to qualify
  - Source any account opened in most recent 90 days if using VODs
  - Asset statements look for one or two month seasoning depending on recommendation
  - Investors often are more conservative so check guidelines

Fannie Mae Single Family Selling Guide
§ B3-4.2-02, Depository Accounts (05/27/2014)

Deposits Which May Indicate Borrowed Funds Must Be Investigated.
Capital

Large Deposits Freddie Mac
– A large deposit is any deposit that is 50% or more of the total qualifying income being used to qualify
  • Source any account opened in most recent 90 days if using VODs

Freddie Mac Seller/Servicer Guide
§ 5103.1 and 5501 Required funds

 Deposits Which May Indicate Borrowed Funds Must Be Investigated.
Capital

Earnest Money
– Documentation
  • From eligible source (account listed on 1003?)
  • Correct documentation per guidelines – Is it a gift?
– Make sure funds are not counted twice
  • Back out of bank account balance if necessary
## Borrower’s Own Funds

– Fannie Mae

The following table describes the minimum borrower contribution requirements for transactions that contain gifts.

<table>
<thead>
<tr>
<th>LTV, CLTV, or HCLTV Ratio</th>
<th>Minimum Borrower Contribution Requirement from Borrower’s Own Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>80% or less</td>
<td>One- to four-unit principal residence Second home</td>
</tr>
<tr>
<td></td>
<td>A minimum borrower contribution from the borrower’s own funds is not required. All funds needed to complete the transaction can come from a gift.</td>
</tr>
<tr>
<td>Greater than 80%</td>
<td>One-unit principal residence</td>
</tr>
<tr>
<td></td>
<td>A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from a gift.</td>
</tr>
<tr>
<td></td>
<td>Two- to four-unit principal residence Second home</td>
</tr>
<tr>
<td></td>
<td>The borrower must make a 5% minimum borrower contribution from his or her own funds. 1 After the minimum borrower contribution has been met, gifts can be used to supplement the down payment, closing costs, and reserves.</td>
</tr>
</tbody>
</table>

---

1. If the borrower receives a gift from a relative or domestic partner who has lived with the borrower for the last 12 months, or from a fiancé or fiancée, the gift is considered the borrower’s own funds and may be used to satisfy the minimum borrower contribution requirement as long as both individuals will use the home being purchased as their principal residence.
Capital

Borrower’s Own Funds

– Freddie Mac

• No requirement for >80% LTV loans where:
  – Primary residence and
  – Gift or gift of equity received from eligible donor used as source of funds or
  – Employer Assisted Homeownership (EAH) Benefit is used as source of funds

• Some >80% LTV loans secured by manufactured loans no longer require borrower’s own funds in transaction

– Genworth follows the GSE guidelines on borrower’s own funds

Avoiding Common Underwriting Errors
Capital- Gift Funds

Gift Funds
– Enter into AUS correctly
– Must come from acceptable source
– A gift can be provided by:
  • A relative, defined as the borrower’s spouse, child, or other dependent, or by any other individual who is related to the borrower by blood, marriage, adoption, or legal guardianship; or
  • A fiancé, fiancée, or domestic partner
– Document correctly
– *Verify donor availability
  • Funds transfer per investor guidelines
    – Fannie Mae prior to, or at closing
    – Freddie Mac prior to closing
– Other restrictions
  • Investment properties, gifts are not allowed

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

* New *

List Assets

- Breakdown by type of asset
- Ask applicant which account or accounts or “source” of funds will be used for the transaction
- Collect two months assets statement
- Know what is considered a large deposit
- Explain any change source of funds must be communicated to you (i.e. borrower was to get a gift but now liquidating their 401k)
- Does borrower have access to retirement accounts without restriction?
- Proof of liquidation?

Do not enter gift funds in Section 2. Gifts are entered in Section 4.
Assets & Liabilities

* New

Do not enter gift funds in Section 2. Gifts are entered in Section 4.

**4d. Gifts or Grants You Have Been Given or Will Receive for this Loan**

Include all gifts and grants below. Under Source, choose from the sources listed here:

- Relative
- Unmarried Partner
- Employer
- Religious Nonprofit
- Community Nonprofit
- Federal Agency
- State Agency
- Local Agency
- Other

**Asset Type (Cash Gift, Gift of Equity, Grant)**

<table>
<thead>
<tr>
<th>Source – use list above</th>
<th>Cash or Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposited</td>
<td>$</td>
</tr>
<tr>
<td>Not Deposited</td>
<td>$</td>
</tr>
<tr>
<td>Deposited</td>
<td>$</td>
</tr>
<tr>
<td>Not Deposited</td>
<td>$</td>
</tr>
</tbody>
</table>

Gifts must be evidenced by a letter signed by the donor, called a gift letter. The gift letter must:
- specify the dollar amount of the gift;
- specify the date the funds were transferred;
- include the donor’s statement that no repayment is expected; and
- indicate the donor’s name, address, and relationship to the borrower.

Documentation of donor ability/transfer and proof of receipt of the gift will be required prior (prior to for Freddie Mac) or at closing.
Capital- Gift Funds/ Documentation Requirement

Gifts must be evidenced by a letter signed by the donor, called a gift letter which:

– Specifies the dollar amount of the gift;
– Specifies the date the funds were transferred;
– Includes the donor’s statement that no repayment is expected; and
– Indicates the donor’s name, address, telephone number, and relationship to the borrower

Acceptable Donor

A gift can be provided by:

– A relative, defined as the borrower’s spouse, child, or other dependent, or by any other individual who is related to the borrower by blood, marriage, adoption, or legal guardianship; or
– A fiancé, fiancée, or domestic partner

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

Availability & Transfer of Funds

The lender must verify that sufficient funds to cover the gift are either in the donor’s account or have been transferred to the borrower’s account. Acceptable documentation includes the following:

– a copy of the donor’s check and the borrower’s deposit slip,
– a copy of the donor’s withdrawal slip and the borrower’s deposit slip,
– a copy of the donor’s check to the closing agent, or
– a settlement statement showing receipt of the donor’s check (Fannie Mae Only)

**Fannie Mae Only:** When the funds are not transferred prior to settlement, the lender must document that the donor gave the closing agent the gift funds in the form of a certified check, a cashier’s check, or other official check with remitter as the donor.

**Freddie Mac:** Requires the gift to be transferred to the borrower prior to closing, unless it is a gift of equity.
### Capital- Gift Funds: Freddie Mac

**ASSET DOCUMENTATION, continued**

<table>
<thead>
<tr>
<th>Topic</th>
<th>Documentation Requirements</th>
</tr>
</thead>
</table>
| Gift funds or a gift of equity (Guide Section 5501.3(c)) | Provide a gift letter signed by the donor. Information provided in the gift letter must:  
- State the donor's name and the funds are given by a related person  
- Include the donor's mailing address and telephone number  
- State the amount of the gift funds or gift of equity  
- Establish the gift funds or gift of equity are a gift that does not have to be repaid  
Gift funds: If the verifications provided in the mortgage file do not show evidence that the gift funds have been deposited in the borrower's account, the borrower must provide evidence of the transfer of funds from the donor to the borrower.  
Gift of equity: A gift of equity must be reflected on the Settlement/Closing Disclosure Statement.  
Note:  
- Investment Property Mortgages: Gift funds or gift of equity are not an eligible source of funds  
- Second Home Mortgages with LTV/TLTV/HTLTV ratios greater than 80%: Minimum contribution from borrower personal funds must be 5% of value when gift funds or grants are used for the transaction. |
| Gift funds received as a wedding gift (Guide Section 5501.3(c)) | Provide the following:  
- A copy of the marriage license or certificate  
- A verification of the gift funds in the borrower's depository account  
The gift funds must be on deposit in the borrower's depository account within 60 days of the date of the marriage license or certificate |
| A gift or grant from an agency (Guide Section 5501.3(c)) | Provide documentation supporting a gift or grant from an agency. Examples of acceptable documentation include copies of grant program materials, award letters or terms and conditions provided to the borrower. The documentation must:  
- Establish that the funds were provided by an Agency  
- Establish that the organization has an established gift or grant program  
- Establish that the funds are a gift or grant that does not have to be repaid  
- Provide evidence that the funds were received by the borrower or by the Seller on the borrower's behalf  
- Identify the donor's mailing address |

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**Much more detailed information regarding gift funds**

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Avoiding Common Underwriting Errors
Borrowers with Multiple Financed Properties – Reserve Requirements

- DU determines the reserves required for the other residential financed properties (excluding the borrower’s principal residence and the subject property)
- The reserve amount is determined by applying a percentage to the outstanding unpaid principal balance (UPB) for all *mortgages and HELOC’s disclosed on the application
- The percentage is based on the number of financed properties the borrower is obligated on
- Max is 10 financed Properties

**RESERVES CALCULATION TABLE**

<table>
<thead>
<tr>
<th>2 to 6 financed properties (Manually Underwritten and Casefiles Underwritten through DU)</th>
<th>The % of UPB is based on the number of financed properties:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• If 2-4 financed properties, reserves = 2% of aggregated mortgage UPBs for all other* financed properties.</td>
</tr>
<tr>
<td></td>
<td>• If 5-6 financed properties, reserves = 4% of aggregated mortgage UPBs for all other* financed properties.</td>
</tr>
<tr>
<td></td>
<td>*Other includes all financed properties which are not the subject property or the borrower’s principal residence.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>7 to 10 financed properties (DU Casefiles Only)</th>
<th>The % of UPB is based on the number of financed properties:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• If 7-10 financed properties, reserves = 6% of aggregated mortgage UPBs for all other* financed properties.</td>
</tr>
<tr>
<td></td>
<td>*Other includes all financed properties which are not the subject property or the borrower’s principal residence.</td>
</tr>
</tbody>
</table>

*If marked paid by close, omit or if associated with subject property, not included.
## Capital: Fannie Mae

Borrowers with Multiple Financed Properties

### Examples of Reserves Calculations

The following tables contain examples of reserves calculations for borrowers with multiple financed properties.

#### Example 1: Three Financed Properties

<table>
<thead>
<tr>
<th>Occupancy</th>
<th>Outstanding UPB</th>
<th>Monthly PITIA</th>
<th>Reserves Calculations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subject: Second Home</td>
<td>$78,750</td>
<td>$776</td>
<td>2 Months PITIA = $1,552</td>
</tr>
<tr>
<td>Principal</td>
<td>$0</td>
<td>$179</td>
<td>N/A</td>
</tr>
<tr>
<td>Investor</td>
<td>$87,550</td>
<td>$787</td>
<td>$230,050 x 2% = $4,601</td>
</tr>
<tr>
<td>Investor</td>
<td>$142,500</td>
<td>$905</td>
<td>Total = $5,153</td>
</tr>
</tbody>
</table>

| Total          | $230,050        |               |                       |
Capital: Freddie Mac

Loan Product Advisor Updated To Determine Reserves For Other Financed Properties

– Loan Product Advisor will determine reserves for additional properties owned and obligated on when subject is a second home or investment property
– Data accuracy is critical
– Enter all eligible assets
– Enter details for each additional 1-4 unit residential property in which the borrower has ownership interest and is obligated on the financing
– Specifically:
  – Property disposition
  – Subject property
  – Current Resident
  – Liabilities associated with each property?
Capital: Freddie Mac

Effective August 20, 2018

Selling Updates

Increasing number of financed properties to 10 when subject is a second home or investment. When 7-10 range loan must have:

- 720 credit score
- 8 months reserves for each second home or investment property borrower owns/obligated on
- Accept/Eligible
Compliance
Completeness
Compliance

Ensure Completeness of the Loan Application and Loan Package

– Two year history
  • Employment
  • Residence

– Occupancy
  • Make sense
  • Consistent throughout loan file

– All 1003 copies
  • Signed original/scratch
  • Final

– AUS updated with final data
  • Within tolerances, if permitted

– Proofread
  • All information provided
  • All documents in file
Compliance

No Cash-Out, Limited Cash-Out. Rate & Term Refinance

– Fannie Mae Limited cash-out refinance transactions must meet the following requirements:

The transaction is being used to pay off an existing first mortgage loan (including an existing HELOC in first-lien position) by obtaining a new first mortgage loan secured by the same property; or for single-closing construction-to-permanent loans to pay for construction costs to build the home, which may include paying off an existing lot lien.

Only subordinate liens used to purchase the property may be paid off and included in the new mortgage. Exceptions are allowed for paying off a Property Assessed Clean Energy (PACE) loan or other debt (secured or unsecured) that was used solely for energy-related improvements. See B5-3.3-01, HomeStyle Energy for Improvements on Existing Properties, for additional information.

The subject property must not be currently listed for sale. It must be taken off the market on or before the disbursement date of the new mortgage loan, and the borrowers must confirm their intent to occupy the subject property (for principal residence transactions).

https://www.fanniemae.com/content/guide/selling/b/index.html
No Cash-Out, Limited Cash-Out. Rate & Term Refinance

– Fannie Mae Limited cash-out refinance transactions. The following are acceptable in conjunction with a limited cash-out refinance transaction:

▪ modifying the interest rate and/or term for existing mortgages;
▪ paying off the unpaid principal balance of the existing first mortgage (including prepayment penalties);
▪ for single-closing construction-to-permanent transactions, paying for construction costs to build a home, which may include paying off an existing lot lien;
▪ financing the payment of closing costs, points, and prepaid items. With the exception of real estate taxes that are more than 60 days delinquent, the borrower can include real estate taxes in the new loan amount as long as an escrow account is established, subject to applicable law or regulation. (For example, if a particular state law does not allow a lender to require an escrow account under certain circumstances, the loan would be eligible as a limited cash-out refinance without an escrow account.) If an escrow account is not being established, see B2-1.2-03, Cash-Out Refinance Transactions;
▪ receiving cash back in an amount that is not more than the lesser of 2% of the new refinance loan amount or $2,000;
▪ buying out a co-owner pursuant to an agreement;
▪ paying off a subordinate mortgage lien (including prepayment penalties) used to purchase the subject property. The lender must document that the entire amount of the subordinate financing was used to acquire the property; or
▪ paying off the unpaid principal balance of PACE loans and other debt used for energy-related improvements, described above.

https://www.fanniemae.com/content/guide/selling/b/index.html
Compliance

No Cash-Out, Limited Cash-Out. Rate & Term Refinance

Freddie Mac - A refinance Mortgage is either:

1. A Mortgage the proceeds of which are used to pay off an existing Mortgage or Mortgages secured by the Mortgaged Premises with the cancellation of the existing promissory note(s) and the execution of a new promissory note and a new Security Instrument, or
2. A Mortgage secured by Mortgaged Premises previously owned free and clear by the Borrower

A Mortgage the proceeds of which are used to pay off an Interim Construction Financing must meet requirements of Chapter 4602 for Construction Conversion and Renovation Mortgages, including, but not limited to, how the transaction type (purchase or refinance) is determined.

Freddie Mac offers three types of refinance Mortgages:
A "no cash-out" refinance
A cash-out refinance
A special purpose cash-out refinance

Within these types, Freddie Mac has special requirements for refinancing certain Mortgages currently owned by Freddie Mac.
Compliance

No Cash-Out, Limited Cash-Out. Rate & Term Refinance

- Freddie Mac No Cash-Out

Cash back requirements for “no cash-out” refinance Mortgages

Effective for Mortgages with Settlement Dates on and after October 27, 2018; but Sellers may implement immediately

Previously, for a “no cash-out” refinance Mortgage, proceeds could be used to disburse cash to the Borrower (or other payee) not to exceed 2% of the new refinance Mortgage, or $2,000, whichever was less.

To provide flexibility in the disbursement of cash back to the Borrower, we are revising our requirements to permit cash back up to the greater of 1% of the Mortgage amount or $2,000.

Guide impacts: Sections 4301.4, 4602.5 and 5703.4
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Training Tools and Information

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