

UNDERWRITING GUIDELINES FOR NON-PROFIT HOME OWNERSHIP LENDING PROGRAMS

I. INTRODUCTION

The underwriting guidelines serve as a reference for loan staff and Loan Committees when reviewing and analyzing requests for NPO loans.

For each loan request that NPO receives, credit-worthiness and property value are not the only factors considered. NPO also examines the impact the loan would have on stabilizing homeownership for the borrower and considers the neighborhood impact that the loan would have.

In addition, it is NPO policy to make its loan funds as accessible to borrowers as is reasonably possible.

As such, when using these underwriting guidelines to review and analyze loan requests, it is important to remember that consideration must also be given to the impact of a loan for the borrower and for the neighborhood.

Since NPO also develops different lending programs to meet a wide variety of lending needs, a specific program may have underwriting guidelines which are different from those of other programs.

Consequently, the following underwriting guidelines are only general guidelines, and consideration must be given when reviewing loan requests to any specific underwriting guidelines that may exist as part of a particular loan program.

II. QUALIFYING RATIOS

A. Payment-to-Income Ratio

The payment-to-income ratio, or "first ratio" as it is commonly called, is calculated by dividing the total monthly housing payment by the applicant's effective gross monthly income, as defined in the following Section III.

Monthly payments for the following items are to be included when considering the monthly housing payment:

1. Principal and interest payment of first mortgage.
2. Any secondary financing.
3. Real estate taxes.
4. Hazard insurance premium.
5. Flood insurance premium, if applicable.
6. Private mortgage insurance premium, if applicable.

Generally, the result of the first ratio calculation should not exceed 33% of the applicant's gross monthly income. However, the most important ratio is the total debt ratio which should not exceed 40%.

B. Debt-to-Income Ratio

The total debt-to-income ratio, or "second ratio" as it is commonly called, is calculated by adding together the total monthly payments of all existing long term debts (with a remaining term of 10 or more months) and the total monthly housing payment and dividing that sum by the applicant's gross monthly income, as defined in the following Section 3.

The total monthly obligations to be considered include:

1. Monthly housing payment on the property (existing and NPO loan).
2. NPO loan.
3. Net monthly housing expenses on other real estate owned.
4. Long term installment debt beyond 10 months remaining to be paid.
5. Revolving accounts and lines of credit.
6. Alimony, child support or maintenance, if applicable.
7. Stock pledges, if applicable.

Generally, the result of the second ratio calculation should not exceed 45% of applicant's gross monthly income.

C. Special Financing Allowances for Higher Ratios

In some cases, NPO will be applying its financing in conjunction with other first mortgage financing for home-purchases that allow the Applicant to have higher ratios. Examples include the NPO Housing Fund Program, the GE Community Homebuyers Program, and the secondary marketing agencies of Fannie Mae and Freddie Mac, in addition to other programs allowing higher ratios.

In these cases, NPO will consider the higher ratios and substantiate that the borrower has met any special requirements of these programs, such as counseling or attendance at a home buying seminar or landlord seminar.

D. Approval Justifications

The ratios discussed here are general guidelines and flexibility may be exercised in specific underwriting situations.

The following are examples of considerations that may justify approvals of loans with higher ratios:

1. Applicant's proven ability to devote a larger amount of income to housing expenses.
2. Applicant's substantial net worth.
3. Applicant's demonstrated ability to maintain good credit history.
4. Evidence of applicant's potential for future increased earnings and job stability.
5. A substantial downpayment on the purchase of the property or strong equity position for existing homeowner.
6. Cost efficient property characteristics (such as documented energy efficient items) that make more income available for repaying mortgage debt.

III. INCOME

A. Gross Monthly Income

The applicant's gross monthly income is a computation of the applicant's and co-applicant's:

1. Stable monthly base earning.
2. Overtime, averaged over a period of at least 2 years.
3. Commissions, averaged over a period of at least 2 years.
4. Bonuses, if documented for a period of at least 2 years.
5. Rental Income.
6. Fixed Income Sources (social security, SSI, pension, etc.)
7. Any other verifiable funds that show the probability of continuing and are pertinent to reviewing the loan.

B. Primary Income

Loan applications are reviewed based on a consideration of primary income. Primary income is:

1. Derived from stable base earnings; and/or,
2. Considered the principal source of income.

Proper documentation of income should provide information necessary to determine the applicant's ability to repay the debt. Identifying the stability, quantity and quality of income is essential to loan qualification purposes.

C. Secondary Income

1. Overview

Secondary income is defined as continuous earnings other than the base pay of primary employment and can be derived from various sources.

2. Secondary income can be considered for loan qualification purposes if:
 - a. Continuation of the income is probable.
 - b. The income is typical of the applicant's occupation.
 - c. There is evidence of a previous two year income history.
 - d. The income is substantiated by proper written documentation.

3. Types of Secondary Income

- a. Commissions

Commissions received in addition to a base salary must be verified on the Verification of Employment form. The last two years' 1040's and W-2's or 1099 forms are also required.

When considering commissions for loan qualification purposes, consideration must be given to previous amounts earned and the likelihood for future earnings.

- b. Bonuses

Bonuses are considered an employer's option and sufficient documentation is required to assure the stability and duration of this income.

- c. Retirement Income

Retirement income is verified by obtaining:

- (1) The company's retirement plan documents and a copy of the award letter.
- (2) Copies of canceled checks previously received.

- d. Alimony and Child Support

Alimony and child support are considered if the applicant reveals the information for repayment purposes.

The following documentation should be supplied for review:

- (1) Copy of the printout from **Superior Court** showing continuity.
- (2) Divorce decree.
- (3) Evidence that payments are current.

Generally, for child support and alimony payments to be considered, the payments must continue for the period of loan repayment. A guarantee of a minimum of three years of payments is required.

e. Social Security, Government Assistance and Disability Income

Social Security, government assistance and disability income can be considered as an income source if the following documentation is submitted:

- (1) An award letter.
- (2) Copies of previous checks.

If benefits are being received for a minor child, the remaining term must be determined before utilizing such income.

f. Tips

Tips are verified using copies of tax returns reflecting this type of income. In some cases, tips may also be verified by the employer on the Verification of Employment form or by copies of pay stubs.

g. Dividend and Interest Income

Dividend and interest income may be considered provided the following is obtained for review:

- (1) Two years tax returns or 1099 forms.
- (2) Statement of interest earned.
- (3) List of stocks owned and dividend statements (from a stockbroker).

The available assets must be analyzed to ensure that the funds or stocks that represent this source of income will not be liquidated for use toward the purchase price.

h. Expense Accounts

Expense accounts, such as those for a car allowance or entertainment, may not be considered since they offset specific expenses.

i. Rental Income

Income from other real estate owned can be considered.

To evaluate rental income, the following items are required:

- (1) Schedule of real estate owned.
- (2) Operating statements, if available.
- (3) Current leases or tenant statements.

Tax returns may also substantiate a net rental income.

If the applicant owns three or more properties, tax returns must be submitted for qualification purposes.

Rental income on other real estate owned is calculated by deducting the following from the gross monthly rental income:

- (1) Principal.
- (2) Interest.
- (3) Taxes.
- (4) Insurance.
- (5) Maintenance.
- (6) Special assessments.
- (7) Allowance for replacement reserves

Any negative cash flow must be considered as a long term debt.

j. Rental Income of Subject Property

Rent from units in the borrower's primary residence can generally be used by deducting 75% of the rent received from the monthly payment for principal, interest, taxes, and insurance. Rent payments will generally be substantiated by tax returns, tenant statements or rent receipts.

D. Employment Income

A verification of employment must be received for all employers for whom the applicant has worked for in the last two years.

If the following circumstances appear when analyzing the employment history, the applicant must provide a written explanation:

1. Gap in the employment history.
2. Frequent change of jobs without advancement.
3. Movement from one line of work to another.

Oddities such as different handwritings or ink colors on the verification of employment are to be questioned. Information on the verification should coincide with the information supplied on the residential loan application. Any discrepancies require explanation.

E. Part Time Employment and Seasonal Employment Income

Part time or seasonal employment can be considered if:

1. Verification is obtained for that position and/or a related field for a period not less than two years.
2. Probability of continuance is established.

F. Self-Employed Borrower

1. Overview
 - a. NPO will consider a self-employed applicant provided that:
 - (1) The applicant supplies all documents required by NPO.

- (2) The business is a viable concern and can be expected to continue.
- b. Complete documentation is required to determine that:
- (1) The applicant's income is sufficient for the loan.
 - (2) The business has been established for at least one year.
- c. The qualifying method for the self-employed applicant must be justifiable and completely documented.

All documentation must be examined to determine:

- (1) An accurate income/cash flow profile.
- (2) That the applicant's business is a viable concern.

2. Uniform Documentation Requirements

Regardless of how the self-employed applicant's business is structured, certain documents are required to consider the loan. For all required tax forms, the applicant must supply signed copies of the past two full years' forms.

- a. The following documents are uniformly required:
- (1) Tax Form 1040-"U.S. Individual Tax Return" Pages 1 and 2 which lists all personal data and summarizes all taxable income activity that creates the final adjusted gross income figure.
 - (2) Tax Form 1040-Schedule A-"Itemized Deductions".
 - (3) Tax Form 1040-Schedule B-"Interest and Dividend Income".
 - (4) Tax Form 1040-Schedule C-"Profit or (Loss) From Business or Profession" which details profit or loss from the business and lists any amortization, depletion, or depreciation.
 - (5) Tax Form 1040-Schedule D-"Capital Gains or Losses" which itemizes gains or losses from investments such as stocks and bonds.

- (6) Tax Form 1040-Schedule E-"Supplemental Income Schedule" which lists income from items such as pensions, rents, partnerships, estates, trusts and annuities.
- (7) Tax Form 1040-Schedule F-"Farm Income and Expenses" which itemizes net income or loss derived from farming.

b. The following documents are also generally required:

- (1) A year-to-date profit loss/income statement, prepared and signed by a Certified Public Accountant, with information covered through the last quarter.
- (2) A year-to-date-balance sheet, prepared to reflect the financial position of the business at a specific point in time.
- (3) A business credit report, required if the operating name of the business is other than that of the applicant and which will verify any debts that are owed in the business name that must be considered when qualifying the applicant.
- (4) Verification of previous employment on standard Verification of Employment form, required if the applicant has been self-employed for less than two years.

3. Underwriting the Self-Employed Applicant

a. Previous Employment

When the Applicant has been self-employed for less than two years, the previous employment verification should be examined for:

- (1) The stability of the applicant's previous income.
- (2) Any similarities between that of applicant's previous occupation to that of the business. (Business similarities will be viewed favorably, but are not to be considered the only determining factor for approval of the loan.)

b. Business Credit Report

When a business credit report has been obtained, it should be examined for any debts owed in the business name which must be considered when qualifying the applicant.

c. **Businesses Less Than Two Years Old**

To gain a complete picture of businesses less than two years old, it may be necessary to obtain a projected income statement. The projected figures may be used if:

- (1) The income is supported by contracts and agreements.
- (2) Copies of the contracts and agreements are part of the loan file.

If the underwriter is comfortable with the future potential of the business, it may be advisable to average the income for the months in the current year with the previous year's income.

Whatever method is used, the income used to qualify the loan must not exceed actual earnings.

d. **Established Businesses More Than Two Years Old**

When the tax returns and financial statements on an established business show a steady decline or increase in income, the actual adjusted gross income figure represented in the applicant's tax documents should be used for qualifying purposes.

When the tax returns and financial statements reflect income that has been stable, the adjusted gross income figure plus all allowable addbacks can be used for qualifying purposes.

e. **Allowable Addbacks to Adjusted Gross Income**

These underwriting guidelines allow the self-employed applicant to add back tax deductions to his or her adjusted gross income, as represented in his or her tax documents. The following generally includes deductions which qualify:

- (1) Depreciation on real property.
- (2) Depreciation on personal property when it is not fully consumed during the current operating cycle (to be acceptable, personal property must be depreciated over its generally accepted useful life)
- (3) IRA/KEOGH contributions.

- (4) Interest income and dividend exclusions.
- (5) Non-taxable pension income.
- (6) Non-cash losses.
- (7) Married couple deductions.
- (8) Non-recurring losses.

IV. LIABILITY

A liability is a debt which a person is legally bound to pay, or an obligation to make good on any loss or damage occurring in a transaction.

The analysis of liability in underwriting will provide insight into the applicant's credit habits and indicate his or her ability to manage financial affairs.

A. Installment Loans

1. There are two types of installment loans, unsecured and secured loans.
 - a. Unsecured Loans

Unsecured loans require a regular, fixed payment amount according to an established schedule. Common types are:

- (1) Charge accounts.
- (2) Personal notes.
- (3) Lines of credit.

b. Secured Loans

Secured loans are those loans in which collateral is given, deposited or pledged to secure the fulfillment of an obligation or the repayment of a debt. Common types are:

- (1) Automobile loans.
- (2) Boat loans.
- (3) Real estate loans.

2. Installment loans must be listed on the residential loan application stating:

- a. Creditor's name and address.
- b. Account number.
- c. Number of remaining payments.
- d. Monthly payment amount
- e. Amount of remaining balance.

B. Real Estate Loans

1. A real estate loan is secured by real property. Written verification from the lender must be obtained to:
 - a. Indicate mortgage status and rating.
 - b. Analyze as a major factor in determining new loan management.
2. Specific documentation on the loan application must appear under:
 - a. Assets section.
 - b. Liabilities and pledged assets section.
 - c. Schedule of real estate owned section, which indicates disposition of property.
3. A review of the assets, liabilities and pledged assets, and schedule of real estate owned sections is necessary to determine if the house will be sold prior to closing and if the equity realized from the sale is required for

purchase of the new home. If so, the applicant must provide the following:

- a. A receipt of a copy of the contract of sale prior to closing.
 - b. A receipt of a fully executed closing statement evidencing amount and receipt of sufficient equity for new purchase.
4. If the house will be rented, the underwriter must determine the following:
- a. Whether a negative cash flow will result which must be added to the applicants' liabilities.
 - b. Whether a positive cash flow will result in additional income.

(See Section III.3.1 for requirements on evaluating rental income.)

C. Pledged Assets

1. Pledged assets is a form of secured borrowing. Items which may be pledged are:
 - a. Stocks.
 - b. Bonds.
 - c. Life insurance.
2. A review of this type of liability will determine:
 - a. The direct relationship to the value of the assets which effects total net worth.
 - b. Monthly payment requirements, if applicable.
3. Pledged assets must be listed on the loan application under liabilities and pledged assets and must be considered when calculating the Applicant's long term total liabilities.

D. Line of Credit

A line of credit enables an applicant to borrow funds by writing a check. The underwriter must determine the following:

1. Repayment terms. Monthly payments, if applicable, must be disclosed on the loan application and may be considered as liabilities.
2. Effect on applicant's available assets and net worth, to include a review of past use of the line of credit, outstanding balance and maximum line of credit available.

E. Alimony, Child Support and Separate Maintenance Payments

When the applicant is obligated to pay alimony, child support or separate maintenance, evidence that payments are current, must be obtained. A copy of the divorce decree, to indicate all alimony, child support and separate maintenance payments, is also required.

Payments should be treated as a long-term debt reported as a recurring liability, unless proof is obtained that payments will not exceed ten (10) months.

When analyzing eligibility, the amount of the applicant's income after the payments have been deducted should be considered.

The decision on whether the applicant qualifies for a loan must be based on a combined analysis of:

1. Total obligations-to-income ratio.
2. Applicant's income exclusive of the payments.

F. Student Loans

1. Student loans are a form of unsecured debt. When an applicant indicates an outstanding student loan:
 - a. The credit report should document the information.
 - b. If the credit report cannot verify the account, a written rating request from the particular loan center is required
 - c. The monthly loan payment must be included in the liability section of the loan application and included in the recurring debts section if payoff exceeds ten (10) months.

G. Liability Review

Outstanding liabilities must be verified and rated either by a written loan status statement from the applicable account holder, or on the credit report.

In addition to documenting all outstanding liabilities on the loan application, inquiries on the credit report must be explained and reviewed to ensure additional loans have not been added.

Analysis of the applicant's liabilities is necessary to ensure over-extension has not occurred. Even though loans may be paid in full within a ten (10) month period, consideration should be given to patterns of credit use and whether the account is revolving or installment.

V. CREDIT DOCUMENTATION

A. Overview

The credit report is used to help determine the applicant's creditworthiness. The information provided on the report will be valuable for determining the applicant's:

1. History of debt repayment.
2. Manner and pattern of repayment.
3. Attitude towards the use of credit.

B. Credit Report Requirements

The following are requirements which apply to credit reports:

1. A credit report must be a standard factual data credit report issued by an authorized credit reporting agency.
2. The report must include information covering at least two years of credit history and residency.
3. The report must be no older than 90 days at the date of loan approval.
4. There is evidence that public records have been checked.
5. The report must disclose information that coincides with the initial and final application.
6. A report must be obtained on each applicant. (It is only necessary to obtain one credit report that will contain information on co-applicants when applicants are married to each other and their assets are combined and reported jointly.)

C. Other Credit Documentation

1. For those borrowers who do not have established credit a 12 month history of rent and utilities will be used.
2. Borrowers may also supply credit reference letters from Rent to Own or furniture stores. Savings pattern can also be used as a credit reference.

D. Examining the Credit Report

It is essential that the entire report be examined. The information presented must be reviewed for accuracy and must be examined for consistency with the initial and final loan applications.

1. The top section of the report must be examined for:
 - a. Applicant's name.
 - b. Address information for the previous two years.
 - c. Employment history for the previous two years.
 - d. Social security numbers.
 - e. Marital status.
2. The next section provides information pertaining to actual credit accounts. The information is to be examined for:
 - a. Identity of the creditor.
 - b. Dates the accounts were opened or closed.
 - c. Highest credit limits.
 - d. Dates of last transactions.
 - e. Account balances.
 - f. Any past due amounts.
 - g. Payment and loan terms.
 - h. Rating as to the manner of payment.
 - i. Public record information.

E. Analyzing the Credit Report

1. The credit report must be analyzed for consistency with loan applications as well as for complete credit account information from the credit reporting agency.
2. Any inconsistencies must be explained by the applicant in writing.
3. Any lapses or inconsistencies in employment or place of residence must be explained by the applicant in writing.
4. Any obligations listed on the credit report that are not verified or rated will require written verification prior to underwriting the loan package.
5. Any obligations that appear on the credit report that do not appear on the initial loan application will require a written explanation from the applicant and proof that payments have been made, or proof that the obligation is paid in full.
6. Any obligations that appear on the initial application that do not appear on the credit report will require a written explanation from the applicant and proof that payments have been made, or proof that the obligations is paid in full.

F. Derogatory Remarks on the Credit Report

All derogatory remarks or information found on the credit report must be explained in writing by the applicant, even if the account has been brought current.

Explanations are required for:

1. Payments referred to as slow (30 days or over).
2. Accounts or payments reported as delinquent.
3. Any negative responses from creditors contained in the report.

G. Public Records

1. The public records reference on each report is to be checked for:
 - a. Suits involving the applicant.
 - b. Judgments against the applicant.
 - c. Collection accounts.
 - d. Bankruptcy.
2. If any of these are reported, the loan will not be considered unless the following documentation is received from the applicant:
 - a. Written explanation as to the cause of the problem.
 - b. Evidence of satisfaction and release from all debts related to the action.
3. For bankruptcy, in addition to a written explanation as to the cause of the problem and evidence of satisfaction and release from all debts related to the action, requires:
 - a. Evidence of discharge of bankruptcy.
 - b. Evidence that a satisfactory credit history has been re-established.

G. Credit Explanations by Applicant

All credit explanations by the applicant must be examined to determine if:

1. The explanations are plausible.
2. The conditions that caused the difficulties are not likely to reappear.

When analyzing bankruptcies, consideration will be given to whether there is a history of recovery and evidence of a current good financial standing.

VI. ASSETS

A. Overview

The applicant's assets are an essential part of underwriting a loan and demonstrate:

1. The applicant's ability to accumulate assets.

2. Whether there are sufficient funds to apply towards the down payment, closing costs and prepaid items.

A strong net worth can be a positive factor in reviewing and analyzing loan requests.

B. Types of Assets

1. Assets include:
 - a. Funds in savings and checking accounts.
 - b. Escrow deposits held toward the purchase of a property.
 - c. Funds received as a gift.
2. Common additional assets include:
 - a. Stocks and bonds.
 - b. Money market funds and IRA accounts.
 - c. Profit sharing and thrift plans.
 - d. Cash value of life insurance policies.
 - e. Automobiles, furniture and personal property.
 - f. Lines of credit.
 - g. Assets related to or involving the ownership of real estate.
 - h. Real property assets.

C. Verification of Deposit

Verification of deposit determines the following:

1. The applicant's assets which are held in a depository institution.
2. The amount and liquidity of assets, sufficient to close the loan.

VII. PROPERTY

A. Property Type

Eligible properties are generally one to four unit properties.

B. Loan to Value Ratio

Generally, the loan to value ratio shall not exceed 110%.

Appraisals generally will be ordered if the loan amount exceeds \$5,000 and/or the combined loan to value exceeds 80% of the estimated value. Tax assessed value will be used in lieu of other estimates.

C. Appraisals

When a loan involves construction, an appraisal will be based on an "after rehab" value, using a scope of work detailing the work to be completed and prepared by the NPO Construction Specialist. For a purchase loan, an appraisal will be done by the first mortgage lender, generally based on the "after-rehab" value of the property. NPO will consider this appraisal since it affects both loans. Consideration must be given to whether NPO is restricted by the first mortgage lender's LTV requirements.

For purchase loans, most first mortgage lenders require an actual bid for the repairs included in the financing to be submitted to the appraiser.

D. Housing Code Compliance

The Ventura County and municipal codes in cities where the program operates have housing and code enforcement programs. NPO will comply with the requirements.

VIII. SUMMARY

Again, the underwriting guidelines presented here are general guidelines only. The proficiency of the underwriter is reflected throughout the total mortgage loan origination. Each case must be investigated, documented and evaluated in accordance with prudent lending policy and with NPO lending goals.