PennyMac Correspondent

Jumbo Program Underwriting Guidelines and Eligibility Requirements

August 30, 2018

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00 INTRODUCTION

This Guide describes PennyMac's underwriting guidelines and eligibility requirements for its Jumbo Program. In addition to ensuring program eligibility and prudent underwriting, PennyMac requires that all loans meet the Ability to Repay (ATR) rules and Qualified Mortgage requirements established by the Consumer Financial Protection Bureau (CFPB). Please see the Ability to Repay and Qualified Mortgage Rule section for complete details.

By submitting a loan for purchase, the Lender certifies that: (i) the Lender has made, or is making, its own credit decision with respect to the Borrower, regardless of whether PennyMac purchases or declines to purchase the loan; (ii) none of PennyMac, its directors, officers, employees, agents, or contractors, or any of its affiliates has influenced, or will influence, the Lender's credit decision with respect to the Borrower by (a) indicating whether it will purchase the loan if the Lender originates and closes the loan, or (b) any other action or statement; and (iii) if the Lender has closed, or will close, the loan to the Borrower, the Lender did, or will, fund the closing of the loan with funds from a source other than PennyMac or any of its affiliates.

Lenders are required to meet all guidelines in the PennyMac Seller Guide, Jumbo Program Underwriting Guidelines and Eligibility Requirements, and the Loan Purchase Agreement (LPA).

10 General Underwriting

10.10 JUMBO ELIGIBILITY MATRIX

10.10.10 Fully Amortizing Standard Jumbo

<table>
<tr><th colspan="6">Purchase and Rate/Term Refinances</th></tr>
<tr><th>Units</th><th>Loan Amount</th><th>LTV/CLTV/HCLTV</th><th>Credit Score</th><th colspan="2">Reserves</th></tr>
<tr><td rowspan="2">1 Unit OO</td><td>$1,500,000</td><td>80%</td><td>700</td><td colspan="2">9 months</td></tr>
<tr><td>$2,000,000</td><td>80%</td><td>700</td><td colspan="2">12 months</td></tr>
<tr><td>2 unit OO</td><td>$1,500,000</td><td>80%</td><td>700</td><td colspan="2">12 months</td></tr>
<tr><td rowspan="2">2nd Home 1 Unit</td><td>$1,000,000</td><td rowspan="2">80%</td><td rowspan="2">700</td><td colspan="2">12 months</td></tr>
<tr><td>$1,500,000</td><td colspan="2">18 months</td></tr>
<tr><th colspan="6">Cash Out Refinance</th></tr>
<tr><th>Units</th><th>Loan Amount</th><th>LTV/CLTV/HCLTV</th><th>Credit Score</th><th>Reserves</th><th>Max Cash-Out</th></tr>
<tr><td rowspan="2">1 Unit OO</td><td>$1,500,000</td><td rowspan="2">75%</td><td rowspan="2">700</td><td>9 months</td><td>$300,000</td></tr>
<tr><td>$2,000,000</td><td>12 months</td><td>$500,000</td></tr>
<tr><td colspan="6">See Eligibility Matrix Notes Below</td></tr>
</table>

Eligibility Matrix Notes

- LTV/CLTV/HCLTV reduced by 5% when the appraisal indicates in either the Neighborhood Section Housing Trends or 1004MC Median Comparable Sale Price that property values are declining
- First time homebuyer (FTHB) max $1,000,000 loan amount
- Non-Permanent Resident Aliens only eligible for owner occupied, 75% LTV/CLTV/HCLTV. See 30.10.10 for complete details
- See Reserves Section for FTHB and multiple financed properties reserves requirements
- When flood insurance is required, must be escrowed, regardless of LTV/CLTV/HCLTV

10.20 UNDERWRITING

All loans are manually underwritten; AUS is not utilized. For items not addressed by the Jumbo Program Underwriting Guidelines and Eligibility Requirements, follow Fannie Mae manual underwriting requirements.

20 Loan

20.10 ELIGIBLE AND INELIGIBLE MORTGAGE PRODUCTS

20.10.10 Eligible Programs and Qualifying Payment Requirements

- 15 Year fixed rate, fully amortized
  - Qualify at the note rate

- 30 Year fixed rate, fully amortized
  - Qualify at the note rate
- 5/1 LIBOR ARM with 2.25 margin and 2-2-5 caps
  - Fully amortizing qualifies at the greater of the note rate plus 2% or the fully indexed rate*
- 7/1 LIBOR ARM with 2.25 margin and 2-2-5 caps
  - Fully amortizing qualifies at the note rate

*Fully indexed rate is index plus the margin

20.10.20 Ineligible Attributes

The following programs and mortgage features are ineligible for purchase by PennyMac:

- Temporary buydowns
- Interest-only amortization
- Negative amortization
- Loans with prepayment penalties
- Construction financing during building phase. Permanent financing is acceptable
- Assumable loans:
  - PennyMac will not purchase assumable loans.
  - Jumbo ARM loans must be originated using PennyMac's Non-Assumability ARM Rider and Non-Assumability Note Addendum

20.30 OCCUPANCY

- Primary Residence: One to two units (1-2) units
- Second Homes
  - One (1) unit only
  - Must be located a reasonable distance away from the borrower's primary residence
  - Must be occupied by the borrower for some portion of the year
  - Must be suitable for year-round occupancy
  - The borrower must have exclusive control over the property
  - Must not be rental property or a timeshare arrangement
  - Cannot be subject to any agreements that give a management firm control over the occupancy of the property
- Investment Properties not allowed

20.40 FINANCING

20.40.10 Financing and Sales Concessions

Interested Party Contributions are allowed in accordance with the following:

- 3% with LTV/CLTV/HCLTV ratios greater than 75% and up to 80%
- 6% with LTV/CLTV/HCLTV ratios less than or equal to 75%

Amounts are calculated on the lesser of sales price or appraised value. Amounts in excess of these limits must be deducted from the lower of sales price or appraised value when calculating the LTV/CLTV/HCLTV.

20.40.20 Maximum Loan Amount

- The maximum loan amounts permitted are reflected in the grid at the beginning of the guide
- First Time Home Buyers (FTHB) are
  - Limited to $1,000,000 loan amount
  - FTHB is defined as an individual who has not had a mortgage in the past three years or owned a home in the past three years
  - Applications with multiple borrowers are not considered FTHB unless all applicants are FTHB

20.40.30 Minimum Loan Amount

The minimum loan amount for all areas is $1 above the conforming standard balance limit.

20.40.40 LTV/CLTV/HCLTV, Secondary Financing

Loan-to-Value is determined by dividing the first lien amount by the lesser of the sales price or appraised value, as applicable.

The Combined Loan-to-Value (CLTV) is determined by dividing the sum of the items listed below by the lesser of the sales price or the appraised value, as applicable.

- the original loan amount of the first mortgage,
- the drawn portion (outstanding principal balance) of a HELOC, and
- the unpaid principal balance of all closed-end subordinate financing. (With a closed-end loan, a borrower draws down all funds on day one and may not make any payment plan changes or access any paid-down principal once the loan is closed.)

HELOC Combined Loan to Value (HCLTV) is determined by dividing the sum of the items listed below by the lesser of the sales price or appraised value of the property.

- the original loan amount of the first mortgage,
- the full amount of any HELOCs (whether or not funds have been drawn), and
- the unpaid principal balance (UPB) of all closed-end subordinate financing.

Subordination of existing secondary financing is allowed. New secondary financing is permitted subject to the following:

- Allowed up to the maximum CLTV as shown in the Eligibility Matrix
- Institutional financing. Seller subordinate (seller-carried second) financing are not allowed
- Employer sponsored financing. The program must be an established company program, not just an accommodation developed for an individual employee
- Subordinate liens must be recorded and clearly subordinate to the first mortgage lien
- Full disclosure must be made on the existence of subordinate financing and the subordinate financing repayment terms
- Acceptable Subordinate Financing Types:
  - mortgages with regular payments that cover at least the interest due so that negative amortization does not occur, and
  - minimum of five years

20.50 TRANSACTIONS

20.50.10 Loan Purpose

- Purchase
    - A complete copy of the signed purchase contract and any applicable addenda must be provided
- Limited Cash-Out / Rate & Term Refinance
    - Proceeds can be used:
        - To pay off a first mortgage regardless of age
        - To pay off any junior liens related to the purchase of the subject property
        - To pay off a 12 month seasoned junior lien. If a HELOC, then it must have no cumulative draws greater than $2,000 within the last 12 months. Based on the note date of the new loan.
            - Proof of no cumulative draws greater than $2,000 within the last 12 months is required
            - Transaction history may be sufficient to document no draws exceeding limits
            - Documentation must be provided showing the HELOC is paid and closed
    - Incidental cash back may not be used to pay off debt on the Closing Disclosure.
    - Incidental cash to the borrower in an amount not to exceed $2,000
    - Listings must have been expired or withdrawn six months prior to the note date of the new loan
    - Payoff of current property taxes is not eligible
    - Payoff of delinquent property taxes are not eligible
- Cash-Out
    - Borrower must have owned the property for at least six months and there must be six months seasoning since the most recent note date
    - Listings must have been expired or withdrawn 12 months prior to the note date of the new loan
- Delayed Financing
    - Defined as the refinance of a property purchased by the borrower for cash within six months of purchase
    - Must be underwritten to the cash-out eligibility matrix, cash out limits do not apply
    - Acceptable in accordance with the following:
        - Owner-Occupied only
        - Eligible during the first six months of ownership only
        - LTV/CLTV/HCLTV calculated from the lesser of the purchase price or current appraised value
        - The original purchase transaction was an arm's-length transaction. Arm's length is defined as no pre-existing relationship between buyer and seller
        - The original purchase transaction is documented by a Closing Disclosure Settlement Statement, or other equivalent documentation, which confirms the borrower's own funds used to purchase the property
            - Borrowed funds are ineligible
            - Gift or blended funds are ineligible
            - Funds secured by a pledged asset or retirement account are ineligible
        - The preliminary title search or report must confirm that there are no existing liens on the subject property
        - The source of funds for the purchase transaction are documented with a minimum of two months' statements

- Value used for refinances:
    - All refinances on properties owned less than 12 months, must use the lesser of the original purchase price or current appraised value for either a rate and term or cash-out transaction. Based on the new note date
    - Refinances of entirely new construction properties may use the current appraised value regardless of the length of time of ownership
- All refinances must meet the more restrictive of these guidelines or the Continuity of Obligation guidelines in the next section.

20.50.20 Continuity of Obligation

Continuity of obligation occurs on a refinance transaction when at least one of the borrower(s) on the existing mortgage is also a borrower on the new refinance transaction secured by the subject property. In addition, PennyMac will consider the following scenarios as meeting the continuity of obligation requirements:

- The borrower acquired the property through an inheritance or was legally awarded the property (for example, divorce, separation, or dissolution of a domestic partnership)
- The borrower on the new refinance transaction has been added to title through a transfer from a trust, or a limited liability company (LLC), or partnership. The following requirements apply:
    - the borrower must have been a beneficiary/creator (trust) or a 25% or more owner of the LLC or partnership prior to the transfer, and
    - the transferring entity and/or the borrower has had a consecutive ownership (on title) for at least the most recent 6 months prior to disbursement of the new loan.

    Note: Transfer of ownership from a corporation to an individual does not meet the continuity of obligation requirement.
- The borrower has been on title for at least 12 months but is not obligated on the existing mortgage(s) that is being refinanced and the borrower meets both of the following:
    - Has been residing in the property for at least 12 months, and
    - Has paid the mortgage from their own account for at least 12 months.
- When there is no existing mortgage on the subject property as a result of the borrower either having purchased the subject property with cash or when any prior mortgage for which the borrower was an obligor was paid in full.

Note: Cash-out transactions require the borrower to be on title to the subject property for at least six months and six months seasoning required on existing loan.

20.50.30 Ineligible Transactions

Intra-family purchases as a means to obtain cash-out for the seller while avoiding cash-out qualifications and pricing are not eligible transactions. These types of transactions may seem to meet guidelines, however they are not bonafide purchase transactions and therefore not eligible for purchase by PennyMac. Unacceptable transactions of this type may have some or all of the following characteristics:

- Gift of equity from the seller
- Large amount of seller credits
- Family member remaining in the home and on title after the “purchase”
- Seller unable to qualify for a cash-out transaction of their own

20.60 STATE RESTRICTIONS

Texas 50(a)(6) transactions are ineligible.

30 BORROWER

30.10 BORROWER ELIGIBILITY

30.10.10 Eligible Borrowers

The following are eligible borrowers:

- U.S. citizens.
- Permanent resident alien:
  - A permanent resident alien is an immigrant who, although not a U.S. citizen, has been granted the right to live and work permanently in the United States.
  - Proof of lawful permanent residence and 24 months United States employment history is required.
- Non-permanent resident aliens:
  - A non-permanent resident alien is a temporary resident, who, although not a U.S. citizen has been granted the right to live and/or work in the United States for a specific period of time. PennyMac requires proof of lawful residence and 24 months United States employment and income history. Employment and income history documentation including but not limited to
    - US tax returns
    - History of visa renewals
    - No indication employment will stop
  - Eligible for:
    - Primary residence only
    - Maximum LTV/CLTV/HCLTV 75%
    - 30 year fixed rate only
    - No other financed properties in the US
    - Unexpired H1B, H2B, E1, L1 and G Series visas only. G Series visas must have no diplomatic immunity
    - Credit and tradeline requirements must be met, non-traditional credit is not acceptable.
    - Borrower must have a current 24 month employment history in the US.
- All borrowers must have a valid Social Security Number. ITINs are not acceptable.
- Inter-Vivos Revocable Trusts (revocable at any time by the Trustor)
- Non-Arm's Length Transaction: Defined as a pre-existing personal or business relationship between the buyer and the seller
  - Two full appraisals required regardless of loan amount
  - When there is an existing mortgage on the property, Lender must obtain a mortgage rating indicating no lates in the last 12 months
- Specific Power of Attorney (POA) allowed. In addition, the POA must be recorded and include a copy of the POA with the county recorder's stamp. There are no exceptions regarding the recordation of the POA.
  Note: POAs are ineligible on cash-out transactions

30.10.20 Ineligible Borrowers

- Irrevocable Trusts or Blind Trusts
- Limited/General Partnerships and Corporations
- Foreign nationals: A non-U.S. citizen who is not a permanent or non-permanent resident alien. This person does not have the right to live and/or work in the U.S. for a specific period of time.
- Borrowers with diplomatic immunity: A form of legal immunity that ensures diplomats are not susceptible to lawsuit or prosecution under U.S. laws
- Non-occupant co-borrowers
- Land Trusts, including Illinois

30.20 MULTIPLE FINANCED PROPERTIES

The financed property limit applies to the borrower's ownership of one-to four-unit financed properties or mortgage obligations on such properties and is cumulative for all borrowers.

- Owner-Occupied: Borrowers may have up to four financed properties.
- Second home: Borrowers may have up to four financed properties.
- PennyMac limits borrowers to four PennyMac serviced properties.
- The subject property is included in the total number of financed properties.
- Borrowers with three or more financed properties require at least 18 months reserves on the subject property.
- The following property types are not subject to these limitations, even if the borrower is personally obligated on a mortgage on the property:
    - commercial real estate,
    - multifamily property consisting of more than four units,
    - ownership in a timeshare,
    - ownership of a vacant lot (residential or commercial), or
    - ownership of a manufactured home on a leasehold estate not titled as real property (chattel lien on the home).
- Examples of Counting Financed Properties. Note: The Jumbo program does not allow for non-owner occupied subject properties. Examples for illustrative purposes only.
    - The borrower is personally obligated on mortgages securing two investment properties and the co-borrower is personally obligated on mortgages securing three other investment properties, and they are jointly obligated on their principal residence mortgage. The borrower is refinancing the mortgage on one of the two investment properties. Thus, the borrowers have six financed properties.
    - The borrower and co-borrower are purchasing an investment property and they are already jointly obligated on the mortgages securing five other investment properties. In addition, they each own their own principal residence and are personally obligated on the mortgages. The new property being purchased is considered the borrowers' eighth financed property.
    - The borrower is purchasing a second home and is personally obligated on his or her principal residence mortgage. Additionally, the borrower owns four two-unit investment properties that are financed in the name of a limited liability company (LLC) of which he or she has a 50% ownership. Because the borrower is not personally obligated on the mortgages securing the investment properties, they would not be included in the property count and the result is only two financed properties.
    - The borrower is purchasing and financing two investment properties simultaneously. The borrower does not have a mortgage lien against his or her principal residence but

does have a financed second home and is personally obligated on the mortgage, two existing financed investment properties and is personally obligated on both mortgages, and a financed building lot. In this instance, the borrower will have five financed properties because the financed building lot does not need to be included in the property count.

30.30 CREDIT

30.30.10 Determining the Representative Credit Score

The representative credit score for the mortgage loan is determined based on the credit scores of each borrower and is used to determine loan eligibility and for pricing purposes (i.e., assessing LLPAs). Follow these steps to calculate the representative credit score for a mortgage:

Step	Description
1	PennyMac recommends obtaining at least two credit scores for each borrower.
2	Select a single applicable score for underwriting each borrower. • When two credit scores are obtained, choose the lower score. • When three credit scores are obtained, choose the middle score. (If two of the three scores are the same, choose the middle of the three scores. For example: 720, 700, 700 = 700; or 720, 720, 700 = 720)
3	If there is only one borrower, the single applicable score used to underwrite that borrower is the representative credit score for the mortgage. If there are multiple borrowers, determine the applicable credit score for each individual borrower and select the lowest applicable score from the group as the representative credit score for the mortgage.

30.30.20 General Requirements

- Residential Mortgage Credit Report from all three repositories is required.
- Credit report must be dated within 90 days of the note date
- Mortgage/Rental history required
  - 0x30x24 mortgage or rental payment history.
    - Individual landlord must be documented via canceled checks
    - Institutional landlord may be documented via Verification of Rent (VOR) or canceled checks.
  - PennyMac will consider the borrower as having timely payments for the time in which the borrower has owned a property "free and clear."
- PennyMac will allow borrowers that are currently living "rent free" or previously lived rent free subject to the following:
  - The “rent free” period is less than or equal to 12 months, and

- The borrower has a 0x30x24 housing history immediately surrounding the rent free period either via previously paid mortgage or rental history,
  - Example: the borrower was rent free for 11 months, a year ago. The borrower is required to have a 0x30x12 since the rent free time, and 0x30x12 prior to the rent free time, to total 0x30x24 housing history.
  - Example: The borrowers have been rent free for the past 4 months. The borrowers are required to have 0x30x24 immediately preceding the current rent free period.
  - Verification of rent free period must come from the third party owner or person obligated on the lease/rental agreement.
- Trade Line Depth Requirements: Borrowers contributing qualifying income must meet one of the following options:
  - Three open trade lines with:
    - All 3 trade lines must have had activity within the last 6 months of the credit report date, and
    - A minimum of 24 months reporting on at least one trade line (open or closed).
  - Two open trade lines with:
    - Purchase transactions only, and
    - Borrowers have 24 month consecutive mortgage history, with some portion of the 24 months in the last 5 years.
  - One open trade line with:
    - A minimum of 12 months reporting on the open trade line, and
    - No less than 10 trade lines reporting with one being a mortgage; and
    - Credit history established for at least 10 years.
  - Borrowers not contributing income for qualifying purposes are not subject to the minimum trade line requirement.
- Non-Traditional Credit cannot be used in place of any trade line.
- Authorized user accounts or collection accounts may not be used to meet any credit or tradeline requirement.
- Letter of Explanation (LOE) required for all inquiries within the last 90 days.

30.30.30 Derogatory Credit

- Bankruptcy Chapter 7, 11, 13: Seven years since discharge or dismissal date
- Foreclosure: Seven years since completion date
- Notice of Default: Seven years since redemption
- Short Sale, Deed-in-Lieu, or other pre-foreclosure sale: Seven years since completion or sale date
- Any Mortgage accounts that were settled for less, or negotiated or short payoff: Seven years since settlement date
- Loan Modification:
  - Lender initiated modification will not be considered a derogatory credit event if the modification did not include debt forgiveness and was not due to hardship as evidenced by supporting documentation. No seasoning requirement would apply.
  - Seven years since modification if the modification was due to hardship or included debt forgiveness
- Multiple significant derogatory credit events, as indicated above, are not allowed.
- Medical collections: Aggregated balances of less than $10,000 do not need to be included.

- IRS and State Tax Payment Plans
    - All current and previous tax debt must be paid, including any liens/judgments on title or credit. Cash-out proceeds may be used to pay taxes.
    - Tax repayment plans from the IRS or other taxing authorities are not allowed.

30.30.40 Frozen Credit

As a precautionary measure, borrowers can "freeze" their credit profile with the different credit reporting agencies. A freeze prevents the reporting agencies from releasing any credit information. PennyMac requires all three credit reporting agencies to be unfrozen in order to proceed with the transaction.

40 Debt-To-Income, Employment and Income

40.10 DEBT-TO-INCOME (DTI) RATIOS

- The maximum DTI ratio is 43%.
- See Eligible Programs for information regarding calculating qualifying payments.
- The DTI ratio is calculated by dividing the total of current monthly liabilities plus any planned or future liabilities based on credit inquiries or otherwise disclosed by the borrower, by the qualifying monthly income.

40.20 DOCUMENTATION

PennyMac's Jumbo income and liability requirements are modeled after Appendix Q, unless otherwise specified. When Appendix Q does not address a situation, Fannie Mae's manual underwriting requirements are to be followed.

40.20.10 Income Documentation Requirements

- Employment and income documentation must be dated within 90 days of the note date.
- Full Documentation is required, which includes:
    - Most recent year to date paystub covering at least 30 days and two years of W2s
        - Written Verification of Employment (WVOE) is not acceptable
        - PennyMac will allow an employment contract and one pay stub in lieu of the 30 days of pay stubs. The pay stub provided must contain sufficient information to accurately verify the qualifying income.
        - The employment offer or contract must:
            - clearly identify the employer and the borrower,
            - be signed by the employer, and be accepted and signed by the borrower;
            - clearly identify the terms of employment, including position, type and rate of pay, and start date; and
            - be non-contingent.
              Note: If conditions of employment exist, the lender must confirm prior to closing that all conditions of employment are satisfied either by verbal verification or written documentation. This confirmation must be noted in the mortgage loan file.
    - Paystubs must:
        - clearly identify the borrower as the employee.

- include all year-to-date earnings. Additionally, the paystub must include sufficient information to appropriately calculate income; otherwise, additional documentation must be obtained.
- be computer-generated or typed by the borrower's employer(s), although paystubs that the borrower downloads from the Internet are also acceptable. Documents must clearly identify the employer's name and source of information.
- be from a third party original source of information, such as the borrower's human resources department, personnel office, payroll department, company's payroll vendor,

- Self-Employed Businesses Generating Positive Income Used to Qualify
  - Two years signed/dated personal tax returns plus two years signed/dated business tax returns, and
  - A signed YTD Profit and Loss (P&L) Statement and signed Balance Sheet are required. The documentation:
    - must be the most recent available statement (within 90 days of the note date)
    - must include the date range for period covered
    - can be:
      - audited
      - reviewed
      - compiled, or
      - internally prepared
    - is required for all Schedule C, 1065, 1120S and 1120 businesses regardless of income or loss amount, unless one of the below exceptions are met.
    - $0 income, $0 assets, $0 liabilities and $0 equity is acceptable if the business has no income, assets or liabilities.
    - must include a full year P&L and Balance Sheet for any full year period where tax returns have not yet been filed.
    - P&L and Balance Sheet must be signed by the borrower(s)
    - P&L and Balance Sheet must have the name of the business and the date range of the information provided.
  - YTD P&L and Balance Sheet may be waived if:
    - Borrower is paid via 1099 and does not actually own a business, if all of the following requirements are met:
      - Schedule C in Block 28 (Total Expenses) must be analyzed in relation to income in Block 7 (Gross Income). Expenses must be less than 5% of income.
      - Analysis of Blocks 8 (Advertising), 11 (Contract Labor), 16a (Mortgage Interest, 20 (Rent/Lease) 26 (Wages) must indicate the borrower does not have expenses in these categories.
      - Analysis of Blocks 17 (Legal and Professional Services) and Block 18 (Office Expense) indicate nominal or $0 expense.
      - Block C (Business Name) does not have a separate business name entity.

        - Year-to-date income in the form of a written VOE or pay history is provided by the employer paying the 1099. YTD income must support prior year's income.
  - Self-Employed Businesses Generating a Loss
      - Any loss generated by a business must be included in the qualifying income, including any losses from hobby businesses
        - Hobby business is a self-employed business generating minimal income or minimal loss. Generally borrower(s) have other employment.
      - If the loss is 5.00% or less of the total qualifying income, P&L and Balance sheet for that business is not required.
      - 5.00% limit is **cumulative** between all self-employed businesses. If one business is generating a 2% loss and another 3.1% loss, the combined loss is 5.1% and P&Ls and Balance sheets for all businesses are required.
      - No exceptions to 5.00%
  - Self-Employed Business Positive Income Not Used to Qualify:
    - Income documentation (business tax returns, P&L, Balance Sheet) are not required if the business is generating a positive income that is not used to qualify.
    - May be applied on a **per business** basis.
- Verbal Verification of Employment for the last two years required for:
  - For all employment used for qualifying income, and
  - For all self-employment, including all businesses generating a loss, unless the loss is 5% or less.
- Verbal Verifications must be:
  - Within 10 business days prior to closing for employed borrowers.
  - Within 30 calendar days prior to closing for self-employed.

40.20.20 Tax Transcripts

- The most recent two years tax transcripts are required for all borrowers, regardless if income is used to qualify. Generally, when the documentation used to verify income is from the same calendar period as the tax transcript, the information must match exactly. However, if the income documentation is from the current calendar year and the transcript is from a prior year, there can be acceptable variances. If this variance exceeds 20%, document the rationale for using current income. W2 transcripts do not satisfy this requirement.
  - If the transcripts reflect any losses, then:
    - The loss must be considered in qualifying income, and
    - Tax returns (including Profit & Loss and Balance Sheet as applicable) must be provided and analyzed according to the requirements in the Tax Returns section below.
- If tax transcripts are not available (due to a recent filing) a copy of the IRS notice showing "No record of return filed" is required along with documented acknowledgement receipt (such as IRS officially stamped tax returns or evidence that the return was electronically received) from the IRS and the previous one year's tax transcripts.
- Business transcripts are not required.
- 4506-T Requirements
  - A fully executed 4506-T for each of the borrower's businesses is required.

  - All borrowers must sign a 4506-T at application and closing.
- Borrowers that are a victim of identity theft, where transcripts cannot be obtained, will be reviewed on a case-by-case basis, but will not require an exception. In general, some, but not necessarily all of the following documentation can be included in the file to support the validity of the income:
  - Police Report
  - IRS confirmation of identity theft
  - Prior year's tax transcripts
  - An institutional written VOE
  - Bank statements supporting payroll deposits
  - Evidence of tax payment made or refund received for that year
  - Other documentation deemed supportive, based upon the specific situation

40.20.30 Variable Income Sources

Income Trending: After the monthly year-to-date income amount is calculated, it must be compared to prior years' earnings using the borrower's W-2's or income tax returns.

- If the trend in the amount of income is stable or increasing, the income amount should be averaged.
- If the trend was declining, but has since stabilized and there is no reason to believe that the borrower will not continue to be employed at the current level, the current, lower amount of variable income must be used.
- If the trend is declining, the income may not be stable. Additional analysis must be conducted to determine if any variable income should be used, but in no instance may it be averaged over the period when the declination occurred.

40.30 EMPLOYMENT AND INCOME

40.30.10 General Appendix Q Requirements

***Note**: Italics indicates a PennyMac requirement, interpretation or clarification.*

Loans must comply with the following income documentation requirements outlined in Appendix Q, unless otherwise specified. When Appendix Q does not resolve how a situation is to be handled, follow Fannie Mae guidelines.

- Stability of Income.
  - Effective Income. Income may not be used in calculating the borrower's debt-to-income ratio if it comes from any source that cannot be verified, is not stable, or will not continue.
  - Verifying Employment History.
    - Lender must verify the borrower's employment for the most recent two full years, and Lender must require the borrower to:
      - Explain any gaps in employment that span one or more months, and
      - Indicate if he/she was in school or the military for the recent two full years, providing evidence supporting this claim, such as college transcripts, or discharge papers.
    - Allowances can be made for seasonal employment, typical for the building trades and agriculture, if documented by Lender.

Note: A borrower with a 25 percent or greater ownership interest in a business is considered self-employed and will be evaluated as a self-employed borrower.

- Analyzing a Borrower's Employment Record.
  - When analyzing a borrower's employment, examine:
    - The borrower's past employment record; and
    - The employer's confirmation of current, ongoing employment status.

    Note: Lender may assume that employment is ongoing if a borrower's employer verifies current employment and does not indicate that employment has been, or is set to be terminated. Lender should not rely upon a verification of current employment that 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.
  - Lender may favorably consider the stability of a borrower's income if he/she changes jobs frequently within the same line of work, but continues to advance in income or benefits. In this analysis, income stability takes precedence over job stability.

- Borrowers Returning to Work After an Extended Absence. A borrower's income may be considered effective and stable when recently returning to work after an extended absence if he/she:
  - Is employed in the current job for six months or longer; and
  - Can document a two year work history prior to an absence from employment using:
    - Traditional employment verifications; and/or
    - Copies of IRS Form W-2s or pay stubs.

    Note: An acceptable employment situation includes individuals who took several years off from employment to raise children, then returned to the workforce.
  - Important: Situations not meeting the criteria listed above may not be used in qualifying. Extended absence is defined as six months

***Note:** PennyMac does not consider the time attributable to school or the military as an extended absence. However, the borrower(s) must provide evidence supporting this claim, such as college transcripts, or discharge papers.*

- Salary, Wage and Other Forms of Income.
  - General Policy on Borrower Income Analysis.
    - The income of each borrower who will be obligated for the mortgage debt and whose income is being relied upon in determining ability to repay must be analyzed to determine whether his/her income level can be reasonably expected to continue.
    - In most cases, a borrower's income is limited to salaries or wages. Income from other sources can be considered as effective, when properly verified and documented by the Lender.

    Notes:
    - 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. Lender must not ask the borrower about possible, future maternity leave.

        - Lender may assume that salary or wage income from employment verified in accordance with section "Analyzing a Borrower's Employment Record" 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. Lender 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
- Overtime and Bonus Income:
    - Overtime and bonus income can be used to qualify the borrower if he/she has received this income for the past two years, and documentation submitted for the loan does not indicate this income will likely cease. If, for example, the employment verification states that the overtime and bonus income is unlikely to continue, it may not be used in qualifying.
    - *While generally PennyMac expects two years history of overtime or bonus income, there can be circumstances where PennyMac will accept 12 months receipt. Overtime or bonus income received in the current position 12 months or more may be considered effective income, and the income should be averaged over the period that the borrower has been in their current position.*
- Establishing an Overtime and Bonus Income Earning Trend
    - Establish and document an earnings trend for overtime and bonus income. If either type of income shows a continual decline, Lender must document in writing a sound rationalization for including the income when qualifying the borrower.
    - See Variable Income Trending for additional information on trending income.
- *Restricted Stock (RS), Restricted Stock Units (RSU), and Stock Options (SO)*
    - *May only be used as qualifying income if the income:*
        - *has been consistently received for two years and*
        - *is reported on the paystubs, W-2s and tax returns as income and*
        - *the vesting schedule indicates the income will continue for a minimum of three years at a similar level as the prior two years.*
    - *A two year average of prior income received from RS, RSUs or SOs must be used to calculate the income,*
    - *A minimum of three year continuance based on the vesting schedule is required*
        - *Continuance is calculated from the close of market stock price as of the application date.*
        - *Income amount used for qualifying must be supported by future vesting based on the stock price used for calculating continuance.*
        - *Documentation confirming the value used to calculate must be included in the loan file. Internet print-out of price may be sufficient.*
    - *Additional awards must be similar to the qualifying income and awarded on a consistent basis.*
    - *Borrower must be currently employed by the employer issuing the RS, RSU and/or SO in order to use as qualifying income.*
    - *Vested restricted stock units and stock options cannot be used for reserves if using for income to qualify.*
- Qualifying Part-time Income.

- Part-time and seasonal income can be used to qualify the borrower if the Lender documents that the borrower has worked the part-time job uninterrupted for the past two years, and plans to continue. Many low and moderate income families rely on part-time and seasonal income for day to day needs, and creditors should not restrict consideration of such income when qualifying the income of these consumers
  - Part-time income received for less than two years may be included as effective income, provided that the Lender justifies and documents that the income is likely to continue
  - Part-time income not meeting the qualifying requirements may not be used in qualifying.

  Note: For qualifying purposes, "part-time" income refers to employment taken to supplement the consumer's income from regular employment; part-time employment is not a primary job that is worked less than 40 hours.
  - *Part-time income received less than 12 months is not considered effective income.*
- Income from Seasonal Employment.
  - Seasonal income is considered uninterrupted, and may be used to qualify the consumer, if the Lender documents that the consumer:
    - Has worked the same job for the past two years, and
    - Expects to be rehired the next season.
  - Seasonal employment includes, but is not limited to:
    - Umpiring baseball games in the summer; or
    - Working at a department store during the holiday shopping season.
- Primary Employment Less Than 40 Hour Work Week
  - When a borrower's primary employment is less than a typical 40-hour work week, Lender should evaluate the stability of that income as regular, on-going primary employment.
  - Example: A registered nurse may have worked 24 hours per week for the last year. Although this job is less than the 40-hour work week, it is the borrower's primary employment, and should be considered effective income.
- Commission:
  - Commission income must be averaged over the previous two years. To qualify commission income, the borrower must provide:
    - Copies of signed tax returns for the last two years; and
    - The most recent paystub.
  - Borrowers whose commission income was received for more than one year, but less than two years may be considered favorably if the underwriter can:
    - Document the likelihood that the income will continue, and
    - Soundly rationalize accepting the commission income.
    - *Commission income received less than 12 months is not considered effective income.*

    Notes:
    - Unreimbursed business expenses must be subtracted from gross income.
    - A commissioned borrower is one who receives more than 25 percent of his/her annual income from commissions.
    - A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns.
- Employer Differential Payments.
  - *This is also known as housing allowance.*
  - *PennyMac does not allow employers to subsidize a borrower's mortgage payment.*

- Retirement
  - Existing distribution of assets from an IRA, 401(k) or similar retirement asset must be sufficient to continue for a minimum of three years.
  - *No history of receipt: Distribution must have been set up at least two months prior to Note date. Document via the below options.*
  - Document regular and continued receipt of income as verified by any of the following:
    - Letters from the organizations providing the income.
    - Copies of retirement award letters.
    - Copies of federal income tax returns (signed and dated on or before the closing date) with tax transcripts to support.
    - Most recent IRS W-2 or 1099 forms.
    - Proof of current receipt with two months bank statements.
- Social Security.
  - Social Security income must be verified by a Social Security Administration benefit verification letter (sometimes called a "proof of income letter," "budget letter," "benefits letter," or "proof of award letter"). If any benefits expire within the first full three years of the loan, the income source may not be used in qualifying.

    Notes:
    - If the Social Security Administration benefit verification letter does not indicate a defined expiration date within three years of loan origination, Lender shall consider the income effective and likely to continue. Pending or current re-evaluation of medical eligibility for benefit payments is not considered an indication that the benefit payments are not likely to continue.
    - Some portion of Social Security income may be "grossed up" if deemed nontaxable by the IRS.
- Automobile Allowances and Expense Account Payments
  - Only the amount by which the borrower's automobile allowance or expense account payments exceed actual expenditures may be considered income
  - To establish the amount to add to gross income, the borrower must provide the following:
    - IRS Form 2106, Employee Business Expenses, for the previous two years; and
    - Employer verification that the payments will continue.
  - If the borrower uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income.
  - Expenses that must be treated as recurring debt include:
    - The borrower's monthly car payment; and
    - Any loss resulting from the calculation of the difference between the actual expenditures and the expense account allowance.
- Borrowers Employed by a Family Owned Business.
  - Income Documentation Requirement. In addition to normal employment verification, a borrower employed by a family owned business is required to provide evidence that he/she is not an owner of the business, which may include
    - Copies of signed personal tax returns, or
    - A signed copy of the corporate tax return showing ownership percentage.

40.30.20 General Information on Self-Employed Borrowers and Income Analysis

- Definition: Self-employed Borrower. A borrower with a 25 percent or greater ownership interest in a business is considered self-employed.
  - Borrowers paid via 1099 are considered self-employed, see 40.20.10 for additional information on documenting income for 1099 borrowers.
- Types of Business Structures. There are four basic types of business structures. They include:
  - Sole proprietorships;
  - Corporations;
  - Limited liability or "S" corporations; and
  - Partnerships.
- Minimum Length of Self Employment.
  - Income from self-employment is considered stable, and effective, if the borrower has been self-employed for two or more years.
  - Due to the high probability of failure during the first few years of a business, the requirements described in the table below are necessary for borrowers who have been self- employed for less than two years.

If the period of self-employment is:	Then:
Between one and two years	For the individual's income to be effective, the individual must have at least two years of documented previous successful employment in the line of work in which he/she is self-employed, or in a related occupation. **Note**: A combination of one year of employment and formal education or training in the line of work in which the individual is self-employed or in a related occupation is also acceptable.
Less than one year	The income from the borrower may not be considered effective income.

- General Documentation Requirements for Self-Employed Borrowers:
  - Signed, dated individual tax returns, with all applicable tax schedules for the most recent two years;
  - For a corporation, "S" corporation, or partnership, signed copies of Federal business income tax returns for the last two years, with all applicable tax schedules; and
  - Year to date profit and loss (P&L) statement and balance sheet.
    - *See Income Documentation Requirements above for additional information.*
- Establishing a Borrower's Earnings Trend.
  - When qualifying income, Lender must establish the borrower's earnings trend from the previous two years using the borrower's tax returns, and
  - If a 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, Lender must base the income analysis solely on the income verified through the tax returns.
  - If the borrower'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.
- Analyzing the Business's Financial Strength: Lender must consider the business's financial strength by examining annual earnings. Annual earnings that are stable or increasing are acceptable, while businesses that show a significant decline in income over the analysis period are not acceptable.
  - *Generally, businesses which show a decline of greater than 25% in the most recent year, compared to the average of the documented income are considered to have a significant decline and are not acceptable as qualifying income. However, on a case-by-case basis, businesses which show a decline of greater than 25% can be acceptable when Lender thoroughly documents the income has stabilized.*

40.30.30 Tax Returns

Income Analysis: Individual Tax Returns (IRS Form 1040)

- General Policy on Adjusting Income Based on a Review of IRS Form 1040.
  The amount shown on a borrower's IRS Form 1040 as adjusted gross income must either be increased or decreased based on Lender's analysis of the individual tax return and any related tax schedules
- Guidelines for Analyzing IRS Form 1040. The table below contains guidelines for analyzing IRS Form 1040:

IRS Form 1040 heading	Description
Wages, Salaries and Tips	An amount shown under this heading may indicate that the individual • is a salaried employee of a corporation, or • has other sources of income. This section may also indicate that the spouse is employed, in which case the spouse's income must be subtracted from the borrower's adjusted gross income.
Business Income and Loss (from Schedule C)	Sole proprietorship income calculated on Schedule C is business income. Depreciation, depletion, *amortization, or business use of home* may be added back to the adjusted gross income.
Rents, Royalties, Partnerships (from Schedule E)	Any income received from rental properties or royalties may be used as income, after adding back any depreciation, *depletion or amortization,* shown on Schedule E.

Capital Gain and Losses (from Schedule D)	*Since capital gains income is generally not sustainable over the long term, capital gains income cannot be considered when determining effective income. Per Appendix Q, recurring capital losses must be considered when determining the income. If both years of tax returns show a loss, Lender must either:* • *Deduct the average capital gains loss from the total income, or* • *Provide the prior year (third year) of tax returns which does not show a loss.* *If all three years show a capital gains loss, deduct the average from effective income. If any of the three years does not show a capital gain loss, the loss is not considered recurring, and does not need to be deducted from income.* *Capital gains losses are accounted for in the year that they occurred. Loss carryforward or deferred recognition of losses, does not impact qualifying income.*
Interest and Dividend Income (from Schedule B)	This taxable/tax-exempt income may be added back to the adjusted gross income only if it • has been received for the past two years, and • is expected to continue. If the interest-bearing asset will be liquidated as a source of the cash investment, Lender must appropriately adjust the amount.
Farm Income or Loss (from Schedule F)	Any depreciation, *depletion, or amortization,* shown on Schedule F may be added back to the adjusted gross income.
IRA Distributions, Pensions, Annuities, and Social Security Benefits	The non-taxable portion of these items may be added back to the adjusted gross income, if the income is expected to continue for the first three years of the mortgage.
Adjustments to Income	Adjustments to income may be added back to the adjusted gross income if they are • IRA and Keogh retirement deductions • penalties on early withdrawal of savings • health insurance deductions, and • alimony payments.
Employee Business Expenses	Employee business expenses are actual cash expenses that must be deducted from the adjusted gross income. *Required regardless of employment type.*

Income Analysis: Corporate Tax Returns (IRS Form 1120)

- Description: Corporation.

A corporation is a State-chartered business owned by its stockholders.

- Need To Obtain Borrower Percentage of Ownership Information
    - Corporate compensation to the officers, generally in proportion to the percentage of ownership, is shown on the
        - Corporate tax return IRS Form 1120; and
        - Individual tax returns.
    - When a borrower's percentage of ownership does not appear on the tax returns, Lender must obtain the information from the corporation's accountant, along with evidence that the borrower has the right to any compensation.
- Analyzing Corporate Tax Returns
    - In order to determine a borrower's self-employed income from a corporation the adjusted business income must:
        - Be determined; and
        - Multiplied by the borrower's percentage of ownership in the business.
    - The table below describes the items found on IRS Form 1120 for which an adjustment must be made in order to determine adjusted business income:

Adjustment Item	**Description of adjustment**
Depreciation, Depletion, and *Amortization*	Add the corporation's depreciation, depletion, *and amortization* back to the after-tax income.
Taxable Income	Taxable income is the corporation's net income before Federal taxes. Reduce taxable income by the tax liability. In addition, the income must also be reduced proportionately by the total obligations payable by the corporation in less than one year*****.
Fiscal Year vs. Calendar Year	If the corporation operates on a fiscal year that is different from the calendar year, an adjustment must be made to relate corporate income to the individual tax return.
Cash Withdrawals	The borrower's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating.

Income Analysis: "S" Corporation Tax Returns (IRS Form 1120S)

- Description: "S" Corporation.
    - An "S" corporation is generally a small, start-up business, with gains and losses passed to stockholders in proportion to each stockholder's percentage of business ownership.
    - Income for owners of "S" corporations comes from IRS Form W-2 wages, and is taxed at the individual rate. The IRS Form 1120S, Compensation of Officers line item is transferred to the borrower's individual IRS Form 1040.
- Analyzing "S" Corporation Tax Returns.
    - "S" corporation depreciation, depletion, *and amortization,* may be added back to income in proportion to the borrower's share of the corporation's income.
    - In addition, the income must also be reduced proportionately by the total obligations payable by the corporation in less than one year*****.
    - Important: The borrower's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating, and must be considered in the income analysis

Income Analysis: Partnership Tax Returns (IRS Form 1065)

- Description: Partnership.
  - A partnership is formed when two or more individuals form a business, and share in profits, losses, and responsibility for running the company.
  - Each partner pays taxes on his/her proportionate share of the partnership's net income.
- Analyzing Partnership Tax Returns
  - Both general and limited partnerships report income on IRS Form 1065, and the partners' share of income is carried over to Schedule E of IRS Form 1040.
  - Lender must review IRS Form 1065 to assess the viability of the business. Both depreciation and depletion may be added back to the income in proportion to the borrower's share of income.

  ***Note**: Amortization may also be added back.*
  - Income must also be reduced proportionately by the total obligations payable by the partnership in less than one year*****.
  - Important: Cash withdrawals from the partnership may have a severe negative impact on the partnership's ability to continue operating, and must be considered in the income analysis.

*When obligations payable by the business in less than one year roll over, or are extended, the debts may be excluded. Documentation confirming the roll over or extension is required.

40.30.40 Non-Employment Related Borrower Income

- Alimony, Child Support, and Maintenance Income Criteria. Alimony, child support, or maintenance income may be considered effective, if:
  - Payments are likely to be received consistently for the first three years of the mortgage;
  - The borrower provides the required documentation, which includes a copy of the:
    - Final divorce decree;
    - Legal separation agreement; or
    - Court order.
    - *Voluntary payment agreements are not acceptable.*
  - The borrower can provide acceptable evidence that payments have been received timely during the last 12 months, such as:
    - Cancelled checks;
    - Deposit slips;
    - Tax returns; or
    - Court records.

    Notes:
    - Child support may be “grossed up” under the same provisions as non-taxable income sources.
- Investment and Trust Income:
  - Analyzing Interest and Dividends.
    - Interest and dividend income may be used as long as tax returns or account statements support a two-year receipt history. This income must be averaged over the two years.
    - Subtract any funds that are derived from these sources, and are required for the cash investment, before calculating the projected interest or dividend income.
  - Trust Income.

        - Income from trusts may be used if constant payments will continue for at least the first three years of the mortgage term as evidenced by trust income documentation
        - Required trust income documentation includes a copy of the Trust Agreement or other trustee statement, confirming the:
            - Amount of the trust;
            - Frequency of distribution; and
            - Duration of payments.
        - Trust account funds may be used for the required cash investment 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.
    - Notes Receivable Income:
        - *Income from notes receivable may be used if payments will continue for at least the first three years of the mortgage term.*
        - In order to include notes receivable income to qualify a borrower, he/she must provide:
            - A copy of the note to establish the amount and length of payment, and
            - Evidence that these payments have been consistently received for the last 12 months through deposit slips, deposit receipts, cancelled checks, bank or other account statements, or tax returns.
        - If the borrower is not the original payee on the note, Lender must establish that the borrower is able to enforce the note.
- Military, Government Agency, and Assistance Program Income
    - Military Income
        - Military personnel not only receive base pay, but often times are entitled to additional forms of pay, such as:
            - Income from variable housing allowances;
            - Clothing allowances;
            - Flight or hazard pay;
            - Rations; and
            - Proficiency pay.
        - These types of additional pay are acceptable when analyzing a borrower's income as long *as there is no indication the income will end.*
          Note: The tax-exempt nature of some of the above payments should also be considered.
    - VA Benefits
        - Direct compensation for service-related disabilities from the Department of Veterans Affairs (VA) is acceptable, provided Lender receives documentation from the VA.
        - Education benefits used to offset education expenses are not acceptable.
    - Mortgage Credit Certificates.
        - If a government entity subsidizes the mortgage payments either through direct payments or tax rebates, these payments may be considered as acceptable income

        - Either type of subsidy may be added to gross income, or used directly to offset the mortgage payment, before calculating the qualifying ratios.

- *Foreign Income:*
    - *Copies of his or her signed federal income tax returns for the most recent two years that include foreign income.*
    - *Provide copy of pay stub from current job (if applicable). Must cover a minimum of 30 days YTD income.*
    - *All income must be translated to U.S. dollars.*

40.30.50 Rental Income

- Analyzing the Stability of Rental Income.
    - Rent received for properties owned by the borrower is acceptable as long as Lender can document the stability of the rental income through:
        - A current lease;
        - An agreement to lease, or
        - A rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal, or military renters, or property rehabilitation).
    - A separate schedule of real estate is not required for rental properties as long as all properties are documented on the Uniform Residential Loan Application.

    Note: The underwriting analysis may not consider rental income from any property being vacated by the borrower, except under the circumstances described below.
- Rental Income From Borrower Occupied Property.
    - The rent for multiple unit property where the borrower resides in one or more units and charges rent to tenants of other units may be used for qualifying purposes.
    - Projected rent for the tenant-occupied units only may:
        - Be considered gross income, only after deducting vacancy and maintenance factors, and
        - Not be used as a direct offset to the mortgage payment.
- Income from Roommates or Boarders in a Single Family Property
    - *PennyMac does not allow boarder income*
- Documentation Required To Verify Rental Income.

  Analysis of the following required documentation is necessary to verify all borrower rental income:
    - IRS Form 1040 Schedule E; and
    - Current leases/rental agreements.

    Note: *Current leases/rental agreements are required for all properties located on the Schedule E (including commercial properties), except when the borrower qualifies without including any rental income on that property and debt ratio is burdened with the full PITIA. An expired lease in the month-to-month phase may be acceptable with proof of receipt of current rent.*
- Analyzing IRS Form 1040 Schedule E.
    - The IRS Form 1040 Schedule E is required to verify all rental income. Depreciation shown on Schedule E may be added back to the net income or loss.
    - *Depletion and Amortization may also be added back.*
    - Positive rental income is considered gross income for qualifying purposes, while negative income must be treated as a recurring liability.

   - Lender must confirm that the borrower still owns each property listed, by comparing Schedule E with the real estate owned section of the URLA.
- Using Current Leases To Analyze Rental Income.
   - The borrower can provide a current signed lease or other rental agreement for a property that was acquired since the last income tax filing, and is not shown on Schedule E.
   - In order to calculate the rental income:
      - Reduce the gross rental amount by 25 percent for vacancies and maintenance;
      - Subtract PITI and any homeowners association dues; and
      - Apply the resulting amount to income, if positive, or recurring debts, if negative.
- Exclusion of Rental Income From Property Being Vacated by the Borrower (departing residence). Underwriters may not consider any rental income from a borrower's principal residence that is being vacated in favor of another principal residence, except under the conditions described below:
   - A properly executed lease agreement (that is, a lease signed by the borrower and the lessee) of at least one year's duration after the loan is closed must be provided. **Note:** Underwriters should also obtain evidence of the security deposit and/or evidence the first month's rent was paid to the homeowner.
   - Sufficient Equity in Vacated Property: The borrower has a loan-to-value ratio of 75 percent or less, as determined by a current (no more than six months old) residential appraisal as described below:
      - Fannie Mae form 1004,
      - exterior-only appraisal using Fannie Mae form 2055, or
      - condominium units form Fannie Mae 1075.

   Notes:
      - This applies solely to a principal residence being vacated in favor of another principal residence. It does not apply to existing rental properties disclosed on the loan application and confirmed by tax returns (Schedule E of form IRS 1040)
      - *PennyMac requires an appraisal and does not allow the comparison of the unpaid principal balance to the original sales price. See Reserves section for information regarding required reserves on the departing and subject properties.*
- Non-Taxable Income and Projected Income
   - Types of Non-taxable Income
      - Certain types of regular income may not be subject to Federal tax. Such types of nontaxable income include:
         - Some portion of Social Security, some Federal government employee retirement income, Railroad Retirement Benefits, and some State government retirement income;
         - Certain types of disability and public assistance payments;
         - Child support;
         - Military allowances; and
         - Other income that is documented as being exempt from Federal income taxes.
   - Adding Non Taxable Income to a Borrower's Gross Income.
      - The amount of continuing tax savings attributed to regular income not subject to Federal taxes may be added to the borrower's gross income.

- The percentage of non-taxable income that may be added cannot exceed the appropriate tax rate for the income amount. Additional allowances for dependents are not acceptable.
- Lender:
  - Must document and support the amount of income grossed up for any non-taxable income source, and
  - Should use the tax rate used to calculate the borrower's last year's income tax.

  Note: If the borrower is not required to file a Federal tax return, the tax rate to use is 25%

- *Projected Income: PennyMac does not allow projected income, either from an increase to existing salary or projected income from a new job.*

40.30.60 Unacceptable Income Sources

- *Boarder Income*
- *Capital gains income*
- *Employer Mortgage Differential Payments: Payments made by a borrower's employer to subsidize the borrower's mortgage payment, including housing allowances.*
- *Employment Assets as Income, or Asset Annuitization*
- *Homeownership Subsidies*
- *Projected Income*

40.40 LIABILITIES

- Types of Recurring Obligation. Recurring obligations include:
  - All installment loans;
  - Revolving charge accounts;
  - Real estate loans;
  - Alimony;
  - Child support; and
  - Other continuing obligations.
- Debt to Income Ratio Computation for Recurring Obligations.
  - Lender must include the following when computing the debt to income ratios for recurring obligations:
    - Monthly housing expense; and
    - Additional recurring charges extending ten months or more, such as
      - Payments on installment accounts;
      - Child support or separate maintenance payments;
      - Revolving accounts; and
      - Alimony
  - Debts lasting less than ten 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.

  Note: Monthly payments on revolving accounts, regardless of the balance, are counted as a liability for qualifying purposes even if the account appears likely to be paid off within 10 months or less.

- Revolving Account Monthly Payment Calculation. If the credit report shows any revolving accounts with an outstanding balance but no specific minimum monthly payment, the payment must be calculated as the greater of:
    - 5% of the balance; or
    - $10.

    Note: If the actual monthly payment is documented from the creditor or Lender obtains a copy of the current statement reflecting the monthly payment, that amount may be used for qualifying purposes.
    - Accounts paid off and closed prior to the loan closing may be excluded from the DTI. Documentation showing sufficient assets to pay off, in addition to any required assets, must be provided.
    - Accounts paid off at close must be included in the DTI calculation.
- *Open-End Accounts (accounts which require the balance to be paid in full monthly). Must follow one of the following bullets:*
    - *In the absence of a monthly payment on the credit report or direct verification of the payment, the greater of 5% of the outstanding balance or $10 can be considered to be the required monthly payment; or*
    - *When the balance is equal to the monthly payment, the borrower may provide sufficient verified funds to pay off the outstanding account balance. The funds must be in addition to any funds required for down payment, closing costs, financing costs, prepaids/escrows or reserves, as applicable.*
- Alimony may be included as a liability or reduction in income.
- Contingent Liabilities:
    - Definition: Contingent Liability. A contingent liability exists when an individual is held responsible for payment of a debt if another party, jointly or severally obligated, defaults on the payment.
    - Application of Contingent Liability Policies. The contingent liability policies described in this topic apply unless the borrower can provide conclusive evidence from the debt holder that there is no possibility that the debt holder will pursue debt collection against him/her should the other party default
    - Contingent Liability on Mortgage Assumptions. Contingent liability must be considered when the borrower remains obligated on an outstanding FHA-insured, VA- guaranteed, or conventional mortgage 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.
    - Exemption From Contingent Liability Policy on Mortgage Assumptions. When a mortgage is assumed, contingent liabilities need not be considered if the:
        - Originating lender of the mortgage being underwritten obtains, from the servicer of the assumed loan, a payment history showing that the mortgage has been current during the previous 12 months, or
- Contingent Liability on Cosigned Obligations.
    - Contingent liability applies, and the debt must be included in the underwriting analysis, if an individual applying for a mortgage is a cosigner/co-obligor on:
        - A car loan;
        - A student loan;
        - A mortgage; or
        - Any other obligation.

- If Lender obtains documented proof 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, the payment does not have to be included in the borrower's monthly obligations.

- *Authorized user accounts must be included in the liabilities calculation. However, when the authorized user account is a corporate account, the payment may be excluded from the liabilities calculation when:*
    - *The borrower is a salaried borrower, and*
    - *Documentation showing the employer is obligated on the account is provided.*
- Projected Obligations.
    - Debt payments, such as a student loan or balloon-payment note scheduled to begin or come due within 12 months of the mortgage loan closing, must be included by Lender as anticipated monthly obligations during the underwriting analysis.
    - Debt payments do not have to be classified as projected obligations if the borrower provides written evidence that the debt will be deferred to a period outside the 12-month timeframe.
    - Balloon-payment notes that come due within one year of loan closing must be considered in the underwriting analysis.
- Student Loans
    - If a monthly student loan payment is provided on the credit report, use that amount for qualifying purposes. If the credit report does not reflect the correct monthly payment, 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, determine the qualifying monthly payment using one of the options below.
        - If the borrower is on an income-driven payment plan, obtain student loan documentation to verify the actual monthly payment is $0. The borrower may then be qualified with the $0 payment.
        - For deferred loans or loans in forbearance, 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.
- Obligations Not Considered Debt. Obligations not considered debt, and therefore not subtracted from gross income, include:
    - Federal, State, and local taxes;
    - Federal Insurance Contributions Act (FICA) or other retirement contributions, such as 401(k) accounts (including repayment of debt secured by these funds);
    - Commuting costs;
    - Union dues;
    - Open accounts with zero balances;
    - Automatic deductions to savings accounts;
    - Child care; and
    - Voluntary deductions.

40.50 ASSETS

40.50.10 General Requirements

- Full asset documentation is required.
    - Verification of Deposits (VOD) are not acceptable.
    - All pages of the most recent two consecutive months' statements or the most recent quarterly statement may be provided. Statements must:
        - Clearly identify the borrower as the account holder;
        - Include the account number;
        - Include the time period covered by the statement;
        - Include all deposits and withdrawal transactions (for depository accounts);
        - Include all purchase and sale transactions (for financial portfolio accounts); and
        - Include the ending account balance.
- All asset documentation must be dated within 90 days of the note date.
- All funds must be owned by the borrowers.
- Business Funds to close allowed when:
    - Borrower is 100% owner, and
    - Two months consecutive business bank statements must be provided, and
    - One of the following:
        - A CPA letter must be provided confirming the withdrawal will not harm the business, or
        - Lender to confirm that business funds used for close do not exceed 50% of the lesser of the prior two months business bank statement ending balances.

        Notes For the 50% count:
        - When the same business has multiple accounts for the same month, it will be counted as the same business account.
        - When business funds are transferred to a personal account for funds to close, the transferred amount is counted as though the funds remained in the business account.
- Business Funds for reserves allowed when:
    - Business is Schedule C, and
    - Borrower is 100% owner, and
    - Borrower must have 2x the amount of required reserves for the transaction
        - Required if any portion of reserves are from the business.
        - Includes any multiple financed properties, first time homebuyer, etc.
- Large Deposits
    - When bank statements (typically covering the most recent two months) are used, Lender must evaluate large deposits, which are defined as a single deposit that exceeds 50% of the total monthly qualifying income for the loan. Requirements for evaluating large deposits vary based on the transaction type, as shown below.
    - Refinance transactions: Documentation or explanation for large deposits is **not** required; however, Lender remains responsible for ensuring that any borrowed funds, including any related liability, are considered.
    - Purchase transactions:
        - If funds from a large deposit are needed to complete the purchase transaction (that is, are used for the down payment, closing costs, or financial reserves), Lender must document that those funds are from an acceptable source.
        - If funds are from a transfer between borrower accounts, copies of outdated statements may be acceptable to source only the deposit. Statements dated

within the allowable age of credit docs must be provided to source funds used for closing and reserves.
    - Occasionally, a borrower may not have all of the documentation required to confirm the source of a deposit. In those instances, Lender must use reasonable judgment based on the available documentation as well as the borrower's debt-to-income ratio and overall income and credit profile.
    - Verified funds must be reduced by the amount (or portion) of the undocumented large deposit (as defined above), and Lender must confirm that the remaining funds are sufficient for the down payment, closing costs, and financial reserves.
    - When a reduced asset amount is used, net of the unsourced amount of a large deposit, that reduced amount must be used for underwriting purposes
    - When a deposit has both sourced and unsourced portions, only the unsourced portion should be used to calculate whether or not it must be considered a large deposit

40.50.20 Eligible Source of Funds

- Bridge Loan:
    - The bridge loan cannot be cross-collateralized against the new property; and
    - Lender must document the borrower's ability to successfully carry the payments for the new home, the current home, the bridge loan, and other obligations.
- Cash value of life insurance:
    - Lender must assess repayment or additional obligation considerations to determine the impact on borrower qualification or reserves.
    - If the funds are needed for down payment or closing costs document the borrower's receipt of funds from the insurance company. Obtain either a copy of the check from the insurer or copy of the payout statement issued by the insurer.
    - If the cash value is being used for reserves, the cash value must be documented but does not need to be liquidated.
- Depository accounts:
    - Checking or savings accounts
    - Provide two months consecutive bank statements
    - Large deposits must be sourced. See General Requirements above for more information regarding large deposits.
- Earnest Money Deposit (EMD):
    - Receipt of the deposit must be verified by either a copy of the borrower's canceled check or a written statement from the holder of the deposit.
    - Provide bank statements covering the month the EMD cleared the borrower's account and the statement prior to the month the EMD cleared.
    - Large deposits noted on the statements must be addressed in accordance with the Large Deposit policy above
- Funds that a borrower recently deposited in a U.S. depository institution are an acceptable source of funds provided all of the following requirements are met:
    - There is documented evidence of funds transfer from the country from which the borrower immigrated;
    - It can be established, with the prior two months bank statements, that the funds belonged to the borrower before the date of the transfer;

- The sources of all funds used for closing can be verified just as they would for a borrower who is a U.S. citizen; and
- All documentation and funds must be translated to English and US Dollars.

- Gift funds are allowed after the borrower contributes 5% from his/her own funds. Document that the gift was transferred to the borrower prior to close or transferred directly to escrow from the donor.
  - Donor must be:
    - 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.
  - An executed gift letter with the gift amount, donor's name, address, telephone number donor’s relationship, and confirmation no repayment is expected must be provided.
  - Not eligible for reserves.
- Retirement Accounts, 401(k)/IRA Distributions. Document:
  - The ownership of the accounts;
  - The borrower's actual receipt of the funds realized from the liquidation of the assets if needed to complete the transaction.
- Sale of Currently Owned Real Estate. Document:
  - The source of funds by obtaining a copy of the Closing Disclosure Settlement Statement on the currently owned home before, or simultaneously with, the settlement on the new home.
- Stocks, Bonds, and Mutual Funds. Document:
  - The borrower’s ownership of the account or 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 of the assets if the stocks, bonds, and mutual funds will be used for the down payment or closing costs.
  - The value of government bonds must be based on their purchase price unless the redemption value can be documented.
  - The value of stocks and mutual funds may be determined by obtaining the most recent two months or quarterly statement from the depository or investment firm.
- Trust Account Funds. Document:
  - That the borrower has immediate access to the trust funds; and
  - Obtain written documentation of the value of the trust account from either the trust manager or the trustee; and
  - The conditions under which the borrower has access to the funds and the effect, if any, that the withdrawal of funds will have on trust income used in qualifying the borrower for the mortgage.

40.50.30 Ineligible Source of Funds

- 1031 exchange funds
- 529 plans
- Cash-on-hand
- Cash-out proceeds from concurrent transactions
- Credit card financing
- Donations

- Personal unsecured loans
- Real estate commissions earned from the subject transaction
- Rent credit from Rent-to-Own transactions
- Sweat Equity

40.50.40 Reserves

- All funds eligible under Source of Funds are acceptable for reserves, unless otherwise noted.
- The minimum reserve requirements are reflected in the grid at the beginning of the Guide.
- First Time Home Buyers (FTHB) require 12 months reserves.
    - FTHB is defined as an individual who has not had a mortgage in the past three years or owned a home in the past three years.
    - Applications with multiple borrowers are not considered FTHB unless all applicants are FTHB.
- Borrowers with three or more financed properties require at least 18 months reserves, based on the subject property's PITIA.
- All assets used to satisfy reserve requirements must be owned by the borrowers.
    - Gift funds may not be used for reserves.
- Stocks/Bonds/Mutual Funds: 70% of the current balance may be considered for reserves.
- Vested Retirement Account Funds
    - 60% of the current vested balance may be considered for reserves.
- Departing Residence Reserve Requirements:
    - If the percentage of equity in the departing residence is 25% or more: 2 months reserves on the departing residence in addition to number of months required in the Eligibility Grid or Multiple Financed Properties section, as applicable.
    - If the percentage of equity in the departing residence is less than 25%: 6 months reserves on the departing residence in addition to number of months required in the Eligibility Grid or Multiple Financed Properties section, as applicable.
    - See Policy Exceptions Regarding the Exclusion of Rental Income From a Principal Residence Being Vacated by a Borrower section for equity determination requirements.
- Business Funds for Reserves
    - Allowed see 40.50.10 for additional information

40.50.50 Ineligible Source of Reserves

- 529 plans
- Cash-on-hand
- Cash-out proceeds from concurrent transactions
- Gift funds
- Real estate commissions earned from the subject transaction
- Restricted Stock, Restricted Stock Units, or Stock Options
- Secured borrowed funds, i.e. funds from a HELOC securing a non-subject property

50 PROPERTY

50.10 GENERAL PROPERTY REQURIEMENTS

50.10.10 Eligible Property Types

- Single Family Detached One Unit

- Single Family Attached One Unit
- 2 Unit (Must be Owner-Occupied)
- PUDs
- Condominiums—Fannie Mae Warrantable only.
    - Any Fannie Mae warranty option is acceptable, including Full or Limited Review
    - Projects with pending litigation are ineligible
- Multiple parcels acceptable subject to:
    - Each parcel must be conveyed in its entirety
    - Parcels must be adjoined to the other, unless they comply with the following exception. Parcels that otherwise would be adjoined, but are divided by a road, are acceptable if the parcel without a residence is a non-buildable lot (for example, waterfront properties where the parcel without the residence provides access to the water). Evidence that the lot is non-buildable must be included in the loan file.
    - Each parcel must have the same basic zoning (for example, residential, agricultural).
    - The entire property may contain only one dwelling unit. Limited additional non-residential improvements, such as a garage, are acceptable. For example, the adjoining parcel may not have an additional dwelling unit. An improvement that has been built across lot lines is acceptable. For example, a home built across both parcels where the lot line runs under the home is acceptable. The mortgage must be a valid first lien that covers each parcel.

50.10.20 Ineligible Property Types

The following types of properties are ineligible:

- 3-4 unit properties
- Agriculturally zoned
- Commercially zoned
- Commercial Enterprises (e.g. Bed and Breakfast, Boarding House, Hotel)
- Condotels
- Cooperatives
- Fannie Mae Unwarrantable Condos
- Geodesic Domes
- Hobby farm properties
- Hotel Condos
- Log homes, except in areas where log homes are acceptable and prevalent
- Manufactured homes, including modular homes built on a permanent chassis.
- Mixed-Use Properties
- Mobile Homes
- Properties held in a business name
- Properties with C5, C6, or Q6 ratings
- Properties with environmental hazards
- Properties with encroachments, except as allowed in section 50.60.40
- Properties with less than 750 square feet of living area
- Properties with more than 15 acres.
- Properties with pending litigation
- Properties with Private Transfer Fee Covenants
- Timeshares

- Unimproved Land and property currently in litigation
- Unpermitted additions
- Working Farms and Ranches
- Zoning violations including residential properties zoned commercial

50.10.30 Recently Listed Properties

- Rate/Term Refinances: The listing must have been expired or withdrawn six months prior to the note date.
- Cash-out Refinances: The listing must have been expired or withdrawn 12 months prior to the note date.

50.10.40 Property Flipping

- Properties that involve a re-sale that occurred within the last 180 days that have a non-arm's length relationship between the buyer and seller and an increase in value are prohibited. Time frame is established by seller's date of acquisition as the date of settlement on the seller's purchase of that property and the execution of a sales contract to another party
- Properties that involve a re-sale that occurred within the last 180 days with a price increase will have the appraisal fully-reviewed PennyMac.

50.20 GENERAL APPRAISAL REQUIREMENTS

The lender is responsible for ensuring that the subject property provides adequate collateral for the mortgage. PennyMac requires that the lender obtain a signed and complete appraisal report that accurately reflects the market value, condition, and marketability of the property. All transactions require a full interior appraisal on a 1004 or 1073 form as appropriate. In addition, the appraisal must be well supported by an independent third party appraisal review. Any issues detected by the appraisal review will need to be addressed and reconciled.

- Transferred appraisal or use of prior appraisal is not allowed.
- Appraisals must be dated within 120 days of the note date. A new appraisal is required after 120 days.
- Two full appraisals (1004 or equivalent) are required on all loan amounts greater than $2,000,000.
- Two full appraisals are required for non-arm's length transactions, regardless of the loan amount.
- PennyMac will review all appraisals provided.
- PennyMac requires lenders order an independent appraisal review product on the appraisal used for qualifying. PennyMac requires using one of the following options:
    - Property Desktop Analysis (PDA) from Old Republic,
        - PDAClientsetup@oldrepublictitle.com
        - ORSSaccountmanagement@Oldrepublictitle.com
    - Collateral Desktop Analysis (CDA) from Clear Capital, or
        - customer@clearcapital.com
- Appraised value variance between the two appraisals or appraisal and appraisal review product may not exceed 10%.
- When two appraisals are required, the following applies:

- the LTV will be determined by the lower of the two (2) appraised values as long as the lower appraisal supports the value conclusion.
  - Both appraisal reports must be reviewed and address any inconsistencies between the two (2) reports and all discrepancies must be reconciled.
  - If the two (2) appraisals are done "subject to" and 1004Ds are required, it is allowable to provide one (1) 1004D. If only one (1) 1004D is provided, it should be for the appraisal that the value of the transaction is being based upon.
- All appraisers must hold at least the minimum required state license and a copy of the license must be submitted with the appraisal.
- Appraisals must be completed in compliance with FIRREA/USPAP and all applicable regulatory requirements.
- 1004MC required. On purchase transactions, the appraiser must review the sales contract, and all subsequent addenda.
- Appraisal 1st generation PDF required.
- Appraisals must be Appraiser Independence Requirements (AIR) compliant.
- For newly constructed homes: All required inspections, licenses and certificates must be obtained.

50.20. 10 Soft Market

LTV/CLTV/HCLTV reduced by 5% when the appraisal indicates in either the Neighborhood Section Housing Trends or 1004MC Median Comparable Sale Price that property values are declining.

50.30 ESCROW HOLDBACKS

Escrow holdbacks are not allowed.

50.40 DISASTER POLICY

It is the lender's sole responsibility to be aware of and act upon any mortgage loans impacted by disasters prior to the sale to PennyMac.

The lender should contact the appropriate source e.g., state office, regional Federal Emergency Management Agency (FEMA) offices, news agency, etc. to determine whether properties located in its origination regions are included in the disaster areas.

PennyMac's Disaster Policy applies to any of the following:

- FEMA declared disaster areas eligible for Individual Assistance.
- Areas identified by PennyMac.
- Properties that the lender has reason to believe sustained damage in a disaster.

When the appraisal is completed on or before the incident period end date, PennyMac will require a post disaster inspection confirming the property has not been adversely affected by the disaster. The lender can utilize any of the following re-inspection options:

- Property Inspection Report (Form 2075), or
- Appraisal Update and/or Completion Report (Form 1004D), or
- Certification from a Licensed Property Inspector, or
- Lender Certification with post-disaster photos that clearly demonstrate the property has not been adversely affected by the disaster. The Certification must not be executed by an employee that receives direct compensation from the subject transaction.

Note: The post-disaster inspection must be provided prior to PennyMac purchasing the loan.

50.50 HAZARD AND FLOOD INSURANCE REQUIREMENTS

50.50.10 Amount of Hazard Insurance Coverage

- For first lien home mortgages on 1-2 unit properties, the hazard insurance coverage must be equal to the lesser of:
    - 100% of the insurable value of the improvements—as established by the property insurer or
    - Guaranteed Replacement Cost Endorsement, which provides that the insurer agrees to replace the insurable property, regardless of the cost or the Replacement Cost Endorsement or;
    - The unpaid principal balance of the mortgage, as long as it equals the minimum amount (80%) of the insurable value (total appraised value minus the estimated site value) required to compensate for damage or loss calculated on a replacement cost basis. **Note**: Due to the revised agency appraisal form, which eliminated the site value box, the estimated site value can be submitted with a notation in the Comments section of the appraisal or an appraisal addendum signed by the appraiser.
- If the hazard insurance is not equal to at least one of the above minimum coverage amounts, then additional hazard coverage that meets the minimum coverage amounts must be obtained before the loan can be closed.
- If the estimated site value, opinion site value, or an appraisal addendum signed by the appraiser is not available on the appraisal, the documents below are acceptable in the following order:
    - Insurance value from the insurance agency
    - Third party vendor (Marshall and Swift [example: Data Quick] may have been used by the vendor.)
    - If the site value is not noted, the tax assessor value from the title policy/commitment or tax assessment form may be used for the calculation.
- Hazard insurance policies that include optional coverage that is not required by PennyMac are acceptable, provided that PennyMac is not obligated to renew any part of the coverage not required hereunder.
- Hazard coverage for units in Project Developments must meet FNMA requirements.

50.50.20 Hazard Insurance Deductible

Deductible requirements on Jumbo loans must meet FNMA requirements.

50.50.30 Flood Insurance Requirements

- When flood insurance is required, it must be escrowed.
- A Flood Zone Determination Certification (FZD or Flood Cert) is required in each loan file. Flood insurance is required for any property located in a Special Flood Hazard Area which has federally mandated flood insurance purchase specifications. Properties located in Special Flood Hazard Areas designated by the symbols "A" and "V" on a Flood Insurance Rate Map (FIRM) require flood insurance.
- Non-Participating Communities
    - PennyMac will not purchase mortgages secured by properties which are determined to be in a Special Flood Hazard Area and which are located in areas where the community does not participate in the National Flood Insurance Program.

- PennyMac may waive its flood insurance requirements if:
    - The improvements constructed on the mortgaged property are not in a Special Flood Hazard Area even though part of the unimproved property may be; or
    - A letter from the Federal Emergency Management Agency (FEMA) is supplied stating the maps have been amended so that the mortgaged property is no longer in a Special Flood Hazard Area.
- Required Documentation
    - Flood insurance generally should be in the form of the standard policy issued under the National Flood Insurance Program. The Policy Declaration page of a policy is acceptable evidence of flood insurance coverage.
    - Policies that meet the National Flood Insurance Program requirements—such as those issued by licensed property and casualty insurance companies that are authorized to participate in NFIP's "Write Your Own" program—will be acceptable.
- If flood insurance is required, the mortgage loan must close with one of the following:
    - A complete flood insurance policy containing a standard mortgagee clause which must read as described in the Guide.
    - A complete application to the National Flood Insurance Program Agency (NFIP) with evidence that the first year premium on the policy has been paid and an elevation certificate if the property was constructed after the date on the FIRM.
- Elevation Certificate
    - A new elevation certificate may be obtained from a private engineer, architect, land surveyor, or a local community permit official who obtains the information by transcribing data from the building permit records provided that the data has been certified.
    - PennyMac will accept the following alternative documentation in an effort to help minimize the expense of obtaining an elevation certificate:
        - A copy of the property seller's elevation certificate;
        - A copy of the property seller's flood insurance declaration page (provided the elevation information is on the declaration page); or
        - A completed application to the NFIP with evidence that the first year premium on the policy has been paid, and a completed Flood Insurance Certification Form if the property was constructed before the FIRM date.
    - With respect to new construction, elevation information may be obtained from the city engineer or the developer's site planning engineer.
    - To determine whether a property was constructed before or after the FIRM date, consult the Community Status Book published by NFIP directly.
- Amount of Coverage
    - If flood insurance is required with respect to a mortgaged property, the amount of flood insurance required, regardless of property type, is the lesser of:
        - The unpaid principal balance of the mortgage, or
        - The maximum amount of coverage available under the NFIP for the type of improvements, or
        - The replacement cost of the improvements
- Condominium Projects must meet FNMA requirements

50.50.40 Flood Insurance Deductible

- Jumbo loans must meet FNMA deductible requirements.

- In addition to any flood insurance required with respect to a specific condominium or PUD unit, if any parts of a project's common elements are in a Special Flood Hazard Area, the homeowners association must maintain a "master" or "blanket" policy of flood insurance and collect premiums from its members as it would any other common expense.
- The specifications for condominiums and PUDs are:
  - For PUD projects, the master policy should cover any common elements in the buildings and other common property.
  - For Condominium projects, the policy should cover common elements in the buildings and any other common property. When the project consists of high-rise or other vertical buildings, the owner's association must have a separate flood insurance policy for each building that contains dwelling units.

50.60 TITLE AND CLOSING

50.60.10 General Requirements

- Title commitment dated within 90 days of the note date, measured from the effective or issue date of the commitment.
- Private transfer fee covenants are not acceptable.
- The original principal amount of the mortgage loan is the minimum amount of title insurance coverage acceptable to PennyMac.
  General Title Waivers: The title to the property that secures a mortgage loan must be merchantable and free and clear of all defects, liens and encumbrances.

50.60.20 Title Commitment Requirements

Title insurance policies must be covered by an American Land Title Association (ALTA) mortgage title insurance policy, or such other generally acceptable form of policy or insurance acceptable to FNMA.

50.60.30 Borrower's Estate

- The borrower's title to the mortgaged property must be in fee simple, unless the mortgage loan is secured by a leasehold estate.
- Title may be held by borrowers individually, or as joint tenants. Corporations, partnerships, real estate syndications, and land trusts are not permitted to hold title to mortgaged properties.
- If a married borrower wishes to take title to the mortgaged property without his or her spouse, the lien created by the mortgage must be superior to any interest in the mortgaged property the spouse may have under the law or otherwise.

50.60.40 Title Impediments

Title for a property that secures a Jumbo mortgage is acceptable even though it may be subject to the following conditions, which are considered minor impediments:

- Customary public utility subsurface easements that were in place and completely covered when the mortgage was originated, as long as they do not extend under any buildings or other improvements;
- Above-surface public utility easements that extend along one or more of the property lines for distribution purposes or along the rear property line for drainage purposes, as long as they do not extend more than 12 feet from the property lines and do not interfere with any of the buildings or improvements or with the use of the property itself;

- Mutual easement agreements that establish joint driveways or party walls constructed on the security property and on an adjoining property, as long as all future owners have unlimited and unrestricted use of them;
- Restrictive covenants and conditions, and cost, minimum dwelling size, or set back restrictions, as long as their violation will not result in a forfeiture or reversion of title or a lien of any kind for damages, or have an adverse effect on the fair market value of the property;
- Encroachments of one foot or less on adjoining property by eaves or other overhanging projections or by driveways, as long as there is at least a ten foot clearance between the buildings on the security property and the property line affected by the encroachment;
- Encroachments on adjoining properties, as long as those encroachments consist only of hedges or removable fences;
- Outstanding oil, water, or mineral rights that are customarily waived by other lenders, as long as they do not materially alter the contour of the property or impair its value or usefulness for its intended purposes;
- Variations between the appraisal report and the records of possession regarding the length of the property lines, as long as the variations do not interfere with the current use of the improvements and are within an acceptable range. (For front property lines, a 2% variation is acceptable; for all other property lines, 5% is acceptable.);
- Rights of lawful parties in possession, as long as such rights do not include the right of first refusal to purchase the property. (No rights of parties in possession, including the term of a tenant's lease, may have a duration of more than two years.);
- Minor discrepancies in the description of the area, as long as Lender provides a survey and affirmative title insurance against all loss or damage resulting from the discrepancies;
- Exceptions to Indian claims, as long as PennyMac is insured against all loss and damage from such claims.

50.60.50 Escrow/Impound Accounts

In general, PennyMac does not require escrow/impound accounts except for flood insurance. When flood insurance is required, it must be escrowed. Flood insurance escrow may not be waived.

60 Regulatory Compliance

Lender must be aware of, and in full compliance with, all federal, state, and local laws (e.g., statutes, regulations, ordinances, administrative rules, and orders that have the effect of law, and judicial rulings and opinions) that apply to any of its origination, selling practices, or other business practices (including the use of technology) that may have a material effect on Lender. This means that Lender must comply with any applicable law, including but not limited to, those addressing fair housing, fair lending, equal credit opportunity, truth in lending, wrongful discrimination, appraisals, real estate settlement procedures, unfair, deceptive or abusive acts or practices, borrower privacy, data security, escrow account administration, mortgage insurance cancellation, debt collection, credit reporting, electronic signatures or transactions, predatory lending, terrorist activity, ability to repay or the enforcement of any of the terms of the mortgage. Lender must comply with Complaint Management and Service Provider program requirements, also ensure that appraisals, and any appraisal review products, conducted in connection with single-family mortgage loans originated by Lender conform to the Appraiser Independence Requirements.

Lender does not discriminate in any aspect of a credit transaction on the basis of sex, marital status, race, religion, national origin, age, income derived from public assistance, or the good faith exercise of rights under the Consumer Credit Protection Act.

60.10 HIGH COST, HPML, AND REBUTTABLE PRESUMPTION

- PennyMac will not purchase High Cost loans or Higher Priced Mortgage Loans (HPML).
- PennyMac will not purchase Rebuttable Presumption Jumbo loans.
  - Rebuttable Presumption for Jumbo loans is defined as an Annual Percentage Rate (APR) ≥ 1.5% above the Annual Percentage Offer Rate (APOR).
  - Average prime offer rates are annual percentage rates derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics.

60.20 ABILITY TO REPAY AND QUALIFIED MORTGAGE RULE

60.20.10 Introduction and Overview

The Consumer Financial Protection Bureau (CFPB) adopted a rule that implements the Ability to Repay and Qualified Mortgage (ATR/QM) provisions of the Dodd-Frank Act. The effective date of the ATR/QM rule is with initial applications received by the creditor on or after January 10, 2014.

For loans subject to the ATR/QM rule, Lender will only originate loans that comply with the requirements of the ATR/QM rule.

The ATR rule requires that the originator make a reasonable, good-faith determination before or when the loan is consummated and that the borrower has a reasonable ability to repay the loan. The origination lender must consider the eight underwriting factors established by the CFPB under Regulation Z section 1026.43 and the loan file must be documented accordingly.

1. The borrower's current or reasonably expected income or assets;
2. The borrower's current employment status;
3. The borrower's monthly payment on the covered transaction;
4. The borrower's monthly payment on any simultaneous loan;
5. The borrower's monthly payment for mortgage-related obligations;
6. The borrower's current debt obligations, alimony, and child support;
7. The borrower's monthly debt-to-income ratio or residual income; and
8. The borrower's credit history.