1.22 Down Payment Assistance

The institution encourages loan originators and community lending officers to research all down payment assistance programs which may be available to qualifying borrowers for primary residence homes. When structured as a subordinate lien with an affordable housing first mortgage program, the down payment assistance must meet the requirements of Fannie Mae Community Seconds or Freddie Mac Affordable Seconds program. Sources of down payment assistance may include any of the following entities:

- State-chartered housing partnership agencies.
- Regional Federal Home Loan Bank.
- Local governmental authorities such as city, town, county, or other municipal office.
- Nonprofit housing partnership organization.
- Federally recognized Native American tribe or tribally designated housing entity.
- Borrower's employer, or loan from other entity that is guaranteed by the employer.

Down payment assistance may be used to cover all or part of the borrower(s)' down payment; closing costs; energy retrofit; or home renovations. The following formats are acceptable:

- Soft second mortgage (or silent second)
- Deferred payment loan
- Forgivable loan (for an initial term or life of loan)

Borrowers must be qualified according to the requirements established by the down payment funding source. Eligibility rules may include maximum borrower income and/or maximum home purchase price. In some instances, a minimum cash investment from the borrower may be required, or rules may be structured according to household size. The monthly cost of principal and interest for the down payment loan must be included in the DTI ratios for loans requiring payments for the first three years.

Community Land Trusts

The institution will consider first mortgages for properties held by a community land trust. In lieu of a cash down payment, the trust retains permanent ownership of the land and forms a group stewardship to oversee the housing community. Homebuyers will sign a long-term lease for the land, typically for 99 years. The land lease, structure of the trust, and terms of the first mortgage must meet Fannie Mae or Freddie Mac guidelines.

Shared Equity Loans

The institution will consider first mortgages that are structured as a shared equity loan. In exchange for providing down payment funds, borrowers agree to give up a modest share of the home's future value. The structure of the shared equity agreement and loan terms must be acceptable to Fannie Mae or Freddie Mac.

Re-sale Restrictions

The institution will consider first mortgages that are structured with a re-sale restriction, generally associated with an affordable housing initiative through a city or town. Generally, the municipality or participating nonprofit subsidizes the price differential so that qualifying borrowers can purchase the home at a below-market price. Borrowers will sign a restrictive re-sale deed, which stipulates that if the home is sold at a future date, it must be sold to an affordable household. Structure of the restrictive deed and loan terms must be acceptable to Fannie Mae or Freddie Mac.

1.23 High Needs Areas

Community loan officers are encouraged to utilize the eligibility lookup tools provided by Fannie Mae and Freddie Mac to explore affordable mortgage eligibility for prospective homebuyers in various geographical areas. Users can complete a query by entering the name of a state, county, city, or town, or a specific address. Alternatively, users can drop a pin on the flash map, and the pin can be dragged to explore nearby locations.

For each geographic area selected, a pop-up window will display borrower income limits in three tiers, delineating figures at 100%, 80%, and 50% of area median income (AMI). The viewing screen also indicates if the census tract is in a Special Focus Area, such as Rural or High-Needs, Minority, Low-income, High-Cost Census Tract, or Designated Disaster Area. The Conforming Loan Limits for 1–4-unit dwellings are also displayed.

The Fannie Mae Area Median Income Lookup Tool can be utilized to identify AMI requirements for Fannie Mae's HomeReady® or other programs. See Fannie Mae's Tool Tips.

The Freddie Mac Home Possible Income and Property Eligibility Tool provides eligibility for Freddie Mac's affordable mortgage programs, and also includes a direct link to a listing of down payment assistance programs available in the selected location.

To search for areas designated as rural, originators can navigate various geographic regions using the USDA property eligibility lookup tool. Under the tab named "Single Family Housing Guaranteed," any state, county, city, or address can be entered. Users may drop a pin on the flash map, and the pin can be dragged to explore nearby locations.

1.24 Compensating Factors

Credit review should include an analysis of any additional compensating factors which may not be included in a standard review. Certain compensating factors may be used to support debt ratios greater than 43% under the Qualified Mortgage (QM) rule. Compensating factors should be noted by originators or processors and documented in a memorandum prior to submitting the loan for approval. Loan underwriters are required to list each compensating factor on the Underwriting Transmittal form. Compensating factors must be acceptable to the loan program or investor. Examples of compensating factors are listed:

- Large down payment.
- Cash reserves of 3 to 6 months of housing payments.
- Considerable liquid assets.
- Additional non-qualifying income.
- No outstanding debt.
- Excellent credit history.
- Non-taxable income such as retirement or Social Security.
- Reimbursed automobile or cost-of-living expenses from employer.
- Career growth potential, such as recent promotion or educational completion.
- Prior housing payment was considerably higher and paid timely.

1.25 Credit Decision

The institution requires that equal and impartial consideration be given to all loan applicants. Departures from credit standards must be explained and documented on the loan transmittal. For non-traditional sources of credit, asset, or income, loan files must include validated documentation and a description of verification steps, such as a telephone confirmation. Qualifying figures may be grossed up 25% for sources of non-taxable income. Loan decisions are based on a range of factors, including without limitation: credit history, equity or down payment, stable and verifiable income and the condition and value of the collateral. Appraisal underwriting standards are based on requisites of participating secondary market agencies and insurers.

The institution shall make a reasonable effort to determine whether the borrower has the capacity to make scheduled payments repay the loan, including principal, interest, hazard insurance, property taxes, and applicable property-related expenses such as mortgage insurance or homeowners' association dues. Credit decision shall be based on the verified, combined monthly pretax income of all borrowers on the application, relevant financial resources, employment status, credit history, and financial obligations.

1.26 Counteroffer

Every attempt should be made to grant a loan approval on the terms and conditions as requested. For situations where the loan can be approved—but at different terms—the following steps must be completed:

1. The LOS system and applicable secondary marketing interface must be updated with the revised loan terms.
2. The underwriting transmittal and other forms must be updated with the revised loan terms, PTI figures, DTI ratios, and CLTV%.
3. The reason for the counteroffer must be documented on the LOS and transmittal.
4. The terms of the counteroffer must be communicated to the loan originator, processor, and staff members involved in the issuance of TRID disclosures or pre-closing instructions.
5. Borrowers must be issued an adverse action notice for the requested loan within 30 days of receipt of a completed application, and the notice may be issued in conjunction with the counteroffer. Alternatively, a "combined" notice may be issued.
6. The reason for the counteroffer may be included in the borrower(s)' letter of approval. For example: "*Loan amount is based on an appraised valuation of $310,500*."
7. A revised Loan Estimate must be issued to the borrower(s).
8. Borrowers must be issued an adverse action notice if the counteroffer is not accepted, or the borrower has not responded within 90 days.

1.27 Credit Denial

All loans which are issued an adverse action must be handled in the most professional, courteous manner possible, with appropriate documentation issued to the borrower on a timely basis. The *Adverse Action Notice* must be issued within 30 days of receipt of a completed application. Applicants must receive the adverse action notice in writing for any of the following circumstances:

- Denial of an application for credit.
- Terminating an existing credit account.
- Making unfavorable changes to the terms of an existing account.
- Refusing to increase a credit limit.

The notice must state whether or not a credit score was used and include the key factors adversely affecting the credit score.

1.28 Specific Reasons for Denial

The institution requires mortgage underwriters to follow each of the following steps in the issuance of a credit denial on all loan applications, with the exception of applications requiring review by the institution's second review team:

1. Each applicable factor must be addressed for each section on the standard *Adverse Action Notice:*
   - The applicant(s)' income.
   - Employment.
   - Credit history.
   - The loan application.

2. The credit score used in the credit decision must be included, along with the date, score range, and a list of key factors that affected the score. For applicants with no credit score, the free-form text field can be used for further explanation.

3. HMDA denial codes must be entered in the LOS system for each applicable factor.

4. The specific reasons for denial must be included in free-form text fields within the LOS system. Reasons must accurately describe the factors considered.

As appropriate, specific reasons should reflect the institution's underwriting policy and specify names, sources, or other pertinent information. Outlined below are examples:

A. *Based on your combined monthly income, your debt-to-income (DTI) ratio is 51.5%. The maximum allowable DTI for your requested loan program is 43%.*

B. *Our office did not receive a response to repeated requests for a copy of a W-2 tax form and recent paystub to confirm David's employment with Amazon.*

C. *Our office did not receive copies of Mary's payment history to Ford Auto Leasing Corp. which was necessary to dispute the 4 delinquencies reported during the past 12 months. We requested supplemental credit information from Equifax but were unable to ascertain any reporting errors or discrepancies.*

D. *Your application for a cash-out refinance loan in the amount of $260,000 exceeds the maximum loan amount of $236,800 based on 80% of the property valuation as determined by a licensed professional appraiser. Our office has provided you with a copy of the appraisal report from Acme Appraisal Corp. indicating a current valuation of $296,000.*

1.29 Artificial Intelligence in Denials

The institution is committed to using AI models that are as transparent as possible. Lending decisions utilizing any algorithmic method must be "explainable" artificial intelligence, also known as XAI. The institution must remain in control of the model and have a working explanation for the outcome of decisions. The customer-facing team must be able to explain to consumers why their loan was denied. The specific reasons for denial must be included in the adverse action notice whether the formula is based on an algorithmic model or conventional method.

Reliance upon technologies that are too complicated or opaque to understand may be considered a violation of ECOA and Regulation B. The institution shall review all loan programs, parameters, and eligibility criteria on a periodic basis to ensure that decisioning technologies are based on explainable methodologies. Depending upon changes in the real estate financing industry, the institution will regularly complete the following evaluations and assess the process for implementation of change:

- Review all product descriptions and parameters.
- Review and amend eligibility parameters for each loan program.
- Review credit grading matrices and criteria.
- Review decisioning algorithms to ascertain level of transparency.
- Ensure algorithms do not disproportionately affect borrowers on a prohibited basis.

1.30 Second Review

The institution shall maintain a "second review" committee that consists of persons working outside of the loan operations area. The committee will meet on an as-needed basis to review the loan applications of loans denied by an underwriter which meet certain criteria. The review committee will make recommendations to loan production managers, and specify reasons to support the denial, or recommend loan approval or a counteroffer. Criteria for loans which may require a second review can include any of the following:

- Properties located in a majority-minority tract (MMT).
- Properties located in a low-to-moderate income tract (LMI).
- Properties located in a rural or designated high needs area.
- Applications with a below-contract appraisal valuation.
- Minorities or any prohibited basis group with marginally close qualifications.
- Loans considered special circumstances by management.

1.31 Withdrawn Applicants

The LOS system and HMDA fields must be updated as soon as a loan application is considered to be withdrawn. The explanation about why the loan was withdrawn must be entered in the LOS system for any of the circumstances outlined below:

1. The applicant has expressly requested they wish to withdraw their loan application before a loan decision was made. The HMDA code for this example is Code 4, Application withdrawn by applicant.

2. The applicant has notified the institution they wish to withdraw their loan application after receiving a letter of approval. The HMDA code for this example is Code 2, Application approved but not accepted.

3. The institution denied the application prior to receiving a withdrawal request. The file is reported as HMDA Code 3, Application denied.

4. The application is "considered to be withdrawn" because the applicant did not respond to a *Notice of Incomplete Application* within the required time frame. The file is reported as HMDA code Code 5, Closed for incompleteness.

5. The applicant has not responded to receipt of a "conditionally approved" letter that was subject to receipt of a verification or an appraisal supporting a certain LTV%. The applicant can be issued a *Notice of Incomplete Application*; and if there is no response within the required time frame, HMDA Code 5, Closed for incompleteness.

1.32 Files Closed for Incompleteness

When the institution receives an application that lacks sufficient data for a credit decision (excluding a preapprovals), one of two options may be followed within 30 days from receipt of the application:

1. The applicant may be issued an *Adverse Action Notice* specifying that the reason for denial is an "Incomplete Application."
2. The applicant may be issued a *Notice of Incompleteness*. The notice must specify what information is needed; designate a reasonable period of time to provide the information; and include a statement that the application will not be further considered if the requested information is not provided.

The LOS system must be updated each time a request was made for information or supporting documents. File memoranda must include the follow-up dates, method of contact (phone, text, mail, email).