Freddie Mac
We make home possible®

Bulletin

NUMBER: 2009-18

TO: Freddie Mac Sellers and Servicers — July 10, 2009

SUBJECTS

Introduction

Although Freddie Mac has seen improvements in credit quality over the last few months, we are still seeing a number of deficiencies in the underwriting process. Common underwriting issues relate to, but are not limited to, income calculation, asset verification, liability calculation, misrepresentation of occupancy and appraisal quality. Our research has shown that a Mortgage that does not meet Freddie Mac *Single-Family Seller/Servicer Guide* ("Guide") requirements is substantially more likely to go into default than a Mortgage that meets Freddie Mac's requirements. Through the promotion of sound underwriting requirements and improved Mortgage underwriting and appraisal processes, Freddie Mac will help Seller/Servicers minimize the risks and costly impacts associated with defaults and repurchases.

In order to improve underwriting quality and, ultimately, performance of the Mortgages we purchase, with this Guide Bulletin, we are providing further guidance on existing underwriting requirements and revising other underwriting requirements with respect to Borrower income, capacity, assets and required documentation. These revisions, along with the best practices we are providing, will help Sellers ensure that the Mortgages they originate meet our definition of investment quality Mortgages and are eligible for sale to Freddie Mac.

In addition, given challenges current market conditions pose in connection with determining accurate property values, it is especially critical that appraisals support the value of the property. To assist Sellers in their determination of whether appraisals are acceptable, we are reminding Sellers of our appraisal requirements, available tools and providing best practices.

We are also changing our definition of a Condominium Hotel to better align with the industry-accepted definition for these projects. Under the new definition, if a project operates as a hotel/resort or has features of or offers services typically associated with a hotel/resort, Mortgages secured by units in the project are ineligible.

We are also revising Form 65, *Fannie Mae/Freddie Mac Uniform Residential Loan Application*, to address the new Federal Housing Finance Agency (FHFA) loan-level origination data requirements.

At Freddie Mac, working with Seller/Servicers to rebuild a strong mortgage finance system is a high priority. By reinforcing responsible lending standards that will withstand market fluctuations, Freddie Mac can help ensure that Seller/Servicers and Borrowers are successful throughout the entire life of a Mortgage.

Effective dates

- **October 1, 2009** – Revisions to underwriting requirements with respect to Borrower income, assets, postfunding quality control and required documentation, are effective for Mortgages with applications dated on and after this date
- **October 31, 2009** – Mortgages secured by units in projects the Seller represents and warrants to be eligible based on our prior definition of a Condominium Hotel (or other such project) and with applications dated before September 1, 2009, must have Freddie Mac Settlement Dates on or before this date
- **January 1, 2010**
  - Revisions to underwriting requirements with respect to Borrower income, assets, postfunding quality control and required documentation, are effective for Mortgages with Freddie Mac Settlement Dates on or after this date
  - Revised Form 65 must be used with loan applications originated on and after this date and may be used prior to this date

Revisions to the Guide

The revisions included in this Bulletin impact the following:

- Chapters 2, 17, 23, 26, J33, A34, 37, 42, 44 and 46
- Forms 65, 70A, 90, 91, 1000
- Glossary

UNDERWRITING REQUIREMENTS

To help ensure Seller/Servicers and Borrowers are successful throughout the entire life of a Mortgage, with this Bulletin we are emphasizing existing underwriting requirements and revising other underwriting requirements with respect to Borrower income, creditworthiness, assets and required documentation.

The revisions to the existing underwriting requirements are effective for Mortgages with application dates on and after **October 1, 2009** and for Mortgages with Freddie Mac Settlement Dates on or after **January 1, 2010**. While the new requirements are not effective until October, we strongly recommend that Sellers begin underwriting Mortgages with these new requirements to help strengthen their origination processes and enhance the quality of the Mortgages they deliver to Freddie Mac.

Loan Prospector® feedback messages related to these changes will be implemented in the system **September 27, 2009** for submissions and resubmissions prior to the **October 1, 2009** effective date for new applications. Sellers with resubmissions to Loan Prospector on and after **September 27, 2009** and with application dates prior to **October 1, 2009** may apply the requirements in effect prior to this Bulletin to complete these loans under the prior guidelines and deliver before **January 1, 2010**.

To determine that a Mortgage is eligible for sale to Freddie Mac, a Seller/Servicer must conclude that the Borrower is creditworthy (acceptable credit reputation and capacity) and the Mortgaged Premises (collateral) are adequate for the transaction. Credit reputation, capacity and collateral are often called the "three Cs" of underwriting; if one of these components is not acceptable or if there is excessive layering of risk across components, the Mortgage is not eligible for sale to Freddie Mac. Sellers must accurately evaluate and determine a Borrower's ability to repay the Mortgage.

Submitting a Mortgage to Loan Prospector is the most efficient way to determine Borrower creditworthiness, provided the information submitted to Loan Prospector is accurate and properly verified. For Manually Underwritten Mortgages, the Seller must manually underwrite the Borrower to determine creditworthiness, as required by Guide Chapter 37. In addition, Sellers are accountable for the quality, integrity and accuracy of the appraisal and other collateral documentation.

As a reminder to Sellers, Freddie Mac reserves the right to conduct a postfunding quality control review of any Mortgage we purchase. We underwrite each Mortgage selected for postfunding quality control review to verify that the Mortgage meets our definition of investment quality.

Chapters 26, 37, 44 and 46 have been revised to reflect these changes.

Training and tools

Freddie Mac is providing Sellers with training and tools that focus on underwriting requirements and best practices, which can help build expertise for ensuring sustainable homeownership for borrowers. These resources are available on the Freddie Mac Learning Center at **http://www.freddiemac.com/learn/uw/**.

Income

With this Bulletin we are emphasizing the following existing income requirements, which help Seller's determine that the source and amount of income used to qualify the Borrower are stable. Sellers are required to comply with these requirements and must continue to comply with these requirements going forward:

- Emphasizing that the Seller must continue to consider income trends and the consistency of the income used to qualify the Borrower
- Reminding the Seller to obtain and analyze the Borrower's federal tax returns and business tax returns when the Borrower is self-employed
- Emphasizing that if the self-employed Borrower is relocating to a different geographic area, the Seller must document and explain the determination that the Borrower's income will continue at the same level in the new location
- Emphasizing that if an Investment Property is currently owned by the Borrower and reflected on the Borrower's federal tax returns, the Seller must use the income reported on Schedule E of the Borrower's federal tax returns for qualifying income in most instances (this applies to all investment properties owned by the Borrower)
- Reminding Sellers that they may not consider income for qualifying purposes if they have knowledge that, or the documentation indicates that the income is likely to terminate within the next three years

Borrower income requirements have been revised to reflect the following:

- Requiring a two-year history of receipt of income used to qualify the Borrower in most instances
- Requiring the Seller to provide a written analysis of how the income was calculated and maintain the analysis in the Mortgage file
- Adding specific documentation requirements for: commission, bonus, overtime, automobile allowance, mortgage differential, military, secondary employment, seasonal employment with associated unemployment compensation, tips, notes receivable, dividend and interest, trust, capital gains, royalty payments, public assistance, foster-care, alimony, child support or separate maintenance payments, Section 8 homeownership assistance payments and housing allowance income
- Permitting the Seller to consider the income of a Borrower who has been employed for less than two years if the Borrower was previously attending school or in a training program
- Permitting the Seller to consider the income of a Borrower with less than two years of recent employment who is re-entering the workforce when the Borrower has been at the current employment for a minimum of six months and the documentation supports a previous employment history

- Revising requirements related to income from alimony, child support or separate maintenance payments to require documentation showing that the payor was obligated to make payments to the Borrower for the most recent 12 months and is obligated to make payment to the Borrower for the next three years. If the payor was obligated for less than twelve months but not less than six months, the income can be considered for qualifying if the amount of the monthly payment does not exceed 30% of the Borrower's qualifying monthly income.
- Removing the requirement that the Seller must consider the creditworthiness of the payor for income such as alimony, child support and separate maintenance
- Removing the allowance to use trailing co-Borrower income as qualifying income
- Requiring documentation such as, but not limited to, tax returns, in order to gross-up tax exempt income
- Introducing new Guide Form 91, *Income Analysis Form*, to aid the Seller in the calculation of self-employed and commission income. Sellers are required to use Form 91 or a comparable form to calculate the income for a Borrower that is self-employed.
- Requiring Sellers to obtain and analyze the Borrower's individual federal tax returns to determine the impact of a business loss on the income used to qualify regardless of whether or not the income is used to qualify when the Borrower is self-employed

Assets

In order to ensure Borrowers have sufficient funds to close, Borrower asset requirements have been revised to require the Seller to subtract outstanding loans secured by the accounts when determining the vested balance for a retirement account (including an IRA and SEP IRA), 401(k), KEOGH, 403(b) and other Internal Revenue Service (IRS)-qualified employer plans and permitting 70% (or the net balance minus the minimum federal income tax withholdings required by the IRS) of the vested balance to be used.

Documentation requirements

To help ensure accurate and complete documentation, which is critical to all aspects of the origination process and is key to delivering loans that are eligible for sale to Freddie Mac, Borrower documentation requirements have been revised to reflect the following:

- Revising the Streamlined Accept documentation requirements for employed Borrowers to include either a written verification of employment (VOE) for one year and a verbal VOE not more than 10 calendar days prior to the Note Date or one year's W-2, a year-to-date paystub for at least 30 calendar days and a verbal VOE not more than 10 calendar days prior to the Note Date
- Requiring the Seller to obtain a verbal verification of employment for employed Borrowers not more than 10 calendar days prior to the Note Date for Standard Accept documentation requirements
- Requiring the phone number for the individual contacted, the dates of employment and whether the Borrower is currently employed for verbal verifications of employment. The phone number for the contact must be obtained from an independent third party source. Use of the new Form 90, *Verbal Verification of Employment,* or a form containing the same information is suggested.
- Removing the Seller's option to provide an additional paystub in lieu of a verbal verification of employment for Streamlined Accept and Standard Accept documentation requirements (except for military income)
- Permitting verbal re-verifications only for verification of employment when updating Mortgage file documents
- Requiring evidence of liquidation if the funds from stocks, bonds, any part of a retirement account or other non-liquid accounts are used for the Borrower's down payment, Closing Costs, Financing Costs and Prepaids/Escrows

- Requiring evidence of the source of funds for a cash deposit for the Borrower's down payment, Closing Costs, Financing Costs and Prepaids/Escrows
- Allowing Sellers to use an executed IRS Form 4506-T for verification of income reported to the IRS
- Requiring a letter from an accountant stating that the Borrower has access to the funds for withdrawal and that withdrawal of the funds will not have a detrimental effect on the business when business assets are used for the transaction. The accountant cannot be an interested party to the transaction and cannot be related to the Borrower.
- Adding a requirement that the Seller must verify the existence of the business through a third party source not more than 30 days prior to closing for a Borrower that is self-employed
- Eliminating Form 70A, *Energy Addendum*, as an addendum to the appraisal
- Changing the postfunding quality control requirements to state that all documentation in the Mortgage file sent to Freddie Mac will be reviewed and used when completing the post purchase quality control review, even if the documentation exceeds the documentation that is required

APPRAISALS

Freddie Mac recognizes the challenges that current market conditions pose in connection with determining accurate property values. Sellers are accountable for the quality, integrity and accuracy of the appraisal and other collateral documentation. To help you address these challenges, Sellers must review Chapter 44, *Appraisal Reports, Inspection Reports and the Property Inspection Alternative (PIA)*, including the Home Valuation Code of Conduct (HVCC), to understand our requirements for appraisals. An appraisal should provide a complete and accurate description of the property, and a supported market-based opinion of value.

Due to current market conditions, with this Bulletin we are reminding Sellers of certain existing appraisal requirements. This section covers the following topics:

- Qualified appraisers
- Credible appraisals
- Comparable sales
- Monitoring appraisal quality

We are also providing additional best practices identified in the exhibit attached to this Bulletin to assist Sellers in their determination of whether the collateral value is accurate. To help ensure that Seller/Servicers meet our appraisal requirements, Freddie Mac is recommending the adoption of these best practices.

Qualified appraisers

Sellers must comply with the following requirements related to the selection of an appraiser:

- Sellers must select appraisers in compliance with the terms of the HVCC
- Appraisers must be certified or licensed in the State in which the property is located, and must be eligible to perform appraisals in that State
- Appraisers must be familiar with the local market in which the property is located, must be competent to appraise the subject property type, and must have access to the data sources needed to develop a credible appraisal
- For loans that are sold to Freddie Mac, Sellers must not engage appraisers who appear on the Freddie Mac Exclusionary List. The list is updated monthly and contains the names and addresses of individuals and companies that have been excluded from participating in transactions involving Freddie Mac Mortgages.

Credible appraisals

Sellers must comply with the following requirements:

- Appraisers must comply with the Uniform Standards of Professional Appraisal Practice (USPAP), any applicable Advisory Opinions and all applicable rules and regulations
- Sellers must provide appraisers with the sales contract (for purchase transactions), the terms of any financing and contributions that are outside the contract, and any specific requirements of their Purchase Documents (i.e., scope of work) or the Sellers' policies and procedures if additional requirements have been established
- The appraiser's opinion of value must reflect the value of the subject property without concessions. The appraiser must take concessions into account for both the subject property, and the comparable sales. The appraiser must make market-based adjustments to the comparable sales to determine the price the purchaser would have paid for the property without the concessions.
- Sellers' staff must be trained to properly underwrite the appraisal reports to ensure that the appraiser's opinion of value meets Freddie Mac's definition of market value, and that the appraiser's conclusions are accurate and fully supported
- Staff must be familiar with USPAP, applicable laws and regulations, and the requirements of the Seller's Purchase Documents
- The underwriting of the appraisal report of an appraisal must be independent of loan production

Comparable sales

The appraiser's selection of comparable sales is crucial to providing an accurate opinion of value based on market data. With respect to comparable sales, the appraiser must choose appropriate comparable sales, and certify that the comparable sales chosen are those most similar to the subject property. In underwriting the appraisal, the underwriter must consider whether any adjustments are supported and are reasonable. The amount and number of any adjustments must also be considered. Typically, the higher the amount of the adjustments or the number of adjustments the more likely the comparable sales might not be representative of the subject property. Freddie Mac does not have requirements about what comparable sales the appraiser is to use. For example, we do not require appraisers to use Real Estate Owned (REO), foreclosure or short sales. However, if the appraiser determines that these are representative of the properties available to typical purchasers for the market in which the property is located, appraisers must consider their use.

Monitoring appraisal quality

The following best practices can greatly aid in determining the accuracy of an appraisal and to detect potential fraud. Freddie Mac is recommending that Seller/Servicers adopt the following best practices to assist in determining that the appraisal is acceptable:

- Use automated valuation models (AVMs) and other tools as part of the origination or pre-funding quality control process to detect fraud and objectively measure the accuracy of the appraisal. Freddie Mac recommends the use of Home Value Explorer® (HVE), Home Value Calibrator® ("Calibrator") or other validated and tested AVMs, as well as other collateral valuation tools, to assess the quality and accuracy of appraisals. More information about HVE and Calibrator, and a list of distributors, can be found on FreddieMac.com at **http://www.freddiemac.com/hve/**.
- If Loan Prospector provides a feedback message stating that the value of the subject property may be excessive, the Seller should carefully review the appraisal to ensure that it is accurate, and that the value is fully supported
- The Seller should have policies and procedures for its valuation processes that include an escalation and governance process when an AVM or other tool indicates that an appraised value is in question

In addition to the recommended best practices, the Seller must review Form 71, *Market Conditions Addendum*, to ensure that the appraiser has provided the Seller with a clear and accurate understanding of the market trends and conditions prevalent in the subject neighborhood; the Seller should ensure that the market trends reported on Form 71 are consistent with the Seller's knowledge of the market in which the property is located.

Review the best practices identified in the exhibit attached to this Bulletin to further ensure that the appraisal is complete and accurate and that underwriting guidelines are properly followed.

CONDOMINIUM HOTELS

We have changed our definition of a Condominium Hotel to better align with the industry-accepted definition. With this change in our definition, we are no longer relying on the existence of a revenue-sharing/rental-rental management agreement between a unit owner and an entity associated with the project as the key to determining whether the project is an ineligible project. Under the new definition, if a project operates as a hotel/resort or has the features of or offers services typically associated with a hotel/resort, the project is ineligible.

This definition of a project operated as a hotel, resort, or similar type of entity is effective for Mortgages with applications dated on and after **September 1, 2009**. For Mortgages with applications dated before **September 1, 2009**, Mortgages secured by units in projects the Seller represents and warrants to be eligible, based on our prior definition of a Condominium Hotel (or other such project), must have Freddie Mac Settlement Dates on or before **October 31, 2009**.

As a reminder, if the project is located in a mixed-use project in which there is a hotel, resort or similar type of entity, the project is ineligible (see Guide Section 42.8.4, *Mixed-use Condominium Projects*, for more information).

Sellers should carefully review the following Guide sections, which have been updated to reflect these changes:

- Section 42.3, *Ineligible projects*
- Section 42.10, *Hotel/Resort Projects*
- Glossary

UNIFORM RESIDENTIAL LOAN APPLICATION

We are revising Form 65, *Fannie Mae/Freddie Mac Uniform Residential Loan Application*, to address the new FHFA loan-level origination data requirements, announced in a FHFA press release on January 15, 2009. Specifically, for Mortgage applications taken **January 1, 2010**, or later, we will begin collecting unique identifiers for the loan originator and the loan origination company on the *Uniform Residential Loan Application*.

The revised *Uniform Residential Loan Application* is available on our Single-Family Uniform Instruments web site on FreddieMac.com (**http://www.freddiemac.com/uniform/**) to assist lenders to prepare for the new requirements. The revised Form 65 must be used with Mortgage applications originated beginning January 1, 2010 and may be used prior to this date. The fields for the identifiers need to be completed only if the identifiers are available.

Further information about using the revised *Uniform Residential Loan Application* will be made available in a future Guide Bulletin.

FRAUD PREVENTION

Freddie Mac is committed to helping more families become successful long-term homeowners and realize the full benefits of homeownership and strongly opposes any fraudulent action that denies homebuyers fair treatment during the home buying process.

Fraudulent mortgage originations have an adverse impact on individual Borrowers, neighborhoods and communities, raising costs for lenders and ultimately all homebuyers. Freddie Mac has always strongly supported efforts aimed at the prevention of fraud. We are committed to helping you and others in the industry to combat fraud.

In connection with Mortgages delivered to Freddie Mac, we are reminding Seller/Servicers to:

- Be vigilant in their efforts to detect fraud through their origination practices and quality control programs prior to the delivery of Mortgages to Freddie Mac
- Exercise vigilance in loan reviews and verification of the Borrower's identity, including, but not limited to, the review of Social Security Numbers (SSNs) and Individual Taxpayer Identification Numbers (ITINs)
- Promptly notify Freddie Mac if they suspect a Borrower has misused a SSN or ITIN, or has provided other misleading information or documentation in connection with the Mortgage
- Notify Freddie Mac when a Suspicious Activity Report is filed on a Freddie Mac-owned Mortgage

Please also visit our web site for reminders on fraud prevention, best practices and red flags. To report suspicions of fraudulent activity and all incidents of fraud, contact our Fraud Hotline at (800) 4FRAUD8 or (800) 437-2838.

CONCLUSION

If you have any questions, please contact your Freddie Mac representative or call (800) FREDDIE.

Sincerely,

Patricia J. McClung
Vice President
Offerings Management

BEST PRACTICES: UNDERWRITING

Misrepresentation of occupancy

Sellers should review the criteria they use to evaluate whether the subject property is a Borrower's Primary Residence. The Seller should identify and investigate the following "red flags":

- Significant or unrealistic commuting distance from the subject property to the Borrower's place of employment
- Borrower is purchasing a smaller or less expensive home than their current Primary Residence and has not sold their Primary Residence
- Borrower does not document the intent to rent or sell their current residence
- Appraisal report reflects "Occupant" as a tenant or as vacant on an owner-occupied refinance application

BEST PRACTICES: APPRAISALS

To help ensure that Seller/Servicers meet our appraisal requirements, Freddie Mac is recommending that they adopt the following best practices to assist them with determining that the appraisal is acceptable.

Appraiser qualifications

- Sellers should review appraisers' licensing and performance at least once each licensing cycle
- Sellers should consider membership in a professional appraisal organization as a qualification criterion, but membership or lack of membership in such an organization should not be the only criterion for or against approving appraisers, or selecting appraisers for specific assignments

Seller staff qualifications

- Staff must be trained to properly underwrite the appraisal to ensure that the appraiser's opinion of value meets the definition of "market value," and that the appraisal is accurate and fully supported
- Staff should be familiar with Uniform Standards of Professional Appraisal Practice, applicable laws and Freddie Mac appraisal requirements
- Staff must be familiar with the Home Valuation Code of Conduct (HVCC)

Appraiser selection

- Ensure that turn times for appraisers to perform appraisals are reasonable as unreasonable turn times may adversely affect the quality and accuracy of the appraisals
- Some markets or properties may require that the appraiser have access to non-traditional data sources in order to provide the Seller with a credible appraisal. In such cases, the Seller should ensure that the appraiser has access to the necessary market data to support any conclusions about the market.

Appraisal reviews

- Underwriting and any appraisal reviews should include the following:
  - All appraisal photos
  - Maps used to identify the location of comparable sales in relation to the subject property
  - Sales history of the Mortgaged Premises to determine consistency with other file documentation
  - Current listings and pending sales to support any adjustments. (Ensure that if the appraiser determines that older sales are more representative of the subject property, the appraiser has provided current listings or pending sales to support any time adjustments or lack of adjustments for the differences in the age of the sales.)
  - Comparison of the original appraisal report or inspection report to the review appraisal report, if one was obtained, for conflicting information; the Seller should have policies and procedures in place to reconcile conflicting information
  - Review the appraiser signature, license number and date of the report
- Have processes in place in which the appraisal, loan application and title work are compared for consistency, and a comparison of the application and legal documents to the property description is provided by the appraiser
- Perform random and targeted reviews
- Be aware of market trends in the markets in which Seller originates Mortgages
- Sellers should also thoroughly review the Mortgage file to identify and investigate the following appraisal red flags:
  - Comparables not independently verified or recorded
  - Value not supported by the comparables, and/or the comparables are not appropriate
  - Incorrect appraisal report form or inspection type for the type of transaction
  - Inconsistencies or unexplained adjustments
  - Typographical and mathematical errors
  - Appraiser is not familiar with the market in which the property is located
  - Appraisal ordered prior to the sales contract date
  - Completion certification required and not in the Mortgage file
- The Seller’s due diligence in monitoring the quality and accuracy of appraisals is part of the Seller’s responsibility for the quality of its lending. Sellers’ policies and procedures for valuation should address the following:
  - The selection of appraisers in compliance with the HVCC and Freddie Mac requirements and monitoring the quality and accuracy of appraisals performed by appraisers
  - Knowledgeable staff underwriting appraisals and performing quality control for appraisals
  - Appraiser’s opinion of value reflects the cash-equivalent price without undue stimulus such as concessions
  - Use of automated valuation models and other tools to monitor appraisal quality