Sun West Manual Underwriting Guideline

The U.S. Department of Housing and Urban Development (HUD) requires all forward mortgage transactions to be evaluated by the TOTAL Mortgage Scorecard to determine the eligibility for insurance. The Scorecard, accessed through an Automated Underwriting System (AUS), evaluates the credit history and determines the overall risk of a borrower by issuing a recommendation through the AUS. It is important to note that an "Accept/Approve/Eligible" recommendation by the AUS does not always guarantee that a loan is of acceptable risk. Lenders are required to review all data that may not be available electronically in the TOTAL Scorecard. Lenders are also required to verify the integrity of all the data entered into the AUS to ensure the accuracy of the risk evaluation. The verification also helps lenders ensure that all supporting documentation and information entered into the Scorecard is consistent with the final underwriting decision of the loan.

Per HUD policies, downgrading to manual underwriting may be required when (1) the AUS does not issue an approval, (2) there is additional information to be considered outside of the TOTAL Scorecard dataset, (3) inconsistencies are found within the AUS findings (although this does not occur on most files), or (4) a downgrade is required per HUD Handbook 4000.1. Consistent with HUD policies, loans that require manual underwriting will be evaluated based on guidelines published in HUD Handbook 4000.1 to ensure the borrower's creditworthiness. Below is an explanation of how HUD's manual underwriting guidelines are used to evaluate some common scenarios:

- The borrower's payment history is evaluated in the following order of importance: (1) previous housing and housing-related expenses, including utilities (telephone, gas, electricity, water, television, and internet bills, etc.); (2) installment debts; (3) revolving accounts; (4) borrower's overall credit behavior other than isolated unsatisfactory or slow payments.

  NOTE: All payments and debts are considered, INCLUDING ONES THAT **<u>DO NOT</u>** APPEAR ON THE CREDIT REPORT

- Per HUD Handbook 4000.1, acceptable credit risk can be established if:
  - The borrower has made all housing and installment debt payments, including rental and utility payments on time for the past 12 months; and
  - The borrower has no more than two 30-day late mortgage or installment payments in the past 24 months; and
  - The borrower has no major derogatory credit (payments made more than 90 days after the due date or three or more payments made more than 60 days after the due date) on revolving accounts in the past 12 months; and
  - The borrower has a history of regular and timely payments of the real-estate tax and hazard insurance

- HUD Handbook 4000.1 Section II-5-d, states that "*The underwriter must review each Mortgage as a separate and unique transaction, recognizing that there may be multiple factors that demonstrate a Borrower's ability and willingness to make timely Mortgage Payments to make an underwriting decision on behalf of their DE Mortgagee in compliance with HUD requirements.* ***The underwriter must evaluate the totality of the Borrower's circumstances and the impact of layering risks on the probability that a Borrower will be able to repay the mortgage obligation according to the terms of the Mortgage***." The DE Underwriter is thus required to develop a historic pattern of a borrower's willingness to save and ability to manage finances. In other words, the DE underwriter is REQUIRED to analyze the savings pattern and bank activity as a trade line. Sun West will ensure that the borrower's ability and willingness to repay is in line with credit risk requirements by evaluating bank statements and other relevant documents below:

- Pattern of savings and/or occurrences of Non-Sufficient Funds (NSF) and overdrafts
- Level of savings or excessive overdrafts and/or high bank charges contributing to NSF and overdraft fees
- Sun West considers three NSFs/overdrafts as equal to one 30-day late payment on an installment account

- Borrowers with prior bankruptcy or foreclosure must have re-established credit for a minimum of a 12-month period or chosen not to incur new credit obligations. Collection/late payments after the bankruptcy/foreclosure will indicate the borrower's inability to manage financial obligations. Open judgment and liens must be resolved or paid off at or before closing or be entered into a valid repayment plan per HUD Handbook 4000.1.

- If a borrower cannot establish acceptable payment history, then Sun West will analyze the reasons for the borrower's delinquency by reviewing (1) disregard for financial obligations, (2) ability to manage debt, or (3) extenuating circumstances (loss of employment, reduction in income due to the death of an earning family member, or prolonged illness, etc.). Additionally, Sun West will consider whether or not delinquencies are likely to recur in the future by examining the following:

    - For all outstanding collection accounts, charge-off accounts, and judgments, Sun West will first explore if an eligible extenuating circumstance occurred by reviewing the borrower's explanation and supporting documentation. If one had occurred, then Sun West will request supporting documentation to evidence the extenuating circumstance and review documentation that correlates the credit blemishes with the extenuating circumstance. Sun West will also verify that explanations and supporting documentation are consistent with other credit information in the file.
    - For collection accounts or judgments less than 12 months, Sun West will not approve the loan unless it can be documented that the delinquency was related to extenuating circumstances (which are not likely to recur in the near future).

- Examples of UNACCEPTABLE credit blemishes which would result in the loan being declined:

    - The borrower applied for a purchase loan. A review of the borrower's credit report shows that most of the accounts are authorized user accounts for the non-borrowing spouse. The borrower also has delinquent taxes for the departing residence. This loan would be declined because the borrower does not have sufficient verifiable history of managing debts.
    - The borrower lost employment due to layoffs from January 2014 to June 2014 and the borrower has installment late payments or multiple NSF/overdrafts in 2015. This loan would be declined as the loss of employment was for the period between January 2014 and June 2014, whereas the installment late payments and NSF/overdrafts occurred in 2015 after the unemployed period.
    - The borrower applies for a Rate-and-Term refinance loan. The borrower had filed for Chapter 7 Bankruptcy, which was subsequently discharged in July 2011. The borrower's credit report shows 30-day late mortgage payments reported in September 2015 and October 2015. There are installment late payments and open collection accounts reported 12 months prior to the application

date. In this case, the loan would be declined as the borrower has neither re-established good credit post-bankruptcy nor chosen not to incur new credit obligations.

- The borrower applies for a purchase loan. A review of the borrower's bank statements shows that year-to-date Non-sufficient funds (NSF) and overdraft fees exceed $234. Bank statements are dated 12/16/2015 and have a beginning balance of (-$4.24) and total NSF and overdraft fees of $234. A review of the borrower's credit report shows that a housing account has gone into collection in the last 12 months and a revolving account opened in July 2015 has also gone into collection. The borrower's housing payment would also increase by 100% from $1,900 (monthly rent) to $3,794.93 (proposed monthly loan payments). This loan would be declined as there will be a significant increase in the housing payment for the borrower with no established saving pattern. Also the NSF and overdraft fees and the recent late payments reported on the revolving account raise concerns about the borrower's ability to manage finances.

- The borrower applies for a Cash-Out refinance loan. The borrower is delinquent on the property taxes for years 2011, 2012 and 2013 (these taxes would be paid at the time of closing of the subject loan). The borrower has mortgage late payments (not in the last 12 months). The borrower also has late payments on student loans, which are in the last 12 months. This loan would be declined because property taxes are considered as a part of the housing payment and Sun West is not able to accept any housing late payments within the last 12 months on Cash-Out refinance transactions.

- The borrower applies for a Cash-Out refinance loan. There are two liens attached to the subject property – one is the primary lien, which is being refinanced, and the second lien is by the Colorado Housing Assistance Corporation. The second lien does not appear on the borrower's credit report. The payoff statement dated 01/14/2016 for the second lien shows the last payment made was on 11/18/2015 but the next payment due is for 10/1/2015, which indicates that the borrower was late/delinquent on the account for the second lien attached to the subject property. This loan would be declined as the borrower's ability to manage finances and willingness to meet credit obligations is questionable.

- The borrower applies for a purchase loan. A review of the borrower's credit report shows that all active trade lines reported are less than 12 months with minor payment amounts. The credit report does not reflect any trade line with repayment amounts that are comparable to the proposed mortgage payments. A review of the borrower's bank statement shows year-to-date NSF and overdraft fees of $3,908. The borrower's housing payment would also increase by 125% from the current $850 (monthly rent) to $1,909.27 (proposed monthly loan payments). This loan would be declined as there will be a significant increase in the housing payment for the borrower with no established saving pattern. Also, the NSF and overdraft fees raise concerns about the borrower's ability to manage finances.

- The borrower applies for a purchase loan. A review of the borrower's credit report shows only one active trade line, which is less than 12 months old. The borrower has an open utility collection account in the last 12 months. The borrower had multiple late payments in the prior years (2011, 2012, and 2013) on revolving and installment accounts. The borrower's housing payment would also increase by 187% from the current $400 (monthly rent) to $1,147.73 (proposed monthly loan payments). This loan would be declined as the borrower's ability to manage finances and willingness to meet credit obligations is questionable while also facing a significant increase in the housing payment.

The primary purpose of manual underwriting is to analyze and document how and why a loan would perform when the AUS has determined that the loan is of unacceptable risk. As explained above, Sun West will analyze a borrower's past credit performance and behavior toward credit obligations to establish a pattern.

Sun West utilizes prudent underwriting with a common sense approach to determine a borrower's ability and willingness to repay and to ensure that a loan is of acceptable risk to Sun West, HUD, and investors.