In July 2005, we will implement DU® Version 5.5. This new version will contain a number of enhancements designed to help more borrowers qualify for homeownership in addition to property-related enhancements. All new loans submitted to DO®/DU on or after July 24, 2005, will be underwritten with DU Version 5.5. These enhancements will not apply to existing DU Version 5.4 (which includes 5.4.2) loans that are resubmitted.

**Update:** The DO/DU Version 5.5 Release Notes are updated to include information on the loan-level price adjustments that will apply to certain MyCommunityMortgage loans; to change the date the 2005 Community Lending income limits will be updated in DU; to advise that a new DU observation message will identify all of the credit reports evaluated during the loan submission by DU; and to include information for mortgage brokers.

Below is a brief summary outlining the changes to the underwriting system – a comprehensive explanation of each change follows.

**IMPORTANT NOTE TO BROKERS:**
You must contact your sponsoring lender for its specific requirements and guidelines regarding the information provided in these Release Notes.

I. 40-YEAR TERM MORTGAGES
Fannie Mae is adding 40-year mortgages to our standard product line. A Selling Guide Announcement providing more details will be issued soon. These mortgages will not require a contract variance or special negotiated commitment for delivery to Fannie Mae. The underwriting guidelines for the new standard 40-year mortgage products will be implemented in DU Version 5.5. Refer to Section I on page 2.

II. MYCOMMUNITYMORTGAGE™ ENHANCEMENTS
We are helping lenders expand homeownership opportunities for many low- to moderate-income borrowers by further enhancing the MyCommunityMortgage product. These enhancements include allowing cash-on-hand as a source of funds; lowering the required mortgage insurance coverage; permitting subordinate financing other than Community Seconds®; and offering 5/1 ARMs with 2/2/5 caps. Refer to Section II on page 4.

III. NEW COLLECTION PAYOFF POLICY
We are relaxing our collection and chargeoff policy on principal residence and second home transactions underwritten with DU. This new policy will require that collections and chargeoffs that total more than $5,000 (instead of $1,000) be paid at or prior to closing. Refer to Section III on page 7.
IV. CONDOMINIUM PROJECT GUIDELINES
DU will be updated to reflect Fannie Mae’s new condominium project acceptance requirements. Details of the new requirements will be provided in an upcoming Selling Guide Announcement. See Section IV on page 7.

V. NEW APPRAISAL FORMS
In Selling Guide Announcement 05-02: Final Appraisal Report Forms, Fannie Mae instructed lenders about using a number of new appraisal report forms. We are modifying DU’s collateral messages to remind lenders that appraisals performed on or after November 1, 2005 must be reported on the final appraisal forms dated March 2005. For more information, see Section V on page 7.

VI. MISCELLANEOUS
Other enhancements in this release are described in Section VI on page 8.

I. 40-YEAR TERM MORTGAGES
Fannie Mae is adding 40-year mortgages to our standard product line. The new standard 40-year mortgage products, which will be available to all lender partners and will not require a contract variance or special negotiated commitment, will be described in an upcoming Selling Guide Announcement. The underwriting guidelines for the new standard 40-year mortgage products will be implemented in DU Version 5.5.

Eligible Loan Types
The standard Fannie Mae 40-year term mortgages are eligible with the following criteria:
- Fully amortizing
- Fixed-rate mortgages or certain non-convertible hybrid 3/1, 5/1, 7/1, and 10/1 ARMs
- One- to four-unit properties
- Principal residence, second homes, or investment properties
- Purchase, limited cash-out refinance, cash-out refinance, construction, or construction-permanent transactions.

Ineligible Transactions
The following characteristics will not be eligible for 40-year terms:
- Manufactured homes
- Community Lending products
- Flexible mortgages
- HomeStyle™ Renovation mortgages*
- InterestFirst™ mortgages
**Note:** As stated in Chapter 1 of the *Guide to Underwriting with DU*, lenders may use DU to process HomeStyle Construction to Permanent loans; however, lenders must determine outside of DU that the loan meets HomeStyle Construction to Permanent guidelines. All HomeStyle mortgages, including those that are submitted to DU as construction loans, are not eligible for 40-year terms.

**New 40-Year Standard ARM Plans**
The following chart lists the new standard 3/1, 5/1, 7/1, and 10/1 hybrid, non-convertible ARM plans that are eligible for 40-year terms.

<table>
<thead>
<tr>
<th>Standard ARM Plan</th>
<th>Index</th>
<th>Adjustment Periods</th>
<th>Caps</th>
</tr>
</thead>
<tbody>
<tr>
<td>2236</td>
<td>Treasury</td>
<td>3/1</td>
<td>2/2/6</td>
</tr>
<tr>
<td>3130</td>
<td>LIBOR</td>
<td>3/1</td>
<td>2/2/6</td>
</tr>
<tr>
<td>2238</td>
<td>Treasury</td>
<td>5/1</td>
<td>2/2/6</td>
</tr>
<tr>
<td>3557</td>
<td>LIBOR</td>
<td>5/1</td>
<td>2/2/6</td>
</tr>
<tr>
<td>2699</td>
<td>Treasury</td>
<td>5/1</td>
<td>5/2/5</td>
</tr>
<tr>
<td>3128</td>
<td>LIBOR</td>
<td>5/1</td>
<td>5/2/5</td>
</tr>
<tr>
<td>2704</td>
<td>Treasury</td>
<td>7/1</td>
<td>5/2/5</td>
</tr>
<tr>
<td>3558</td>
<td>LIBOR</td>
<td>7/1</td>
<td>5/2/5</td>
</tr>
<tr>
<td>2703</td>
<td>Treasury</td>
<td>10/1</td>
<td>5/2/5</td>
</tr>
<tr>
<td>3559</td>
<td>LIBOR</td>
<td>10/1</td>
<td>5/2/5</td>
</tr>
</tbody>
</table>

**Note:** The online loan application will be updated in August 2005 to reflect the new standard 40-year ARM Plans. The changes will be described in detail in the upcoming DO/DU User Interface Release Notes.

Although lenders can select Generic ARM plans when submitting loans to DU, we strongly recommend that lenders submit loans with the actual Fannie Mae ARM plan. This will facilitate the lender’s underwriting, processing, and delivery of ARM loans. Furthermore, it enables DU to provide messages specific to the Fannie Mae ARM plan, including eligible loan transactions and property types, loan-level price adjustments, mortgage insurance coverage, and special feature codes, as applicable.

**Mortgage Insurance Coverage**
Standard mortgage insurance coverage applies:

<table>
<thead>
<tr>
<th>LTV</th>
<th>80.01 – 85.00%</th>
<th>85.01 – 90.00%</th>
<th>90.01 – 95.00%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coverage</td>
<td>12%</td>
<td>25%</td>
<td>30%</td>
</tr>
</tbody>
</table>

**Note:** The “Reduced MI” and “Lower-Cost MI” options are not available for mortgages with 40-year terms.
Price Adjustment
A price adjustment equal to 0.125% of the loan amount will be assessed to MBS loans with a 40-year term. Pricing will be adjusted for whole loan delivery. DU will return a message reminding lenders that a loan-level price adjustment applies.

Maximum Allowable Loan-to-Value (LTV) Ratios
The LTV ratios, including the combined LTV (CLTV) and the home equity line of credit (HELOC) combined LTV (HCLTV) for 40-year mortgages underwritten with DU are the same as those for standard 30-year mortgages.

DU Processing
Generally, DU will apply the same underwriting analysis for 40-year term loans as it does for standard 30-year term loans.

Note: Forty-year mortgages can be underwritten manually if the lender decides not to use DU.

DU Recommendations
On July 24, 2005, DU Version 5.5 will implement the 40-year mortgage underwriting guidelines. Loans submitted to DU Version 5.5 must receive an Approve/Eligible or Refer/Eligible recommendation to be delivered to Fannie Mae. Loans with 40-year terms that receive a Refer with Caution recommendation, an EA-I, -II, -III, or Refer W Caution/IV recommendation are generally not eligible for delivery to Fannie Mae.

Forty-year mortgages that are submitted to DU prior to Version 5.5 (in other words, Version 5.4) will receive an Ineligible recommendation. Loans that receive an Approve/ or Refer/Ineligible recommendation may be delivered to Fannie Mae provided the loan meets Fannie Mae requirements for 40-year mortgages and the only reason for the ineligibility is the 40-year term. We will grant the lender the limited waiver of underwriting representations and warranties for loans that receive an Approve/Ineligible as long as the loan term is the only reason for the ineligibility and the loan complies with all other requirements related to the limited waiver as stated in Chapter 2 of the Guide to Underwriting with DU.

As stated earlier, Fannie Mae will soon issue an Announcement, which will provide details on the new standard 40-year mortgage products, including information on the required mortgage instruments, execution options, and delivery instructions.

II. MYCOMMUNITYMORTGAGE ENHANCEMENTS
In DU Version 5.5, we will implement a number of enhancements to the MyCommunityMortgage product that are designed to help more low- to moderate-income borrowers qualify for homeownership. These enhancements are described below.

As a reminder, lenders must complete the approval and registration processes, obtain the MyCommunityMortgage Terms and Conditions in their Master Agreement, and be “activated” before they can successfully submit MyCommunityMortgage loans to DU.

Note: The MyCommunityMortgage enhancements described below apply to manually underwritten and DU-processed loans. Loans with these enhancements may be delivered beginning July 24, 2005.

Cash-on-Hand
- Borrowers who meet the underwriting criteria listed below may be able to use cash-on-hand for the down payment and closing costs when purchasing their one-unit, principal residence.
The cash-on-hand policy does *not* apply to Community Renovation™ loans.

The lender must verify and document that the following underwriting requirements are met:

- The borrower customarily uses cash for expenses and that usage and reasonableness of using cash, as well as the amount of funds saved, are consistent with the borrower’s previous payment practices. An example for determining the reasonableness of the amount of funds saved would be through the use of an income and expense budget.
- The borrower’s credit report and other verifications indicate limited use of credit, and no depository relationship exists between the borrower and a financial institution.
- The borrower must provide a written and signed statement that discloses the source of funds and states that the funds have not been borrowed.
- The borrower must deposit with a financial institution funds sufficient for the down payment and closing costs at the time of loan application or no less than 30 days prior to closing.

- Data must be entered correctly prior to submitting the loan to DU.
  - You must enter the amount of cash-on-hand as “Cash on Hand” in the Assets section (Section VI) of the online loan application.
  - If you use a third party loan origination system where “Cash on Hand” is not an available asset type, or where the asset type does not correctly transmit to DU, you must access the DO/DU online loan application and enter the amount in the Assets section as “Cash on Hand”.

- DU will use the “Cash on Hand” amount to calculate the available funds to close. However, cash-on-hand funds will not be used to calculate reserves. As an example, if a borrower needs $2,000 to close and the amount of cash-on-hand is $3,000, DU would count the cash-on-hand as sufficient funds to close; however, DU would not apply the remaining $1,000 toward reserves.

- DU will return the following new message:
  
  *Cash on hand has been included in the funds available for the borrower’s down payment and/or closing costs. Verify that the cash on hand is being received from a borrower that customarily uses cash for expenses and that its usage and reasonableness, as well as the amount of funds saved, are consistent with the borrower’s previous payment practices. The borrower’s credit report and other verifications should indicate limited (or no) use of credit and no depository relationship between the borrower and a financial institution. A written statement must also be obtained disclosing that the funds have not been borrowed. These funds must have been deposited in a lending institution account at the time of application, or no less than 30 days prior to closing.*

**Lower Mortgage Insurance Coverage**

Fannie Mae is lowering the mortgage insurance coverage required for MyCommunityMortgage products that are submitted to DU Version 5.5 and receive an Eligible recommendation.

<table>
<thead>
<tr>
<th>LTV Ratios</th>
<th>Minimum MI Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; 80% &lt;= 85%</td>
<td>6%</td>
</tr>
<tr>
<td>&gt; 85% &lt;= 90%</td>
<td>12%</td>
</tr>
</tbody>
</table>
### LTV Ratios Minimum MI Coverage

<table>
<thead>
<tr>
<th>LTV Ratios</th>
<th>Minimum MI Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; 90% &lt;= 95%</td>
<td>16%</td>
</tr>
<tr>
<td>&gt; 95% &lt;= 97%</td>
<td>18%</td>
</tr>
<tr>
<td>&gt; 97% &lt;= 100%</td>
<td>20%</td>
</tr>
</tbody>
</table>

#### 5/1 ARMs with 2/2/5 Caps

We will offer Fannie Mae 5/1 ARM Plans 659, 660, 661, 2724, and 2725, which have 2/2/5 interest rate caps, for MyCommunityMortgage loans secured by one- to two-unit properties.

ARM Plans 660 and 661 are listed in the DO/DU user interface; for Plans 659, 2724, and 2725, you must select the 5-year generic ARM to submit the loan to DU. In all cases, the lender must use the actual Fannie Mae ARM plan when delivering the loan to DU.

While Community Lending loans are typically not subject to loan-level price adjustments, a 5/1 ARM with an LTV greater than 90% under MyCommunityMortgage will be subject to a loan-level price adjustment of 0.25% over the base MyCommunityMortgage pricing.

**Note:** ARMs are not eligible for three- to four-unit properties in conjunction with any MyCommunityMortgage loan.

#### New Subordinate Financing Guidelines

We are extending our subordinate financing guidelines to allow certain non-Community Seconds on MyCommunityMortgage loans. This new guideline applies to one- to four-unit properties.

This policy does not apply to Community Renovation loans.

The second mortgage must meet Fannie Mae requirements as stated in the Selling Guide Part VII, Chapter 1, Sections 104.08, 105, and 106. In addition, HELOCs and seller-carried seconds are not permitted.

DU will return the following new message:

*Verify that the subordinate lien in the Details of Transaction is a closed-end second trust. Seller carried second mortgages and home equity lines of credit are not permitted in conjunction with a MyCommunityMortgage loan. If this lien is a Community Seconds transaction, document the terms of the lien in the loan file and verify that the terms of the program comply with the requirements outlined in the Fannie Mae Selling Guide.*

A loan-level price adjustment of 0.50% over the base MyCommunityMortgage pricing will apply to loans that have non-Community Seconds.

For more details on MyCommunityMortgage loans with subordinate financing, refer to the Terms and Conditions.
III. NEW POLICY FOR PAYING OFF COLLECTIONS

We are relaxing our collection and chargeoff policy for principal residence and second home transactions that are underwritten with DU. This new policy will require that collection and chargeoffs that total more than $5,000 (instead of $1,000) be paid at or prior to closing. In addition, the requirement to pay off individual collections of $250 or greater will no longer apply.

This new policy applies to all DU loans without regard to the underwriting recommendation. DU will return the following new message regarding outstanding collections and chargeoffs:

*If the following collection and chargeoff accounts have not been satisfied and the aggregate of all accounts is greater than $5,000, all accounts must be paid in full prior to or at closing. Funds sufficient to settle the account(s) must be verified and documented.*

*Note:* The new collection payoff policy does not apply to investment property transactions. For these transactions, the existing $250/$1000 policy and DU message will continue to apply.

IV. CONDOMINIUM PROJECT GUIDELINES

With an upcoming *Selling Guide* Announcement, Fannie Mae will substantially revise our condominium review and acceptance guidelines to enable lenders to determine project acceptance for more projects.

DU Version 5.5 will return a new message to reflect the revised criteria for condominiums that will be eligible for a “Limited Project Review”. The new criteria applies to:

- Units where the subject legal phase is complete; and
- Investment properties with an LTV/CLTV of 75% or less that receive an Approve recommendation from DU; or
- Second homes with an LTV/CLTV of 75% or less; or
- Principal residences with an LTV/CLTV of 80% or less; or
- Principal residences with an LTV/CLTV of 80% or greater that receive an Approve recommendation from DU. (Previously these loans required full project completion.)

As stated earlier, Fannie Mae will soon issue an Announcement, which will provide details on the new project review guidelines.

V. NEW APPRAISAL FORMS

With the *Selling Guide Announcement 05-02*, Fannie Mae released eleven final appraisal report forms, which are dated March 2005. These final forms must be used for appraisals performed on or after November 1, 2005. We are updating the appraisal messages in DU to remind lenders that the March 2005 appraisal forms must be used beginning November 1, 2005.

*Note:* Effective November 1, 2005, we will retire the Desktop Underwriter Qualitative Analysis Appraisal Report (Form 2065). For loans where DU recommended Form 2065, lenders must obtain, at a minimum, the March 2005 version of Form 2055 if the appraisal is performed on or after November 1, 2005.
VI. MISCELLANEOUS

New Property-related Message
We are providing a new property-related message to alert lenders when there appears to be a question concerning a unit number for the subject property. This message will appear in the Property and Appraisal section of the Fannie Mae Underwriting Findings report, and is intended to further help the lender ensure data integrity. The message will not affect the underwriting recommendation. The new message is:

*Desktop Underwriter has identified this property as a main address of a building that contains multiple units. However, the unit for the subject property address was not included in the loan application, or the number included did not match the legal address. The lender should confirm if a unit number does apply, and, if so, enter the correct unit number on the application and resubmit the loan to DU.*

Community Lending Income Limits
DU Versions 5.4 and 5.5, together with the DO/DU user interface, will be updated August 2005 to reflect the 2005 income limits. These limits are based on the HUD area median income limits, but are specific to Fannie Mae for use with Community Lending loans.

With the update of the limits this year, we are also incorporating numerous changes to the Metropolitan Statistical Areas (MSAs) and county designations. As a result, many of the MSAs and counties displayed in the list will be different from what was displayed in the prior list. These changes are the result of the 2000 census data that HUD incorporated into its median income list this year.

The new limits and associated MSA and county changes will apply to all loans submitted to DU Version 5.5, as well as Version 5.4 loans that are resubmitted.

*Note:* For Version 5.4 loans that are resubmitted after the new income limits have been implemented in DU, lenders should review the selection of the MSA or county to make sure that it correctly reflects the updated MSA or county information. If a loan is resubmitted with a prior county or MSA that is no longer in the 2005 list, then the loan will receive an underwriting error. The error can be corrected by selection of a new MSA or county.

For your reference, the new income limits, county, and MSA information can be found on eFannieMae.com using our HUD Median Income Search tool.

Processing Efficiencies
In our continuing effort to bring more processing efficiencies to our customers, we are modifying DU so that more borrowers will qualify for verbal verifications of employment.

New and Modified DU Messages
In addition to the new DU messages described earlier in these Release Notes, DU will be updated to reflect the following new and modified messages:

- A new message will advise lenders when it appears that an Individual Taxpayer Identification Number (ITIN) has been entered on the loan application as a Social Security number:

  *It appears that an ITIN has been entered as the Social Security number for <the borrower>. Borrowers with a valid ITIN must be either a United States citizen or a lawful permanent or*
non-permanent resident of the United States in order for this loan to be eligible for delivery to Fannie Mae. Verify that the borrower is a legal resident of the United States. An ITIN by itself does not prove or disprove that a borrower is a legal resident.

- We are moving the following DU message from the Potential Red Flags section to the Verification Messages/Approval Conditions section of the Fannie Mae Underwriting Findings (Underwriting Findings) report:

  According to the credit report, the total payments and/or balances declared on the 1003 differ by more than selected tolerances. Verify that all liabilities belonging to the borrowers are disclosed on the 1003 and that the balances and payments are accurate.

  This DU message is being relocated in the Underwriting Findings report as part of an ongoing effort to display only the most appropriate messages in the Potential Red Flags section.

- A new DU observation message will identify all of the credit reports evaluated during the loan submission by DU.

VII. FOR MORE INFORMATION

For more information, contact the Fannie Mae Customer Contact Center at 1-877-722-6757. In addition, lenders can contact their Fannie Mae customer account team or their eBusiness consultant. Brokers should contact their sponsoring lenders.